

CHAPTER 7:

DETERMINATION OF PREJUDICE AND COMPENSATION BASIS

Introduction

909. This Chapter is based on ToRs (ix) and (x), which require the following:-

- a) to identify appropriate criteria for assessing whether any pension fund members or insurance policyholders have been prejudiced and, based on these, to establish the extent of prejudice, if any, to pension fund members or to insurance policyholders or the beneficiaries of such persons.
- b) where it has been established that pension fund members or insurance policyholders have been materially prejudiced, to establish an appropriate basis for compensating such pension fund members or insurance policyholders or the beneficiaries of such persons.

910. With respect to ToR (ix), the Commission decided that it was necessary;

- a) to **identify** appropriate criteria for assessing whether any pension fund members or insurance policyholders have been prejudiced; and based on these
- b) to establish the **extent of prejudice**, if any, to pension fund members or to insurance policyholders or the beneficiaries of such persons.

911. With respect to ToR (x), the Commission decided that it was necessary to **establish an appropriate basis for compensating** such pension fund members or insurance policyholders or their beneficiaries.

912. In order to deal adequately with these two inter-related ToRs, the Commission decided to determine the following issues;

- a) appropriate criteria for assessing prejudice;
- b) the extent of prejudice;

- c) where prejudice has been established, an appropriate basis for compensation.

913. With respect to the quantification of prejudice, ToR (ix) cannot be addressed in isolation to ToR (x) regarding an appropriate basis for compensation. It is, therefore, necessary to establish an appropriate compensation basis before quantifying the prejudice.

Appropriate Criteria for Assessing Prejudice

914. Since insurance and pension arrangements are contractual relationships, it is necessary to assess their legal definitions in order to establish the rights and obligations of the contracting parties. This helps in establishing the extent to which a party to the contract breached its duties and obligations to the prejudice of the other party. Therefore, prejudice is established where one party's breach occasions pecuniary loss to the other party, resulting in loss of value.

915. The Commission considered the contract terms, together with policyholder minimum reasonable expectations and the minimum reasonable benefit expectations of members of pension funds. The minimum reasonable benefit expectations, in this context, is used to describe the minimum expected benefit which should not be lower than the real value of premiums or contributions paid in the context of savings-only products.

916. The equivalent interpretations for products which have both savings and protection elements is the accumulation of real premiums paid, allowing for the cost of cover enjoyed during the term of the policy.

917. In general, the computations of the minimum reasonable benefit expectation took into account the loss of value to both the policyholders and the members of pension funds as discussed in Chapter 5 which considered loss of value due to macro-economic, meso and micro-factors.

918. The Commission's recommended currency for compensation is the US\$, notwithstanding that some of the contracts were entered into and subsequently concluded in ZW\$. The consideration for use of the US\$ was determined by the general stability of the

currency, as well as the fact that it has been the currency of settlement since 2009.

919. Real value, in this context was taken to mean the value of ZW\$ premiums or contributions paid converted to US\$ at the appropriate exchange rate at the time. It was assumed that US\$ inflation, although having an impact on real purchasing power over time, was reasonably moderate and, therefore, required no further adjustment,

Life Insurance Contracts

920. The legal definition of an insurance contract, as provided in Lake v Reinsurance Corporation¹, was used to establish the rights and obligations of the parties to an insurance contract. An insurance contract was defined as follows in that case-

“A contract between an insurer and an insured whereby the insurer, in exchange for the payment of a premium, undertakes to render a certain amount of money, or money’s equivalent, at the occurrence of an uncertain future event, where the insured has an interest.”

921. From the above, the following can be identified as being the essential elements (*essentialia*) of a valid insurance contract:-

- a) **Cover** – This is the sum assured by the insurer for a protection policy and or the accumulation arising from a savings policy. This represents the promise made by the insurer to the insured i.e. it is the insurer’s obligation in terms of the insurance contract;
- b) **Premium** – This is the amount paid by the insured (policyholder) in consideration of the cover by the insurer for a protection or savings policy. It represents the policyholder’s obligation in terms of the insurance contract;
- c) **Risk** – This is the likelihood of the occurrence of an uncertain future event that causes loss to the insured or his beneficiaries. The future event may however be certain e.g. death, where the timing becomes the uncertainty;

¹¹ 1967 (3) SA 124 (W)

- d) **Insurable interest** – This represents the relationship between the subject of insurance and the object of insurance such that the subject of insurance suffers loss of appreciable commercial value by the loss or damage of the object of insurance. With respect to life insurance, insurable interest relates to the relationship between the life assured and the policyholder.

922. It is important to note that a contract of insurance is based on reciprocity, thus, the insurer's obligation (to pay the sum assured and/or the savings accumulated) depends on the payment of a premium (or the commitment to pay a premium) by the insured (policyholder). In a life insurance contract, the duty of the insurer is, therefore, to pay the sum assured provided that the policyholder has paid or committed to pay the premium(s).

923. As aforementioned, in assessing the prejudice caused to policyholders, it is instructive to establish whether the insurer breached its duties notwithstanding that the policyholder had discharged its obligations, namely, paying the premium(s). It is , necessary, to establish whether or not:-

- a) the policyholder honoured the contractual premium payments; and
- b) the insurer honoured the payment of the contractual sum assured or savings accumulations.

Pension Contracts

924. The following case authorities provide a legal definition of a pension contract:-

in Molleur v Minister of National Revenue², a pension was defined as follows:-

"...an annuity or other periodical payment made, especially by a Government, a company or an employer of labour, in consideration of past services or of the relinquishment of rights, claims or emoluments..."

² 1965 CTC 267

Pensions are universally construed as a reward for long continued service paid upon retirement from service, and all pensions of public employees are paid upon their retirement.

A pension is a stated allowance or stipend made in consideration of past services or of surrender of rights or emoluments to one retired from service, and is not wages as wages are defined as remuneration for employment”.

925. A more succinct description was provided in **Boston v Boston**³, where a pension was described as follows:

“A pension right arises as an asset or a contingent bundle of rights to a future income stream. After retirement, when the pension produces an income, the pension asset is, in a sense, being liquidated.”

