

## Multi-Managed Smoothed Bonus



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## Introduction

### **Dear Multi-Managed Smoothed Bonus Investor,**

Smoothed Bonus products in general have been criticised of non-transparent management practices. The main areas of concern centre on

- the methods of declaring bonus rates,
- the segregation of policyholder funds from shareholder funds, and
- the impact of bonus smoothing reserves on the equitable allocation of investment returns to policies.

In light of the above, Old Mutual has engaged its independent auditor KPMG to provide independent assurance in respect of our annual report on the governance of our Smoothed Bonus business for the year ended 30 June 2009.

KPMG has reviewed our processes and its findings are included as Appendix 5 to this report.

This report aims to shed more light on the internal operation on the Old Mutual Smoothed Bonus Portfolios from Old Mutual Corporate.

We trust that this will go a long way towards providing a greater understanding of how these portfolios operate. This report, along with the independent report by KPMG, is intended to give assurance about the governance surrounding your investment in Multi-Managed Smoothed Bonus (MMSB) and the sound financial management of your money.

It is with great pleasure that we present this report for Multi-Managed Smoothed Bonus for the financial year ended 30 June 2009.

## Executive Summary and Declaration

We, Old Mutual, make the following declaration in respect of the MMSB Portfolio under the following main headings:

### **1. Investment philosophy**

The investment philosophy of the MMSB Portfolio is described in detail in Appendix 1 to this report. Contained within the investment philosophy is a description of the investment mandate of the MMSB Portfolio. The MMSB performance benchmark is also included in the investment philosophy.

We declare that the portfolio is being managed in line with the specifications of the mandate.

We declare that the risk management controls employed by the asset manager are of a sound financial nature.

We declare that the MMSB portfolio performance (gross of asset management charges) over the 3-year period ending 30 June 2009 (8.6% p.a.), as measured against the benchmark (8.9% p.a.), has underperformed the benchmark return over the same period.

### **2. Bonus philosophy**

The bonus philosophy is described in detail in Appendix 2 to this report.

We declare that the approach taken in determining the bonus declarations is financially sound and equitable between the 100%, 95% and 90% guarantee levels.

We declare that the documented methodology in controlling the level of the Bonus Smoothing Reserve is compliant with the stated bonus philosophy.

### **3. Segregation of funds between policyholders and shareholders ("ring-fencing")**

Old Mutual's approach to ring-fencing is set out in Appendix 3 to this report.

We declare that the structures and controls set in place to ensure portfolio segregation are adequate and are being adhered to.

### **4. Portfolio solvency levels**

A statement regarding the MMSB Portfolio solvency level is set out in Appendix 4 to this report.

We certify that the Bonus Smoothing Reserve (BSR) as at 31 December 2008, of the MMSB Portfolio, was not more negative -7.5% of the value of the liabilities.

In addition, we can also disclose that the Bonus Smoothing Reserve (BSR) as at 30 June 2009 was between 0% and 5% of the value of the liabilities.

Signed on this the 9th day of November 2009



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Trevor Pascoe  
Product Solutions Executive  
Investment Services  
Old Mutual Corporate



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Roger Birt  
Head of Guaranteed Investment Portfolios  
Investment Services  
Old Mutual Corporate

## APPENDICES

### Appendix 1 - Investment Philosophy

- The Symmetry Multi-Manager boutique within the Old Mutual Investment Group (South Africa) (OMIGSA) manages the underlying portfolio.
- Symmetry is allowed discretion in the allocation of the underlying asset managers and construction of the underlying mandates. As a minimum, relevant boutique investment houses within Old Mutual Investment Group (South Africa) (OMIGSA) must manage the following classes: South African Alternative Assets and South African Direct Property.
- Although this mandate is not expected to change frequently, Old Mutual will make adjustments as changes occur in the economic and investment environment and if a change occurs in the assessment of the inherent risks in the portfolios. This report describes the mandate effective 30 June 2009, with references to the mandate applicable for the period 1 July 2008 to 30 June 2009 where relevant.

