



Reversionary Bonus



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Licensed Financial Services Provider

REVERSIONARY BONUS BUSINESS

1. BACKGROUND

Discretionary Participation Business

Reversionary Bonus 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.

The purpose of this document is to provide a summary of the way in which Old Mutual currently exercises its discretion in the management of Reversionary Bonus business.

Should there be any conflict between this summary 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 (<https://www.oldmutual.co.za/about/ppfm>). Hard copies are also available, on request, from the Customer Service 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 REVERSIONARY 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 Reversionary Bonus policies.

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

Investment mandates

The Reversionary 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 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 related 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 Reversionary Bonus policyholders such as scrip lending.

2.2 ALLOCATING BONUSES TO POLICYHOLDERS

Bonus Smoothing Accounts

Reversionary 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 all 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 Reversionary Bonus business is less than the value of the Reversionary 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.

Types of Bonus

Bonuses for Reversionary Bonus policies are of two kinds viz.

- Reversionary bonuses and
- Final bonuses

Reversionary Bonuses

Reversionary bonuses are declared and added to policies every three years. (For some groups of policies this process takes place annually rather than every three years).

They are normally expressed as a percentage addition to the Basic Sum Assured and previously declared reversionary bonuses. Once declared they, together with the Basic Sum Assured, constitute the vested i.e. guaranteed part of the total claim payout.

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.

Reversionary bonus rates are not normally changed from one bonus declaration date to the next, unless there is a significant change in circumstances (for example, a significant fall in asset values or a significant change in the applicable tax rate).

As reversionary bonuses are only declared every three years, a temporary Interim Bonus is added in the years between bonus declarations for policies that become claims during this period.

Final Bonuses

Final bonuses are usually declared annually but could be declared more frequently depending on conditions in the investment markets e.g. in periods where the investment markets fall.

Final bonuses are never guaranteed and thus form the non-vested portion of the total claim payout.

Final bonus rates are based on a smoothed asset share, which is calculated by accumulating net premiums at a smoothed investment return equal to the Flexi Smoothed Bonus rate plus 0.5% (The 0.5% difference reflects the differences in policy charges between the two portfolios). For policies about to mature a smoothed asset share is calculated for each year of commencement and the final bonus rates are based on the difference between this smoothed asset share and the guaranteed benefits.

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 an MVA to discontinuing policies (as described above)
- Reducing final bonuses

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 Reversionary 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 the 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 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 reversionary 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

Reversionary 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.