Principles and Practices of Financial Management for Sanlam Corporate Smoothed Bonus Products

Sanlam

Sanlam Corporate: Investments

Contents

Page

Introduction

Background

Sanlam is a leading financial services group in South Africa, providing a broad range of financial products and services. Our vision is to be the leader in wealth creation and protection for our clients. Our business philosophy is captured in the traditional values of honesty, diligence, ethical behaviour, innovation, stakeholder values and strong ties with business partners.

In order to safeguard the interests of our clients, sound governance and strong financial backing are required. The PPFM forms part of the governance structure, and Sanlam's financial strength is illustrated, inter alia, by the level of its capital and assets under management and administration. These are disclosed in Sanlam's Annual Report that is available from Sanlam's website (www.sanlam.co.za).

The Sanlam Group conducts its business through the holding company Sanlam Limited, a corporate head office and various business clusters:

- Retail cluster
- Investment cluster
- Short-term Insurance cluster
- Corporate Cluster
- Sanlam Emerging Markets

Sanlam Corporate (SC) provides life insurance, investment and annuity products for group schemes and retirement funds.

These business activities are conducted in the name of various legal subsidiaries such as Sanlam Life Insurance Limited, Sanlam Developing Markets (previously African Life Assurance Limited), Sanlam Investment Management (Pty) Limited, etc.

Purpose of Principles and Practices of Financial Management

In order to manage *discretionary participation business*[1], long-term insurers must use their discretion in managing investments and allocating bonuses. This documents sets out the Principles and Practices of Financial Management (PPFM) that are applied in the management of Sanlam Corporate's discretionary participation funds. It should be noted, however, that a PPFM is neither a comprehensive explanation of the management of the *discretionary participation* business nor of every matter that may affect a particular policy contract.

Sanlam Life Insurance Limited ("Sanlam Life ") has published the following six documents covering the PPFM on its website, (www.sanlam.co.za).

- PPFM for SPF smoothed bonus products
- PPFM for SC smoothed bonus products
- PPFM for SPF reversionary bonus products
- PPFM for Sanlam Life participating annuity products
- PFM for Sanlam Life linked and market-related products
- PFM for SC Provider pension products

Note

1 Items in italics are defined in the Glossary

Sanlam Developing Markets Limited has published the following document covering the PPFM on its website,

- PPFM for Sanlam Developing Markets Limited's individual *smooth bonus products*.

Please contact Channel Life (www.channel.co.za) if you require the PPFM for their *smoothed bonus products.*

All Sanlam Life's *smoothed bonus products* fall into the *discretionary participation business* category.

This document comprises the PFM for the following SC *smoothed bonus products*:

- Monthly Bonus Fund
- Stable Bonus Portfolio
- Sanlam Multi Manager Vesting Bonus Fund
- Absolute Return Plus Guaranteed Fund
- Progressive Smooth Bonus Fund
- Sanlam Select Growth Fund
- Sanlam Smooth Growth Fund

Principles and Practices

The **Principles** define the overarching standards that have been adopted to manage Sanlam Life's smoothed bonus business and are not expected to change often. The Principles are the standards used to maintain the long-term solvency of the fund for current and future policyholders. They also describe the broad framework used:

- when discretion is applied in the management of *smoothed bonus products*; and
- in response to longer-term changes in the business and economic environment.

The Practices describe the current approach used to:

- manage smoothed bonus products; and
- respond to changes in the business and economic environment in the shorter term.

Practices are therefore expected to change more frequently than Principles.

Compliance

The Sanlam Life Insurance Limited Board ("Sanlam Life Board") is responsible for the governance of *smoothed bonus products* written by Sanlam Life, and it has tasked the Sanlam Customer Interest Committee to monitor compliance with the PPFM on its behalf.

The PPFM may change as the economic or business environment changes. Any change to a Principle or Practice will be approved by the Sanlam Life Board, on recommendation from the *Head of Actuarial Function* and the Sanlam Customer Interest Committee.

At least three months before a change to a Principle is implemented, the relevant policyholders and the Registrar of Long-Term Insurance will be informed and the proposed change will be published on our website. Any change to a Practice will be published on our website and policyholders will also be informed of such a change in the annual portfolio statement.

Overriding Principles of Financial Management

The principles in Section 2 cover all SC *smoothed bonus products*. Principles specific to certain products are covered in the various sections relating to these products.

Principle regarding legal and contractual obligations

Sanlam Life is committed to comply with the requirements of all contractual obligations and other legal and regulatory requirements, including the *demutualisation rules* (for policies in force at demutualisation). These requirements apply if there is any inconsistency between them and the PPFM.