**The MMSB Portfolio invests in four broad asset classes, namely International Assets, South African Direct Property, South African Alternative Assets, and South African Equities & Interest-bearing Assets (including Targeted Investments).**

**The following specifies the mandated allocation to each broad class:**

Broad Class	Sub Class	Strategic Allocation (1 June 2008)	Strategic Allocation (30 June 2009)
South African Equities and Interest-bearing Assets	South African Equities	36.00%	33.00%
	South African Bonds	21.00%	19.00%
	South African Cash (incl. FSC assets)	15.50%	15.50%
South African Direct Property	South African Direct Property	7.50%	7.50%
South African Alternative Assets	South African Alternative Assets	5.00%	5.00%
International Assets	International Equities	5.00%	8.00%
	International Fixed Interest Investments	5.00%	7.00%
	International Alternative Assets	5.00%	5.00%

The following specifies the mandated asset allocation range for each broad class:

Broad Class	Sub Class	Range (1 July 2008)	Range (30 June 2009)
South African Equities and Interest-bearing Assets	South African Equities	[29%;43%]	[26%;40%]
	South African Bonds	[14%;28%]	[12%;26%]
	South African Cash (incl. FSC assets)	[10%;21%]	[10%;21%]
South African Direct Property	South African Direct Property	[5%;10%]	[5%;10%]
South African Alternative Assets	South African Alternative Assets	[2.5%;7.5%]	[2.5%;7.5%]
International Assets	International Equities	[2%;9%]	[3%;13%]
	International Fixed Interest Investments	[2%;9%]	[2%;12%]
	International Alternative Assets	[2%;9%]	[2%;7%]

## Mandate Changes

The following is a summary of mandate changes that were effected during the 12 months ending 30 June 2009:

**Direct property:** The benchmark for direct property was changed from the IPD South African Property Total Return Index to CPIX+5.5% p.a, effective from 7 July 2008. Due to the change in the CPI and CPIX indices introduced in 2009, the benchmark became CPI+5.5% with effect from 1 April 2009.

**Asset Allocation:** The strategic allocation to offshore assets was changed from 15% to 20% with effect from 1 January 2009.

### ***International Assets (Equities, Interest-bearing Assets & Alternative Assets):***

The objective of this component is to maximise the exposure to international assets within the applicable regulatory constraints. Prior to 1 June 2008, due to the existence of exchange controls, the exposure to international assets in the benchmark portfolio was set equal to the actual international exposure at the start of each month. In creating the benchmark portfolio, the following fixed allocations are made within this broader class:

Equities: 33.3%  
Interest-bearing: 33.3%  
Alternative Assets: 33.3%

However, effective from 1 June 2008, the exposure to international assets in the benchmark portfolio is set to the fixed weightings as indicated at the start of this section.

The benchmark for international equities is the total return of the MSCI World Equity Index (in South African rands).

The benchmark for international interest bearing assets is the Lehman Global Aggregate Total Return Index (now named the Barclays Capital Aggregate Index) (in South African rands).

The benchmark for international alternative assets is 9% (in US dollars). International alternative assets can include hedge funds, funds of hedge funds, absolute return funds and other defensive portfolios.

An overall limit of 20% exposure was placed on international assets.

International Assets Managers	SEI	Origin	Orbis	SEI	Stenham	Episode
Type	Equity	Equity	Equity	Bonds	Alternative Assets	Alternative Assets
Target proportion of asset class	60%	20%	20%	100%	87%	13%
Target proportion of total portfolio	4.8%	1.6%	1.6%	7%	4.35%	0.65%
Benchmark	MSCI World Equity Index	MSCI World Equity Index	MSCI World Equity Index	Barclays Capital Aggregate Total Return Index	USD Cash	USD Cash
Target	MSCI + 1.25% p.a. over rolling 3 years	MSCI + 4% p.a. over the long term	MSCI + 4% p.a. over the long term	Barclays + 0.5% p.a. over rolling 3 years	USD 9%	USD 9%

**South African Direct Property:**

As from 1 June 2008, the portfolio has a strategic asset allocation to South African Direct Property of 7.5%. Previously, the long-term objective of this component was to maintain an exposure of 5% of the total portfolio.

