



Channel Life Principles and Practices of Financial Management (PPFM) Bonus Annuities – 8 April 2008

Channel
life ■

BROUGHT TO YOU BY THE  **Sanlam** GROUP

Table of Contents

SECTION	PAGE
1. Introduction	2
2. The Amount Payable Under a Bonus Annuity Policy	6
3. Bonus Philosophy	10
4. Investment Strategy	12
5. Charges and Expenses	15
6. Discretionary Participation Committee	16
APPENDICES	
1. Glossary	17

Section 1: Introduction

- 1.1 Channel Life is a licensed South African Long Term Insurer and was established in 1969. Channel Life sells products throughout South Africa. Channel Life is proprietary company and the majority shareholder is Sanlam.
- 1.2 The purpose of this document is to define the nature and extent of the discretion used by Channel Life in the management of their discretionary participation products.
- 1.3 None of the contents of this document form part of, or varies, the terms and conditions of any policy issued, or to be issued, by Channel Life. In the event of any inconsistency, between this document and any policy, the policy terms and conditions will prevail.
- 1.4 The FSB has issued Directive 147A, applicable to long-term insurers, regarding the “governance of discretionary participation policies” within the context of the Long-Term Insurance Act, 1988 (Act 52 of 1998) (The Act). This document has been prepared in accordance with Directive 147A.
- 1.5 The key elements of the requirements described in this directive are:
 - To define the Principles and Practices of Financial Management (PPFM) that are applied in the management of discretionary participation products;
 - To disclose the nature and extent of the discretion used by insurers, and the parameters within which it will be used, by publishing the PPFM;
 - To ensure that decisions by the insurers are in accordance with the PPFM;
 - To monitor any changes that are made to the PPFM; and
 - An annual confirmation of compliance to the PPFM in the statutory return.
- 1.6 The principles of the PPFM are intended to:
 - Be enduring statements of the overarching standards the insurer adopts in managing discretionary participation products (i.e. policy conditions); and
 - Describe the business model used by the insurer for managing the discretionary aspects of its discretionary participation policies (in terms of its policy conditions) and in responding to longer-term changes in the business and economic environment.

- 1.7 The practices of the PPFM are intended:
- To describe the insurer's specific approach to managing discretionary participation products and responding to changes in the business and economic environment in the shorter-term; and
 - Must contain sufficient detail to enable a knowledgeable observer to understand the possible risks and rewards from effecting a discretionary participation policy with the insurer.
- 1.8 This document describes the principles and practices applied by Channel Life in managing its Bonus annuity business and covers the principles and practices under the following headings:
- The amount payable under a Bonus annuity policy;
 - Bonus philosophy;
 - Investment strategy;
 - Business risk; and,
 - Charges and expenses;
- 1.9 This document has been approved by Channel Life's Board and is publicly available. Bonus annuity policyholders will be notified of any amendments to this document, which may arise from changes to the structure of Channel Life and/or the business environment.
- 1.10 Appendix 1 defines the key terms used in this document.
- 1.11 This document only applies to Channel Life's Bonus annuity product.
- 1.12 There are no surrenders applicable to the Bonus annuity business.
- 1.13 Channel Life does not currently write any new Bonus annuity business and the current Bonus annuity fund is closed to new business.

Section 2: The Amount Payable under a Bonus Annuity Policy

2.1 PRINCIPLES – AMOUNT PAYABLE

- 2.1.1 The amount payable is set with reference to Earned Asset Shares (as described in Section 2.2.5) taking into consideration the experience of the Bonus annuity fund, the overall financial position of Channel Life and the fair treatment of Bonus annuity policyholders.
- 2.1.2 The level of increases given to the Bonus annuity policies is targeted so that 100% of Earned Asset Shares (EAS), on average are paid out.
- 2.1.3 Any annuity increases will be payable based on the principle that sufficient Earned Asset Share remains to ensure that the annuity can continue to be paid.
- 2.1.4 There are no death benefits on the Bonus annuity.
- 2.1.5 The Earned Asset Share is calculated annually in accordance with generally accepted actuarial principles. Annuity increases are declared annually.
- 2.1.6 Any changes to the methods or assumptions used to determine the amount payable will require approval from the Channel Life Board.

2.2 PRACTICES – AMOUNT PAYABLE

- 2.2.1 On average, the Earned Asset Share, subject to smoothing, is targeted as the amount payable over the life of the policy.
- 2.2.2 The Earned Asset Share methodology is outlined in Section 2.2.6. Bonus philosophy and smoothing are covered in Section 3.

