

# Principles & Practices of Financial Management

How we manage our Absolute Smooth Growth Portfolio on Max Income and Max Investments



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## *Purpose of this guide*

This guide explains how Old Mutual manages its Absolute Smooth Growth Portfolio ('the fund') including:

- How do the bonus rates work?
- What is smoothing and what are its benefits?
- What is the bonus smoothing account?
- What happens if investment returns are low or if there is a market crash?
- What investments does the fund own?

These principles and practices are important because of the fact that although the fund is directly invested in the market, the bonuses declared are not directly linked to the returns achieved. Policyholders must thus rely on the life company to ensure they receive fair returns.

The fund is currently open to new business in the following products:

- Max Income
- Max Investments

It is also important to note that these principles and practices may need to be adapted over time to take account of changing circumstances, for example in the business, economic, or regulatory environments. Approval of any change needs to be given by the Old Mutual Board and its Committee for Customer Affairs, and will be communicated to affected clients.



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### *How do the bonus rates work?*

Policies in the fund are allocated investment growth by the addition of bonuses to their fund value.

#### Setting bonus rates

The main objective of Old Mutual's bonus declaration policy is to ensure that over time the bonuses produce a similar return to the underlying investments in the fund (after any applicable tax, charges and expenses that impact on the funds available for the declaration of bonuses).

A formula is used to determine the bonus declared each month for the Absolute Smooth Growth Portfolio. However, Old Mutual does reserve the right to depart from the formula and use discretion in exceptional circumstances.

No bonus will be declared that would result in the Absolute Smooth Growth Portfolio's ongoing viability being knowingly threatened.



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### **What is smoothing and what are its benefits?**

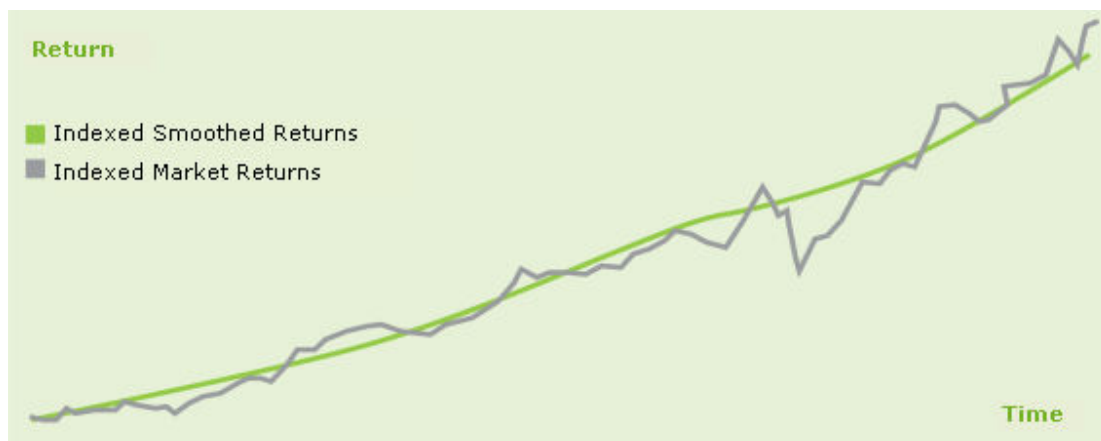
The main objective of Old Mutual's bonus declaration policy is to ensure that over time the bonuses produce a similar return to the underlying investments in the fund (after any applicable tax, charges and expenses). A secondary objective is to achieve this in a way that reduces policyholders' exposure to market ups and downs.

This is known as 'smoothing' of investment returns. During periods of relatively strong investment performance of the Absolute Smooth Growth Portfolio's investments, a portion of investment growth is not declared as a bonus. It is held back, so that in times of relatively poor investment performance, there are funds available to declare a higher bonus than would otherwise have been the case.

The effect of smoothing is illustrated in the graph below.

#### **A typical Market Return Portfolio versus a Smoothed Return Portfolio**

(Indexed returns net of applicable tax, charges and expenses)



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**It is important to note that any funds held back in order to smooth investment returns are kept entirely for the future benefit of policies invested in the fund. These funds are managed completely apart from Old Mutual's shareholders' assets.**

The **benefits** of smoothing include:

- Reduced exposure to the extreme ups and downs of investing in the stock market in the shorter term (and the anxiety and rash behaviour associated with it!).
- Reduced risk of investing in / disinvesting from the market at the wrong time.



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### *What is the bonus smoothing account?*

The fund owns investments that have a market value. Policies in the fund have individual fund values that depend on previously declared bonuses. The bonus smoothing account (BSA) represents the difference in value between the market value of the fund's investments and the aggregate value of individual policy fund values.

**It is important to note that any funds in the BSA are kept entirely for the future benefit of policyholder whose policies are invested in the fund. These funds are managed completely apart from Old Mutual's shareholders' assets.**

A positive BSA means that some good past returns have been held back, and can be added to policies in future as bonuses. A negative BSA means that previous bonuses added to policies have been greater than the net investment returns actually earned. This will need to be recovered in future by declaring bonuses that are lower than the investment returns earned.

The BSA represents how much past investment returns earned have differed from their longer-term average.