Principles regarding the general management of smoothed bonus business

Sanlam Life applies the following key principles to its *discretionary participation business*.

a) Each product has separate assets that are used to support the benefits of the particular policyholders as a group. The assets are increased by *net premiums* and adjusted with investment returns earned, which can be positive or negative. It is reduced by benefit payments, *terminations*, charges and applicable taxes, which are deducted from the portfolio. The value of the underlying assets of a particular *smoothed bonus product* is also called the market value of that product.

   At death, disability, resignation, retrenchment and retirement, the benefit payment is based on the *book value* of that policy. The *book value* is calculated by accumulating the *net premiums* with declared bonuses. The *book value* will be reduced by benefit payments, *terminations* and charges, and may further be reduced should accumulated *non-vested bonuses* be reduced or removed. As bonuses are smoothed, changes in the market value of the assets might not be reflected in changes in the *book value* immediately.

   The surplus or deficit in a portfolio is the difference between the market value and the *book value*. This is called the *Bonus Stabilisation Reserve (BSR).* A product's *funding level* is the ratio of market value to *book value*.

   For the products covered in this PPFM, policyholders share in the investment return of their respective underlying portfolios as well as the profits or losses resulting from differences between market value and *book value* when benefits (including benefits on death) are paid. Policyholders do not share in other experience profits and losses, for example those arising from expenses. This means that policyholders are exposed to the investment risk (including credit risk), but not to other *business risks*. The Sanlam Life shareholders are exposed to the risks and rewards associated with those *business risks*.

   Sanlam Life may leverage the assets in the underlying portfolios for transactions such as scrip lending. Any income or losses arising from these transactions will be for Sanlam Life shareholders' own account, and therefore do not affect the benefits to which policyholders are entitled.

b) It is important for the various elements of product design and pricing to fit together. Particular attention is therefore paid to the following elements during the design and ongoing management of our *smoothed bonus products*:

   - pricing and reserving for smoothed bonus benefits;
   - investment policy;
   - the nature of bonuses declared – partially or fully vesting, declared annually in arrears with adjustable interim bonuses until the next declaration or monthly declarations;
   - policyholder expectations, in particular with regard to bonuses, through marketing material, policy contracts and other communications that are accurate and easy to understand; and
   - conditions for movements into and out of a fund to protect the interests of all policyholders.

Principles regarding bonuses

a) Sanlam Life's bonus philosophy is that the underlying assets for a particular group of smoothed bonus policies will, over time, be used for the benefit of those policyholders subject to charges recovered from the portfolio.

b) The bonus philosophy further aims to provide a reasonable compromise between smoothing the volatility of investment returns on the one hand and ensuring equity among different generations of policyholders on the other. The approach used when determining bonus rates is as follows:

- The starting point is the net expected long-term investment return, taking into account the asset composition of the particular portfolio.
- This return is adjusted to eliminate surpluses or deficits in the portfolio over a suitable period.

c) Policyholders' reasonable benefit expectations are also taken into account when discretion is applied to bonus declarations.

d) The Sanlam Life Board approves the bonus philosophy on the advice of the *Head of Actuarial Function*. A committee of the Sanlam Life Board approves the bonus rates that are determined in accordance with the bonus philosophy.

e) Depending on the product, bonuses can be vested, non-vested or a combination of vested and non-vested. Declared *vested bonuses* cannot be removed for death, disability, resignation, retrenchment and retirement claims. Declared *non-vested bonuses* (or a portion thereof) may, however, be removed to maintain the on-going solvency of the policyholder fund. *Non-vested bonuses* will only be removed by the Sanlam Life Board, based on a recommendation from the *Head of Actuarial Function*, when the *funding level* becomes unacceptably low.

f) Where bonuses are declared annually, interim bonus rates apply to the period from the previous bonus declaration date to the claim date. They are set to achieve greater fairness between policyholders leaving (because of a claim) and policyholders remaining in the fund.

Principles regarding investment strategy

a) An *Asset-liability committee (ALCO)*, comprising Sanlam Life employees with actuarial, investment and client solution backgrounds, oversees the investment policy for the various smoothed bonus portfolios.

b) The aim is to find the optimum balance between attractive investment returns and stable investment returns, given the need to meet smoothed benefits and to support the granting of stable bonus rates in line with the product design.

c) Policyholders' funds are managed separately from shareholders' funds.

d) The requirements for the investment management of each portfolio are set out in investment guidelines, with a view to managing risk through:

- limits on exposure to *volatile assets*;
- limiting credit risk to investment grade or higher rated debt instruments. Adequate diversification is also ensured by setting limits for any single counter party. There is no limit on exposure to the RSA government, since this is considered risk free;

- limits on asset concentration – particularly with regard to *strategic investments* and Sanlam Limited shares. The exposure of policyholders' portfolios to these investments is based on portfolio investment considerations and is restricted with reference to a specific counter party's weight in the *benchmark portfolio*;
- limits on exposure to certain types of assets, such as assets that cannot be easily liquidated and unlisted equities; and
- compliance with regulatory constraints.