2.2.3 EARNED ASSET SHARE (EAS) METHODOLOGY

- 2.2.3.1 Earned Asset Shares are calculated in accordance with generally accepted actuarial practice.
- 2.2.3.2 Earned Asset Shares are calculated in accordance with generally accepted actuarial practice.
- 2.2.3.3 The Earned Asset Shares generally reflect the sources of profit or loss to the Bonus annuity fund. It is broadly the accumulation of past premiums allowing for actual investment returns, tax, expense charges (based on the policy design), the cost of risk benefits, cost of capital and other charges (see Section 2.2.5).
- 2.2.3.4 Individual Earned Asset Shares are calculated per policy based on assumptions reflecting the actual experience of the Bonus annuity fund.

2.2.3.5 Earned Asset Shares are updated annually to reflect the experience of the Bonus annuity fund. The methodology, parameters and assumptions are reviewed each year by the Statutory Actuary. Any changes to methodology will be documented and subject to Board approval.

2.2.4 **Earned Asset Share Data (and Approximations)**

2.2.4.1 Earned Asset Share calculations require the accumulation, to date, of all past investment premiums net of charges.

2.2.4.2 For all Bonus annuity policies, the single premium is known and used in the Earned Asset Share calculations.

2.2.5 **Earned Asset Share Assumptions (and Approximations)**

2.2.5.1 Earned Asset Share calculations require the following assumptions and inputs.

2.2.5.2 Asset Mix Backing the Earned Asset Shares

- The asset mix of the Bonus annuity fund is determined in accordance with the actual assets and its investment strategy (see Section 4).

2.2.5.3 Investment Return

- The rate of investment return credited to Earned Asset Shares is determined at the end of the financial year, based on the rates of return on the assets allocated to the Bonus annuity fund.

2.2.5.4 Expenses and Commission

- These are allowed for based on the actual charges as outlined in the original product literature; and
- The relevant charges (as a percentage of the premium) vary by product.

2.2.5.5 Cash bonuses

Where cash bonuses are payable, these are deducted from the Earned Asset Share.

2.2.5.6 Tax

- Rates of Investment return are reduced to allow for the appropriate rate of tax. Expenses are reduced to allow for tax relief, where appropriate. Tax is based on the tax position of the Untaxed Policyholder Fund for each year in the calculation.
- Corporate tax is not charged to the Bonus annuity fund.

2.2.5.7 The Earned Asset Share calculations do not allow for profits from other sources of business.

2.2.6 **Scope of the Earned Asset Share Calculation**

2.2.6.1 Only the Bonus Annuity product is included in these calculations. Annuity increases are set at the same level for all policies within the Bonus annuity fund.

Section 3: Bonus Philosophy

3.1 PRINCIPLES – ANNUAL ANNUITY INCREASE

- 3.1.1 Annuity increases are set on an annual basis with the intention of approximating the investment return earned over the year allowing for smoothing as outlined below.
- 3.1.2 The over-arching aim is to distribute the investment return (less charges) via annuity increases. This will result in total annuity payments equating, on average, to Earned Asset Shares over the lifetime of the policies.
- 3.1.3 Once an increase is granted, it vests fully and cannot be taken away.
- 3.1.4 Annuity increases will be smoothed.
- 3.1.5 The same increase rate applies to all the current Bonus annuity policies of Channel Life.
- 3.1.6 Annuity increases will be recommended by the Statutory Actuary and approved by the Board.

3.2 PRACTICES – ANNUAL ANNUITY INCREASE

- 3.2.1 Annual increases are reviewed and declared as at 31 December each year based on the investment returns of the previous calendar year. This declaration is approved by the Board and implemented by 30 June of the following year.
- 3.2.2 Annuity increase changes are implemented upon Board approval of annuity increases set out in the Statutory Actuary's report.
- 3.2.3 The amount of annuity increase depends on:
 - The surplus in the Bonus annuity fund;
 - The investment return expected in the long term; and,
 - The current and projected regulatory solvency levels.

