LIFE INVESTMENTS HEALTH **CORPORATE** PROPERTIES ADVICE

Liberty Stable Growth Fund

Principles and Practices of Financial Management (PPFM)

LIBERTY

This document sets out the Principles and Practices of Financial Management (PPFM) of the Liberty Stable Growth Fund, in accordance with Directive 147 issued by the Financial Services Board (FSB).

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For Noting by : **Group Actuarial Committee (GAC)**
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1 Introduction

The Liberty Stable Growth Fund utilises modern investment and risk management techniques, seeking long term growth, while minimizing short term investment uncertainty for our policyholders. This portfolio is **different** from traditional smoothed bonus portfolios, in that it:

- does not offer investment guarantees
- only applies return smoothing to minimise return volatility, **not** to preserve capital
- reduces capital losses as a result of the investment mandate, and **not** through a Liberty guarantee
- does not result in any conflict of interests for the Liberty shareholders. All the returns generated in accordance with the portfolio's investment mandate are for the benefit of the policyholders.

1.1 Principles and Practices of Financial Management (PPFM)

This document sets out the Principles and Practices of Financial Management (PPFM) of the Liberty Stable Growth Fund in accordance with Directive 147 issued by the Financial Services Board (FSB).

The Liberty Stable Growth Fund is an absolute return portfolio targeting a return of CPI + 5% p.a. gross of fees, over rolling three year periods. The portfolio also aims to preserve capital, and reduce the volatility of returns experienced by policyholders over the short to medium term.

Capital preservation is not guaranteed by Liberty, but is rather a result of the portfolio's Tactical Asset Allocation strategy. No investment guarantee is provided to policyholders.

In order to reduce the volatility of returns experienced by policyholders over the short to medium term, the portfolio declares returns monthly in advance, based on a Monthly Return Declaration Formula). Due to the unique nature of the portfolio's overall value proposition, the Monthly Return Declaration Formula together with the investment mandate, have been designed to balance the need for market responsiveness (i.e. performance comparable to other Absolute Return portfolios over the different market conditions), and the objective of reducing volatility experienced by policyholders. This need for balance means that the portfolio's declared returns may be slightly more volatile than those of traditional guaranteed smoothed bonus funds.

The Monthly Return Declaration Formula is designed to facilitate return smoothing over the short term. However should significant changes in economic conditions prevail, and the portfolio's Return Smoothing Reserve (RSR) either becomes too large or too negative, Liberty reserves the right to declare RSR Adjustment Return ("RAR") (see section 3.1.2 below), or amend the Monthly Return Declaration Formula.

The timing and level of the Return Smoothing Adjustment is explained in section 3.1.2.

Liberty further reserves the right to declare an Ad Hoc Return (see section 3.1.3 below) if, in the Statutory Actuary's opinion it is necessary to do so in the best interests of policyholders.

These measures will be aimed at stabilising the portfolio's RSR and protecting the interests of remaining policyholders, by limiting the scope for selection against the portfolio.

The level and timing of the Ad-Hoc Return will be at Liberty's discretion and this is described in section 3.1.3. Liberty will also apply discretion when it comes to other measures (such as notice periods) aimed at protecting existing policyholders against active selection against the portfolio.

The purpose of this PPFM is to document how Liberty will manage its discretion on the issues outlined above. 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 portfolio's Return Smoothing Reserve, and does not provide any guarantee.

Users of this PPFM should note that this document explains the management of discretion on the Liberty Stable Growth Fund; it does not give advice as to the benefits of investing in the Liberty Stable Growth Fund.

Liberty is committed to providing open and honest communication and we believe that this PPFM assists with that aim. The Liberty Stable Growth Fund 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 Liberty Stable Growth Fund may involve the declaration of an Ad-Hoc Return, or deviation from the portfolio's stated Monthly Return Declaration Formula, there is discretion on the level and timing of such a change. There is also discretion on measures to be taken to protect policyholders against active selection against the portfolio.

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 a monthly declared return statement.

1.5 Communication of the PPFM

A copy of the PPFM should be received on request with the Policy Contract if the Liberty Stable Growth Fund is selected as an investment option or with the change in contract terms if the Liberty Stable Growth Fund 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 Actuarial Committee (GAC) 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, which may be delegated to the GAC. The Board may seek the advice of the Liberty Statutory Actuary in considering such changes.

1.8 Approval of discretionary actions

The Statutory Actuary is responsible for the approval of the following:

- Monthly Declared Returns, based on the stated Monthly Return Declaration Formula.
- The level and timing of the RSR Adjustment Return
- The level and timing of the Ad-Hoc Returns
- Amendments of the stated Monthly Return Declaration Formula,
- Other measures aimed at protecting policyholders against active selection against the portfolio

2 Return Declaration 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 regard 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 the Return Smoothing Reserve, and/or does not provide any guarantee on the Liberty Stable Growth Fund, fairness of treatment between policyholders and shareholders is not impacted by the discretion that can be applied.

