

**momentum**

# **Principles & Practices of Financial Management**

**in respect of Momentum Employee Benefits'  
discretionary participation products  
underwritten by Metropolitan Life Ltd**



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Website : [www.meteb.co.za](http://www.meteb.co.za)

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## 1. INTRODUCTION

This document sets out the Principles and Practices of Financial Management (“PPFM”) of the discretionary participation business of Momentum Employee Benefits underwritten by Metropolitan Life Limited (hereinafter referred to as “the Insurer”). This introduction and any subsequent introductory sections are provided as background information and do not constitute principles or practices.

### 1.1. Company Information

The Insurer is a life assurance company based in South Africa. It is over 100 years old, having started business in 1898, and is currently a wholly owned subsidiary of MMI Holdings Ltd.

### 1.2. Purpose of the PPFM

- 1.2.1. The Insurer is required to meet all its contractual obligations to policyholders. It also seeks to provide our discretionary participation policyholders with competitive returns over and above these minimum obligations. In seeking to achieve these objectives, it makes decisions that it believes are in the interests of its discretionary participation policyholders, having regard to their reasonable expectations and to the requirement to treat policyholders fairly.
- 1.2.2. The PPFM defines the principles and practices the Insurer follows when making these decisions. It describes the nature of the discretion retained by the Insurer and the parameters within which this discretion would be used.
- 1.2.3. The principles are the enduring statements of the overarching standards adopted by the Insurer in managing its discretionary participation business. They also describe the business model used by the Insurer for managing the discretionary aspects of this business and in responding to longer-term changes in the business and economic environment.
- 1.2.4. The practices aim to set out in more detail how the Insurer seeks to manage its discretionary participation business. Together with the principles they aim to provide sufficient detail to enable our clients to understand the possible risks and rewards of investing in a discretionary participation portfolio with the Insurer.
- 1.2.5. Management of discretionary participation business is not a mechanistic process carried out strictly on the basis of compliance with a detailed set of pre-determined rules. Rather, it requires the Insurer to make many judgements about the actions it should take in endeavouring to meet the objectives which are described in this document. These judgements are made by the Insurer in good faith, although it cannot be guaranteed that they will result in the objectives described in this document being achieved.

- 1.2.6. The Insurer may adjust the principles and practices by reference to which it seeks to manage this business. The Insurer will endeavour to inform policyholders of changes to the principles at least three months in advance of such changes taking effect, and will endeavour to inform policyholders of changes to the practices within a reasonable period after such changes take effect.
- 1.2.7. The PPFM is not intended to alter the rights and obligations which the Insurer, or its policyholders, have under any policy documents that the Insurer has issued. Should there be any conflict between the PPFM and any such policy documents, the latter shall prevail.
- 1.2.8. This PPFM is available on the Insurer's website ([www.meteb.co.za](http://www.meteb.co.za)). Printed copies will be made available to interested parties on request, although a fee may be charged for this service.
- 1.2.9. It should be noted that the PPFM should not be read as a document providing advice on whether or not to invest in discretionary participation products. This document is intended only to provide information regarding the management of these products and any individual/group considering this as an investment opportunity should still seek financial advice in this regard.

### **1.3. Governance**

The responsibility for the governance of discretionary participation business lies with the Insurer's Board of Directors. The Insurer's Board has appointed the Discretionary Participating Committee to oversee the management of the Insurer's discretionary participation business. The function of the Discretionary Participation Committee is to provide the Insurer's Board with an independent assessment of the Insurer's compliance with the principles and practices set out in this document. The committee has at least one non-executive director as a member and one independent member.

### **1.4. Business covered by the PPFM**

The PPFM applies to the following products:

- 1.4.1. Momentum Employee Benefits smoothed bonus business underwritten by the Insurer.
- 1.4.2. Momentum Employee Benefits with-profit annuity business underwritten by the Insurer.

## 2. MOMENTUM EMPLOYEE BENEFITS SMOOTH BONUS BUSINESS

### 2.1 Introduction

2.1.1 The purpose of this section is to define the Principles and Practices of Financial Management (“PPFM”) that apply to Momentum Employee Benefits Smooth Bonus Business underwritten by the Insurer. In particular this section covers the following smooth bonus products, including additional bonus series that are launched under any of these products, managed by Momentum Employee Benefits:

- Metropolitan Smooth Growth Fund (Global)
- Metropolitan Smooth Growth Fund (Local)
- Metropolitan Secure Growth Fund
- Investment Solutions Global FullVest
- Investment Solutions Domestic FullVest
- Metropolitan Multi-Manager Smooth Growth Fund (Global)
- Metropolitan Multi-Manager Smooth Growth Fund (Local)
- Metropolitan Multi-Manager Secure Growth Fund
- Metropolitan Cash Growth Fund

2.1.2 Momentum Employee Benefits operates two distinct categories of smoothed-bonus business, namely fully-vested and partially-vested smooth bonus products. The partially-vested smooth bonus products declare monthly final bonuses in advance consisting of vesting and non-vesting components, and the fully-vesting smooth bonus products declare monthly final bonuses in advance consisting of just a vesting component.

