Principles & Practices of Financial Management

How we manage our Stabilised Investment Fund

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Purpose of this guide

This guide explains how Old Mutual manages its Stabilised Investment 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 smoothed bonus funds are 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 Stabilised Investment Fund was previously open to new business in the following products:

- Investment Frontiers
- Investment Horizons

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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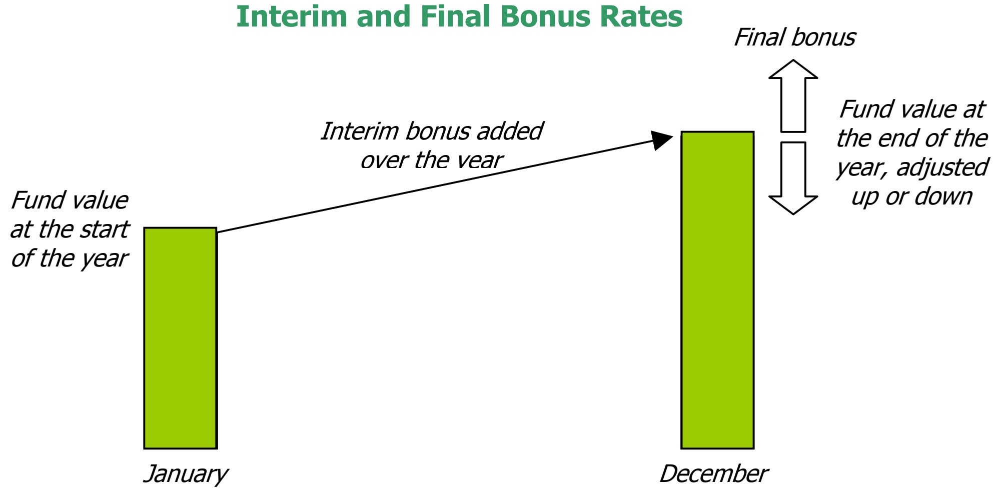
How do the bonus rates work?

Policies in Old Mutual's smoothed bonus funds are allocated investment growth by the addition of bonuses to their fund value.

The Fund Year runs from January to December. At the start of the year, an interim bonus is set. The interim bonus is used to determine policy fund values during the year, for the purposes of determining claims or termination values during the Fund Year. After the end of each year, final bonuses are declared in respect of the investment performance over that year.

If the final bonus is higher than the interim bonus, each policy's fund value is adjusted upwards. If the final bonus is lower than the interim bonus, each policy's fund value is adjusted downwards.

Interim and Final Bonus Rates



Setting interim bonus rates

The following aspects are taken into account when setting interim bonus rates:

- The interim bonus should (as far as possible) provide a reasonable return compared with inflation
- Interim bonus rates are set fairly conservatively to minimise the possibility of having to adjust fund values downward at year-end
- Interim bonus rates may be changed during the year as economic conditions unfold

Setting final 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, contractual charges and expenses that impact on the funds available for the declaration of bonuses).

The following are the major aspects taken into account when setting the final bonus rates:

- The overall investment return on the fund's investments (after any applicable tax, charges and expenses) earned since the previous bonus declaration
- The difference between policies' fund values and the value of the smoothed bonus fund's investments must be within acceptable limits (see "*What is the bonus smoothing account?*")
- Prevailing economic conditions, including the level of inflation
- The ability of the smoothed bonus fund to withstand adverse changes in investment conditions
- The bonus rates declared by Old Mutual's main competitors

No bonus will be declared that would result in a smoothed bonus fund's ongoing viability being knowingly threatened.

What is smoothing and what are its benefits?

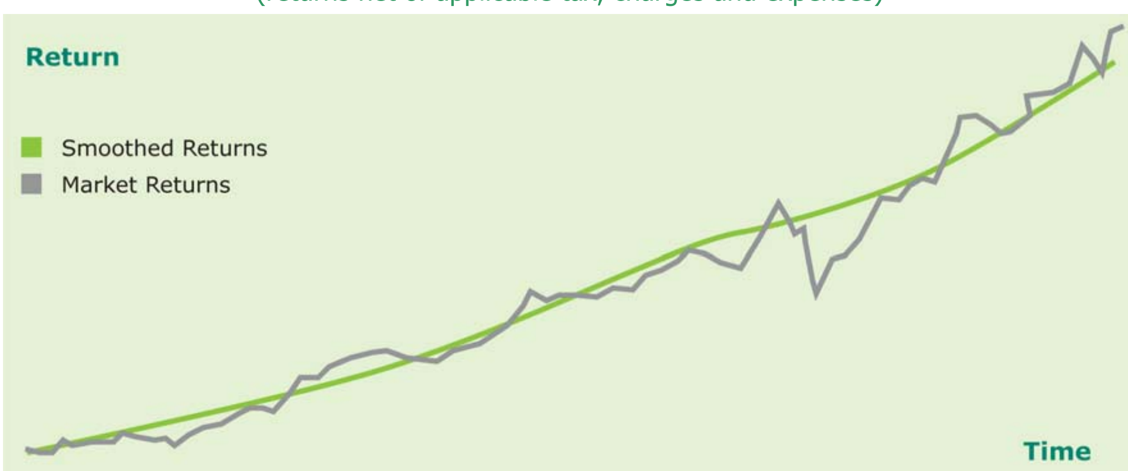
The main objective of Old Mutual's bonus declaration policy is to ensure that over time the bonuses produce a similar return to the underlying investments in the fund (after any applicable tax, charges and expenses). A secondary objective is to achieve this in a way that reduces policyholders' exposure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