Due to the illiquidity of this asset class, the portfolio manager is not in a position to effect asset allocation changes in the short term. Prior to 1 June 2008, in calculating the benchmark portfolio performance, the exposure to Domestic Direct Property was set to the actual exposure at the start of each month. From 1 June 2008, in calculating the benchmark portfolio performance, the exposure to this asset class in the benchmark portfolio was set to the strategic exposure (i.e. 7.5%).

The management of this component of the portfolio has been outsourced to OMIGSA Property Investments (OMIGPI), and exposure to South African Direct Property is achieved through investments in OMIGPI's Triangle Core, Development and SRI funds.

Prior to 30 June 2008, the benchmark of South African Direct Property was the IPD South Africa Property Total Return Index. Due to the infrequency of publishing of the IPD benchmark (published annually effective 31 December each year), when calculating the benchmark portfolio performance, the South African Direct Property benchmark in the benchmark portfolio was taken as the actual performance of the South African Direct Property portfolio. To overcome this, a benchmark against inflation (CPIX) + 5.5% per annum was introduced to the portfolio's investment mandate. Therefore, effective from 30 June 2008, the primary objective for South African Direct Property is to outperform inflation over the long term, while in the short term the portfolio was measured against CPIX + 5.5% per annum, this has since changed to CPI + 5.5% per annum.

### ***South African Alternative Assets:***

This asset class contains investments in the IDEAS Fund. Other alternative investments (e.g. hedge funds and structured products) will only be included if agreed to by the OMLAC(SA) investment committee. As from 1 June 2008, the portfolio has a strategic allocation to South African Alternative Assets of 5%. Previously, the long-term objective of this component was to maintain an exposure of 2.5% of the total portfolio.

The Ideas Fund – Infrastructure, Developmental and Environmental Assets Fund – invests specifically in infrastructure and development assets aimed at financing projects to promote SA's long-term economic development.

Due to the nature of the investments in this class, Symmetry is not in a position to effect asset allocation changes in the short term. Prior to 1 June 2008, when calculating benchmark portfolio performance, the exposure to this class was set to the actual exposure at the start of each month. However, effective from 1 June 2008, the exposure to South African Alternative assets in the benchmark portfolio is set to the fixed weighting as indicated at the start of this section.

The performance benchmark for this broader class is to generate a real return (relative to CPI) in excess of 7% per annum (before tax and charges) over rolling 3-year periods.

### ***South African Equities & Interest-bearing Assets:***

The balance of the portfolio is invested in South African equities and interest-bearing assets. When calculating the benchmark portfolio performance, the exposure to this broad class in the benchmark portfolio will be set to the actual exposure at the start of each month. In creating the benchmark portfolio, the following fixed allocations will be made within this broader class:

Equities: 50%

Interest-bearing: 50% (comprising 60% of Bonds and 40% of Money market)

However, effective from 1 June 2008, the exposure to each asset class (within this broader class) in the benchmark portfolio is set to the fixed weighting as indicated at the start of this section.

### **Equities**

The South African listed equities portion of the portfolio contains a diversified portfolio of shares listed on the JSE Securities Exchange South Africa. The Benchmark for the South African Equities portion of the portfolio is the SWIX (excluding Old Mutual shares, i.e. adjusted for a zero exposure to Old Mutual plc). The

Old Mutual plc adjustment is made by removing Old Mutual plc from the benchmark and increasing the weight of the remaining stocks in the benchmark.

SA Equity Managers	Prudential	Frater	Polaris	SIM	Osborne	Stanlib	Alphen	Investec
Type	Core equity	Satellite equity	Satellite equity	Satellite equity	Satellite equity	Satellite equity	Satellite equity	Satellite equity
Target proportion of asset class	22.0%	18.5%	23.0%	9.0%	5.0%	6.5%	5.0%	11.0%
Target proportion of total portfolio	7.3%	6.1%	7.6%	2.9%	1.7%	2.1%	1.7%	3.6%
Benchmark	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)	SWIX (ex OML)
Target	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years	SWIX (ex OML) + 5% p.a. over rolling 3 years
Limits	Tracking Error of up to 7% p.a.  Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Minimum allocation to equities = 90%	Tracking Error of up to 9% p.a.  Minimum allocation to equities = 90%

### Interest-bearing

The South African Bond portion of the South African Interest Bearing portfolio invests only in investment grade South African bonds. This includes investment grade inflation-linked bonds. The Benchmark for the South African Bond portion of the Portfolio is the BEASSA All Bond index.