2.2 Objective

The main objectives of the Liberty Stable Growth Fund's Return Declaration Philosophy are:

2.2.1. Supporting the portfolio's overall value proposition, of attractive inflation beating returns over the long term, with capital preservation focus and reduced return volatility in the short to medium term.

2.2.2. Declaring stable returns to policyholders, while also being responsive to underlying market returns (in order to be comparable to similar Absolute Return portfolios in the market). Declared returns can be positive or negative.

2.2.3. Manage the portfolio's Return Smoothing Reserve such that it allows the portfolio to declare stable returns commensurate with policyholder expectations, while also taking into account point 2.2.4 below.

2.2.4. Minimise cross-generational cross-subsidisation of returns between the policyholders within the portfolio, declaring stable returns broadly in line with the performance of the portfolio's underlying assets.

3 Financial Management of the Liberty Stable Growth Fund

3.1 Background

The Liberty Stable Growth Fund declares returns monthly in advance based on a Monthly Return Declaration Formula, incorporating the portfolio's base return and level of Return Smoothing Reserve (RSR). Declared returns can be positive or negative.

The portfolio's RSR is the difference between the total of all policyholder liabilities based on the declared return (Investment Account Value) and the market value of the assets underlying the policyholder investments in the Fund (Market Account Value). The RSR is then expressed as a percentage of the Investment Account Value and this percentage is called the RSR ratio.

RSR ratio = (Market Account Value– Investment Account Value)/ Investment Account Value

3.1.1. Monthly Return Declaration Formula

Monthly Return (%) = Base Return + RSR ratio Adjustment
Base Return (%) = (1 + CPI + 5%)^(1/12) – 1
RSR ratio Adjustment (%) = RSR ratio /3

CPI = 12 monthchange in CPI, expressed as a percentage, lagged by 3 months

The portfolio targets a long term RSR ratio level of 0%, as this aligns the return declared to policyholders of a particular generation with the return earned on the underlying assets of that particular generation.

The Return Declaration may be positive or negative and is based on an analysis of the assets and liabilities on the 25th (or the nearest working day should the 25th fall on a weekend or public holiday) of the previous month. The Return Declaration is made on the 1st of each month and vests in a linear fashion over the month.

This Monthly Return Declaration Formula has been designed and tested to fit the prevailing economic conditions at the time the product was developed, and any minor changes that may occur in the future. In order to protect remaining policyholders, Liberty however reserves the right to deviate from this formula should significant changes in economic conditions prevail in the future.

3.1.2. RSR ratio Adjustment Return

Significant deviation of the RSR ratio from the target level of 0%, could result in:

- significant cross-subsidisation of return received between existing and new policyholders
- subsequent declared monthly returns deviating significantly from the portfolio's base return.

For example, a sudden drop in the RSR ratio from 0% to -10% would mean that new policyholders that join just after the drop would have to receive reduced (and even negative) declared returns over the subsequent months, as the RSR ratio is being rebuilt. This may result in a significant disconnect between the declared returns received by these new policyholders, and the returns actually generated on their underlying assets since joining the portfolio.

For this reason the RSR ratio level will be monitored on a daily basis and should the RSR ratio drop to a level of -5%, an immediate negative return will be declared so as to return the RSR to at least -2.5%. This is subject to Liberty's discretion, should such an adjustment be deemed by the Statutory Actuary to be contrary to the best interests of policyholders.

In a similar manner, should the RSR ratio grow above a positive 5%, an immediate positive return would be declared would be so as to return the RSR ratio to a maximum of 2.5%. This is subject to Liberty's discretion, should such an adjustment be deemed by the Statutory Actuary to be contrary to the best interests of policyholders.

This RSR Adjustment Return will be declared and will vest immediately, unlike the Monthly Declared Return that vests over the month of declaration. The RSR Adjustment Return can be positive or negative.

3.1.3. Ad-Hoc Return

The Ad-Hoc Return is intended to minimise cross-generational cross-subsidisation, by ensuring that the returns earned on assets of each generation of policyholders are shared by that particular generation. An example of when the Ad–Hoc return might be imposed is when large cashflows, whether positive or negative, have the potential to unduly prejudice existing policyholders. This Ad-Hoc Return will be declared when the Statutory Actuary deems it to be in the best interests of the policyholders and will vest immediately, unlike the Monthly Declared Return that vests over the month of declaration. The Ad-Hoc Return can be positive or negative.

3.1.4. Measures aimed at protecting policyholders against active selection against the portfolio

Additional measures may be taken where in the opinion of Liberty's Statutory Actuary they are necessary to protect policyholders in the portfolio. This would for example be relevant in situations where withdrawals, which may or may not be actively anti-selective, from the portfolio result in adverse consequences for remaining policyholders. Notice periods will be applicable on disinvestment from the portfolio, intended for the protection of all policyholders within the portfolio, depending on the amount disinvested. Notice periods can be waived, at Liberty's discretion.

