Liberty Group Limited Liberty Living Annuity

Principles and Practices of Financial Management (PPFM)

Effective 1 September 2020

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1 Introduction

1.1 *Principles and Practices of Financial Management*

This document sets out the Principles and Practices of Financial Management (PPFM) of the Liberty Living Annuity in accordance with Directive 147 issued by the Financial Services Board (FSB). This document is only applicable if the Income Enhancer Benefit has been selected since this is the only benefit on the Liberty Living Annuity that contains an element of discretion.

The purpose of this PPFM is to document how Liberty will manage its discretion on the Liberty Living Annuity. In managing such business, Liberty relies on its ability to use discretion, in particular over the methodology of distributing the bonus pool between eligible policyholders.

This document:

- explains the nature and extent of the discretion available; and
- shows how competing or conflicting interests or expectations of different groups and generations of policyholders are managed so that policyholders are treated fairly. The discretion should not give rise to competing or conflicting interests between policyholders and shareholders as Liberty does not participate in the distribution of the bonus pool.

Users of the PPFM should note that this document explains the management of discretion on the Liberty Living Annuity; it does not give advice as to the benefits of a Liberty Living Annuity.

Liberty is committed to providing open and honest communication and we believe that the PPFM assists with that aim. The Liberty Living Annuity is managed in accordance with these Principles and Practices.

1.2 *Discretionary Participation Products (DPP)*

A PPFM is required for Discretionary Participation Products (DPP) in accordance with Directive 147. Since the Income Enhancer Benefit involves the sharing of mortality proceeds between different policyholders, there is discretion on how these proceeds are split between the policyholders in the bonus declaration process.

1.3 *Principles*

The principles are enduring statements of the overarching standards that Liberty adopts in managing *discretionary participation products* and are not expected to change often. They are the standards used to maintain the long-term solvency of the fund for current and future policyholders.

The principles also describe the business model used:

- when discretion is applied in the management of *discretionary participation products;* and
- in responding to longer-term changes in the business and economic environment.

Liberty does not expect to change the principles often and will give at least three months advance written notice to *discretionary participation product* policyholders of any changes to the principles, unless the regulator grants Liberty exemption from this requirement.

Practices

The practices describe Liberty's current approach to managing discretionary participation products and how Liberty intends responding to changes in the business and economic environment in the shorter term.

They are intended to contain sufficient detail for a knowledgeable observer to understand the material risks and rewards when taking out a discretionary participation product with Liberty.

Liberty expects to change the practices as the circumstances in Liberty's business environment change. Liberty will advise discretionary participation product policyholders of any change in the practices within a reasonable period of the change becoming effective, for example, in conjunction with an annual bonus statement or an annual member benefit statement in the case of retirement funding business.

1.4 Communication of the PPFM

A copy of the PPFM should be received with the Liberty Living Annuity contract if the Income Enhancer Benefit is selected or with the change in contract terms if the Income Enhancer Benefit is selected at a later date. The latest version of the PPFM will also be available on the STANLIB website and will be available on request to interested parties.

1.5 Monitoring compliance

It is the responsibility of the Liberty Board of Directors (Board) to ensure that the company manages DPP in line with the principles and practices set out in this document. The Board has delegated this responsibility to the Liberty Group Actuarial Committee (GAC) who will report to the Board annually on this compliance.

1.6 Changes to the PPFM

Any changes to the PPFM must be approved by the Liberty Board, which may be delegated to the GAC. The Board may seek the advice of the Liberty Head of Actuarial Function in considering such changes.

2 BONUS PHILOSOPHY

2.1 Overriding Principles

2.1.1 The overriding principles will take precedence over any other principles.

2.1.2 Liberty will meet all its contractual obligations, legal and regulatory requirements. In the event of a conflict arising between the PPFM and the policy conditions, the policy conditions will prevail.

The policy conditions include provisions that afford Liberty the ability to amend policy benefits in response to external taxation and regulatory changes. Policyholders are urged to familiarise themselves with the relevant clauses in their contracts.

2.1.3 The business will be managed having regards to policyholder reasonable benefit expectations which have arisen from original contractual entitlements as well as past practice by Liberty, industry practice and representations made to policyholders.

2.1.4 Subject to the above, Liberty aims to achieve fairness of treatment between different types and groups of discretionary participation policyholders, and between them and shareholders. Since Liberty does not participate in the distribution of surplus on the Liberty Living Annuity, fairness of treatment between policyholders and shareholders is not impacted by the discretion that can be applied.

2.2 *Objectives*

2.2.1 The main objectives of the bonus distribution policy for the Liberty Living Annuity with the Income Enhancer Benefit are:

- To give each surviving DPP policyholder a fair and equitable distribution of the proceeds accumulated in the bonus pool (the surplus) arising from the deaths of policyholders with funds committed to the Income Enhancer Benefit.
- To not smooth the distribution of the surplus.