This is known as "smoothing" of investment returns. During periods of relatively strong investment performance of the smoothed bonus 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 effect of smoothing is illustrated in the graph below.

A typical Market Return Portfolio versus a Smoothed Return Portfolio

(returns net of applicable tax, charges and expenses)



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

In addition, the Stabilised Investment Fund offers a guarantee that ensures a certain minimum payout at fixed future points in time. This guarantee is an extremely valuable part of many policyholders' portfolios. It allows policyholders whose policies are invested in the fund to have exposure to the market's growth potential, knowing that their investment will never be worth less than the guaranteed amount at certain fixed points in time, provided they adhere to their contractual obligations. The policy contract contains details of these guarantees.

What is the bonus smoothing account?

The Stabilised Investment 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 total 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 policyholders whose policies are invested in the fund. These funds are managed completely apart from Old Mutual 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 more has previously been added to policies as bonuses than has been 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 total policy fund values, while in the shorter-term it could vary between –15% and +20% of total policy fund values.
- Care is taken to ensure that the BSA does not become too negative, as this would adversely affect future bonuses.

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

Market / fund value adjustments

After periods of poor investment returns, the amount that policyholders receive when withdrawing from the fund prior to thepremium cease date of their policy may need to be adjusted downward. This "market value adjustment" is 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 before premium cease date would be too high and could mean that those policies that remain receive future bonuses that would be too low.

A market value adjustment may be applied when both:

- The BSA of the fund is negative, and
- A policyholder withdraws all or part of a policy's fund value before the premium cease date of their contract (on a date other than a guarantee date), or makes other changes that result in a withdrawal of all or part of the policy's fund value from a smoothed bonus fund.

The size of any market value adjustment will vary with the size of the BSA, but changes to the adjustment are only made in steps of 5%. In some instances the amount paid would be higher than the market value of the underlying investments, and in other instances it would be lower.

It is important to note the following:

- A market value adjustment will not apply at the end of any contractual regular premium term or on any guarantee date (normally every 5 years). This means that all policyholders can benefit from receiving their smoothed fund values at certain dates, regardless of market conditions at the time.
- The adjustment does not benefit Old Mutual's shareholders but rather those policyholders whose policies remain invested in the fund. The adjustment is credited to the BSA of the fund and 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):

- Market value adjustments may be applied.
- Interim bonuses may be reduced during the Fund Year.
- Low or zero final bonuses may be declared.
- The non-guaranteed fund values may be removed.
  - This is an extreme situation and will only happen if the BSA becomes more negative than can be recovered over the next three years. If the removal of non-guaranteed fund values is not sufficient to ensure this, Old Mutual shareholder capital will be used to support the fund for as long as is necessary.

Guarantees provided by Old Mutual will at all times be honoured.

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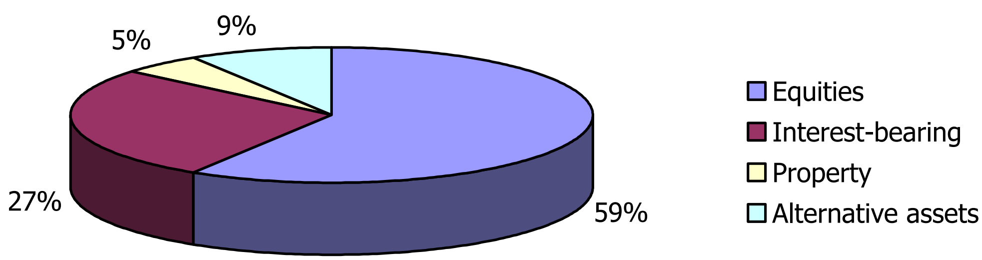
What investments does the fund own?

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 – currently approximately 59% equities (shares), 27% interest-bearing investments, 5% property and 9% 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 percentages are not expected to change often, Old Mutual may adjust these if changes occur 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).

Indicative Stabilised Investment Fund Investments



Where you can find out more

This guide aims to provide a high-level explanation of how the Stabilised Investment Fund 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).

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 60 35 00 (for Investment Horizons) or 0860 30 00 00 (for Investment Frontiers).