3.2 Principles

3.2.1. Liberty does not provide any investment guarantee on the Liberty Stable Growth Fund

3.2.2. Liberty does not participate in the distribution of the portfolio's Return Smoothing Reserve

3.2.3. The Liberty Stable Growth Fund will only deviate from the Monthly Return Declaration Formula in cases where it is deemed in the best interest of the policyholders invested in the portfolio to do so.

3.2.4. The RSR Adjustment Return will be declared where it is deemed that declaring returns in accordance with the portfolio's Monthly Return Declaration Formula will or may result in significant cross-generational cross-subsidisation between the policyholders invested in the portfolio as a result of the RSR ratio exceeding 5% (positive or negative).

3.2.5. The Ad-Hoc Return will be declared where it is deemed that declaring returns in accordance with the portfolio's Monthly Return Declaration Formula will or may result in significant cross-generational cross-subsidisation between the policyholders invested in the portfolio.

3.3 Practices

3.3.1. The portfolio will declare monthly returns through the Monthly Return Declaration Formula unless prevailing economic conditions render it necessary to deviate from this.

3.3.2. Should the Ad-Hoc Return be declared, it will be declared across the entire portfolio through an adjustment in the portfolio's Investment Account unit price.

3.3.3. The Ad-Hoc Return vests immediately on declaration.

3.3.4. The Ad-Hoc Return can be declared on any calendar date, and will not necessarily be declared on the 1st of the month.

3.3.5. The Ad-Hoc Return declared is designed to "bring forward" the returns that would have been declared by the portfolio's Monthly Return Declaration Formula in subsequent months

3.3.6. Should the Ad-Hoc Return be declared, it will result in an immediate shift (up or down depending on the value of the Ad-Hoc Return declared) in the portfolio's Investment Account unit price. The unit price will then continue accumulating (from this new level) at the rate of the regular monthly declared return as per the portfolio's Monthly Return Declaration Formula

3.3.7. The portfolio's Return Smoothing Reserve will be monitored regularly to determine if there is a need to declare the Ad-Hoc Return or amend the portfolio's Monthly Return Declaration Formula.

3.3.8. Should the RSR Adjustment Return be declared, it will be declared across the entire portfolio through an adjustment in the portfolio's Investment Account unit price.

3.3.9. The RSR Adjustment Return Return vests immediately on declaration.

3.3.10. The RSR Adjustment can be declared on any calendar date, and will not necessarily be declared on the 1st of the month.

3.3.11. The RSR Adjustment Return declared is designed to "bring forward" the returns that would have been declared by the portfolio's Monthly Return Declaration Formula in subsequent months

3.3.12. Should the RSR Adjustment Return be declared, it will result in an immediate shift (up or down depending on the value of the RSR Adjustment Return declared) in the portfolio's Investment Account unit price. The unit price will then continue accumulating (from this new level) at the rate of the regular monthly declared return as per the portfolio's Monthly Return Declaration Formula

3.3.13. The portfolio's Return Smoothing Reserve will be monitored regularly to determine if there is a need to declare the RSR Adjustment Return or amend the portfolio's Monthly Return Declaration Formula.

3.3.14. Notice periods will be applicable on disinvestment from the portfolio, intended for the protection of all policyholders within the portfolio, depending on the amount disinvested. Notice periods can be waived, at Liberty's discretion.

3.4 Additional guidelines on application of discretion

3.1.5. Notice periods

The portfolio has notice periods applicable on disinvestments, aimed at limiting the negative impact of disinvestments when the portfolio's RSR ratio is significantly negative. Given that the portfolio declares returns monthly **in advance**, and that the declared returns are likely to be negative when the portfolio's RSR ratio is significantly negative, the potential for and impact of voluntary disinvestments increases the more negative the RSR ratio becomes.

The notice periods are intended to protect the interests of policyholders remaining within the portfolio by limiting the potential for anti selection against the remaining policyholders . A secondary objective of the notice periods is to manage the liquidity on the portfolio's underlying investment assets. Therefore the notice periods are applicable regardless of the level of the RSR ratio.

The portfolio is marketed as having notice periods applicable (regardless of RSR level) as illustrated below. These notice periods can be waived at Liberty's discretion.

Table 1: Notice Periods applicable when the RSR is negative

Type of Disinvestment		Notice period
Member withdrawals	Benefit payments (death, disability, divorce, retirement, retrenchment, resignation)	None
All other withdrawals		Below R50m - 30 days Between R50m and R200m - 90 days Above R200m - 180 days

Member switches out of the portfolio, but into another portfolio offered by Liberty Corporate will be treated as member withdrawals and attract no notice period, with the exception of when behavior is detected that in the opinion of the Statutory Actuary amounts to anti selection which may negatively impact policyholders.

4 Glossary of Technical Terms

4.1 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 (declared returns) 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;

4.2 Declared Return

A return declared each month while the policy is in-force. This may be positive or negative.

4.3 Monthly Return Declaration Formula

The formula used to declare the Fund’s monthly returns to policyholders.

4.4 Smoothing

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

4.5 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.