All Bond Managers	Foord Bonds	Coronation Bonds	Prudential Bonds
Type	Satellite bonds	Core bonds	Core Bonds
Target proportion of asset class	33.33%	33.33%	33.33%
Target proportion of total portfolio	6.33%	6.33%	6.33%
Benchmark	BEASSA ALBI	BEASSA ALBI	BEASSA ALBI
Target	BEASSA ALBI + 1.25% p.a. over rolling 3 years	BEASSA ALBI + 1% p.a. over rolling 3 years	BEASSA ALBI + 1% p.a. over rolling 3 years
Limits	Must comply with CISCA credit guidelines	Must comply with CISCA credit guidelines Modified Duration limited to within 2 years of BEASSA ALBI	Must comply with CISCA credit guidelines Modified Duration limited to within 1 year of BEASSA ALBI At least 50% of portfolio invested in SA Government bonds

The South African Interest Bearing portfolio includes Targeted Investments, which are investments in assets that partially or wholly meet the definition of Targeted Investments as published by the Financial Services Charter Council. The long-term performance objective of the Targeted Investments is to earn a return of 3 month JIBAR plus 70bps per annum, gross of asset management fees.

The South African Money Market portion of the South African Interest Bearing portfolio invests only in highly secure bank, government and parastatal issued money market paper. Capital security and liquidity are the primary objectives. The Benchmark for the South African Money Market portion of the Portfolio is the STeFI Money Market Composite index.

SA Money Market Managers	Gryphon Money Market	Taquanta Money market
Type	Satellite money market	Satellite money market
Target proportion of asset class	50%	50%
Target proportion of total portfolio	7.75%	7.75%
Benchmark	STeFI	STeFI
Target	STeFI + 0.5% p.a. over rolling 1 year	STeFI + 0.5% p.a. over rolling 1 year
Limits	<p>Must comply with CISCA credit guidelines</p> <p>Maximum Weighted Average Duration = 120 days</p> <p>Maximum term of single instrument = 18 months</p>	<p>Must comply with CISCA credit guidelines</p> <p>Maximum Weighted Average Duration = 180 days</p> <p>Maximum term of single instrument = 72 months</p>

For the purposes of performance measurement, total returns on the benchmarks are used for all asset classes.

## Overall Restrictions & Limitations

- The portfolio is required to comply with the requirements of Regulation 28 of the Pension Funds Act.
- All statutory requirements will be adhered to at all times.
- Symmetry retains responsibility for determining, setting and monitoring appropriate limits within the mandates given to the managers underlying the portfolio. The limits would be communicated to OMLAC(SA) on an annual basis, or more frequently if any material changes to these limits are made.
- At least 40% of the total portfolio must be invested in Interest Bearing Assets (both South African and International).
- Strategic re-balancing of the portfolio will be effected if the actual allocation to one of the specified asset classes deviates by more than 3% (measured as a percentage of the total portfolio's value) from the required strategic allocation to that asset class.
- Rebalancing will also be effected if the allocation to an individual manager deviates by more than 3% from the manager's strategic allocation. If it is not possible to make the required adjustment (due to statutory limitations) then the OMLAC(SA) investment committee will be made aware of this.

- Derivatives may be used for hedging purposes and/or in order to achieve the desired asset or sector allocation exposures. Derivatives will not be used for purposes of speculation. Derivative positions must be taken on a “covered” (not “naked”) basis only.
- The use of derivatives shall at all times comply with Part 2 of the Schedule to the Regulations under the Long-term Insurance Act.
- Symmetry may perform securities lending. The entire scrip-lending fee, after deduction of intermediary charges, must be reinvested into the portfolio in order to improve the performance of the portfolio. Symmetry must inform OMLAC(SA) timeously of any material changes to this scrip lending arrangement.
- Investment in shares of Symmetry’s own company, group and associated companies, or where there are strategic or significant holdings, will be subject to OMLAC(SA) approval. Moreover, the portfolio will be subject to statutory constraints from time to time. Symmetry will communicate these conditions / restrictions to the OMLAC(SA) investment committee as appropriate.