926. A contributory pension contract is, therefore, one in which a member and the employer make regular contributions into a pension fund to fund a retirement benefit, which can be a lump-sum, an annuity or a combination of both. The terms of such a contract may be set out in the rules of the pension fund or, alternatively, in a statute e.g. the NSSA Act. The member’s or employer’s obligation, therefore, is the payment of a contribution while the pension fund’s duty is to pay the retirement benefits.
927. There are generally two types of contributory pension contracts, namely, defined benefit (DB) schemes and defined contribution (DC) schemes.

Defined Benefit Pension Schemes

928. DB schemes provide for defined pension benefits. These may be stipulated as follows:
- a) a percentage of a defined final average salary (FAS) of the member for each year that he or she participated i.e., full pension = pensionable service x accrual rate x FAS. The primary objective of this DB structure is to provide benefits that reward long-serving members, because the benefit increases with pensionable service, and to protect the

³ 2001 SCC 43

member's quality of life, against inflation, through salary increases prior to retirement and discretionary pension increases after retirement; or

- b) a percentage of total earnings throughout an individual's employment; or
- c) a fixed or indexed amount specified up-front.

929. In a DB scheme, the sponsor undertakes to fund any deficit in the pension fund in order to honour pension payments in terms of the aforementioned formulations.

930. In order to establish prejudice in a DB pension scheme, it is, therefore, necessary to establish:-

- a) whether or not the member and the sponsor honoured their contractual contribution payments; and
- b) whether or not the pension fund honoured the retirement benefit(s) in terms of the aforementioned formulations.

Defined Contribution Pension Schemes

931. A DC pension arrangement provides for the payment of defined amounts of regular contributions, from which accumulations pension benefits are paid. The net accumulations, which are the contributions paid less all expenses, grow at the rate of investment returns earned by the fund for each year of participation.

932. The employer and the employee contribution rates are stipulated in the rules of the fund. The employer is only obligated to make the regular contributions into the pension fund, in terms of the rules, and has no further contributory obligations.

933. In order to establish prejudice in a DC pension scheme, it is, therefore, necessary to establish whether or not :-

- a) the employees and the employer(s) honoured the contractual contribution payments; and
- b) the pension fund honoured the retirement benefit in terms of the employee's accumulation entitlements.

Compensation Basis

934. The following considerations inform the appropriate compensation basis:-

- a) the criteria for assessing prejudice for insurance and pension contracts as provided by the respective legal definitions as aforementioned;
- b) the factors and causes of loss of value as outlined in Chapter 5 on ToRs (iv) and (v);
- c) the shortcomings of the conversion processes and the approaches employed by life insurance and pension funds at dollarisation as highlighted in Chapter 6 on ToR (viii); and
- d) the financial soundness of the insurance and pensions industry as outlined in Chapter 8 on ToRs (xi) and (xii).

Compensation Basis for Life Insurance Companies

935. The following shortcomings characterised the conversion processes and approaches employed by life assurance companies as outlined in Chapter 6 on ToR (viii):-

- a) the failure by life insurers to index premiums and benefits, thus, the failure to recognise the difference in purchasing power across monetary regimes. This resulted in the prejudicial transfer of value from old to new generation policyholders, as well as from policyholders to shareholders of the insurance entity;
- b) the creation of contingency reserves emanating from different conversion and allocation exchange rates at dollarisation. This disenfranchised policyholders of their assets in that the reserves were channelled towards expenses for other policies, such as paid-ups, as well as towards those who remained in the pension scheme;
- c) the unilateral alteration of policies (insurance contracts) by insurers such as decisions to make policies paid-up, wholesale cancellation of policies, as well as switching of

products. This resulted, in some cases, in insurers expunging liabilities to the detriment of policyholders;

- d) the failure to honour obligations by both parties caused by currency de-basing and deteriorating economic conditions.

936. The following factors were identified under ToRs (iv) and (v)] as having contributed to policyholder prejudice:-

Factor	
Macro	Inflation.
	Currency de-basing.
	Exchange rate used for de-monetisation.
Meso	Failure by the Regulator to guide the industry on currency de-basing, inflation and conversion processes.
	Failure to protect consumers of insurance and pension products.
	Weak legislation, regulatory processes and systems.
	Absence of a resolution framework for failed pension funds and insurance companies institutions.
	Failure to deal with contribution arrears.
	Failure to provide and enforce good corporate governance
Micro	Failure to index contributions, premiums and benefits to inflation.
	Unsustainable administration and other expenses
	Products terminations and closures
	Actuarial service provision
	Contribution arrears
	Poor investment and risk-management practices
	Surrenders and lapses
	Poor accounting methods and practices
	Lack of transparency surrounding de-mutualisation processes
	Arbitrary conversion methods
	Excessive expenses
	Poor compositions and conflicted Boards of directors and trustees subversion
	Poor record-keeping
	Failure to separate insurance, pension and shareholder assets
Poor composition and conflicted Boards of directors and trustees.	

937. The following checks were prescribed under the criteria for establishing prejudice to policyholders of life insurance companies:

- a) establish whether or not the policyholder honoured the contractual premium payments; and
- b) establish whether or not the insurer honoured the payment of the contractual sum assured.

938. The following are the major challenges faced in establishing whether or not the parties to the insurance contracts discharged fully their duties and obligations:-

- a) the contractual premiums as well as the sums assured were set in ZW\$, which were subject to currency de-basing due to hyper-inflation; and
- b) the payment of the sum assured in US\$ with respect to contracts concluded and performed in ZW\$.

