Principles and Practices of Financial Management (PPFM) for Sanlam Developing Markets Limited’s Legacy Reversionary Bonus Products

Principles and Practices of Financial Management (PPFM) for Sanlam Developing Markets Limited's Legacy Reversionary Bonus Products

Version 1: December 2012

TABLE OF CONTENTS

Section 1 – Introduction

1.1 BACKGROUND

a) In order to manage *discretionary participation business*[1], long-term insurers must use their discretion in managing investments and allocating bonuses. Directive 147.A.i (LT) issued by the Financial Services Board requires insurers to define, and make publicly available, the Principles and Practices of Financial Management (PPFM) that are applied in the management of their 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.

b) Sanlam Developing Markets Limited (the Company) accepts the principle that policyholders have the right to full disclosure of issues that affect the value of their policy, and therefore provides these principles and practices of financial management in the interests of our policyholders and sound corporate governance.

c) The Company publishes the following documents covering the PPFM on its website, (www.sanlam.co.za):
   - PPFM for Sanlam Developing Markets Limited's individual smooth bonus products.
   - PPFM for Sanlam Developing Markets Limited's individual *reversionary bonus products.*

d) **This document comprises the PPFM for the *reversionary bonus products*.**

e) The Company has in the past offered various products that had the right to participate in profits through the addition of bonuses on a reversionary bonus basis. All of these are legacy products which have been closed to new business for some time. The types of products are given in annexure 2.

f) This document is not intended to be a complete description of the financial management of these products. If in any instance this document contradicts the policy wording, the policy wording would take precedence. These principles and practices have been approved by the Company's board and apply from 31 December 2012.

1.2 PRINCIPLES AND PRACTICES

a) **Principles** describe the standards which are applied in general to the *discretionary participation business* in order to balance the need to meet the reasonable expectations of policyholders with the need to maintain the long term solvency of the portfolio, while achieving equity between cohorts of policyholders. This must be achieved in an environment of uncertain future economic circumstances.

b) **Practices** offer in more detail the specific features of this business and the actions applied to manage this business. These features and management actions are consistent with the principles set out in this document.

---

[1] ***Items in italics are defined in the glossary (Annexure 1)***

1.3 GOVERNANCE AND COMPLIANCE

a) The Company's board is responsible for the governance of *discretionary participation business* written by the Company. The governance structures relied on by the board comprise:
   - The board's Discretionary Participation Committee (DPC)
   - The board's Audit, Actuarial and Risk Committee
   - The *statutory actuary*
   - The management committee of Sanlam Sky Solutions
   - The external auditors and their actuaries.

b) The board is responsible for this document and the governance of the *discretionary participation business*. The DPC and *statutory actuary* apply the principles and practices in making recommendations to the board.

c) The compliance officer is tasked with monitoring compliance with these principles and practices.

d) The PPFM may change as the economic or business environment changes. Any change to a Principle or Practice will be approved by the board, on recommendation from the DPC and the *statutory actuary*. 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.

Section 2 – Overriding Principles of Financial Management

2.1 LEGAL AND CONTRACTUAL OBLIGATIONS

a) The Company is committed to complying with the requirements of all contractual obligations and other legal and regulatory requirements. These requirements apply if there is any inconsistency between them and the PPFM.

2.2 BONUSES

a) The Company's bonus philosophy for reversionary bonus products is that the assets held in respect of the reversionary policies will, over time, be used for the benefit of those policyholders, subject to the charges to be recovered in respect of these policies

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

c) The board approves the bonus philosophy and the bonus rates on the advice of the *statutory actuary* and the DPC.

d) Bonuses are a combination of vested and *non-vested bonuses*. Declared vested reversionary bonuses are added to the policy and cannot be removed. Declared non-vested terminal bonuses (or a portion thereof) may, however, be removed or reduced based on a recommendation from the statutory actuary, when the funding level of the reversionary bonus products becomes unacceptably low.

2.3 SURRENDER VALUES AND OTHER EARLY TERMINATIONS BENEFITS

a) The payment of benefits on early termination of policies either as a result of a surrender or transfer to another fund should not materially affect the value of the benefits to policyholders that remain in the portfolio. The Company may apply a *market value adjustment,* for example when investment markets have crashed, in order to protect the values of the remaining policyholders.

b) The principles of the regulations (Part 5) of the Long Term Insurance Act are applied in determining early termination values.