3.3 PRINCIPLES – SMOOTHING

- 3.3.1 The actual payout on a Bonus Annuity policy may be different to the targeted payout because Bonus Annuity payouts are smoothed.
- 3.3.2 The nature of Bonus Annuity policies means that actual payouts do not necessarily immediately reflect changes in investment returns, but are smoothed over time.
- 3.3.3 Annuity increases are not calculated for individual policies but for the entire book of Bonus Annuity policies within the Bonus annuity fund. This has the effect of smoothing payouts across different policies within the Bonus annuity fund.
- 3.3.4 The degree of smoothing and the amounts of smoothing costs are limited by the financial position of the Bonus annuity fund.

3.4 PRACTICES - SMOOTHING

3.4.1 The following smoothing is applied:

- Payouts across different policies are smoothed because annuity increases are not calculated for individual policies but are calculated for the entire book of policies within the Bonus annuity fund.

3.4.2 Smoothing over time is achieved by maintaining a Bonus Smoothing Reserve. The aim is to maintain this reserve at a level of between -7.5% and 15% of the underlying liabilities.

3.4.3 The following process is followed when deciding on the annuity increase each year:

- The Earned Asset Share for the portfolio is calculated based on the methodology outlined above.
- The actual payout on this business is targeted to be approximately the Earned Asset Share over the duration of the policy.
- There will be some smoothing over the lifetime of the policy to ensure that the annuity increases do not change excessively from year to year. The smoothing will result in a Bonus Smoothing Reserve being set up.
- Set the annuity increase so that the Bonus Smoothing Reserve remains within the -7.5% and 15% corridor.
- The annuity increase will not dramatically change from the previous year's annuity increase unless due to exceptional (favourable or poor) investment performance.
- Allowance will be made for any over provisions of increases made in the past (if any).

Section 4: Investment Strategy

4.1 PRINCIPLES

4.1.1 The investment strategy aims to maximise long term investment returns having regard to:

- The regulatory solvency position of Channel Life;
- The nature and expected payout of the Bonus annuity liabilities;
- The management of cash flows and need for liquid assets;
- The current and expected level of guaranteed benefits;
- The validity of different asset classes;
- The need to diversify the investments so as to limit exposure to any one asset class, market sector, currency, interest rate market or counterparty; and
- The overall financial position of Channel Life.

4.1.2 Channel Life's Board determines the allocated asset mix and the acceptable level of investment risk, taking the above factors into account.

4.1.3 There will not be any investments in derivative instruments or assets that are not readily tradable, other than for the purpose of efficient portfolio management.

4.1.4 The Board approves the use of new financial instruments subject to the advice of the Statutory Actuary and the Investment Committee.

4.2 PRACTICES

4.2.1 An investment management agreement exists with our investment managers setting out investment strategy mandates and guidelines.

4.2.2 The Board-appointed Investment Committee is responsible for managing the relationship with the Fund Managers, setting the investment strategy and reviewing the Fund Manager's performance against benchmarks.

4.2.3 The Channel Life Board formally reviews the asset mix and investment strategy from time to time. The frequency of reviews depends on the overall financial position of Channel Life, the experience of the Bonus annuity fund and the solvency risk, i.e. risk of failing to meet the statutory solvency requirements allowing for the current mix of assets and liabilities. Where the risk is high, reviews will be more frequent than once a year.

4.2.4 The assets in the Bonus annuity fund are predominantly invested in fixed investment securities, equities and cash.

4.2.5 An appropriate degree of matching between assets and liabilities will be maintained by calculating a suitable equity backing ratio, so that the annuity payments can be met.

4.2.6 Equity investments are only permitted in listed shares.

4.2.7 Investments in corporate bonds will be restricted to a minimum credit rating/grading of A – (unless specifically approved by the Investment committee). The ratings of these bonds will be monitored regularly for any downgrades.

Section 5: Business Risk

5.1 PRINCIPLES

- 5.1.1 Bonus annuity policyholders are entitled to a share of the distributable surplus. They are therefore exposed to general business risks such as miscellaneous profits and losses that may arise from various sources within the Bonus annuity fund.
- 5.1.2 The Bonus annuity fund is currently closed to new business.
- 5.1.3 The Bonus annuity fund will make investments in accordance with legal and regulatory requirements.
- 5.1.4 Existing business risk is controlled via regular monitoring of all significant business risks such as insurance, market, credit, liquidity, operational risks and their impact on the financial position of the Bonus annuity fund. Where necessary, mitigating actions will be implemented.