939. To resolve the above challenges, the Commission deemed it appropriate to effect the following adjustments to the processes and approaches employed by life insurance entities during conversion. This effectively became the compensation basis for life insurance products:-

- a) convert the contractual ZW\$ premiums and sums assured to US\$ at the conclusion of the insurance contract, using an appropriate exchange rate then prevailing;
- b) convert the series of ZW\$ premium payments made by the policyholder to US\$ at the time of each payment, using an appropriate exchange rate then prevailing. It should be noticed that due to hyper-inflation, the US\$ premium would decline successively from the time of conclusion of the contract;
- c) make an assumption that each premium payment was entitled to purchase a portion of the sum assured. This means that a constant sum assured would have been purchased by each constant premium. The effect of hyper-inflation would have been to reduce successive premium payments in US\$ terms, which means that a lesser amount of sum assured would have been purchased successively;⁴
- d) make adjustments to the sum assured to take into account the lower premiums received during the contractual period. The resultant sum assured should be the fair sum assured to pay to the policyholder at the end of the term, provided all

⁴ This principle resonates with the *ratio decidendi* in *Shoko v Old Mutual* HB-149-16

premiums were received. The rationale is that the fixed US\$ premium at commencement, set to be payable throughout the contract, was meant to purchase a fixed portion of the promised US\$ benefits. Therefore, any subsequent reduced US\$ premium would purchase a proportionately reduced portion of the promised US\$ benefits. Thus, the policyholder would be compensated by a proportionately reduced sum assured purchasable using the reduced US\$ premiums. This calculation must allow for the mortality cost of any cover given during the period.

940. The prejudice caused to a policyholder should equal adjusted sum assured in US\$ net of the benefit actually paid in US\$. This amount must be adjusted for the time value of money.

Illustration – Compensation Basis for Generic Life Insurance Policies

Assume an endowment policy contract concluded on 1 July 1990, with a promised sum assured of ZW\$100,000 and a monthly premium of ZW\$100 maturing in 20 years i.e., on 30 June 2010. In terms of this policy, the policyholder would typically have managed to pay the ZW\$100 monthly premium until August 2006 when the currency was de-based through the removal of 3 zeroes, making the premium payable on this policy equal to ZW\$0.10. At this point in time, the sum assured would be revalued to ZW\$100.

Assuming that the policyholder had continued to remit the revalued premium of ZW\$0.10, this premium would have been completely wiped out by the second currency de-basing of August 2008, when 10 zeroes were removed. At this point in time, the revalued sum assured of ZW\$100 would also be completely wiped out. Subsequent to this event, the policyholder would technically be in default in terms of the insurance contract in that he or she would fail to honour subsequent premium payments. However it is important to note that such default would have been caused by a *casus fortuitus* (event beyond both the insurer's and the policyholder's control).

In the interests of equity and in fulfilment of reasonable policyholder expectations, the policyholder should be entitled to compensation (at the maturity of the contract) because the insurer would typically have invested historic premiums in existing assets. In terms of the recommended compensation basis, the policyholder's entitlement would be calculated using the guidance provided in the Annexure 7 published separately from this Report.

941. The above recommended compensation basis would represent the appropriate framework applicable to insurance contracts in general. It will be noticed, however, that various insurance

products with varying characteristics existed in the life insurance market. The proposals below seek to provide guidance in dealing with the more common variations available in the market place.

Guidance on With-Profits Insurance Policies

942. In these policies, the basic sum assured is typically lower than that for a non-participating policy paying the same premium. These policies are entitled to participation in profits. Typically, there is a pre-determined profit sharing arrangements between shareholders and policyholders. The premiums are higher than a without profit policy of the same cover to reflect the benefit of profit participation. The declared bonus increases the sum assured by the extent of the profit share. Annexure 7B shows typical computation of rightful benefits for with-profit funds.

Recommended Compensation Basis for With-Profit Policies:-

943. There is need to factor in policyholder reasonable expectations based on the bonus philosophy of the with-profit fund. The following adjustments to the formulation of a compensation basis for a generic insurance contract are recommended:-
- a) increase the sum assured by the amount of declared bonus at every bonus declaration date in ZW\$;
 - b) convert the ZW\$ bonus amount to US\$ at the applicable exchange rate then prevailing;
 - c) compute the new sum assured by adding the declared bonus to the previous sum assured in US\$;
 - d) compute the portion of the new sum assured that is purchased by the US\$ equivalent of the periodic premium;
 - e) repeat the above procedure as frequently as premiums are paid in terms of the contract;
 - f) at the interruption of the contract, e.g., lapse due to currency de-basing, establish the compensation payable on the contract as the summation of US\$ purchased sums assured as computed above (this amount is payable at maturity).

944. The prejudice caused to a policyholder is, thus, the adjusted sum assured in US\$ net of benefits actually paid in US\$.

Guidance on Inflation-indexed Policies

945. While some insurers attempted to index premiums and benefits for inflation, such indexation may not have been effective because of the rapid growth of the consumer price index relative to frequency and extent of indexation. For policies whose premiums and sums assured were adjusted for inflation, the following adjustments should be made to the compensation basis provided for generic insurance contracts:-

- a) at each instance of premium adjustment due to inflation indexation, establish the new ZW\$ premium and sum assured;
- b) compute the difference between the new premium and the prior premium as well as the difference between the new sum assured and the prior sum assured in ZW\$;
- c) compile a new series of the ZW\$ difference in premiums and let them run parallel to the initial series in terms of purchasing a proportion of the new sum assured;
- d) convert the ZW\$ series above into US\$ at an appropriate exchange rate then prevailing;
- e) establish fair compensation at the time of policy interruption as the US\$ summation of the purchased sums assured for the different series of premiums, bearing in mind that a new series is established whenever a premium indexation happens.

946. The prejudice caused to a policyholder is thus the adjusted sums assured in US\$ minus benefit actually paid in US\$. This amount must be adjusted for the time value of money. Annexure 7C shows typical computation of rightful benefits for inflation-indexed funds.

Guidance on Unit-linked Policies

947. In these policies, a policyholder's premiums purchase units in a fund. The values of the units depend on the value of the underlying assets held by the fund, less fund expenses. These contracts

should operate on the basis of a framework that has the following pillars: an investment policy statement, benefit illustrations, benefit statements and expected reasonable benefit. This policy is, therefore, an investment-type policy whose compensation basis should be similar to that of investment contracts. Annexure 7D shows typical computation of rightful benefits for unit-linked funds.