e) The guidelines contain benchmarks for the performance measurement of each asset class and limits on deviations from these benchmarks to help manage returns on portfolios.

f) Feedback on the investment policy, its implementation and the performance of the smoothed bonus portfolios is provided regularly to the *Asset Liability Committee (ALCO)* and the Sanlam Life Board.

g) Some portfolios may invest in one or more of the managed asset classes in order to improve the diversification of these portfolios. Managed asset classes include, amongst others: *hedge funds, exchange traded funds, property investments, private equity investments, derivatives,* credit conduits, etc. The managers of these managed asset classes, which may include companies within the Sanlam Group, deduct their management fees and expenses directly from the investment returns. These deductions are in addition to the charges contained in the *actuarial basis*.

h) *Derivative* instruments may be utilised:

- to hedge the portfolio against unforeseen circumstances;
- for strategic and tactical asset allocation; and
- to take advantage of anomalies or inefficiencies in the derivative market pricing in order to enhance returns.

Derivatives may not be used to speculate.

Principles regarding termination and *partial termination* benefits

Sanlam Life aims to pay out amounts that do not have a materially adverse effect on continuing policies. *Book value* is paid out immediately, unless it is considered not to be in the interests of remaining policyholders to pay out *book value*, in which case either market value is paid or the payment may be deferred over a number of years.

Principles regarding charges

a) Charges, as applicable, will be recovered from policyholders' funds for, inter alia:

- administration and marketing;
- tax (if applicable);
- other regulatory charges; and
- investment activities and other guarantees.

b) The charges are set mindful of the need to provide competitive products that provide value for money to policyholders and reasonable profits to shareholders. Charges also take into account the need for capital to operate a life insurance business (and smoothed bonus business in particular) and the need for fair compensation to shareholders for risks assumed.

c) No explicit profit charges are taken, but profit will arise from the difference between charges taken and expenses incurred.

d) The charges are specified in the *actuarial basis* that applies to a specific policy.

e) Rand-based charges are increased to allow for inflation, as specified in the *actuarial basis*.

f) Charges are used to, inter alia, pay for policy expenses. Policy expenses may change in the long term. If the *actuarial basis* permits it Sanlam may, in addition to the inflationary increases, also change the charges. The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable, based on actual past and expected future experience.

g) In the case of policies issued prior to Sanlam Life's demutualisation, the *Head of Actuarial Function* has to certify that changes in charges are fair in relation to charges in the market and must inform the Financial Services Board of such changes.

Principles regarding new business and portfolio mergers

a) The Sanlam Life Board manages the types and volumes of new business as part of its management of the overall risk, profitability and ongoing solvency of Sanlam Life.

b) The Sanlam Life Board may close portfolios to new business if new business is no longer considered to be viable or if new fund inflows are deemed to be unfair, based on the *funding level* of the portfolio, to either existing policyholders in the fund or to new policyholders entering the fund. Alternatively, adjustments may be made to the terms on which new business is accepted to ensure equity. The administration processes involved in the closing of portfolios to new business will then determine whether portfolios are closed or terms adjusted for new policyholders.

c) It may be in the best interest of policyholders in a *diminishing mature portfolio* to have their diminishing portfolio combined with a larger portfolio. This will entail a transfer of the market value, including the *Bonus Stabilisation Reserve*, from the diminishing portfolio to the larger portfolio. This will only be done if equity is achieved between the portfolios being combined.

Principles regarding financial assistance

Regarding the Progressive Smooth Bonus Fund, Sanlam Select Growth Fund & Sanlam Smooth Growth Fund

If, after the removal of the non-guaranteed portion through negative bonuses, the Sanlam Life Board believes that the deficit is not capable of being restored within three years, shareholder capital will be used to provide temporary support to the portfolios. If and when the position improves, the support provided will be returned to shareholder funds with returns earned.

Regarding the other portfolios in this document

It is a statutory requirement to provide financial support to *under funded* portfolios if the deficit in the portfolio is not expected to be eliminated within the next three years. The Sanlam Life Board may also decide to provide support under other circumstances if it is deemed to be in shareholders' interests. The support will normally be in the form of interest-free loans that may be recovered from the portfolio if the loans are no longer considered necessary.

Governance

A sound governance structure is needed to manage *discretionary participation business*, which forms a substantial proportion of Sanlam Life's liabilities. The Sanlam Life Board is ultimately responsible for the governance of *discretionary participation business*, but a number of parties assist in this regard, including:

- the Sanlam Audit, Actuarial and Finance Committee;
- the Sanlam Customer Interest Committee;
- the Asset Liability Committee (ALCO);
- the Head of Actuarial Function; and
- the external auditors and their actuarial resources.

Monthly Bonus Fund

This section also applies to the Superflex Monthly Bonus Fund.