Performance, compliance with mandate and historic tracking error is monitored on a monthly basis. Actual time-weighted performance is compared to the benchmark performance over the rolling periods specified.

No strict criteria are set for performance relative to peers. However, the monthly performance monitoring process will have regard to the performance of similar mandates offered by other asset managers. This will be used to assess the robustness of the benchmark, the reasonability of the outperformance target, and the relative success of Symmetry, taking into account any differences in benchmark and restraints imposed on Symmetry.

## Appendix 2 - Bonus Philosophy

The smoothing process inherent in the bonus philosophy aims to ensure that, over time, the bonus should produce the same return as the underlying portfolio net of the guarantee and other costs, but with the impact of short-term market volatility significantly reduced.

### Bonus Philosophy

The surplus attributable to smoothed bonus policies (i.e. generally the net investment return earned on policyholder funds) is credited to a Bonus Smoothing Reserve (BSR), from which bonuses are declared. The BSR is, in effect, the difference between the market value of the assets and the value of the basic liabilities. A separate BSR is maintained for each of the Old Mutual Corporate Smoothed Bonus Portfolios.

The amount available for each bonus declaration is therefore taken as the accumulated balance in the BSR. This balance depends primarily on:

- Amounts earned in the past, which have not previously been declared as bonuses.

Positive BSR balances represent surplus attributable to with-profit policyholders that have not yet been declared as bonuses, which will be used to support subsequent bonus declarations. A negative BSR balance means that more has been declared as bonuses to policyholders than has been earned to that date (as a consequence of the smoothing process), and that this will be recovered in future bonus declarations (i.e. future bonuses will be less than the net investment return earned).

- The net investment return earned during the prior month.

Bonuses declared usually differ from the actual net (of charges) investment return earned in any month, so as to reduce the impact of short-term volatility of returns to policyholders. In months when above average investment returns are earned, the bonus declared tends to be lower than the net investment return earned, and in months when below average investment returns are earned, the bonus declared tends to exceed the net investment return earned.

The BSR is therefore credited with the net investment return and is debited with the cost of bonuses declared, the cost of investment guarantees.

It is important to note that the BSR is used to declare bonuses for the benefit of MMSB policyholders only, and can therefore not be accessed by Old Mutual shareholders.

### Bonus Declaration Process

Bonuses are declared monthly in advance, based on the financial position at the beginning of each month. The bonus declaration is at the discretion of the Board and is based on the recommendation by the Statutory Actuary. The Board has delegated the authority for approving monthly bonuses to the Statutory Actuary, who will keep the Board informed periodically.

In addition to the above considerations, the process that follows describes how the monthly bonus is determined:

- The impact of the declaration of a proposed bonus on the BSR is assessed.

The BSR is targeted in the long term to be within a range of 0% to 5% of the accumulated policy values. However, the smoothing process, coupled with short-term market movements, and the impact of cashflows will inevitably cause the BSR to move outside of this range in the short term.

The bonus process is designed to restore the BSR to its long-term target over a reasonable period, consistent with guidelines issued by the Actuarial Society of South Africa (ASSA) that require the Statutory Actuary not to allow the BSR to drop below a position that can reasonably be expected to be restored within three years.

Consideration is given to the current level of the BSR, e.g. if the BSR is at a level below the target range, the proposed bonus may be reduced. The greater any shortfall, the greater the downward adjustment. Any shortfalls or excesses are not eliminated immediately but rather recouped or redistributed over time.

- A view on the relative level of the market compared to historical levels, as well as the current and medium-term economic outlook and prospects for investment markets are factored into the equation. This is necessary to assess the amount available for the bonus declaration. For example, in times when the relative level of the market is high, and returns on the underlying assets have consequently been high, the BSR will be more positive. This allows an assessment to be made of the appropriate level of the BSR going forward.