Recommended Compensation Basis for Unit-linked Policies:-

948. The following procedure is recommended to establish the appropriate benefit payments on unit-linked policies as a general rule, i.e. assuming that the insurer acted in good faith in making investment decisions on behalf of the insured:-

- a) establish the policyholder's ZW\$ or US\$ unit valuation, whichever is applicable, as a product of the number of units held by the policyholder and the market value per unit of the underlying assets or instruments at the time of redemption;
- b) establish the actual amount paid to the policyholder at redemption date; and
- c) compensation is equal to the difference between (i) and (ii) above. It should be noted that for unit-linked contracts, conversion should be based on the market value of the underlying asset or instrument at the time of redemption.

949. However, where it can be established that the insurer did not act in good faith in executing its duty, for instance mis-selling, fraud or mis-allocation of assets, the insured is entitled to restitution of real value of paid premiums as well as consequential damages. In this case, the following procedure is recommended to establish the appropriate benefit payments on unit-linked contracts:-

- a) convert the member's ZW\$ premiums into US\$ at the time of contribution, using an appropriate exchange rate then prevailing;
- b) establish the summation of the US\$ premiums paid;
- c) prejudice caused to the member is, thus, the summation of premiums in US\$ net of benefits paid in US\$, plus consequential damages and time value of money.

Guidance on Terminations due to Currency De-basing

950. For contracts that were interrupted by the de-basing of currency, the following procedure should be adopted:-

- a) convert the contractual ZW\$ premiums and sum assured to US\$ at the conclusion of the insurance contract using an appropriate exchange rate then prevailing;
- b) convert the series of ZW\$ premium payments made by the policyholder to US\$ at the time of payment, using an appropriate exchange rate then prevailing;
- c) establish the amount of sum assured purchased by each premium payment. The effect of hyper-inflation would have been to reduce successive premium payments in US\$ terms;
- d) at the time of interruption, i.e. when the currency debasement eradicates the ZW\$ premium payments, establish fair compensation as the summation of the US\$ purchased sums assured from inception to currency debasement.

951. The prejudice caused to a policyholder is, thus, the adjusted sum assured at time of currency de-basing in US\$ minus benefit actually paid in US\$. Annexure 7E shows typical computation of rightful benefits in cases where value was lost through currency debasing.

Guidance on Stopped Premiums

952. For contracts that were interrupted by the cessation of premiums due to their decimation by hyper-inflation, the following procedure should be adopted:-

- a) convert the contractual ZW\$ premium and sum assured to US\$ at the conclusion of the insurance contract using an appropriate exchange rate then prevailing;
- b) convert the series of ZW\$ premium payments made by the policyholder to US\$ at the time of payment, using an appropriate exchange rate then prevailing;

- c) establish the amount of the sum assured purchased by each premium payment. The effect of hyper-inflation would have been to reduce successive premium payments in US\$ terms;
- d) at the time of premium cessation, i.e., when the premiums could not be economically collected due to the ravaging nature of hyper-inflation, establish fair compensation as the summation of the US\$ purchased sums assured from inception to premium cessation.

953. The prejudice caused to a policyholder is, thus, the adjusted sum assured at point of premium cessation in US\$ minus benefit actually paid in US\$.

Guidance on Investment Contracts or Cash Accumulation Policies

954. In these policies, the cover is represented by the accumulation of premiums and investment returns, less expenses. The premium is thus the fixed saving by the policyholder. These contracts usually operate on the basis of a framework that has the following pillars: an investment policy statement; benefit illustrations; benefit statements and expected reasonable benefit.

Recommended Compensation Basis for Investment Contracts:-

955. The following procedure should be used to establish the appropriate benefit payments on investment contracts as a general rule i.e. assuming that the insurer acted in good faith in making investment decisions on behalf of the insured:-

- a) compile the policyholder's ZW\$ premiums since inception to time of policy interruption (pre-dollarisation);
- b) convert these ZW\$ premiums to US\$ using an appropriate exchange rate then prevailing;
- c) the US-dollar sum of premiums at the time of policy interruption, is the fair entitlement on the policy.

956. The prejudice caused to a policyholder is, therefore, the adjusted sum of premiums in US\$ less benefits actually paid in US\$. This amount must be adjusted for the time value of money.
957. However, where it can be proved that the insurer did not act in good faith in executing its duty e.g. mis-selling, fraud or mis-allocation of assets, the insured is entitled to restitution of paid premiums as well as consequential damages. In this case, the following procedure is recommended to establish the appropriate benefit payments on investment contracts:-
- a) convert the member's ZW\$ premiums into US\$ at the time of contribution, using an appropriate exchange rate then prevailing;
 - b) establish the member's minimum accumulations as a summation of the US\$ premiums paid;
 - c) prejudice caused to the member is, therefore, the adjusted accumulation of premiums in US\$ net of benefits paid in US\$ plus consequential damages and time value of money.

Compensation Basis for Pensions

958. The following shortcomings characterised the conversion processes and approaches employed by pension funds as outlined in Chapter 6 on ToR (viii):-
- a) the failure by pension schemes to recognise the difference in purchasing power between old and new generation pension contributions and benefits. This resulted in the prejudicial transfer of value from old to new generation members;
 - b) the failure by sponsors to remit employer and employee contributions to pension funds fully. This caused significant deficits in DB schemes and stunted accumulations in DC schemes, both of which were prejudicial to scheme members;
 - c) the unilateral commutation of pension benefits by sponsors in the case of the Government Pensions Agency and other pension schemes;

- d) the failure to honour obligations by both parties caused by currency de-basing, as well as deteriorating economic conditions.

Compensation Basis for DB Schemes

959. The following checks are specified in the criteria for establishing prejudice to DB pension fund members, (including the Government Pension Fund):

- a) establish whether the member and employer honoured the contractual contribution payments; and
- b) establish whether the pension fund honoured the retirement benefits in terms of the DB benefit formulation as follows: $\text{full pension} = \text{pensionable service} \times \text{accrual rate} \times \text{final average salary (FAS)}$.