Overview of Monthly Bonus Fund

This is a portfolio, where investment returns are smoothed by way of monthly bonus declarations. The *book value* is paid out for benefits payable on death, disability, resignation, retrenchment and retirement.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the Monthly Bonus Fund

Bonuses vest fully for benefit payments on death, disability, resignation, retrenchment and retirement. Bonuses may not be taken away by declaring negative bonuses.

Practices of managing the Monthly Bonus Fund

Practices regarding bonuses

a) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

b) Bonuses are declared net of charges and gross of retirement fund tax (if applicable).

c) The starting point is to set bonuses equal to the expected long-term rate of return on the assets underlying the fund and then to adjust these bonuses with actual experience to date (as reflected by the *funding level*). The difference between the actual *funding level* and 103% is normally added to the bonus over a rolling 24-month period. The following exceptions apply:

- if the *funding level* is significantly above 103% (in the region of 110% or more), the difference between the actual *funding level* and 103% may (depending on market conditions) be added to the bonus over a shortened rolling period depending on market conditions;
- if the *funding level* is lower than 95%, the difference between the actual funding level and 103% is deducted from the bonus over a shortened rolling period according to the number of consecutive months for which the *funding level* was lower than 95%, with a minimum rolling period of 6 months; and
- if the *funding level* is lower than 92,5%, no bonuses are declared.

d) Bonuses are declared at the start of the month to which they apply, and vest at the end of the month to which they apply.

Investment practices

a) Sanlam Investment Management (SIM) manages most of the assets.

b) The current investment guideline limits the maximum exposure to *volatile assets* to 59% of the portfolio.

c) Credit risk is limited to investment-grade debt instruments. Fixed-interest instruments with any counter party, other than the RSA government, may not comprise more than 20% of the market value of RSA fixed interest and RSA cash components of the portfolio.

d) The maximum offshore exposure is subject to limits prescribed by the regulatory authorities.

e) ALCO can increase or decrease the above limits, subject to regulatory requirements, by up to 10% as circumstances change. For example, it can increase the maximum exposure to *volatile assets* from 59% to 69%.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- demutualisation requirements;
- the *actuarial basis* permitting such changes; and
- approval by the *Head of Actuarial Function*.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefit payments on death, disability, resignation, retrenchment and retirement)

a) One calendar month's written notice is required for *terminations* and *partial terminations*. *Book value* is paid out immediately, unless it is considered not to be in the interests of remaining policyholders to pay out *book value* (e.g. if market value is less than *book value*). Payment is then made over a period that must not exceed 10 years. (Alternatively, the fund may agree with Sanlam Life to pay out the lower of *book value* and market value immediately.)

b) Member *switches* (where members transfer to other portfolios) are allowed with details of the switch basis set out in each policy contract.

Other practices

The determination of a retirement fund's tax liability (if applicable) is the responsibility of the retirement fund. Sanlam Corporate provides the fund with the required information to calculate its tax liability (if applicable). The deduction of tax may result in negative net returns.

Stable Bonus Portfolio

There are a number of versions of the Stable Bonus Portfolio. Although there are slight differences in the level of charges and bonus declarations, the Principles and Practices in this section are applicable to all of these portfolios.

Overview of Stable Bonus Portfolio

This is a portfolio where investment returns are smoothed by way of monthly bonus declarations. The *book value* is paid out for benefits payable on death, disability, resignation, retrenchment and retirement.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the Stable Bonus Portfolio

Bonuses will change over time in line with changes in the investment conditions. Bonuses consist of a vesting bonus and a non-vesting bonus. Non-vested bonuses that accumulated from previous bonus declarations may be reduced or removed if the financial circumstances of the portfolio deteriorate to the extent that the Sanlam Life Board deems these measures to be necessary.

Practices of managing the Stable Bonus Portfolio

Practices regarding bonuses

a) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

b) The starting point is to set bonuses equal to the expected long-term rate of return on the assets underlying the fund and then to adjust these bonuses with actual experience to date (as reflected by the *funding level*). The difference between the actual *funding level* and 103% is normally added to the bonus over a rolling 24-month period. The following exceptions apply:

- if the *funding level* is significantly above 103% (in the region of 110% or more), the difference between the actual *funding level* and 103% may (depending on market conditions) be added to the bonus over a shortened rolling period, depending on market conditions;
- if the *funding level* is lower than 95%, the difference between the actual *funding level* and 103% is deducted from the bonus over a shortened rolling period according to the number of consecutive months for which the *funding level* was lower than 95%, with a minimum rolling period of six months; and
- if the *funding level* is lower than 92,5%, no bonuses are declared.

c) Under normal circumstances, 40% of the declared bonus will vest every month. The remaining 60% will be in the form of *non-vested bonuses*. To the extent that the monthly bonus increased as a result of the *funding level* exceeding 110% (see paragraph b above), the entire additional bonus will in all likelihood be non-vesting. Over and above this, another 10% of the total accumulated *non-vested bonuses* will vest every year.

d) Bonuses are declared net of charges and gross of retirement fund tax (if applicable).

e) *Vested bonuses* cannot be reduced, but *non-vested bonuses* are partially or fully removed when the *funding level* at year-end is below 90%. *Non-vested bonuses* are cancelled so as to restore the *funding level* to at least 92,5%.

f) Bonuses are declared at the start of the month to which they apply, and are credited at the end of the month to which they apply.

