

Old Mutual Corporate Smoothed Bonus Portfolios



PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

ABSOLUTE SMOOTH GROWTH | ABSOLUTE STABLE GROWTH | ABSOLUTE SECURE GROWTH
GUARANTEED FUND | GENESIS GROSS AND GENESIS NET
COREGROWTH 100, 95 AND 90 | MULTI-MANAGED SMOOTHED BONUS 100, 95 AND 90
BONUS ESCALATING ANNUITY TARGETING PORTFOLIO



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This document has been updated with effect from January 2011 and replaces any previous versions.

For more information on our Smoothed Bonus Range visit our website for corporate investors at www.oldmutual.co.za/corporate

THE PURPOSE OF THIS GUIDE

This guide provides a brief outline of how Old Mutual manages its Corporate Smoothed Bonus Funds. It covers the following aspects:

- What are the underlying investments?
- How are bonuses declared, including what is smoothing, what is the bonus smoothing reserve and what happens if investment returns are low or if there is a market crash?
- What are the charges and fees?
- What happens on termination?

The principles and practices described in this document are important because of the fact that, while the Corporate Smoothed Bonus Funds invest directly in the market, the bonuses declared on these funds are not directly linked to returns achieved. Old Mutual has discretion in the actual level of bonus declared and exercises this discretion to ensure fairness in the declaration of bonuses.

The guide applies to the following funds:

- Absolute Smooth Growth, Absolute Stable Growth and Absolute Secure Growth for both of the 2007 and 2009 Series.
- The Guaranteed Fund
- Genesis Gross
- Genesis Net
- CoreGrowth 100, 95 and 90
- Multi-Managed Smoothed Bonus 100, 95 and 90
- Bonus Escalating Annuity Targeting Portfolio

It is also important to note that these principles and practices may need to be adapted over time to take account of changing circumstances, e.g. changes in the business, economic and/or regulatory environment. Approval of any change needs to be given by the Old Mutual Board and its

Committee for Customer Affairs, and will be communicated to all affected clients.

This guide is derived from Old Mutual's official Principles and Practices of Financial Management (PPFM) of Discretionary Participation Business. If there is any discrepancy between the official PPFM and this document, the official PPFM applies.

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UNDERLYING INVESTMENT PORTFOLIO

This section of this document provides information on the structure of assets underlying Smoothed Bonus Funds.

These Funds backing Old Mutual's policy obligations are invested in portfolios of assets, including local and international investments, which aim to provide inflation-beating returns. These investments are actively managed to produce the best possible return for policyholders, without adopting too much risk.

The products covered in this document have different allocations to the various asset classes, and therefore present different risk/return profiles. These strategic asset allocations are provided below.

Within each portfolio, limits are in place, which allow the fund manager to depart to some extent from the asset allocation percentages, based on their view of the markets and where they expect to earn higher returns. Although the percentages and limits are not expected to change often, Old

Mutual may adjust these in the light of changes in the regulatory, economic or investment environment, or if 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).

Old Mutual may from time to time engage in alternative strategies (such as scrip lending and the sale of dividend rights) to enhance returns without exposing its policyholders to undue risk.

The portfolio of underlying assets that supports each Smoothed Bonus Fund is managed separately from the assets of other portfolios (both policyholder and shareholder portfolios).

It is to be noted that policyholders do not have any entitlement to the assets or investment returns of the Funds. They benefit indirectly from the investment returns of the Funds by means of bonuses declared by the Board of Old Mutual.