960. It must be pointed out that, while the pensionable service and the accrual rate were straight forward and easily obtainable parameters of the DB benefit calculation, the FAS applicable for the periods of high inflation up to 2008 was extremely subdued, when converted into US\$. That led to very small, inequitable US\$ DB benefits for those members who retired during this period. This was largely because salary increments in general did not keep pace with inflation. Equally, members retiring in 2009 suffered similar prejudice on account of the very low US\$ salaries that prevailed immediately after dollarisation.

961. Some former senior members of a DB pension scheme, such as those who were in the Police Force, who retired during the period of hyper-inflation, particularly from about 2006 to 2008, retired on pensions which were much smaller than those of their juniors who retired soon after dollarisation. Senior members retiring in later years of hyper-inflation got smaller pensions than juniors retiring in earlier years of inflation. These small, inequitable pensions ran counter to the primary objective of the DB benefit structure as aforementioned.

962. In order to achieve fairness, the FAS should thus be recomputed to ensure equity among members, further taking into account seniority and other factors, to ensure that the primary objective of the DB benefit structure is achieved. The FAS should thus be read

off from US\$ earnings of active members of similar grade as retirees at point of compensation. This should be applied to DB members who exited between 2000 and 2009. The prejudice caused to a member is, therefore, calculated as follows; adjusted pension benefit in US\$ minus benefit paid in US\$.

Compensation Basis for DC Schemes

963. The following checks are specified in the criteria for establishing prejudice to DC pension fund members:

- a) establish whether the member and employer honoured their contractual contribution payments; and
- b) establish whether the pension fund honoured the retirement benefit in terms of the accumulation entitlements of each member.

964. The net accumulations in a DC scheme belong to members. The following procedure should be adopted to establish the US\$ asset-shares of each member:-

- a) convert each member's ZW\$ total contributions into US\$ at the time of contribution, using an appropriate exchange rate then prevailing;
- b) convert the ZW\$ net portfolio returns into US\$ at each year-end, using an appropriate exchange rate then prevailing;
- c) establish each member's accumulations as a summation of the US\$ contributions plus net investment returns, i.e., total returns less fund expenses;
- d) establish each member's asset share as the member's total accumulations as a percentage of the total accumulations for the fund and applied to the total assets of the fund. This is the asset share adjustment referred to under the findings of ToR (viii) that mitigates inter-generational transfer of assets due to hyper-inflation;
- e) at conversion, in March 2009, apply the asset-shares established above to allocate US\$ assets. The asset values should be determined as at 31 December 2014 net of new

assets acquired after 31 March 2009, plus fair value of assets disposed of that existed on the date of conversion. The use of the 2014 asset values mitigates the loss of value on assets due to conversion distortions and allows the price discovery for assets that were understated at conversion.

965. This calculation is recommended for DC members who exited between 2000 and 2009. The prejudice caused to members is thus the member's asset share in US\$ less benefit paid in US\$ or its equivalent.

Compensation Basis for Schemes that Converted from DB to DC Schemes

966. In considering the employer's duty of good faith to the fund or lack thereof, conversions from DB to DC may have been motivated by the following:-

- a) the desire to avoid fluctuations in contribution rates associated with DB schemes;
- b) the desire to unlawfully access surpluses in the DB fund;
- c) the desire to write-off deficits in the DB fund.

967. Prior considerations should establish whether the above is consistent with the motive for conversion.

968. For pension schemes that converted from DB to DC, the following procedures should be adopted:-

- a) calculate the present value of the member's accrued benefit entitlement up to the date of conversion by using the procedure outlined above on DB schemes;
- b) subject to any agreement reached regarding the process of conversion, make a benefit comparison between the benefits that were due in the DB fund on a member-by-member level. For all members that are worse off in the DC fund, calculate the present value of the liability in respect of that difference;
- c) after establishing the funding level, establish if the fund had an actuarial deficit. If it did, the member's entitlement must be

adjusted to make the scheme fully funded, thus the employer must fund the deficit before conversion;

- d) the member's DB entitlements, as established above, can be deployed as initial capital injection into the new DC scheme;
- e) subsequent to commencement of the DC scheme, apply the procedure for establishing the appropriate US\$ liabilities for DC schemes as outlined above from time of conversion onwards.

969. Prejudice caused to members is thus the member's asset share in US\$ less benefits paid in US\$ or its equivalent.

NSSA Compensation

970. Post-dollarisation, NSSA has been paying a flat pension benefit to its retired members, regardless of their salary level or years of participation in the fund. This method of compensation is patently unfair, in that members are given the same compensation despite varying periods of contributions and pensionable salaries. Thus, a member who contributed for 22 years is treated exactly the same as a member who contributed for 10 years.

971. The benefit is 1.33% of final pensionable salary, where the pensionable salary is the member's salary, subject to a maximum of \$700, multiplied by years of services. The years of service are subject to pensionable service credits for all members that joined the Scheme at launch in October 1994 with ages above 49, where the credits are as stipulated in the Act.

972. NSSA is currently paying a flat retirement benefit amount of \$60, having grown from \$25 in 2009. This methodology disregards the different contribution levels by members due to different salary levels and years of contribution.

Recommended Compensation Basis for NSSA Benefits:-

973. The following framework should be adopted by NSSA:-

- a) the basis of calculation of pension benefits should be the final salary defined above, capped at the insurable earnings, of the member for each year that he or she participated i.e. pension

= (pensionable service + credit, if above age 49 at launch of NSSA x accrual rate x final salary as defined above;

- b) the primary objective of this NSSA DB framework is to provide benefits that increase as pensionable service increases, and also as the final salary increases in real terms to the cap of \$700;
- c) in order to achieve fairness, the final salary should thus be recomputed to ensure equity among members, taking into account seniority, pensionable service and other factors, and to ensure that the primary objective of the NSSA DB benefit structure is achieved. The final salary should thus be read off from a time series US\$ earnings progression of other men in the same grade as that of the retiring member;
- d) the prejudice is, therefore, the NSSA benefit as defined above less the amount paid as benefits.