Investment practices

a) Sanlam Investment Management (SIM) manages most of the assets.

b) The current investment guideline limits the maximum exposure to *volatile assets* to 59% of the portfolio.

c) Credit risk is limited to investment-grade debt instruments. Fixed-interest instruments with any counter party, other than the RSA government, may not comprise more than 20% of the market value of RSA fixed interest and RSA cash components of the portfolio.

d) The maximum offshore exposure is subject to limits prescribed by the regulatory authorities.

e) ALCO can increase or decrease the above limits, subject to regulatory requirements, by up to 10% as circumstances change. For example, it can increase the maximum exposure to *volatile assets* from 59% to 69%.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- demutualisation requirements;
- the *actuarial basis* permitting such changes; and
- approval by the *Head of Actuarial Function*.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefit payments on death, disability, resignation, retrenchment and retirement)

a) One calendar month's written notice is required for *terminations* and *partial terminations*. *Book value* is paid out immediately, unless it is considered not to be in the interests of remaining policyholders (e.g. if market value is less than *book value*). Payment is then made over a period that must not exceed 10 years (alternatively, the fund may agree with Sanlam Life to pay out the lower of *book value* and market value immediately).

b) Member *switches* (where members transfer to other portfolios) are allowed with the switch basis set out in each policy contract.

Other practices

The determination of the retirement fund's tax liability (if applicable) is the responsibility of the retirement fund. Sanlam Corporate provides the fund with the required information to calculate its tax liability (if applicable). The deduction of tax may result in negative net returns.

Sanlam Multi Manager Vesting Bonus Fund

Overview of Sanlam Multi Manager Vesting Bonus Fund (SMM VBF)

This product is a multi-managed fund. It provides smooth investment returns by investing primarily in equity, fixed-interest and cash via collective investment schemes, and declaring the smoothed returns in the form of bonuses. The *book value* is paid out for benefits payable on death, disability, resignation, retrenchment and retirement.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the SMM VBF

Bonuses vest fully for benefit payments on death, disability, resignation, retrenchment and retirement. Bonuses may not be taken away by declaring negative bonuses.

Practices of managing the SMM VBF

Practices regarding bonuses

a) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

b) The starting point is to set bonuses equal to the expected long-term rate of return on the assets underlying the fund and to adjust these bonuses with actual experience to date (as reflected by the *funding level*). The difference between the actual *funding level* and 103% is normally added to the bonus over a rolling 24-month period. The following exceptions apply:

- if the *funding level* is significantly above 103% (in the region of 110% or more), the difference between the actual *funding level* and 103% may (depending on market conditions) be added to the bonus over a shortened rolling period;
- if the *funding level* is lower than 95%, the difference between the actual *funding level* and 103% is deducted from the bonus over a shortened rolling period according to the number of consecutive months for which the *funding level* was lower than 95%, with a minimum of six months; and
- if the *funding level* is lower than 92,5%, no bonuses are declared.

c) Bonuses are declared net of charges and gross of retirement fund tax (if applicable). Bonuses have a minimum value of zero.

d) Bonuses are declared at the start of the month to which they apply and vest at the end of the month to which they apply.

Investment practices

a) Sanlam Multi Managers International (SMMI) manages most of the assets.

b) The current investment guideline limits the maximum exposure to *volatile assets* to 60% of the portfolio.

c) Credit risk is limited to investment-grade debt instruments. Fixed-interest instruments with any counter party, other than the RSA government, may not comprise more than 20% of the market value of RSA fixed interest and RSA cash components of the portfolio.

d) The maximum offshore exposure is subject to limits prescribed by the regulatory authorities.

e) ALCO can increase or decrease the above limits, subject to regulatory requirements, by up to 10% as circumstances change. For example, it can increase the maximum exposure to *volatile assets* from 60% to 70%.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- the *actuarial basis* permitting such changes; and
- approval by the Head of Actuarial Function.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefits payments on death, disability, resignation, retrenchment and retirement)

a) All member *switches* are at the lower of *book value* and market value. *Switches* may take place monthly, subject to 15 calendar days' notice.

b) One month's written notice is required for *terminations*. All *terminations* are at the lower of *book value* and market value.

Other practices

The determination of the retirement fund's tax liability (if applicable) is the responsibility of the retirement fund. Sanlam Corporate provides the fund with the required information to calculate its tax liability (if applicable). The deduction of tax may result in negative net returns.