- The BSA will be positive when past returns are greater than their longer-term average, and can be negative when returns are less than their longer-term average.
- In the longer-term the BSA is expected to average between 0% and 5% of aggregate policy fund values, while in the shorter-term it could vary between -15% and +20% of total policy fund values.



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## *What happens if investment returns are low or if there is a market crash?*

### Market/fund value adjustments ('MVA') on voluntary withdrawal

After periods of poor investment returns, the amount that policyholders receive when withdrawing voluntarily from the fund may be lower than the face value of their policy's funds. This will be due to a MVA that may be necessary to protect future bonus levels for policies remaining in the fund. If this adjustment was not in place, the values paid to those leaving could be too high and could mean that those policies that remain receive future bonuses that would be too low. The size of any MVA will vary with the size of the BSA.

Such a situation may only arise on voluntary withdrawal from the Absolute Smooth Growth Portfolio when:

- The BSA of the Absolute Smooth Growth Portfolio is negative, and;
- The product rules regarding the timing of voluntary withdrawals require a MVA.

In the event of a voluntary withdrawal the amount paid out can therefore be lower than the fund value of the underlying investments.

It is important to note the following:

- This adjustment to the face value on voluntary termination (i.e. the MVA) in response to a negative BSA does not benefit Old Mutual's shareholders, but rather those policyholders whose policies remain invested in the fund. This helps support future bonus rates for the remaining policies.



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## Management actions

If investment conditions are extremely adverse (for example, there is a significant fall in investment values), management actions may need to be taken to ensure the ongoing viability of the fund. The aim of these actions (which need to be approved by the Old Mutual Board) is to restore the level of the BSA to its longer-term target range in order that reasonable future bonuses can be declared.

While Old Mutual has internal guidelines, there are no absolute BSA levels at which particular management actions are automatically taken – this will depend on the specific circumstances at the time.

Management actions can include the following (taking the economic and investment environment into account at all times):

- Low or negative bonuses may be declared, as per the bonus formula (with allowance for discretion and only up to the guaranteed value).
- An MVA might be applied as described previously. This measure can continue until the BSA returns to its longer-term target range in order that reasonable future bonuses can be declared, currently and in future.

The Absolute Smooth Growth Portfolio guarantees 50% of capital contributions and bonuses declared on contractual withdrawals before fees. Contractual withdrawals include annuity payments, retirement and death. Old Mutual will at all times honour this guarantee.



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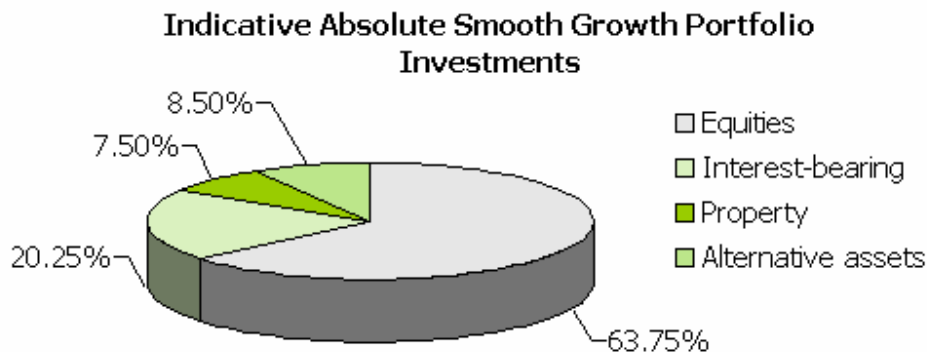
### What investments does the fund own?

The fund aims to provide policyholders with smoothed returns that beat inflation and in so doing, create wealth. To achieve this, the investments underlying the fund are made up of a balanced mix of local and international investments – with a benchmark split of 63.75% equities (shares), 20.25% interest-bearing investments, 7.50% property and 8.50% alternative assets. These investments are actively managed to produce the best possible return for policyholders, without adopting too much risk.

The fund manager may depart to some extent from the above percentages, based on their view of the markets and where they expect to earn higher returns.

Although the benchmark splits are not expected to change often, Old Mutual may adjust these if:

- Changes occur in the regulatory, economic or investment environment,
- A change occurs in the standards of capital management (in other words, what Old Mutual needs to do to ensure that it can meet any guarantees provided).



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### *Where you can find out more*

This guide aims to provide a high-level explanation of how the Absolute Smooth Growth Portfolio works. Because we have kept it as short as possible we have only outlined the most important information.

If you are an existing policyholder, your policy documentation and / or original quote should contain additional detail about your specific fund. Although every effort has been made to present information consistent with your contract, the terms and conditions in your contract will apply where these differ from this document.

A copy of Old Mutual's official Principles and Practices of Financial Management (PPFM) of Discretionary Participation Business, from which this guide is derived, is available on the Old Mutual website ([www.oldmutual.co.za/personalppfm](http://www.oldmutual.co.za/personalppfm)).

**Note that if there are any differences between this guide and the official PPFM, the official PPFM applies.**

You can also find out more from your Old Mutual Personal Financial Adviser or broker, or by calling Old Mutual's client communication centre on 0860 30 00 00.



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