Strategic Asset Allocations

Asset Class	Absolute Growth Portfolios	Guaranteed Fund & Genesis Portfolios	CoreGrowth Portfolios & Bonus Escalating Annuity Targeting Portfolio	Multi-Managed Smoothed Bonus Portfolios
Domestic Equity	52.25%	44.0%	33.0%	33.0%
Domestic Bonds	8.25%	14.0%	19.0%	19.0%
Domestic Cash (incl. FSC assets)	7.0%	9.5%	15.5%	15.5%
Domestic Property	7.5%	7.5%	7.5%	7.5%
Domestic Alternative Assets	5.0%	5.0%	5.0%	5.0%
Global Equity	11.5%	11.0%	8.75%	8.75%
Global Interest-Bearing Assets	4.0%	4.5%	6.75%	7.75%
Global Alternative Assets	3.5%	3.5%	3.5%	3.5%
African Assets	1.0%	1.0%	1.0%	0.0%

HOW BONUSES ARE DECLARED

Policyholders benefit from the returns earned on the underlying portfolio of investments through bonus declarations. The bonuses are declared to present a smoothed return to policyholders over time.

What is smoothing and what are its benefits?

The main objective of the bonus declaration philosophy is to ensure that over time the bonuses produce a broadly similar return to the underlying investments in the fund (after deduction of guarantee costs and other applicable costs, expenses, taxes and charges).

A secondary objective is to achieve this in a way that reduces policyholders' exposure to the volatility of the market in the shorter-term. This is known as "smoothing" of investment returns. During periods of relatively strong investment performance on the fund'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 benefits of smoothing include:

- Reduced exposure to the extreme ups and downs of investing in the stock market in the shorter-term.
- Reduced risk of investing in and disinvesting from the market at the wrong time.

What is the Bonus Smoothing Reserve (BSR)?

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 excess of the market value of the assets over the total value of policyholders' policy balances. A separate BSR is maintained for each of the Old Mutual Corporate Smoothed Bonus Portfolios:

- Absolute Growth Portfolios
- Guaranteed Fund
- Genesis Portfolios
- CoreGrowth Portfolios and Bonus Escalating Annuity Targeting Portfolio
- Multi-Managed Smoothed Bonus Portfolios.

If a new series is launched for a particular Smoothed Bonus Portfolio, the BSR for that series is maintained separately from that of the original series. This is maintained until such time as the levels of BSR for each series are closely aligned, at which point the BSRs for each series are combined.

The BSR depends primarily on:

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

Positive BSR balances represent surplus attributable to smoothed bonus policies that has not yet been declared as bonuses and which will be used to support subsequent bonus declarations. A negative BSR balance means that more has been declared as bonuses to policies than has been earned to that date (as a consequence of the smoothing process).

The shortfall will be recovered from future net investment returns (i.e. future bonuses will be less than the future net investment return earned).

- The net investment return earned during the bonus period.

Bonuses declared usually differ from the actual net (of applicable costs, expenses, taxes and charges) investment return earned in a bonus period, so as to reduce the impact of shorter-term volatility of returns to policyholders. In periods when above average investment returns are earned, the bonus declared tends to be lower than the net investment return earned, and in periods 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 earned and is debited with the cost of bonuses declared, the charge for investment guarantees and the costs of managing the assets.

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

Bonus Declaration Process

Bonuses are declared over different periods for each product. They are declared annually in arrears for the Guaranteed Fund and monthly in advance for the Absolute Growth, Genesis, CoreGrowth, Multi-Managed Smoothed Bonus and Bonus Escalating Annuity Targeting Portfolios.

The Guaranteed Fund, Genesis, CoreGrowth, Multi-Managed Smoothed Bonus and Bonus Escalating Annuity Targeting Portfolios declare bonuses of a discretionary nature. A formula is used to determine the bonus declared each month for the Absolute Growth Portfolios, however Old Mutual does reserve the right to depart from the formula and use discretion.

Where discretion is used, the process below describes how each bonus is determined:

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

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

The bonus process is designed to restore the BSR to its longer-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 reduction in proposed bonus. 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 is also factored into the equation. This is necessary to assess the amount available for the final 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, and therefore amount available for the final bonus declaration.

Further factors that are considered when determining the bonus to be declared include the following:

- 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 each bonus.
- The impact on bonuses if there were to be a significant decline in market values. 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.
- Old Mutual's competitive position against the bonus declarations of Smoothed Bonus Portfolios offered by other providers.

