OLD MUTUAL
ABSOLUTE GROWTH PORTFOLIOS

PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT

ABSOLUTE SMOOTH GROWTH PORTFOLIO
ABSOLUTE STABLE GROWTH PORTFOLIO
PURPOSE OF THIS GUIDE

This guide explains how Old Mutual manages the Absolute Growth Portfolios (“the Funds”), consisting of the Absolute Smooth Growth Portfolio and the Absolute Stable Growth Portfolio. The Absolute Growth Portfolios are Smoothed Bonus Funds, which is a specific type of fund that uses smoothing to deliver returns that are less exposed to investment market fluctuations.

It covers the following:
- What is smoothing and what are its benefits?
- What is the Bonus Smoothing Reserve?
- How does the guarantee work?
- What happens if investment markets fall?
- Investments owned by the Fund
- Fees and charges

The principles and practices described in this document are important because of the fact that, while the Absolute Growth Portfolios are invested directly in the market, the bonuses declared on the Funds are not directly linked to the returns achieved. Old Mutual has the ability to use discretion in the actual level of bonuses declared. This discretion is used to ensure smoothed returns are declared over time and that investors invested in Smoothed Bonus Funds are treated fairly.

The Absolute Smooth Growth Portfolio and the Absolute Stable Growth Portfolio are currently available for selection as funds on the following products:

<table>
<thead>
<tr>
<th>PRODUCT AVAILABILITY</th>
<th>OLD MUTUAL WEALTH</th>
<th>MAX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Annuity</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Preservation Fund</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Living Annuity</td>
<td>•</td>
<td>•</td>
</tr>
<tr>
<td>Investment Plan (LIFE)</td>
<td>•</td>
<td>•</td>
</tr>
</tbody>
</table>

These principles and practices may need to be adapted over time to take account of changing circumstances, for example 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 affected clients.

WHAT IS SMOOTHING AND WHAT ARE ITS BENEFITS?
The underlying investments of the Absolute Growth Portfolios are in line with that of an aggressive balanced fund. Smoothing is the process used to pass investment returns from investments that are exposed to market fluctuations on to investors in a way that is more predictable and stable, or smoothed. These smoothed returns are referred to as bonuses.

The objective of smoothing is to protect investors against market volatility in the shorter term while ensuring that the bonuses declared produce a broadly similar return to the Fund’s investments over time (after any applicable tax, charges and expenses). During periods of relatively strong investment returns on the Absolute Growth Portfolios’ investments, a portion of the investment growth is not declared as a bonus. It is set aside so that in times of relatively poor investment returns, there is a reserve available to declare a higher bonus than would otherwise have been possible.

THE EFFECT OF SMOOTHING IS ILLUSTRATED BELOW (USING SIMULATED INVESTMENT RETURNS).

The Absolute Growth Portfolios declare bonuses monthly in advance. A formula is used to determine the bonus declared each month. However, Old Mutual reserves the right to depart from the formula and use discretion should the circumstances require it.

The benefits of smoothing are:
- Reduced exposure to the extreme ups and downs of investing in a market related fund in the shorter-term.
- Reduced risk of investing in and disinvesting from the market at the wrong time.
- A smooth progression of your investment over time, leading to less emotional turmoil.

WHAT IS THE BONUS SMOOTHING RESERVE?
An investor in the Absolute Growth Portfolios has a smoothed fund value that depends on investments and disinvestments into the Fund, as well as past bonuses declared on the Fund. On the other hand, the Absolute Growth Portfolios owns investments that have a market value. The Bonus Smoothing Reserve (BSR) represents the difference between the market value of the Fund’s investments and the sum of the individual investors’ smoothed fund values.

The BSR can be positive or negative. A positive BSR means that the market has been performing well and a portion of these returns was placed in the BSR. This positive BSR will be used to declare bonuses on investors’ smoothed fund values in the future. A negative BSR means that more has been declared to investors as bonuses than the investment returns earned. This will be recovered in the future by declaring bonuses that are lower than the investment returns earned.
is the BSR that “absorbs” the ups and down of the market. Bonuses are declared from the BSR, which is either built up by setting aside returns when the market performed well or drawn down when markets perform poorly.

In the longer-term the BSR is expected to average between 0% - 5% of the sum of investors’ smoothed fund values, while in the shorter term it could vary between -15% and 20% of the sum of investors’ smoothed fund values.

It is important to note that the value of the BSR is kept entirely for the future benefit of investors in the Fund. These funds are managed completely separate from Old Mutual’s shareholder assets.

**HOW DOES THE GUARANTEE WORK?**
The Absolute Growth Portfolios offer a proportional guarantee on capital contributions and bonuses declared. This proportional guarantee differs depending on the fund you have chosen:

- Absolute Smooth Growth Portfolio guarantees 50% of capital contributions and bonuses declared.
- Absolute Stable Growth Portfolio guarantees 80% of capital contributions and bonuses declared.