The following additional factors are considered when determining the final bonus to be declared:

- The degree to which returns are smoothed compared to previous bonus declarations and levels of returns earned on the underlying assets.
- The reasonable expectations of policyholders as to the size of the bonus.
- The impact on bonuses if a severely falling market environment was experienced. For example, in such an environment, bonuses will be affected by the need to ensure that the BSR does not become too negative, as this would adversely affect subsequent bonuses.
- Our competitive position against the bonus declarations of Smoothed Bonus Portfolios offered by other providers.

Three bonuses will be declared each month, one for each guarantee option. The differential in bonuses is defined in advance, and has been set at 0.04% initially – i.e. the 95% guarantee option will earn a bonus that is 0.04 percentage points per month higher than the 100% guarantee option, and the 90% guarantee option will earn a bonus that is 0.04 percentage points per month higher than the 95% guarantee option. This does not imply a cross-subsidy between the different guarantee options, as the higher bonus is funded for through the charging of a lower charge for investment guarantees.

In the instance where market conditions dictate that a 0% bonus is required on the 90% guarantee option these differentials will not be applied, i.e. we will not declare negative bonuses for the 95% and 100%

guarantee options. In other words, there could be months where the bonus on all three guarantee options will be zero.

### **Guaranteed vs Non-Guaranteed Bonuses**

For MMSB 100, 100% of the total bonus declared (gross of investment fees and retirement fund tax) is guaranteed. Similarly, for MMSB 95 and MMSB 90 respectively, 95% and 90% of the total bonus declared is guaranteed.

### **Allowance for Management Action in Adverse Circumstances**

As mentioned, the BSR is targeted in the long term to be within a range of 0% to 5% of the liabilities. Tolerance for BSR levels outside this range reduces as the absolute levels move further away from this range. The tolerance for a particular level of smoothing reserve is also a function of the prevailing investment and economic conditions and the outlook for these.

The focus here is particularly on a three-year time horizon, in line with the Actuarial Society of South Africa guidelines as described in this section. While Old Mutual has some internal guidelines, there are no absolute levels set at which particular management actions are automatically taken. Such an approach may be imprudent, as it may not consider all the factors involved at that time. However, if the BSR trends away from the long-term average, the extent of management action will become more pronounced, and will make use of the following remedial steps, taking due consideration of the economic and investment environment at all times.

The first would be through the bonus mechanism as described in this section, a mechanism used at all levels of BSR. The second would be to remove the non-guaranteed element (difference between Total Account and Vested, or guaranteed, Account) where this is possible. Such a removal will occur only if the board, on the recommendation of the Statutory Actuary, considers it not possible to restore the level of the BSR during the ensuing three years through the bonus declaration process, given the prevailing investment and economic conditions.

If, after the removal of the non-guaranteed element, the Board considers that the level of the BSR may not be capable of being restored within three years, shareholder capital will be used to provide temporary support to the portfolio. If and when the position improves, the support provided will be returned to shareholder funds with returns earned.

### **The Cost of Providing Guarantees**

Old Mutual levies a capital charge of 1.8% per annum for MMSB 100, 1.3% per annum for MMSB 95 and 0.8% per annum for MMSB 90. The capital charge will be levied monthly in arrears on the assets underlying the policy. Thus any bonuses declared are net thereof. This charge is in respect of the cost of providing the guarantees inherent in this product.

### Appendix 3 - Segregation of Portfolios (“Ring-Fencing”)

Smoothed Bonus products constitute a significant proportion of the Company’s business. Because of the nature of this business, specific steps are taken to ensure that policyholder funds in respect of Smoothed Bonus business are managed in the interests of the policyholders concerned.