Guaranteed vs Non-Guaranteed Bonuses

Genesis and the Guaranteed Fund guarantee 100% of invested contributions and declare partially guaranteed bonuses.

The Absolute Growth, CoreGrowth, Multi-Managed Smoothed Bonus and Bonus Escalating Annuity Targeting Portfolios have fixed guarantee levels. The level at which both invested contributions and declared bonuses are guaranteed, as follows:

Portfolio	Guarantee Level
Absolute Smooth Growth	50%
Absolute Stable Growth	80%
Absolute Secure Growth	100%
CoreGrowth 90	90%
CoreGrowth 95	95%
CoreGrowth 100	100%
Multi-Managed Smoothed Bonus 90	90%
Multi-Managed Smoothed Bonus 95	95%
Multi-Managed Smoothed Bonus 100	100%
Bonus Escalating Annuity Targeting Portfolio	100%

Allowance for Management Action in Adverse Circumstances

The BSR is targeted in the longer-term to be within a range of 0% to 5% of the liabilities. This is applicable for all portfolios covered in this report. 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 BSR 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 further negative from the longer-term average, the extent of management action will become more pronounced, and will include some or all of the following remedial steps, taking due

consideration of the economic and investment environment at all times.

The first would be through the bonus declaration process as described in this section, a process used at all levels of BSR. The second would be to remove the non-guaranteed element 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 it not possible to restore the level of the BSR during the ensuing three years, shareholder capital will be used to provide temporary support to the portfolio. If and when the position improves, the capital provided will be returned to shareholder funds with returns earned.

FEES AND CHARGES

The contractual fees and deductions applying to a particular policy are set out in the relevant policy contract.

This section discusses charges and fees on the portfolios covered in this document, which are not contracted in nature and which Old Mutual has the discretion to set or vary. The following charges and fees are levied on the portfolios.

Charge for Providing Guarantees

In respect of all portfolios covered, Old Mutual levies a capital charge. The capital charge is levied monthly in arrears on the assets underlying the policies. Thus any bonuses declared are net thereof. This charge is in respect of the cost of providing the guarantees inherent in these products.

Charges and Fees for Managing and Administering the Assets

Guaranteed Fund

The Guaranteed Fund includes two separate charges or fees:

- A charge in respect of managing the assets underlying the Guaranteed Fund is deducted on the underlying assets and any bonuses declared are net thereof. This charge will vary slightly depending on asset allocation.
- A fee in respect of the investment administration performed by Old Mutual, deducted from client accounts monthly in arrears, calculated on the daily balance in respect of the Guaranteed Fund. This fee is deducted after bonuses are declared.

Genesis Net

Genesis Net includes a single charge in respect of both managing the assets underlying Genesis, as well as the investment administration performed by Old Mutual. This charge is deducted on the underlying assets and any bonuses declared are net thereof.

Absolute Growth, Genesis Gross, CoreGrowth, Multi-Managed Smoothed Bonus and Bonus Escalating Annuity Targeting Portfolios

The Absolute Growth, Genesis Gross, CoreGrowth, Multi-Managed Smoothed Bonus and Bonus Escalating Annuity Targeting Portfolios include a single fee in respect of both managing the assets under these portfolios, as well as the investment administration performed by Old Mutual. This fee is deducted from client accounts monthly in arrears, calculated on the daily balance. This fee is deducted after bonuses are declared. This fee includes the majority of costs levied by asset managers to manage the assets, but specifically excludes:

- Performance fees payable in respect of alternative assets and in respect of assets placed with external asset managers;
- Specific expenses incurred in the management of the assets, including brokerage, taxes, levies, audit charges, bank charges, custodian charges, agent fees, licensing fees and other expenses incurred on behalf of clients;
- Specialist investment management costs, including costs incurred in respect of scrip lending and dividend right sale.