NSSA Grants

Contribution Refund

974. Post-dollarisation, NSSA has been paying a flat grant of \$25 as a contribution refund for members who retire before achieving 10 years participation in the fund. A flat lump-sum final benefit of \$25 is paid, regardless of the actual amount of contributions paid by a member. Thus, a member who contributes for 9 years and one who contributes for 2 years are each paid the same, \$25.

Recommended Compensation Basis for Contribution Refund Grant:-

975. The contribution refund grant should be equal to the actual amount of contributions by a member during his or her years of participation. The contributions received pre-dollarisation should be converted to US\$, based on the reasonable rate. Prejudice is, therefore, the difference between the actual contributions paid less the \$25 received.

Five Year Limit on Claiming of Grants

976. NSSA members or beneficiaries have a 5 year limit to claim grants or pensions. Members or beneficiaries who fail to claim their benefits within 5 years have their benefits forfeited to NSSA.
977. The Commission considered this provision to be prejudicial and recommends that it should be repealed. All prejudiced members and beneficiaries should be paid the benefits due to them. This responds well to the numerous public complaints received by the Commission relating to NSSA.

FUNERAL POLICIES

Fully-Paid Funeral Policies

978. The Commission observed that some paid-up policies were compelled to start afresh after dollarisation or were subjected to the unilateral alteration of promised benefits.

Recommended Compensation Basis for Funeral Policies:-

979. The Commission recommends that funeral policies that became fully paid-up during the ZW\$ era should not have been subjected to any unilateral contractual alteration in the form of benefit alterations or compelling new US\$ premium payments. As such, parties ought to resort to, and be bound by, the initial contract and restitution of post-conversion premiums and any variations should be redressed accordingly.
980. For deceased policyholders, compensation in the form of cash or equivalent value of services that had been rendered should be paid to the estate heir.

Unilaterally Terminated Funeral Contracts

981. There were circumstances where funeral policies were terminated by insurers due to massive erosion of premium values as a result of inflation. This was perceived by the policyholders as unilateral termination by the insurer. In order to compensate this category of policyholders, the insurer should reinstate them, taking cognisance of the earlier years of contributions prior to the termination in deciding when the policy will be paid-up.

982. In such circumstances, where the policyholder, for whatever reason, is no longer keen on the policy that had been unilaterally terminated by the insurer, the policyholder should be paid termination benefits according to the surrender or lapse terms of the policy.

Other Compensation Findings

Pension Lump-sums Lost Due to Withdrawal Access and Subsequent De-monetisation

983. It was the finding of the Commission that some benefits with respect to pension commutations from about 2007 to 2008 were never received by the beneficiaries, owing to restrictions imposed by the RBZ on bank withdrawals, as well as failure by pension funds to inform beneficiaries of the benefits payments. The residual bank balances were then adversely affected by the de-monetisation process in 2015, where an average amount of \$5 per account was subsequently received.

Basis for Compensation

984. The first stage of compensation should be in accordance with the compensation basis for the respective product as discussed above. Furthermore, in order to establish fair compensation for losses due to de-monetisation, Government must establish an independent body to revisit the de-monetisation process. In addition, it is recommended that the burden of proof be imposed on the employer to demonstrate that it made full settlement of commutations during the ZW\$ era.
985. The Commission considers that the exchange rates applied on de-monetisation were prejudicial to pensioners who received lump-sums during the period 2007 and 2008, as the maximum proceeds of de-monetisation amounted to \$5 per pensioner.

Contribution Arrears

986. It was observed by the Commission that contribution arrears constituted a significant explanatory factor to pensioner prejudice. It is thus recommended that all sponsor organisations owing contributions to their requisite pension schemes should honour their obligations. Where the obligation is considered to be

burdensome, an appropriate payment plan should be agreed between the scheme and the sponsor, and be registered with the Regulator. This arrangement would only be applicable to pension schemes with surviving sponsors.

Burden of Proof

987. A number of challenges relating to burden of proof were encountered by pensioners as set out in the following sections:-

a. Change of Fund Administrators

988. In cases where fund administrators had changed, some pensioners struggled to identify the new administrator of their pension scheme. This applied especially for members of pension schemes whose sponsors had been wound up. It is recommended that the burden of proof of identifying the current fund administrator be imposed on the new fund administrator, who would have access to the data relating to contribution history.

b. Alleged Payments Made by Employers to Industry Pension Schemes

989. The Commission found that some pensioners were frustrated in attempts to establish who owed them their pensions. Whereas employers are alleged to have made full contributions to industry pension schemes, the latter claimed that there were contribution arrears outstanding from the employer. It is recommended that the burden of proof be imposed on the employer to demonstrate that it had made full contribution remittances to the relevant industry pension scheme.

c. Alleged Payments Made by Fund Administrators and Insurance Companies to Individual Insurance and Pension Fund Members

990. The Commission received a number of complaints from pensioners and former policyholders who, upon claiming their benefits from insurance companies and pension fund administrators, were informed that their benefits had been processed into their bank accounts during the ZW\$ era. The irony is that the pensioners and policyholders had not received the alleged payments. The burden of proof was imposed on the

pensioner and policyholder to prove that they had not received the money. Considering that banks maintain records for a period of 6 years, pensioners and policyholders had no recourse to the bank's records. Against this background, the Commission recommends that the burden of proof be imposed on the fund administrator or insurance company that it had processed the amount.

Compensation Implementation Framework

991. The primary objective is to ensure that prejudiced members of insurance schemes and pension funds get their rightful benefits, whilst maintaining stability and confidence in the industry. Cognisant of the importance of objectivity and impartiality in the implementation of the framework for compensation outlined above, it is recommended that IPEC, as the industry Regulator, should assume overall oversight over the implementation of the compensation framework by industry players.

Compensation Scheme

992. The Commission recommends that IPEC obligates institutions to prepare, approve and submit a compensation scheme, within a year of a date to be specified by IPEC. The compensation scheme should be comprised of the following reports and processes:-

- a) to identify all potential claimants and communications with them;
- b) to calculate the quantum of loss in respect of each claimant, based on standardised assumptions, methods and models set by the Regulator;
- c) to invite potential claimants or their representatives, complainants, pressure groups, media and public to comment on the compensation scheme and raise any queries they may have;
- d) to consider payment mechanisms and payment timetables; and
- e) to submit the compensation scheme consisting of the actuarial reports, audit reports, complaints and queries for consideration by the Regulator before it approves the scheme.