The following are some of the steps that are taken:

- There is a clear separation of shareholder and policyholder funds.
- The assets within the shareholder and policyholder funds are managed by different portfolio managers, in terms of different investment mandates.
- The portfolio managers responsible for the policyholder funds have been clearly instructed that all investment decisions taken within the policyholder funds are to be in the longer-term best interest of policyholders, within the constraints of specified investment mandates.
- Each product portfolio has an investment mandate that sets out the mandate for that product portfolio. Amongst others, the mandate specifies which asset classes may be held, and in what proportions.
- In addition to the limitation specified in the Long-term Insurance Act Investment Regulations, there are further self-imposed limits on investments in associated companies of the Old Mutual Group within each policyholder portfolio.
- Major investment in Old Mutual Group companies (such as Nedbank and Mutual & Federal) and loans to other companies in the Group (such as to Old Mutual plc) are predominately held in shareholder funds. Policyholder fund may, from time to time, have some limited exposure to such investments as part of their normal portfolio investments.
- All potential conflicts of interests arising out of proposals that policyholder funds invest in a company or fund in which shareholders could have an interest that could conflict with the policyholders’ interest, are disclosed to the Statutory Actuary, and if material are approved by the Board. Any such transactions are conducted on arms-length terms, and only when it is clearly demonstrated that such investments are in the interest of policyholders.
- The portfolio manager produces a monthly report covering amongst others the structure of each portfolio relative to its mandate and investment performance relative to benchmarks.
- The method of allocation of profits and investment returns between policyholders and shareholders is clearly specified, and Smoothed Bonus policyholder funds are credited (via bonus stabilisation reserves) with the full investment return earned on their funds, less specified charges.
- Any profit allocated to shareholder funds is only transferred from policyholder funds on the recommendation of the Statutory Actuary, following an actuarial valuation. Such transfers are always subject to the assets in the policyholder funds remaining sufficient to cover all the corresponding liabilities as determined by the Statutory Actuary on the valuation date. These liabilities include provision for any guarantees that may apply.

- With each valuation, a detailed analysis of profit is done, which confirms that there are no material errors or inconsistencies in the valuations, and that valuation assumptions are appropriate.
- The Company pays particular attention to ensuring that the declaration of bonuses is done in a responsible manner, such that sufficient reserves are retained for bonus smoothing purposes, and that sufficient reserves and capital are maintained to meet policy benefits. The way in which the Company manages these products, ensures that information is produced on the financial strength of its Smoothed Bonus funds, and their ability to pay bonuses at an individual fund level. This information is carefully considered whenever bonuses are declared, and is monitored regularly throughout the year. All investment returns credited to policyholder funds that are not declared as bonuses are retained in bonus stabilisation reserves, which may only be used to support subsequent bonus declarations.

## Appendix 4 - Portfolio Solvency Levels

As of 31 December 2002, mandatory guidance relating to the disclosure of solvency levels (Bonus Smoothing Reserves) in Smoothed Bonus Portfolios became effective.

Old Mutual complies with this guidance through making public, information relating to the solvency levels for all classes of business. The published reports contain a statement regarding the solvency levels of each class relative to a level of -7.5% of the value of the liabilities in that class.

This information is effective as at 31 December.

As at 31 December 2008, the Bonus Smoothing Reserves for the MMSB portfolio was not more negative than -7.5%.

On an annual basis Old Mutual provides information on the Bonus Smoothing Reserves (BSR) in the following format. The aim of this information is to demonstrate the extent to which the long-term objective in terms of a target range of BSR is being achieved.

The actual BSR for MMSB after taking account of all declared bonuses falls within one of the following BSR ranges:

Bonus Smoothing Reserve range:	
Greater than 20%	
Between 15% and 20%	
Between 10% and 15%	
Between 5% and 10%	
Between 0% and 5%	✓
Between -5% and 0%	
Between -10 and -5%	
Smaller than -10%	

As at 30 June 2009, the actual BSR is in the range between 0% and 5%.



## Appendix 5 - KPMG Independent Assurance Report

**Independent assurance report to the Directors of Old Mutual Life Assurance Company of South Africa Limited**

### **Introduction**

We have performed our reasonable assurance engagement for the Old Mutual Life Assurance Company of South Africa Limited (Old Mutual) with respect to the extent of compliance with the governance policies set out on pages three to eighteen of the Annual Governance Report on the Internal Policies, Practices, Processes and Philosophies of the Old Mutual Smoothed Bonus Portfolios for the MMSB Investment Portfolio (the Annual Governance Report) for the year ended 30 June 2008.

