



Flexi Smoothed Bonus



OLD MUTUAL

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FLEXI SMOOTHED BONUS BUSINESS

1. BACKGROUND

Discretionary Participation Business

Flexi Smoothed Bonus and Smoothed Bonus Plus policies are classified as discretionary participation business because Old Mutual exercises a certain amount of discretion in the management of this business, for example in the way policyholder funds are invested and the way in which investment returns are passed on to policyholders in the form of bonuses.

This discretion is limited as Old Mutual must still meet its contractual obligations, comply with regulatory requirements and take into account the reasonable benefit expectations and fair treatment of policyholders.

This document summarises the way in which Old Mutual currently exercises its discretion in the management of Flexi Smoothed Bonus business.

Should there be any conflict between this document and the PPFM document mentioned below the latter will prevail.

Principles and Practices of Financial Management

Old Mutual is required to publish information on how it manages its discretionary participation business and has therefore published a document called the Principles and Practices of Financial Management (PPFM) which is currently available on the Old Mutual website (www.oldmutual.co.za/personalppfm). Hard copies are also available, on request, from the Client Communication Centre (0860 50 60 70 or +27 21 509 2765 during office hours).

Changes to these principles and practices require Board approval and input from the Committee for Customer Affairs and Old Mutual's Statutory Actuary.

Old Mutual will take reasonable steps to communicate any changes to principles and practices to those policyholders who are affected by these changes.

2. WHAT DISCRETION DOES OLD MUTUAL HAVE IN MANAGING FLEXI SMOOTHED BONUS BUSINESS?

Old Mutual has discretion to manage various aspects of this business such as:

- Investing policyholder fund money
- Allocating bonuses to policyholders
- Calculating benefits on termination or alteration of a policy
- Varying expense, tax and capital charges

2.1 INVESTING POLICYHOLDER FUND MONEY

The Old Mutual Investment Group of South Africa (OMIGSA) manages the portfolio of assets backing Flexi Smoothed Bonus policies.

These policyholder fund assets are managed separately from shareholder fund assets.

Investment mandates

The Smoothed Bonus portfolio is managed in accordance with a mandate provided by Old Mutual which sets out the investment objective and benchmark of the portfolio as well as the limits on how much of the portfolio can be invested in various types of asset (e.g. equities, fixed interest, property and alternative assets such as private equity).

The benchmark asset allocation is given in the table at the end of this document.

The investment mandate aims to balance the reasonable benefit expectations of policyholders with the capital requirements relating to the investment guarantees provided. Although the mandate is not expected to change frequently, Old Mutual may adjust it if changes occur in the regulatory, economic or investment environment.

Investment Policy

Old Mutual also has internal policies and procedures that govern a number of issues relating to the investment of policyholder fund assets, for example:

- Compliance with the requirements of the Insider Trading Act
- The prevention of possible conflicts of interest arising in the investment decisions taken by the Old Mutual Investment Group
- Limiting the exposure of policyholder funds to credit risk.
- The use of derivative instruments.
- The use of various strategies to enhance returns for Smoothed Bonus policyholders such as scrip lending.

2.2 ALLOCATING BONUSES TO POLICYHOLDERS

Bonus Smoothing Accounts

Smoothed Bonus policies are invested in a balanced portfolio of assets with a view to providing returns in excess of inflation over the longer term.

Investment returns on these assets are smoothed and passed on to policyholders via the Bonus Smoothing Account (BSA) mechanism:

- The net investment return (i.e. after the deduction of product management fees, capital charges, investment expenses and policyholder tax) on the assets is added to the BSA.
- Bonuses paid to policyholders and the cost of any guarantees are deducted from the BSA.

The smoothing of returns is achieved by holding back some of the net investment return during periods of above average investment performance and releasing it again in times when investment performance is below average.

The average BSA (expressed as a percentage of total liabilities excluding the BSA itself) for smoothed bonus business is expected to be between 0% and +5% in the longer term. Due to market volatility, shorter-term movements of the BSA within the range of -15% to +20% would not be unexpected.

Market Value Adjuster

The value of the assets fluctuates on a daily basis but policyholders receive a smoothed investment return via the bonus rate, which changes less frequently. Situations can therefore arise where the market value of the assets backing Flexi Smoothed Bonus business is less than the value of the Smoothed Bonus policies. The BSA would be negative in these situations.

In such circumstances a Market Value Adjuster (MVA) is applied on termination in order to reduce the amount paid out to clients who discontinue their policies to an amount that more closely reflects the market value of the assets backing their policy value.

This ensures that discontinuing clients receive a fair share of the assets relative to policyholders who continue to stay invested. The amount of the MVA is credited to the BSA.

Declared Bonuses

Bonuses for Flexi Smoothed Bonus policies are declared annually at the discretion of the Board on the recommendation of the Statutory Actuary and are reviewed by the Board's Committee for Customer Affairs.

Bonuses are usually declared during February in respect of the prior calendar year and would generally be credited to policies towards the end of February. Claims on or after 1 March would include the effect of the declared bonus.

Policies must have a non-zero balance on the date that the bonus is credited to policies, in order to receive the declared bonus.