### 2.2 Bonus Declarations

#### *Principles*

2.2.1 Monthly final bonus rates are set with the aim of providing a smoothed build-up of benefits over time for all products except the Metropolitan Cash Growth Fund. Monthly final bonus rates for the Metropolitan Cash Growth Fund are set with the aim of replicating the returns of a money market portfolio.

2.2.2 Vested bonuses become guaranteed additions to the vested policy benefits.

2.2.3 All policyholders will receive the bonus rate applicable to the bonus series in which they are invested.

2.2.4 There will be no cross-subsidisation between different bonus series or products.

2.2.5 There will, however, be cross-subsidisation between different generations of policyholders within a particular bonus series. This is an implicit feature of smooth bonus products.

2.2.6 The bonuses declared for a particular product will be independent of bonuses declared for any other products.

### **Practices**

2.2.7 A bonus smoothing formula is used to assist in the declaration of bonuses. The purpose of the formula is to provide an element of objectivity in the bonus declarations.

2.2.8 The structure of the smoothing formulae used will be reviewed and adjusted when necessary to ensure that they continue to meet the objectives of the respective products.

2.2.9 The assumptions, parameters and methods used to determine the monthly bonuses can be changed to:

- comply with any new legislative or regulatory requirements or guidance.
- ensure that the smooth bonus products can meet their reserving and capital adequacy requirements at all times.
- allow for the possible use of new financial management techniques.
- respond to changes in financial markets and/or economic conditions.

2.2.10 Final monthly bonuses are declared in advance and may consist of a vesting and/or a non-vesting component. For the fully vesting products only vesting bonuses are declared.

2.2.11 Monthly gross final total and vesting bonuses are non-negative.

2.2.12 For all products except the Metropolitan Cash Growth Fund, bonuses target long-term inflation related returns which are then adjusted by taking into account the underlying experience as implied by the products' current funding levels in arriving at the bonuses. For the Metropolitan Cash Growth Fund, the bonuses target a money market-related return.

2.2.13 The bonus smoothing methodology essentially allows for the distribution of surplus or the recovery of deficits. The period over which the surplus is distributed or deficit recovered is dependent on the funding level and the smoothing philosophy of the respective products.

2.2.14 The smoothing process will decrease returns to policyholders during times of above average investment returns, as some of the returns will be held back for future distribution, and will increase returns to policyholders during times of below average investment returns.

- 2.2.15 The higher the level of investment returns earned, the greater will be the proportion of total bonus declared that is non-vesting (where applicable).
- 2.2.16 The Insurer reserves the right to stop using any bonus smoothing formulae during periods of exceptional market conditions.
- 2.2.17 The Insurer may remove non-vested bonuses (in whole or in part) if funding levels fall below the 100% level and there is no reasonable prospect of restoring them to acceptable levels within a reasonable period of time. The Insurer may reduce the fund value for the Metropolitan Cash Growth Fund at any time should the funding level fall below 100%. The reduction in fund value will be limited to the amount necessary to restore the funding level to 100%.
- 2.2.18 On 30 June and 31 December each year, a percentage of the non-vested account may be transferred to the vested account. The Insurer reserves the right to adjust this percentage depending on the financial position of the respective products and prevailing investment market conditions.

### **2.3 Discontinuances**

#### ***Principles***

- 2.3.1 The terms applicable to both partial and full terminations will be as set out in the policy contracts. No additional charges will be levied on payments to policyholders, except as set out in the policy contracts.

#### ***Practices***

- 2.3.2 If a policyholder's smooth bonus fund investment is fully funded, all payments are guaranteed at that policyholder's smooth bonus fund's fund value for both full and partial terminations.
- 2.3.3 However, if a policyholder's smooth bonus fund investment is underfunded (i.e. the funding level is less than 100%), then part or all of the termination value may be paid at the lower of fund value and market value. This practice does not apply to the Metropolitan Cash Growth Fund; the full fund value is always payable.

## **2.4 Charges**

### ***Principles***

- 2.4.1 A capital/risk charge is levied on the underlying assets of a product to provide the Insurer with a return on their capital employed to support the guarantees inherent in the product. The capital/risk charge may be different for different products and policy conditions.
- 2.4.2 A management fee is also levied to compensate the Insurer for the services provided in the management and administration of the smooth bonus products.
- 2.4.3 Charges can be amended subject to the provisions of the policy contracts.

### ***Practices***

- 2.4.4 Charges are set to remain stable over the long term and are only expected to be changed infrequently.
- 2.4.5 The declared monthly bonuses are net of the capital/risk charge and gross of the management fee.