This report is made solely to Old Mutual in accordance with the terms of our engagement. Our work has been undertaken so that we might state to Old Mutual those matters we have been engaged to state in this report and for no other purpose. We do not accept or assume responsibility to anyone other than Old Mutual, for our work, for this report, or for the conclusions we have reached.

### **Responsibilities of the directors**

The directors of Old Mutual are responsible for the preparation and presentation of the Annual Governance Report. This responsibility includes the design, implementation, and maintenance of processes and procedures for compliance with the governance policies for the relevant investment portfolios and for all underlying information reported therein.

### **Responsibilities of the assurance provider**

Our responsibility is to express our conclusion based on our independent reasonable assurance engagement, performed in accordance with the International Standard on Assurance Engagements (ISAE 3000): Assurance engagements other than audits or reviews of historical information issued by the International Audit and Assurance Standards Board. This standard requires us to comply with ethical requirements and to plan and perform the assurance engagement to obtain reasonable assurance, regarding the subject matter of the engagement.

### **Basis of our work and inherent limitations**

As there are no published International Standards for reporting on corporate governance, the disclosures in the Annual Governance Report have been evaluated against the extent of compliance with the stated governance policies applicable to the four aspects set out in the body of the Annual Governance Report on pages five to eighteen, namely:

- Appendix 1: Investment Philosophy
- Appendix 2: Bonus Philosophy

- Appendix 3: Segregation of Portfolios (“Ring-fencing”), and
- Appendix 4: Portfolio Solvency Levels.

The application of the governance policies is dependent on the effective functioning of internal controls, which are subject to inherent limitations and, accordingly, errors or irregularities might occur and may not be detected. Our procedures cannot provide assurance that fraudulent collusion or misrepresentation, especially on the part of those holding positions of authority or trust, has not occurred. Furthermore, our conclusions are limited to the period reported on and the projection of any conclusions to future periods is inappropriate. Individual calculations have not been subject to detailed recalculation and, accordingly, we do not express a conclusion on any specific calculation.

### Work performed

We planned and performed our work to obtain all the information and explanations we considered necessary to provide sufficient evidence for us to provide reasonable assurance that the four aspects indicated are substantially in compliance with the stated governance policies applicable to the Old Mutual Smoothed Bonus Portfolios for the MMSB Investment Portfolio. The procedures performed depended on our judgement, including the assessment of risks of material misstatement of the information contained in the Annual Governance Report, whether due to fraud or error. In making those risk assessments, we have considered internal control relevant to the company’s preparation and presentation of information in the Annual Governance Report in order to design assurance procedures that are appropriate in the circumstances, but not for the purpose of expressing a conclusion on the effectiveness of the company’s internal control.

Our procedures consisted of:

- Obtaining an understanding of the governance policies applied by management in the governance of the investment portfolio;
- On a test basis determining that the performance calculations and related statements of performance have been calculated in accordance with the stated policies;
- Inquiring about and obtaining representations that the stated investment philosophy, and in particular the investment limitations, the bonus philosophy and segregation of investments have been complied with;
- On a test basis determining that the Bonus Smoothing Reserves and portfolio solvency levels have been calculated in accordance with the governance policies applicable to the relevant investment portfolios.
- Reviewing the presentation of the four aspects of the Annual Governance Report in light of the findings from our work performed.

We believe that the evidence that we have obtained is sufficient and appropriate to provide a basis for our conclusion, expressed below, for the application of the governance policies for the Old Mutual Smoothed Bonus Portfolios for the MMSB Investment Portfolio and does not extend to any other business or operations of Old Mutual.

**Conclusion**

Based on our work performed, in our opinion, Old Mutual has complied with the governance policies stated in the Annual Governance Report on the Internal Policies, Practices, Processes and Philosophies of the Old Mutual Smoothed Bonus Portfolios for the MMSB Investment Portfolio for the year ended 30 June 2009.

Yours faithfully

KPMG Services (Proprietary) Limited.



Per G Pickering  
Chartered Accountant (SA)  
Director  
Cape Town  
16 November 2009

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