993. Considering the difficulties encountered by the Commission in reconciling and accounting for all the assets of the industry, it recommends that the Regulator sets stringent requirements for the accounting and valuation of assets. These requirements should also take into account assets that were improperly transferred, removed or expropriated from policyholder funds and pension schemes.

994. In consideration of the controversies that may be associated with the compensation scheme, it is recommended that the compensation scheme be preceded by appropriate legislative reviews to minimise controversies.

Period Earmarked for Compensation

995. The Commission recommends that the compensation scheme be applicable from 1996 up to the time determined by the regulator.

Exchange Rate Issues Arising from the Period of Investigation

996. The investigation period for the Inquiry was delineated into the following three generations for the purposes of establishing old and new generation assets:-

- a) first generation – covering the period prior to 31 December 1998;
- b) second generation – covering the period 1 January 1999 to February 2009; and
- c) third generation – covering the post dollarization period (from March 2009 onwards).

997. The Commission established that there were no exchange rate conversion controversies with respect to the first generation and the third generation for the following reasons:-

- a) the first generation was characterised by mild inflation and a single exchange rate regime, appropriately represented by the official exchange rate; and

- b) the third generation covered the multi-currency era in which the US\$ was the primary currency of use. As such, no exchange rate controversy arises.

998. The second generation would thus be the only period during which an exchange rate controversy would arise because of the existence of multiple and divergent exchange rates, such as the official exchange rate, the UN exchange rate, the Old Mutual Implied Rate (OMIR) and other parallel market exchange rates, such as the cash rate and RTGS rate.

Guidance on Appropriate Exchange Rate for the Conversion of Premiums, Contributions and Benefits

999. The Commission offers the following guidance for the purposes of converting insurance premiums and pension contributions, as well as insurance and pension benefits from ZW\$ to US\$ during the first and second generations in fulfilment of the recommended Compensation Framework:-

- a) first generation – the official exchange rate should be regarded as the appropriate exchange rate for the conversion of ZW\$ premiums or contributions and benefits;
- b) second generation – institutions should identify an appropriate average of the existing parallel rates and exclude the official exchange rate. For the avoidance of doubt, an appropriate parallel rate is the average of the UN rate and the OMIR rate that best maintains a healthy relationship between assets and liabilities for the scheme or product in question. The official exchange rate is excluded as it became unrelated to market fundamentals in the latter stages of the second generation. The UN rate and OMIR rate are the preferred market indicators as they can be objectively established i.e., their record is not a matter of controversy relative to the other parallel market rates. A healthy relationship between assets and liabilities is sought in the interests of balancing the interests of policyholders and pension members against their respective insurance companies or pension funds. The onus is upon the respective insurance companies and pension funds to present a compensation proposal to the Regulator IPEC that contains an average market-related exchange rate

that balances the interests of the institution and its policyholders and or pension fund members.

Securitisation of Property to Meet Rightful benefits

1000. The Commission notes that insurance companies and pension funds are largely invested in listed equities, money market and property. However, there could arise a situation where the recommended compensation may require disposal of real estate. In this regard, the Commission recommends the securitisation of commercial and other real estate to enhance its liquidity for the purposes of compensating prejudiced pension fund members and insurance policyholders. The unitised real estate assets can also be traded on the secondary market, through over-the-counter or listed on the Zimbabwe Stock Exchange. This is expected to provide a significant amount of liquidity to the real estate, which otherwise, would have been quite illiquid without securitisation.

Chapter Summary

1001. This Chapter presents findings under ToRs (viii), (ix) and (x), which required the Commission to come up with an appropriate criteria for assessing prejudice, examining the extent of prejudice and coming up with an appropriate basis for compensation for material prejudice. The ToRs are interrelated and it was convenient to address them in one Chapter.

Criteria for Determining Prejudice

1002. In coming up with the criteria for the quantification of prejudice, the Commission considered different types of insurance and pension products and policyholder minimum reasonable expectations, as well as the minimum reasonable benefit expectations of members of pension funds.

1003. Since insurance and pensions arrangements are contractual relationships, the Commission assessed the relationships from a legal point of view, in order to establish the rights and obligations of each contracting party. In addition, factors causing loss of value identified in Chapter 5 and other Chapters were considered in coming up with the criteria for assessing prejudice. Such factors include the failure to index against inflation, currency de-basing, dollarisation, conversion processes, de-monetisation, pension contribution arrears, legislative deficiencies and poor corporate

governance. The investigation also considered shortcomings in the conversion processes and approaches employed by life assurance companies and pension funds. The shortcomings included the failure to index premiums and benefits resulting in the prejudicial transfer of value from old to new generation policyholders, as well from policyholders to the shareholders of the insurance company.

Compensation Basis

1004. The investigation revealed that the prejudice suffered by insurance policyholders and pension fund members was very material. Therefore, the Commission recommended a compensation framework that clearly outlines the processes required to achieve an objective and transparent compensation. The primary objective is to ensure that prejudiced members of insurance schemes and pension funds get their rightful benefits, whilst maintaining stability and confidence in the industry.

1005. The Commission recommends a compensation framework that takes into consideration the following:-

- a) the criteria for assessing prejudice in relation to the insurance and pension contracts as provided by the respective legal definitions as aforementioned;
- b) the factors and causes of loss of value as outlined in Chapter 5 on ToRs (iv) and (v);
- c) the shortcomings of the conversion processes and the approaches employed by life insurance and pension funds at dollarisation as highlighted in Chapter 6 on ToR (viii);
- d) the financial soundness of the insurance and pensions industry as outlined in Chapter 8 on ToRs (xi) and (xii).

1006. Cognisant of the importance of objectivity and impartiality in the implementation of the framework for the recommended compensation, it is recommended that IPEC, as the industry Regulator, should assume overall oversight of the implementation of the compensation framework by industry players.

