



# Performance Profits



**OLD MUTUAL**

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success

## **PERFORMANCE PROFITS BUSINESS**

### **1. BACKGROUND**

#### **Discretionary Participation Business**

The following Performance Profits policies are classified as discretionary participation business:

- Balanced, Balanced Plus, Equity, Equity Plus, Select and Property
- Worldwide Balanced and Worldwide Equity
- Top 40, Standard Bank Growth, Standard Bank Balanced & Standard Bank Defensive
- Stable and Stable Plus

This business is 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 Performance Profits 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](http://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 PERFORMANCE PROFITS 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 most of the portfolios of assets backing Performance Profits policies.

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

#### **Investment mandates**

Each of the Performance Profits portfolios 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).

Benchmark asset allocations are given in the table at the end of this document.

The investment mandates aim to balance the reasonable benefit expectations of policyholders with the capital requirements relating to the investment guarantees provided. Although the mandates are not expected to change frequently, Old Mutual may adjust them 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 Performance Profits policyholders such as scrip lending.

## **2.2 ALLOCATING BONUSES TO POLICYHOLDERS**

### **Bonus Accounts**

Performance Profits policies are invested in various assets depending on the objective and investment mandate of the particular portfolio concerned.

Investment returns on these assets are passed on to policyholders via bonus rates that can be positive or negative (except for Stable and Stable Plus policies where the bonus rate is always greater than 0%).

The mechanism by which the investment return is passed on to policyholders involves maintaining Bonus Accounts for these policies:

- Net investment returns (i.e. after the deduction of product management fees, capital charges, investment expenses and policyholder tax) earned on the assets backing these portfolios are added to the Bonus Accounts.
- Bonuses paid to policyholders and the cost of any guarantees are deducted from the Bonus Accounts.

As a result of the above, bonuses will generally closely follow (but will not necessarily equal) the underlying net investment return on the portfolio concerned.

### **Bonus Rates**

Performance Profits bonuses are declared monthly, based on the level of the Bonus Account shortly before the end of each month.

### **Market Value Adjuster**

The value of the assets fluctuates on a daily basis while the bonus rates only change once a month. Situations can therefore arise where the market value of the assets backing these policies drops below the value of the policies during the month.

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 Bonus Account.

MVAs do not apply to Stable or Stable Plus policies.

## **Management Actions in Adverse Conditions**

Should the bonus account become unacceptably negative (as determined by the Statutory Actuary), consideration will be given to the most appropriate way to restore it to an acceptable level, taking into account the circumstances that led to the negative position. This could include transfers between portfolios of Performance Profits business or a transfer from shareholder funds.

Shareholders will carry the cost of guarantees when the bonus account becomes unacceptably negative and remains so after appropriate actions have been taken to ensure the ongoing viability of the business.

## **2.3 TERMINATIONS & ALTERATIONS**

Performance profits policy contracts do not specify how the benefit 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 Allocations for Performance Profits Business**

### **Performance Profits Balanced and Select Portfolios**

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	6.00 %

### **Performance Profits Equity Portfolio**

Domestic equity	90 %
Global equity	10 %

### **Performance Profits Stable Portfolio**

Domestic interest-bearing assets	100 %
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### **Performance Profits Property Portfolio**

Property	100 %
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### **Performance Profits Top40 Portfolio**

Domestic equity	100 %
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### **Performance Profits World Wide Equity Portfolio**

Global equity	80 %
Domestic Equity	20 %

**NOTE:** The domestic equity portion will consist of shares in companies which generate at least 25% of their earnings outside South Africa and which are also listed offshore.

### **Performance Profits World Wide Balanced Portfolio**

Global equity	55 %
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Global interest-bearing assets	30 %
Domestic equity	15 %

**NOTE:** The domestic equity portion will consist of shares in companies which generate at least 25% of their earnings outside South Africa and which are also listed offshore.