Declared bonuses are split into a vested and a non-vested portion. Vested bonuses are guaranteed on claims (for example maturity and death claims) and cannot be removed. Vested bonuses are not guaranteed on termination or alteration of a policy.

Interim Bonuses

Interim bonus rates apply in the periods between annual bonus declarations in order to provide (as far as possible) a reasonable return compared with inflation for policies that terminate during this period.

Interim bonus rates are reviewed at least quarterly but may be reviewed at any time depending on prevailing conditions in investment markets.

Interim bonus rates are set prudently to minimise the possibility that they are reduced before the next bonus declaration, or that declared bonuses are lower than interim bonuses.

Management Actions in Adverse Conditions

When the BSA is negative various actions can be taken to restore it to its longer-term target range of 0% to 5%. Some or all of the following steps can be taken depending on economic conditions and how negative the BSA is:

- Applying a MVA to discontinuing policies (as described above)
- Reducing interim bonuses
- Declaring low or zero bonuses at the annual bonus declaration date.

There is no absolute BSA threshold level at which particular actions are automatically taken to restore the BSA to its longer-term target range, as this will depend on the specific circumstances at the time. The main concern is to ensure the ongoing viability of the smoothed bonus fund for the benefit of remaining policyholders.

Should the above actions not have the desired effect – and the Board is of the opinion that there is no reasonable prospect of otherwise restoring the BSA to an acceptable level over the next three years - Old Mutual will remove a sufficient amount of non-vested policy balances to bring the BSA back to a level close to zero. Any amounts removed will be added back to the BSA.

If after the removal of non-vested policy balances, the Board does not consider it possible to restore the level of the BSA to zero during the ensuing three years, shareholder capital will be used to provide support to the Smoothed Bonus policyholder fund for as long as this is necessary. If and when the BSA position improves, the capital provided will be returned to shareholder funds together with any returns earned on that capital.

2.3 TERMINATIONS & ALTERATIONS

Smoothed Bonus policy contracts do not specify how the benefits payable on termination of the policy will be calculated, nor do they specify how benefits will be adjusted when a policy is altered. Old Mutual therefore has some discretion in determining these benefits.

Old Mutual aims to provide termination, paid-up and other alteration benefits that provide reasonable value to affected policyholders, without prejudicing those policyholders who continue to meet their contractual obligations.

Policy Terminations

Terminations include the surrender of a policy, retirement prior to the contractual retirement date for any reason, transfer of a policy and situations in which policies lapse.

Apart from regulatory requirements Old Mutual also takes account of the following when calculating termination benefits:

- the recovery of unrecouped initial expenses
- the deduction of a disinvestment charge
- any Market Value Adjuster applying at the time.

Policy Alterations

Alterations include changing the term during which premiums or benefits are payable, changing the amount of premium payments, making a policy paid-up (i.e. ceasing payment of premiums), disinvesting part of a policy and changing the amount or type of benefits covered by the policy.

Apart from regulatory requirements Old Mutual also takes account of the following when calculating benefits after an alteration to a policy:

- the recovery of unrecouped initial expenses
- the deduction of a disinvestment charge
- the deduction of an alteration fee
- as far as possible, termination values should not change materially before and after a policy is altered.

2.4 CHARGES

This section discusses those charges that Old Mutual has the discretion to set or vary.

Capital Charges

Capital charges are deducted from policyholder funds in return for the capital support provided by shareholder funds.

Capital charges are calculated to provide shareholders with an appropriate return on this capital, which has to be available at all times to support policyholder funds when required.

Capital charges will only be amended if the reasonable benefit expectations of affected policyholders would not be adversely affected or if extraordinary circumstances arise.

Expense Charges

Charges to cover expenses are calculated in order to cover expected costs including some margin for profit.

Expense charges expressed as a Rand amount are amended annually (where policy contracts permit this) with reference to the rate of inflation. For this purpose the year-on-year inflation rate as published by Statistics South Africa for the Core Consumer Price Index for the historical metropolitan and other urban areas is used. Should Statistics South Africa no longer publish this index it will be replaced by the closest equivalent index, as assessed by Old Mutual.

Investment expenses relating to asset management (for example fees paid to asset managers, brokerage, taxes, levies, audit charges, bank charges and custodian charges) are deducted from the investment return earned.

Fees paid to asset managers for the management of the assets will be market-related. Where a performance-related fee is introduced it is set such that the level of the fee at expected future investment returns is similar to that being charged before the performance-related fee was introduced.

Tax

Tax on investment income and capital gains is deducted from investment income and capital gains at the applicable policyholder fund tax rates.

In the event of changes to tax legislation, the Statutory Actuary shall recommend to the Board's Committee for Customer Affairs a revised basis of allocation of tax charges to policyholder funds.

ANNEXURE: Benchmark Asset Allocation for Flexi Smoothed Bonus Business

Domestic equity	48.75 %
Domestic interest-bearing assets	23.75 %
Domestic property	7.50 %
Domestic alternative assets	5.00 %
Global equity	7.00 %
Global interest-bearing assets	2.00 %
Global alternative assets	<u>6.00 %</u>
	<u>100.00 %</u>