2.4 NEW BUSINESS AND PORTFOLIO MERGERS

a) The *reversionary bonus products* are closed to new business.

b) 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. The bonus structure of reversionary bonus products may then also need to be aligned with the bonus structure applicable to the larger portfolio. Such transfers will, however, only be done if an appropriate degree of equity is achieved between the portfolios being combined.

2.5 FINANCIAL ASSISTANCE

a) In the event that the products are underfunded the following actions are possible and are in general applied in the order presented:
   - Lower bonus than would be declared if the funding position was satisfactory.
   - Removal of interim and non-vested bonuses.
   - Applying a market level adjustment on policies terminating earlier than expected.
   - The Company's shareholders provide financial support.

b) The support by the Company will normally be in the form of an interest free loan to the policyholder portfolio which is repayable if and when the funding position of the portfolio is restored to an acceptable level.

Section 3 – Practices for Reversionary Bonus Products

3.1 BONUSES

a) The benefit under a *reversionary bonus product* consists of various parts:
   - the vested sum assured as chosen on the inception date of the policy,
   - vested reversionary bonuses on the sum assured,
   - vested reversionary bonuses on reversionary bonuses accumulated to date,
   - non-vested terminal bonuses as a percentage of the sum assured,
   - non-vested terminal bonuses as a percentage of reversionary bonuses accumulated to date.

b) Reversionary bonuses on the sum assured and accumulated reversionary bonuses vest immediately. All other bonuses are non-vesting and can be removed if financial conditions change.

c) Vested and non-vested benefits are payable on the maturity date or earlier death but not at early termination.

d) Bonuses are declared annually for the last calendar year. Interim bonus rates apply to the period from 1 January of each year to the claim date.

e) Bonuses are declared net of charges, fees and taxes.

f) Interim bonus rates are reviewed regularly and may be changed retrospectively between bonus declaration dates, based on the investment returns actually earned. Interim bonuses would normally be equal to the last declared bonus.

3.2 EARLY TERMINATION

a) On early termination, the *book value* (which allows for the loss of future premiums) is payable. In addition, in times of market duress, *market value adjusters* (MVAs) may be applied to the *book value* to reduce the amount paid to policyholders.

Annexure 1 – Glossary

Bonus Stabilisation Reserve (BSR) – The difference between the market value and the *book value* of a portfolio.

Book value – The *book value* is calculated on a prospective basis and equals the discounted value of the projected vested benefit plus the discounted value of the projected non-vested benefit less an adjustment to allow for the loss of expected future premiums. In this calculation provision is made for future bonuses that are expected to be declared to ensure policyholders shall receive reasonable benefits compared to the assets underlying their policies. The vested benefit is calculated as the sum assured plus reversionary bonuses on the sum assured plus further reversionary bonuses on the accumulated reversionary bonuses. The non-vested benefit is the non-vested terminal bonuses on the sum assured and on the reversionary bonuses. Declared bonuses are net of charges and tax.

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 of Sanlam Developing Markets Limited's *reversionary bonus products* fall into this category.

Funding level / funding position – refers to the level of the assets held in respect of the policies relative to the value of the liabilities.

Market value adjuster / adjustment – This is the reduction of early termination values, based on the current level of the market, to protect remaining policyholders.

Non-vested bonuses – Bonuses that can be removed under certain circumstances.

Reversionary Bonus products – Sanlam Developing Markets Limited's business that allows discretion to be used in the way bonuses are declared.

Statutory actuary – The actuary appointed in terms of the Long-Term Insurance Act, whose main role is to certify that in his (or her) professional actuarial opinion a life insurance company is conducting business on a financially sound basis.

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.

Annexure 2 – Types Of Products

The types of products offered in the past with conventional reversionary bonuses include the following:

- Underwritten by Sanlam Developing Markets Limited (and its predecessors such as African Life Assurance Limited):
    - Midas
    - Series 9
    - Series 2001
- Underwritten by Sentry Assurance of South Africa Limited (and its predecessors such as Permanent Life Assurance Company Ltd):
    - Permanent Life
    - Sentry
- Underwritten by Kganya Insurance Company Limited (and its predecessor The Universal Assurance Company Limited):
    - New India