The excluded costs and fees disclosed above are deducted from the underlying assets as and when these are incurred and all bonuses declared are net of these excluded costs and fees.

Principles for Use of Discretion

Where Old Mutual has the discretion to set or vary charges or fees, it will do so on the basis of the following principles:

- Capital charges will only be amended, if the benefits that affected policyholders may reasonably expect to receive, will not be reduced as a result of the amendment, or if extraordinary circumstances arise.
- Fees will be set to cover expected costs plus a margin. The size of the margin will depend on competitive pricing considerations.
- Expense charges will only be increased if actual experience in respect of expenses deteriorates. The wish to increase shareholder profit is not sufficient reason to increase charges.
- Asset management fees paid to asset managers will be market-related.

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TERMINATION CONDITIONS

Market value adjustments are applied on termination of business in the Smoothed Bonus Funds covered in this document, if the relevant BSR is negative. They are set by reference to the value of the underlying assets in which the fund is invested. If termination values are adjusted downwards because of depressed asset values, the consequent reduction in termination values paid out will be credited to the BSR.

The method used to adjust termination values when the BSR is negative is as follows:

An underlying market value is maintained in respect of each policy. The termination value is the lower of the underlying market value and the policyholder's book value (the face value of the policyholder's guaranteed and non-guaranteed funds).

Where the contract so specifies, the policyholder may elect to receive the book value, with payments spread evenly over 10 years. In this case, the book value of a payment may be paid even if it is higher than the market value of that payment at that time. Furthermore, the policy will continue to participate in normal bonuses during the 10-year payment period.

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RING FENCING

The portfolios of underlying assets that support each of:

- Absolute Growth Portfolios 2007 Series
- Absolute Growth Portfolios 2009 Series
- Guaranteed Fund,
- The Genesis Portfolios,
- The CoreGrowth and Bonus Escalating Annuity Targeting Portfolios, and
- The Multi-Managed Smoothed Bonus Portfolios

are managed separately from each other and the assets of other portfolios (both policyholder and shareholder). This separation extends to the portfolio-specific Bonus Smoothing Reserve (BSR) that forms an integral part of the portfolio of underlying assets that support each product.

Similarly, if a Smoothed Bonus Portfolio operates with more than one series, the portfolio of assets that support each series (including each series' BSR) is managed separately from each other. This is maintained until such time as the levels of BSR for each series are closely aligned, at which point the portfolio of assets for each series are combined.

These products are managed in accordance with a specific investment mandate as described earlier in this document.

Although the assets are managed separately they are not housed in a separate legal entity but remain the registered property of OMLAC(SA).

Net profits attributable to shareholders will be transferred from the respective portfolio to shareholder funds.

Other transfers of assets between different portfolios would occur in the normal course of events.

Such transfers could reflect normal trading between two portfolio managers with different investment mandates and investment views or the transfer of a pool of assets where a client chooses to change their investment from, say, the Guaranteed Fund to Old Mutual Absolute Stable Growth.

The transfer of Bonus Smoothing Reserves between different policyholder portfolios is not precluded but will only happen in specific circumstances. This could occur where a client moves its investment from one Smoothed Bonus Portfolio to another.

As a mature portfolio diminishes in size over time a stage might be reached where Old Mutual considers the size of the portfolio to be less than optimal for the smoothing of returns to be effective. At such a point the mature portfolio could be combined with a larger portfolio with a corresponding transfer of BSR taking place. The principle applied in such an instance is that policies covered by either of the portfolios should, as far as possible, not be materially prejudiced by such a step.



How to Contact Us

THE OFFICIAL PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT (PPFM) IS AVAILABLE ON THE OLD MUTUAL WEBSITE AT

■ www.oldmutual.co.za/corporateppfm

THE PPFM IS ALSO AVAILABLE ON REQUEST, BY CONTACTING YOUR OLD MUTUAL CORPORATE CONSULTANT, OR BROKER, OR YOUR NEAREST OLD MUTUAL CORPORATE OFFICE.

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