2.2.2 A fair and equitable distribution for the Liberty Living Annuity with the Income Enhancer Benefit is one that distributes the surplus in a manner that is not expected to result in material cross-subsidies between different policyholders and results in no distribution of the surplus to shareholders.

3 FINANCIAL MANAGEMENT OF THE LIBERTY LIVING ANNUITY

3.1 *Background*

On the Liberty Living Annuity, bonuses are declared from the accumulated proceeds arising from the deaths of policyholders with funds committed to the Income Enhancer Benefit (i.e. the surplus). The bonuses are credited to the policyholder funds of each entitled policyholder at the bonus declaration date.

The main factors affecting the determination of the bonuses on the Liberty Living Annuity with the Income Enhancer Benefit are:

- The expected mortality experience based on a range of risk factors (e.g. age and sex)
- The Rand value of funds committed to the Income Enhancer Benefit
- The proportion of the year for which the Income Enhancer Benefit has been active
- The proceeds that have accumulated in the bonus pool arising from the actual deaths of policyholders with funds committed to the Income Enhancer Benefit.

3.2 *Principles*

3.2.1 There is no smoothing of the distribution of surplus.

3.2.2 Liberty only has discretion over the expected mortality used for determining the split of the bonus pool between policyholders and over the frequency of bonus distributions.

3.2.3 Liberty does not participate in the distribution of surplus. Liberty is only entitled to the fees in accordance with the policy terms.

3.2.4 The full bonus pool is distributed annually based on each policyholder’s proportional expected contribution to the bonus pool. The expected mortality assumed will be reviewed each year based in part on the actual experience of the pool of policyholders.

3.3 *Practices*

3.3.1 The bonus pool will comprise the sum of the amounts allocated to the IEB benefit in respect of those policyholder deaths that have been notified over the bonus year. These amounts will accumulate at a cash return until the bonus declaration date. The bonus is fully vested once applied to policies.

3.3.2 The bonus is currently declared annually in May.

3.4 Investment strategy

3.4.1 Liberty will provide each policyholder with the investment return of the underlying assets (net of the fees as per the policy terms) in accordance with his/her selected investment portfolio(s). The bonus pool will accumulate the death proceeds at a cash return (net of the asset management fees as per the policy terms).

3.5 New bonus classes

3.5.1 The Liberty Living Annuity has its own bonus class. There should be no explicit need to have new bonus classes for the Liberty Living Annuity in future as the bonus distribution principles and practices are not expected to result in material cross-subsidies between different policyholders. Liberty does, however, still reserve the right to create different bonus pools for Liberty Living Annuities in the future.

3.5.2 In the event that other types of DPP business were to be written by Liberty, this business will not belong to the same bonus class as the Liberty Living Annuity.

3.6 Small funds

3.6.1 Liberty Living Annuities will not be able to merge with larger DPP funds since there is no smoothing of the distribution of surplus as is the case for Liberty's other DPP policies. If the Liberty Living Annuity funds become too small to declare sufficiently stable bonuses, Liberty reserves the right to convert the fund value committed to the Income Enhancer Benefit into a Living Annuity Benefit – (i.e. the policyholder will no longer benefit from future bonuses, but the full funds will be payable to the beneficiaries on death).

4 Glossary

Discretionary participation products

Discretionary participation products have certain features that normally include some or all of the features below:

- Using premiums to invest in a pooled fund made up of a range of assets, a significant proportion of which are (usually) in the form of equities;
- Smoothing the allocations to policies (bonuses) to cushion policyholders from short-term fluctuations in asset prices or other possible experience variations;
- For some products, sharing in certain of the profits or losses of the insurer, including those arising from mortality and expense risks;
- Certain guarantees, which usually increase over the lifetime of the policy (for example, the payment of vesting bonuses at maturity, retirement or death); and
- In many policies, a terminal/final/non-vested bonus is declared, which does not form part of the guaranteed amount, but which may be added to the value of the contract at claim stage.

Regular bonus

A bonus declared typically each year while the policy is in-force.

Smoothing

The concept of smoothing is fundamental to a discretionary participation product contract. When investment returns are distributed via a bonus rate declaration to policyholders, the full investment return is not granted to the policyholder as and when it is earned, but rather over time.

When investment returns are higher than expected, a bonus rate that is lower than the return is usually declared, and the balance is reserved so that when returns are lower than expected a higher bonus rate than the return may be declared.

Head of Actuarial Function

The Head of Actuarial Function is the actuary appointed by a long-term insurance company in accordance with the Insurance Act No 18 of 2017. This person should be a natural person who is permanently resident in the Republic, is a Fellow of the Actuarial Society of South Africa and has, as an actuary, appropriate practical experience relating to long-term insurance business. The duties of the Head of Actuarial Function are set out in the Act and accompanying Prudential Standards.

Surplus

The surplus in a class of discretionary participation products is the difference between the asset share and the book value. This may be negative.

Vested bonus

The portion of bonus declared under a discretionary participation product which is guaranteed on declaration and cannot be removed.