1007. The Commission recommends that the Regulator requires institutions to prepare and submit a compensation scheme within a year of a date to be specified by the Regulator. The compensation period shall be 1996 to the date when the compensation scheme is instituted.

1008. Thus, insurance companies and pension funds should come up with compensation schemes within one year, the implementation of which will be supervised by the Regulator. The Commission's recommended currency for compensation is US\$ or its equivalent, notwithstanding that many of the contracts were entered into and subsequently concluded in the ZW\$ era.

1009. The Commission proffers compensation guidance on the following insurance and pension products:-

- a) With-Profit Insurance Policies;
- b) Investment Contracts or Cash Accumulation Policies;
- c) Unit-linked Policies;
- d) Inflation-indexed Policies;
- e) Unilaterally Terminated Funeral Contracts;
- f) Terminations due to Currency De-basing;
- g) Guidance on Stopped Premiums;
- h) Pension Products (DB and DC);
- i) NSSA's National Pension Scheme.

1010. Annexes 7A to 7G guide the computations of rightful benefits for each of the above mentioned products. Considering the challenges faced by pensioners in accessing their pensions owing to missing records associated with the change of fund administrators and payments allegedly processed into their bank accounts but not reflected, the Commission recommends that the burden of proof be placed on the insurance company, pension fund or pension administrator.

1011. The Commission established that contribution arrears were one of the major factors causing loss of value by pensioners. It, therefore, recommends that all sponsoring employers with outstanding pensions be obliged to honour their obligations.

Quantification of Prejudice

1012. The Commission examined prejudice suffered by a selected number of complainants. As highlighted in Chapter 5 on the Factors, Causes and Reasons for loss of value, some pensioners received insignificant amounts as low as US\$0.08, after several years of working, and the majority of them got zero values, owing to the lack of benefit inflation indexation and currency de-basing.

1013. However, owing to data limitations, the Commission was unable to quantify the total prejudice suffered by insurance policyholders and pension fund members who were paid during the investigation period of 1996 to 2014. Most of the information, such as contribution histories of policyholders and pension fund members, as well as their salary progressions, was not made available to the Commission to enable it to make the determination. Considering the finite tenure of the Commission, it was also practically impossible to calculate the total prejudice suffered, on a product by product basis, for every institution that was investigated and for the entire industry. In this regard, the Commission recommends that a sensitivity analysis be conducted, as part of the compensation framework, to establish the likely impact of the recommended compensation on the soundness and sustainability of the industry.

Securitisation of Property to Meet Rightful benefits

1014. The Commission recommends the securitisation of commercial and other real estate to enhance its liquidity for the purposes of compensating prejudiced pension fund members and insurance policyholders if the liquid or semi-liquid assets are insufficient to meet compensation obligations. The unitised real estate assets can also be traded on the secondary market, through over-the-counter or listed on the Zimbabwe Stock Exchange. This is expected to provide a significant amount of liquidity to the real estate, which otherwise, would have been quite illiquid without securitisation.

CONCLUSION OF THE INQUIRY

1603. The Commission was set up to investigate the loss of value by insurance policyholders and pensioners during the conversion from the ZW\$ to the US\$. The findings of the investigation indeed confirm that there was huge loss of value to insurance policyholders and pensioners owing to failure by Government, IPEC and the industry to set up a fair and equitable process of converting insurance and pension values from ZW\$ to US\$.

1604. In addition, the Commission found that policyholders and pensioners did not lose value during the conversion period alone, but have been losing value throughout the investigation period due to other reasons which are fully discussed in Chapter 5 on Factors, Causes and Reasons for Loss of Value.

1605. The Commission found that the insurance and pension industry was not being effectively regulated over the investigation period of 1996 to 2014. As a result, the Regulator failed to intervene effectively to correct market failures and guide the industry when required. This led to the industry failing to institute and follow financially sound systems and procedures.

1606. Other than the failure of regulation, the Commission also noted failures on the part of Government, in particular the absence of clear policy guidelines relating to currency-de-basing, the demonetisation and conversion processes, as well as the operating environment that was characterised by prolonged high inflation levels.

1607. In the absence of such essential guidance from both the Regulator and Government, and in the face of an unstable macro-economic environment, the interests of policyholders and pension fund members were not protected. The industry players trampled on the reasonable benefit expectations of its customers, leading to loss of value. Poor corporate governance, arbitrary benefit calculations, shambolic record-keeping and unsustainable expense ratios, among other ills, became prevalent in the industry, with policyholders and pension fund members bearing the brunt of such excesses.

1608. In order to strengthen the plethora of weaknesses in the industry, the Commission has identified the need to strengthen the

regulatory and legislative frameworks as the major building blocks towards restoring soundness in the industry.

1609. The regulatory framework will need to, among other recommendations given by the Commission, institute major governance reforms by setting up an insurance and pensions industry corporate governance framework which is effective and enforceable

1610. Notwithstanding the unsound practices in the industry, the Commission is of the view that a fair and just compensation framework can be implemented to compensate for the loss of value suffered by policyholders and pension fund members over the investigation period. In the recommended compensation framework, the Commission assessed the asset and capital structure of the industry in evaluating its capacity to compensate for loss of value. The Commission was satisfied that, the industry has reasonable capacity to make good and compensate policyholders and pension fund members for loss of value.

1611. The Commission stresses the very high expectations from members of the public on the findings of the Commission with regard to compensation. The loss of value has impoverished policyholders and pensioners and there is an expectation that the findings of the Commission will remedy this. Government is, therefore, urged to implement the recommended compensation framework as a matter of urgency, in order to alleviate the plight of impoverished policyholders and pensioners.

1612. Notwithstanding the loss of value due to poor industry practices, wherein compensation will be expected from the private sector, the Commission notes that the largest reason for loss of value was the operating environment that was characterised by very high levels of inflation. Even after implementation of the compensation framework, there remains a large number of impoverished policyholders and pensioners who lost all their savings due to inflation. The Commission recommends that Government considers setting up a means-tested old age pension to alleviate the plight of these policyholders and pensioners and to address the issue of poverty in old age.