5.2 PRACTICES

- 5.2.1. When contemplating whether to undertake a business risk, Channel Life will consider:
 - Existing risks;
 - Potential rewards to policyholders;
 - Opportunity cost; and
 - Impact on the fixed investment securities fund.

Section 6: Charges and Expenses

6.1 PRINCIPLES

- 6.1.1 The Bonus annuity fund is charged for the costs of managing the Bonus Annuity policies.
- 6.1.2 The Statutory Actuary must ensure that the expenses, profit and tax charges, based on actual incurred costs to the Bonus annuity fund, are reasonable and fair.

6.2 PRACTICES

- 6.1.3 Expenses allocated to the Bonus annuity fund are based on the charges in the product design.
- 6.1.4 The tax paid is apportioned to the Earned Asset Share calculation.
- 6.1.5 Once-off expenses and expense losses are not borne by the Bonus annuity fund.
- 6.1.6 The Statutory Actuary is responsible for ensuring that these charges to Earned Asset Shares are fair and reasonable.

Section 7: Discretionary Participation Committee

7.1 STRUCTURE

- 7.1.1 The Discretionary Participation Committee (DPC), which is part of the Investment Committee, will report directly to the Board.
- 7.1.2 The Committee will include non-executive independent members to ensure impartiality is maintained.

7.2 BRIEF

- 7.2.1 The Committee will be responsible for ensuring that the PPFM are followed.
- 7.2.2 The Committee will confirm compliance with PPFM to the Board in an annual report. This report will also incorporate proposed annuity increase recommendations.
- 7.2.3 The Committee will also report any changes to PPFM to the Financial Services Board as part of the annual statutory returns. These changes will also be reported to policyholders.

Appendix 1: Glossary

Actuarial Reserves: The amount set aside to meet liabilities to policyholders calculated on the Statutory Valuation Method.

Amount Paid on Death: There are no death benefits

Amount Paid on Maturity: There is not maturity benefit.

Amount Payable on Surrender: There are no surrender benefits.

Asset Class: Refers to different types of assets in which Channel Life invests e.g. equities, fixed interest securities, property and cash.

Benchmark: The standard position against which any difference would be measured for assessing performance (e.g. of Fund Managers).

Bonus smoothing reserve: This is a reserve utilized for smoothing annuity increase rates. When experience is favorable, part of the profits arising will be set aside to fund years when experience is less favorable. The Bonus Smoothing Reserve is the difference between the Earned Asset Share and Actuarial Reserves.

Channel Life: The legal entity Channel Life established in 1969.

Cohort: A particular group (e.g. of policies) with common characteristics.

Counterparty: The other party in an investment contract; both parties have an obligation to meet the terms of the contract.

Discretionary Participation Products: Any products that allow discretion to be used in the way bonuses are declared.

Earned Asset Share (EAS): The premiums paid, less deductions for expenses, guarantees, tax and other charges, accumulated at the investment return achieved on the assets in the with-profits fund.

FSB: The Financial Services Board (FSB) is an independent non-governmental body given statutory powers by the Long-Term Insurance Act, 1998 to regulate the financial services industry in South Africa.

Overall Financial Position of Channel Life: This refers to the current and ongoing position of Channel Life relative to its solvency requirements, taking into account all assets and liabilities.

Regulatory Solvency: The required minimum level of assets in excess of liabilities including any regulatory buffers (Capital Adequacy Requirement).

Smoothing: The amount payable under a with-profits policy aims to dampen the volatility of return from the underlying assets in the with-profits fund.

Statutory Actuary: An actuary appointed by an insurance company and approved by the FSB in terms of the Act.

Surrender: The termination of a contract prior to its maturity date.

Bonus annuity fund: The pool of assets held in respect of Bonus annuity policies.
annuity

Sanlam Business Park
13 West Street
Houghton 2198
PO Box 1941
Houghton 2041
South Africa

Tel: 0860 480 000
Fax: 0860 480 001
E-mail: clientservices@channel.co.za
Customer Service Centre 0860 480 000

Sanlam Developing Markets Limited
Registration Number: 1911/003818/06
An Authorised Financial Services Provider: 11230/1

The logo for Channel Life features the word "Channel" in a bold, black, sans-serif font. The letter "C" is stylized with a red swoosh that curves around its top and left sides. Below "Channel", the word "Life" is written in a smaller, black, sans-serif font, with a small red square positioned to the right of the letter "e".

BROUGHT TO YOU BY THE  **Sanlam** GROUP