PRINCIPLES AND PRACTICES OF FINANCIAL MANAGEMENT (PPFM)

Liberty: Flexible Annuity Business

1 May 2012

1 INTRODUCTION

1.1 Principles and Practices of Financial Management (PPFM)

This document sets out the Principles and Practices of Financial Management (PPFM) of the Flexible 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 Flexible Annuity that contains an element of discretion.

The purpose of this PPFM is to document how Liberty will manage its discretion on the Flexible 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 Flexible Annuity; it does not give advice as to the benefits of a Flexible Annuity.

Liberty is committed to providing open and honest communication and we believe that the PPFM assists with that aim. Liberty's Flexible Annuities are 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
- describe the business model used for managing the discretionary aspects of Liberty's discretionary participation policies and in responding to longer-term changes in the business and economic environment.

We do not expect to change the principles often and, except with the permission of the regulator, we will give at least three months advance written notice to discretionary participation policyholders of any changes to the principles.

1.4 Practices

The practices:

- describe Liberty's current approach to managing discretionary participation products and responding to changes in the business and economic environment in the short term; and
- are intended to contain sufficient detail to enable an understanding by a knowledgeable observer of the material risks and rewards from effecting a discretionary participation policy with Liberty.

We expect to change the practices as the circumstances in our business environment change. We will advise discretionary participation 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.

1.5 Communication of the PPFM

A copy of the PPFM should be received with the Flexible 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 Liberty website and will be available on request to interested parties.

1.6 Monitoring compliance with the FSB Directive

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 Audit and Actuarial Committee (GAAC) who will report to the Board annually on this compliance.

The Board will produce an annual 'Compliance with PPFM report' that will be made available on the Liberty website.

1.7 Changes to the PPFM

Any changes to the PPFM must be approved by the Liberty Board. The Group Audit and Actuarial Committee (GAAC) may propose changes to the PPFM to the Board. The Board may seek the advice of the GAAC or the Liberty Statutory Actuary in considering such changes.

1.8 Approval of Bonus declarations

Bonus rates are recommended by the statutory actuary, following the principles and practices laid down below. The bonus rates are then discussed and approved in the following forums:

- The Liberty Bonus Committee
- The Liberty Group Audit and Actuarial Committee
- The Liberty Board

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.

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 Flexible 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 Flexible 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 Flexible 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 FLEXIBLE ANNUITIES

3.1 Background

On Flexible Annuities, 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 Flexible Annuity with the Income Enhancer Benefit are:

- The estimated future 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 length of time 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 differences between the value of the policyholders' funds (increased by any minimum investment return guarantees provided if applicable) and the death values paid to beneficiaries (or the estate if applicable) 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 Flexible Annuity has its own bonus class. There should be no explicit need to have new bonus classes for the Flexible 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 Flexible 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 Flexible Annuities.

3.6 Small funds

3.6.1 Flexible 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 Flexible 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 OF TECHNICAL TERMS

Discretionary participation policies (DPP)

In accordance with Directive 147, Discretionary Participation Policies (DPP) 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.

Non-vested bonus

The portion of bonus declared which is not guaranteed on declaration and hence may be removed by the insurer if investment conditions dictate.

Regular bonus

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

Smoothing

Smoothing is the process whereby the surplus is not fully distributed after a bonus period but is over and under declared over time to provide more stable bonuses. In the long term, the total surplus is still expected to be declared.

Statutory Actuary

The Statutory Actuary is the actuary appointed by a long-term insurance company in terms of section 20(1) of the Long Term Insurance Act 1998. 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 appointment is approved by the Registrar of long-term insurance. The duties of the statutory actuary are set out in the Act.

Surplus

The surplus is the amount available for distribution to discretionary participation policyholders that has not yet been reserved for or allocated to the policy fund account.

Vested bonus

The portion of bonus declared which is guaranteed on declaration.