

Old Mutual Corporate With-Profit Annuity Funds



PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT



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This document has been updated with effect from 1 March 2010 and replaces any previous versions.

For more information on our With-Profit Annuity Range visit our website for corporate investors at www.oldmutual.co.za/corporate

THE PURPOSE OF THIS GUIDE

This guide explains how Old Mutual manages its with-profit annuity funds, including:

- How do pension increases 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 assets back the portfolios?

The principles and practices described in this document are important because, although the funds are directly invested in investment markets, pension increases are smoothed and not directly linked to the returns achieved. Old Mutual has discretion in the actual level of pension increases declared and exercises this discretion to ensure fairness in the declaration of increases.

The guide applies to the following funds:

- OptiPlus (including Pensions Plus) (closed to new business)
- Platinum Pension (closed to new business)
- Platinum Pension 2003 (currently open to new business)
- Platinum Multi-manager (IS & SYmmETRY) (currently open to new business)

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 changes in the business, economic 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 affected clients.

HOW DO PENSION INCREASES WORK?

Policies in Old Mutual's with-profit annuity funds are allocated investment growth by the addition of bonuses in the form of pension increases.

Pension increases are declared with effect from 1 January, 1 April or 1 September each year. Clients each have their own pension increase month. For example, if a client has a pension increase month of July, and the pension increase is declared with effect from 1 April each year, then pension increases for that client will take effect from the July immediately following the 1 April pension increase declaration.

Setting Pension Increases

The main objective of Old Mutual's pension increase declaration policy is to ensure that over time the pension increases produce a broadly similar but smoothed return to the underlying assets backing the portfolio (after deducting the pricing interest rate and any applicable tax, expenses and charges).

The following are the major aspects taken into account when setting the pension increases:

- The overall net investment return earned on the assets backing the portfolio (after deducting the pricing interest rate and any applicable tax and charges) since the previous pension increase declaration
- Prevailing economic conditions, including the level of inflation
- The ability of the with-profit annuity fund to withstand adverse changes in investment conditions
- The pension increases declared by Old Mutual's main competitors

The pricing interest rate is the minimum net investment return that has to be earned before any pension increase can be declared. Each client has its own pricing interest rate. Common pricing interest rates are 3.5%, 4%, 4.5% and 5%. The higher the pricing interest rate, the lower the price the client would have had to pay for a given initial pension. On the other hand, the higher the pricing interest rate, the lower the future expected pension increases.

No pension increase will be declared that would result in a with-profit annuity fund's ongoing viability being knowingly threatened.

WHAT IS SMOOTHING AND WHAT ARE ITS BENEFITS?

The main objective of Old Mutual's pension increase declaration policy is to ensure that over time the pension increases produce a broadly similar but smoothed return to the underlying assets backing the portfolio (after deducting the pricing interest rate and any applicable tax, expenses and charges). The tax, expenses and charges referred to here are costs on the underlying portfolio of investments that impact on the funds available for the declaration of pension increases. A secondary objective is to achieve this in a way that reduces pensioners' exposure to market ups and downs.

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 pension increase. It is held back, so that in times of relatively poor investment performance, there are funds available to declare a higher pension increase than would otherwise have been the case.

It is important to note that any funds held back in order to smooth investment returns will be used for the future benefit of pensioners. These funds are kept completely separate from Old Mutual's shareholders' assets.

The **benefits** to pensioners of the smoothing of pension increases include reduced exposure to the extreme ups and downs of the stock market (and the anxiety associated with it!).

In addition, Old Mutual's with-profit annuity funds offer guarantees. These guarantees are extremely valuable. They allow pensioners participating in these funds to have exposure to the market's growth potential, knowing

that their pension is guaranteed for life, and any increase, once granted, is also guaranteed for life.

WHAT IS THE BONUS SMOOTHING ACCOUNT?

Old Mutual operates two bonus smoothing accounts (BSAs) for its with-profit annuity funds – a long-term BSA and a short-term BSA.

Part of the asset portfolio backing with-profit annuity funds is invested in matched bonds to ensure that cash flow is available over the full period for which pensions are expected to be paid. The long-term BSA represents the difference between the current market value of the matched bonds and the amortised value of those same bonds. The effect of the long-term BSA is that support for pension increases from the matched bond component of the assets emerges smoothly over the full expected lifetime of the pensioners, and is not affected by changes in the market value of the bonds from time to time.

The short-term BSA represents the remaining difference between the market value of the assets (i.e. excluding the long-term BSA) and the value of the liabilities, and largely represents the effect of shorter-term equity volatility.

It is important to note that any funds in either of the two BSAs will be used for the future benefit of pensioners. These funds are kept completely separate from Old Mutual's shareholders' assets.

A positive BSA means that some good past returns have been held back, and can be paid out in future as pension increases. A negative BSA means that more has previously been allocated to pension increases than has been earned. This will need to be recovered in future by declaring pension increases that are lower than the investment returns earned.

The BSAs represent how much past investment returns earned have differed from their longer-term average.

- BSAs 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.
- The short-term BSA is expected to average between 0% and 5% of the liabilities over the long run, while in the shorter-term it could vary between -10% and +15%. The level of the long-term BSA depends on interest rate movements, and there are no specified limits.
- Care is taken to ensure that neither BSA becomes too negative, as this would adversely affect future pension increases.

WHAT HAPPENS IF INVESTMENT CONDITIONS ARE LOW OR THERE IS A MARKET CRASH?

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 with-profit annuity funds. 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 for with-profit annuity funds (taking the economic and investment environment into account at all times) are restricted to the declaration of low or zero bonuses. Guarantees provided by Old Mutual will at all times be honoured.

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WHAT INVESTMENTS ARE HELD FOR THE BENEFIT OF PENSIONERS?

The funds aim to provide pensioners with smoothed pension increases that offset some of the effects of inflation. To achieve this, the investment benchmarks for the funds are made up of a balanced mix of local and international investments. The current approximate benchmarks are given in the following table.

Asset Class	Equity-type assets *	Interest Bearing
Pensions OptiPlus	50%	50%
Platinum Pension: Fund 1	55%	45%
Platinum Pension: Fund 2	50%	50%
Platinum Pension: Fund 3	35%	65%
Platinum Pension 2003: Fund 10	60%	40%
Platinum Pension 2003: Fund 11	50%	50%
Platinum Pension 2003: Fund 12	40%	60%
Platinum Multi-Manager	45%	55%

* Equity-type assets include local and international equities, local and international alternative assets and direct property.

These investments are actively managed to produce the best possible return for pensioners, without taking on too much risk.

The fund managers 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).

There is a clear separation between the with-profit annuity funds and any other smoothed bonus funds run by Old Mutual.

WHERE CAN YOU FIND OUT MORE?

This guide aims to provide a high-level explanation of how with-profit annuity funds work. Because we have kept it as short as possible we have only outlined the most important information.

If you are an existing client, 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 at

www.oldmutual.co.za/corporateppfm

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 50 60 70.



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 PERSONAL FINANCIAL ADVISOR OR BROKER, OR BY CALLING OLD MUTUAL'S CLIENT COMMUNICATION CENTRE.

Old Mutual Client Communication Centre

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