Absolute Return Plus Guarantee Fund

Overview of the Absolute Return Plus Guarantee Fund

This product provides risk-averse policyholders with limited exposure to positive equity returns, accompanied by minimal termination and switching restrictions. This is achieved through extensive use of *derivative (hedging)* instruments and the declaration of a monthly, fully vesting bonus. The *book value* is paid out for benefits payable on death, disability, resignation, retrenchment, retirement and termination.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the Absolute Return Plus Guarantee Fund

Bonuses vest fully for benefit payments on death, disability, resignation, retrenchment and retirement. Bonuses may not be taken away by declaring negative bonuses. Bonuses may, however, be negative after deduction of charges.

Practices of managing the Absolute Return Plus Guarantee Fund

Practices regarding bonuses

a) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

b) Bonuses are declared based on the expected rate of return on the assets underlying the fund (including *derivatives* used) and the *funding level* of the portfolio. We aim to have an average *funding level* over time of 102.5%. If the *funding level* is higher or lower than this, bonuses are adjusted so that the *funding level* is returned to 102.5% over a rolling 12-month period.

c) Bonuses are declared gross of charges and gross of retirement fund tax (if applicable). Gross bonuses have a minimum value of zero but the bonuses net of charges, may be negative.

d) Bonuses are declared at the start of the month to which they apply, and vest at the end of the month to which they apply.

Investment practices

a) Sanlam Investment Management (SIM) manages most of the assets.

b) Absolute Return Plus Guarantee Fund will be invested in a portfolio with a core holding in a collective investment scheme (Sanlam Inflation Plus Fund) and some cash for liquidity purposes. *Derivative* instruments and forward purchase of collective investment scheme units are also used extensively to reduce the risk of capital loss and to ensure liquidity.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- the *actuarial basis* permitting such changes; and
- approval by the Head of Actuarial Function.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefits payments on death, disability, resignation, retrenchment and retirement)

a) One calendar month's written notice is required to receive *book value* (for *terminations* and *switches*).

b) Sanlam retains the right to make the payment over a 12-month period (alternatively, the fund may reach an agreement with Sanlam where a cash value is paid out immediately, which will be lower than the normal termination value).

Other practices

The determination of the retirement fund's tax liability (if applicable) is the responsibility of the retirement fund. Sanlam Corporate provides the fund with the required information to calculate its tax liability (if applicable). The deduction of tax may result in negative net returns.

Progressive Smooth Bonus Fund

Overview of Progressive Smooth Bonus Fund

This product is a multi-managed fund. Investment returns are smoothed by way of monthly bonus declarations. The *book value* is paid out for benefits payable on death, disability, resignation, retrenchment and retirement.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the Progressive Smooth Bonus Fund

Bonuses will change over time in line with changes in the investment conditions. Book value consists of a guaranteed and a non-guaranteed portion. The portfolio has an 80% guarantee level on book value. This means that 80% of capital, contributions and bonuses are allocated to the guaranteed portion and the remainder to the non-guaranteed portion.

The non-guaranteed portion may be reduced or removed if the financial circumstances of the portfolio deteriorate to the extent that the Sanlam Life Board deems these measures to be necessary. If this happens, all bonuses will be added to the non-guaranteed portion of the book value, until the original ratio between the guaranteed portion and the non-guaranteed portion has been restored.

Practices of managing the Progressive Smooth Bonus Fund

Practices regarding bonuses

a) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

b) Bonuses are declared net of charges and gross of retirement fund tax (if applicable).

c) The starting point is to set bonuses equal to the monthly equivalent of CPI + 4% (using annualised rolling three-year CPI with a three-month lag) and then to adjust these bonuses with actual experience to date (as reflected by the *funding level*). The difference between the actual *funding level* and 103% is normally added to the bonus over a rolling 24-month period. The following exceptions apply:

   - if the *funding level* is above 115%, the difference between the actual *funding level* and 103% is added to the bonus over a rolling 14-month period;
   - if the *funding level* is lower than 97.5%, but equal to or above 92.5%, the difference between the actual funding level and 103% is deducted from the bonus over a 12-month rolling period;
   - if the *funding level* is lower than 92.5%, but equal to or above 85%, no bonuses are declared;
   - if the *funding level* is lower than 85%, but equal to or above 80%, a -10% bonus is declared for the month; and
   - if the *funding level* is lower than 80%, a -20% bonus is declared for the month.

   In the following month the *funding level* will be recalculated and the next bonus will be determined as above.

d) Bonuses are declared at the start of the month to which they apply, and are credited at the end of the month to which they apply.