These guarantees apply on Defined Benefit Payments only. Defined Benefit Payments include:

<table>
<thead>
<tr>
<th>INVESTMENT PRODUCT</th>
<th>DEFINED BENEFITS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement Annuity</td>
<td>Retirement, annuity income payments, death and disability.</td>
</tr>
<tr>
<td>Preservation Fund</td>
<td></td>
</tr>
<tr>
<td>Living Annuity</td>
<td>Payments on a Guaranteed Smoothed Value Date and on death.</td>
</tr>
<tr>
<td>Investment Plan (LIFE)</td>
<td></td>
</tr>
</tbody>
</table>

For Investment Plans, the Guaranteed Smoothed Value Date is defined as the date set 5 years from the day of first investment into the Fund. If an investor wants to access their smoothed fund value on reaching the Guaranteed Smoothed Value Date, a disinvestment instruction will have to be submitted in the month after the Guaranteed Smoothed Value Date. If a disinvestment instruction is not received, the Guaranteed Smoothed Value Date will automatically be set for a further 5 years into the future.

For Defined Benefit Payments investors’ full smoothed fund values are available to them without any adjustment.

**WHAT HAPPENS IF INVESTMENT MARKETS FALL?**

**Management actions**
If investment conditions are extremely adverse (for example, there is a significant fall in the value of the Funds’ investments), management actions may need to be taken by Old Mutual to ensure the ongoing sustainability of the Funds. The aim of these management actions (which need to be approved by the Old Mutual Board) is to restore the BSR to a level where reasonable future bonuses can be declared without threatening the Funds’ ongoing sustainability.

Management action can include a combination of the following (whilst taking the economic and investment environment into account at all times):

- Low bonuses may be declared, as per the bonus formula (with allowance for discretion).
- Negative bonuses may be declared, as per the bonus formula (with allowance for discretion), but not exceeding the guaranteed value.
- A Market Value Adjustment (MVA) might be applied on voluntary withdrawals, as described below.

While Old Mutual has internal guidelines, there are no absolute BSR levels at which particular management actions are automatically taken – this will depend on the specific circumstances at the time.

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

**Market value adjustment (MVA)**
After periods of poor investment returns, the amount that investors receive on voluntary withdrawals from the Fund may be lower than the investor’s smoothed fund value. This reduction in an investor’s smoothed fund value is called a Market Value Adjustment, or MVA. An MVA is used to bring an investor’s smoothed fund value in line with their share of the value of the Fund’s investments.

An MVA is used to protect the investors remaining in the Fund. If this adjustment was not in place and an investor choose disinvestments early when markest are down, then the value paid to this investor from the Fund would be too high and would mean that investors that remain in the Fund will receive future bonuses that are too low.

Such a situation may only arise on voluntary withdrawal from the Absolute Growth Portfolios when:

- The BSR of the Absolute Growth Portfolios are negative and
- The fund rules regarding the timing of voluntary withdrawals require an MVA.

It is important to note the following:

- An MVA will not apply on a Defined Benefit Payment. This means that investors can benefit from receiving their smoothed fund values at certain points in time, regardless of market conditions at the time.
- The adjustment to an investor's smoothed fund value on a voluntary termination (that is, the MVA) in response to a negative BSR does not benefit Old Mutual’s shareholders, but rather those investors who remain invested in the Fund. This helps support future bonus rates for the remaining investors.

**INVESTMENTS OWNED BY THE FUND**
The Funds aim to provide policyholders with smoothed returns that beat inflation over the long term (in excess of 10 years). The Funds’ investments consist of local and global
assets, including equities, interest-bearing assets, property and alternative assets. These assets are actively managed to produce the best possible return for investors, without taking on too much risk.

![Asset Allocation Diagram]

The long-term asset allocation split for the Absolute Growth Portfolio is shown above. This asset allocation split is aggressive with a large portion exposed to growth assets in order to achieve inflation-beating returns over the long term. The asset allocation on the Absolute Growth Portfolios are in line with that of an aggressive market related balanced fund.

The fund managers may depart to some extent from this asset allocation percentages over the short to medium term, based on their view of the markets and where they expect to earn higher returns.

Although the long-term asset allocation is not expected to change often, Old Mutual may adjust these if:
- Changes occur in the regulatory, economic or investment environment,
- 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).

Investors are not entitled to the investments owned by the Funds. They benefit indirectly from the investment returns of the Funds by means of the bonuses declared on their smoothed fund values by the Board of Old Mutual.

**FEES AND CHARGES**

Fees and charges are applied to the Absolute Growth Portfolios in order to cover the costs of managing the Funds, as well as the cost of providing the guarantees. The fees and charges are available on the Fund fact sheet.

**Asset management fees**
The Absolute Growth Portfolios charge a single asset management fee which includes the majority of costs levied by asset managers to manage the investments. This fee is levied after bonuses are declared (bonuses are gross of asset management fees).

The asset management fee excludes some expenses incurred in the management of the Funds, such as brokerage fees, bank charges and performance fees in respect of alternative assets and external asset managers.

**Charges for providing guarantees**
A capital charge is levied in respect of the cost of providing the guarantees included in the Absolute Growth Portfolios. Capital charges are imposed monthly in arrears on the value of the Fund’s investments. Bonuses are declared net of capital charges.

**HOW TO FIND OUT MORE**

This guide aims to provide a high-level explanation of how the Absolute Growth Portfolios work. To keep it as short as possible we have only outlined the most important information.

If you are an existing investor, your policy documentation and/or original quote should contain more 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/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 the relevant number below.

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