Investment practices

a) The portfolio is multi-managed.

b) The current investment guideline limits the maximum exposure to *volatile assets* to 59% of the portfolio.

c) Credit risk is limited to investment-grade debt instruments. Fixed-interest instruments with any counter party, other than the RSA government, may not comprise more than 20% of the market value of RSA fixed interest and RSA cash components of the portfolio.

d) The maximum offshore exposure is subject to limits prescribed by the regulatory authorities.

e) ALCO can increase or decrease the above limits, subject to regulatory requirements, by up to 10% as circumstances change. For example, it can increase the maximum exposure to *volatile assets* from 59% to 69%.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- the *actuarial basis* permitting such changes; and
- approval by the Head of Actuarial Function.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefit payments on death, disability, resignation, retrenchment and retirement)

a) For *terminations* and *partial terminations*, *Book value* paid as soon as practical (but within 30 business days), unless

- disinvestment exceeds the available cash in the Investment Plan. Sanlam may the delay settlement until such time as the necessary assets can be liquidated.
- it is considered not to be in the interests of remaining policyholders (e.g. if market value is less than *book value*). Payment is then made over a period that must not exceed 10 years (alternatively, the fund may agree with Sanlam Life to pay out the lower of *book value* and market value as soon as is practical).

b) All member switches are at the lower of *book value* and market value.

Other practices

The determination of the retirement fund's tax liability (if applicable) is the responsibility of the retirement fund. Sanlam Corporate provides the fund with the required information to calculate its tax liability (if applicable). The deduction of tax may result in negative net returns.

Sanlam Smooth Growth Series (Sanlam Select Growth Fund & Sanlam Smooth Growth Fund)

This section also applies to the Multi-Managed Smooth Growth Fund.

Overview of the Sanlam Smooth Growth Series

This product consists of two options, a multi-managed fund (*Sanlam Select Growth Fund*) and single-managed fund (*Sanlam Smooth Growth Fund*). Investment returns are smoothed by way of monthly bonus declarations. The *book value* is paid out for benefits for:

- **Living annuitants**: death and pension payments
- **Retirement annuities**: death, disability, and retirement.

If the market value of the assets in the portfolio is greater than the *book value*, a positive *Bonus Stabilisation Reserve* is created, which will be used to enhance future bonuses. Conversely, if the market value of the assets is less than the *book value*, a negative *Bonus Stabilisation Reserve* is created, which will be eliminated by lower bonuses in the future.

Principles of managing the Sanlam Smooth Growth Series

Bonuses will change over time in line with changes in the investment conditions. Book value consists of a guaranteed and a non-guaranteed portion. The portfolio has a 50% guarantee level on book value. This means that 50% of capital, contributions and bonuses are allocated to the guaranteed portion and the remainder to the non-guaranteed portion.

The non-guaranteed portion may be reduced or removed if the financial circumstances of the portfolio deteriorate to the extent that the Sanlam Life Board deems these measures to be necessary. If this happens, all bonuses will be added to the non-guaranteed portion of the book value, until the original ratio between the guaranteed portion and the non-guaranteed portion has been restored.

Practices of managing the Sanlam Smooth Growth Series

Practices regarding bonuses

c) Bonuses are declared monthly in advance according to the bonus formula approved by the Sanlam Life Board. The Sanlam Life Board receives an annual bonus report and must approve any changes to the formula.

d) Bonuses are declared net of charges and gross of retirement fund tax (if applicable).

e) The starting point is to set bonuses equal to the monthly equivalent of CPI + 4.5% (using annualised rolling three-year CPI with a three-month lag) and then to adjust these bonuses with actual experience to date (as reflected by the *funding level*). The difference between the actual *funding level* and 103% is normally added to the bonus over a rolling 24-month period. The following exceptions apply:

  - if the *funding level* is above 115%, the difference between the actual *funding level* and 103% is added to the bonus over a rolling 14-month period;
  - if the *funding level* is lower than 97.5%, but equal to or above 92.5%, the difference between the actual funding level and 103% is deducted from the bonus over a 12-month rolling period;
  - if the *funding level* is lower than 92.5%, but equal to or above 85%, no bonuses are declared;
  - if the *funding level* is lower than 85%, but equal to or above 80%, a -10% bonus is declared for the month; and

- if the *funding level* is lower than 80%, a -20% bonus is declared for the month.

In the following month the *funding level* will be recalculated and the next bonus will be determined as above.

a) Bonuses are declared at the start of the month to which they apply, and are credited at the end of the month to which they apply

Investment practices

a) The Sanlam Select Growth Fund is multi-managed and the Sanlam Smooth Growth Fund is single-managed.

b) The maximum offshore exposure is subject to limits prescribed by the regulatory authorities.

Practices regarding charges

a) If applicable, tax and any other statutory charges are levied.

b) The fund charges (including any investment management performance charges) are contained in the *actuarial basis*.

c) Any changes to charges are subject to:

- the *actuarial basis* permitting such changes; and
- approval by the *Head of Actuarial Function*.

The *Head of Actuarial Function* should be satisfied that any change to charges is reasonable based on actual past and expected future experience.

Practices regarding movements out of the fund (other than benefit payments on death, disability, retirement and pension payments)

a) All member or annuitant switches are at the lower of *book value* and market value.

b) If disinvestment exceeds the available cash in the Investment Plan. Sanlam may the delay settlement until such time as the necessary assets can be liquidated.

Further Information

For further information please contact:

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Sanlam Corporate (SC) is an operating division of Sanlam Life Insurance Ltd, which specialises in the provision of risk, investment and fund administration services to institutions and retirement funds. Sanlam Corporate Investments is a sub-division of SC which develops and provides structured investment and retirement solutions, annuity and guaranteed products for the institutional and retirement fund industry.

Sanlam Life Insurance Ltd is an authorised financial services provider.

Registration Number 1998/021121/06

Glossary

Actuarial basis

In relation to a policy, this means the underlying actuarial rules, specifications and formulae in terms of which the policy operates, which:

a) in compliance with the Long-Term Insurance Act, 1998 are approved by the Head of Actuarial Function of the insurer, in particular for the purposes of sections 46 and 52; and

b) if and while the Insurance Act, 1943 applied to the policy, in compliance with that Act, were approved by the valuator of the insurer, in particular for the purposes of sections 34 and 62(2) of that Act.

Asset Liability Committee (ALCO)

A committee of investment and actuarial professionals that determines the investment strategy for the asset portfolios underlying the discretionary participation business.

Benchmark portfolio

The portfolio against which performance is measured.

Bonus Stabilisation Reserve (BSR)

The difference between the market value and the book value of a portfolio.

Book value

Book value is calculated by accumulating the net premiums with declared bonuses. Declared bonuses are usually gross of tax (if applicable) and net of charges. However, some funds' (e.g. Absolute Return Plus Guarantee Fund) declared bonuses are gross of charges. The Bonus Stabilisation Reserve is the difference between the book value and the market value.

Business risks

The risk of losses due to the actual experience being different from the assumptions made when pricing a product. Business risks also include the risk of losses incurred in respect of other products.

Demutualisation rules

Restrictions on changes to charges as set out in Sanlam's demutualisation proposal. These restrictions are applicable to policies in force on the demutualisation date. In the case of the pre-demutualisation policies, the Head of Actuarial Function has to certify that changes in charges are fair in relation to charges in the market and inform the FSB of such changes.

Derivative

A contract whose value is derived from that of other investment instruments.

Diminishing mature portfolio

A mature portfolio (often closed for new business) is one where the claims paid out are greater than the new premiums being received. The portfolio becomes so small that it is difficult to manage on its own.

Discretionary participation business

Any business that allows discretion to be used in the way bonuses are declared. All Sanlam Life's *smoothed bonus products* fall into this category.

Exchange traded funds

ETFs are investments that try to replicate a stock market index such as the ALSI40.

Funding level

The funding level is the ratio of market value to book value of a portfolio.

Hedge fund

A portfolio which uses any strategies or takes any positions that could result in the portfolio incurring losses greater than its total market value at any point in time, and which strategies or positions include but are not limited to short positions. A short position is where an asset is sold by a seller for delivery at a future date or time, and the seller does not own such asset at the time of the sale. Though hedge funds do not necessarily hedge their investments against adverse market moves, the term is used to distinguish them from regulated retail investment funds – for example, collective investment schemes.

Hedging

Hedging is a strategy designed to reduce exposure to market risk, for example a fall in equity prices.

Net Premiums

The premium less charges recovered from the premium.

Non-vested bonuses

Bonuses that can be removed under adverse circumstances.

Partial terminations

Removing part of the funds under Sanlam Life's management from Sanlam Life's portfolios or products.

Private equity investments

Private equity is a broad term that commonly refers to any type of equity investment in an asset in which the equity is not freely tradable on a public stock market.

Head of Actuarial Function

The Head of Actuarial Function performs an oversight and reviewing role on specified actuarial functions (calculations, results and reports) within an Insurer, as well as providing advice to the Board of directors on these activities, by reporting to the Board.

Smoothed Bonus products

Sanlam Life's business that allows discretion to be used in the way bonuses are declared.

Strategic investments

Sanlam Life's investments in subsidiaries and associated companies.

Switches

Movement of funds between different Sanlam Life portfolios or products.

Terminations

Removing funds under Sanlam Life's management from Sanlam Life's portfolios or products.

Under funded

When the liabilities are more than the assets in the portfolio, i.e. when the portfolio is less than 100% funded. The Bonus Stabilisation Reserve (BSR) will then be negative.

Vested bonuses

Bonuses that may not be taken away.

Volatile assets

The value of these assets is expected to vary considerably over time. Volatile asset classes include equities and international investments.

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