## **2.5 Profit Sharing**

### ***Principles***

- 2.5.1 In this context profit (or surplus) is defined to be the excess market value remaining once a client's fund value has been paid out on either full or partial termination.
- 2.5.2 All profits (as defined above) arising within the smooth bonus funds will be retained for the sole benefit of existing and future policyholders.
- 2.5.3 Products are managed on a stand-alone basis and do not participate in the profits of any other area of the business.

### ***Practices***

- 2.5.4 Any profit arising in a product / bonus series as a result of a termination (both full and partial) will remain within that product / bonus series. Such profits may be held as a separately identifiable reserve in the product.

## **2.6 New Business**

### ***Principles***

- 2.6.1 A product / bonus series may be closed to new policyholders or inflows from existing policyholders, if it is deemed that the cross-subsidy between new policyholders or inflows from existing policyholders and existing investments in the product / bonus series will be unacceptably high.
- 2.6.2 If a product / bonus series has been closed to new policyholders or inflows from existing policyholders then a new bonus series may be opened for new policyholders and/or inflows from existing policyholders. This new bonus series may be merged with the old bonus series once their funding levels are within acceptable limits of each other.

## **2.7 Investment Policy**

### ***Principles***

- 2.7.1 Investments of the smooth bonus products are in a broad range of asset types which may include equities, bonds, property, cash and alternative investments.
- 2.7.2 Each product's assets will be held separately from other products and will be clearly identifiable.
- 2.7.3 The availability of suitable assets will influence the investment policy.
- 2.7.4 The above principles are nevertheless overridden by any prevailing regulatory requirements.

### ***Practices***

- 2.7.5 Given the nature and term of the liabilities and the inflation-related return objective, the investment strategy is built on those asset classes that are most likely to provide a real return over the long-term. The underlying assets of the Metropolitan Cash Growth Fund will be invested in assets that are more likely to provide money market returns.
- 2.7.6 The assets are actively managed with the aim of exceeding the real return and money market return targets.
- 2.7.7 The existence of non-vesting bonuses within certain products implies that such products may have significant exposure to equities versus fixed interest investments and property.

2.7.8 The investments underlying the smooth bonus funds are managed by various asset managers in accordance with investment mandates and guidelines specified by the Insurer. The areas of importance covered by the investment mandates include:

- The approved asset classes that must be invested in to ensure an appropriately diversified investment strategy;
- Target percentage allocations for each of these asset classes;
- Asset allocation ranges - the minimum and maximum limits for each asset class that the investments must comply with;
- Benchmarks against which the performance of each asset class is measured;
- Limitations on credit and counterparty exposures; and
- The use of derivatives.

2.7.9 Derivatives can be used to reduce risk and improve the management of the portfolio.

2.7.10 Counterparty exposure limits will be maintained within the limits set by the Insurer and the regulatory authorities.

## 3. MOMENTUM WITH-PROFIT ANNUITY BUSINESS

### 3.1 Introduction

3.1.1 The purpose of this section is to define the Principles and Practices of Financial Management (“PPFM”) that apply to the Momentum Employee Benefits With-profit Annuity Business underwritten by the Insurer. In particular this section covers the following with-profit annuity products, including additional bonus series that are launched under any of these products, managed by Momentum Employee Benefits:

- Golden Growth With-Profit Annuity (GGWPA)
- IS Golden Growth With-Profit Annuity
- Flexible Growth Living Annuity Plan

The Flexible Growth Living Annuity Plan is a hybrid annuity with two constituent products, (1) a guaranteed annuity, one of the options being the Golden Growth With-Profit Annuity, and (2) a living annuity where the investment options include the Momentum Employee Benefits Smooth Bonus products underwritten by the Insurer. As the constituent products are covered in detail within the PPFM, the Flexible Growth Living Annuity Plan will not be covered separately.

### 3.2 Amounts Payable and Bonus Declarations

#### *Principles*

3.2.1 The products pay a monthly pension for the life of the pensioner and the surviving spouse (if applicable). In return, the pensioner pays the Insurer a single premium at inception of the policy - normally the pensioner’s retirement date.

3.2.2 The initial pension payable under these products is calculated at inception based on certain assumptions such as mortality, expenses and the post-retirement interest rate (PRI). Additional factors affecting the initial pension include the pensioner’s marital status, spouse’s reversion percentage and the guarantee period, if applicable. This pension is guaranteed for life.

3.2.3 The initial guaranteed pension is increased every year through the declaration of an annual bonus (which may be zero), the level of which is at the Insurer’s discretion. Once an increase has been granted, the new, higher pension is guaranteed for life.

3.2.4 Bonuses are declared for each product and/or bonus series. The bonuses declared for a particular product will be independent of bonuses declared for any other products.

3.2.5 There will be no cross-subsidisation between different bonus series or products.

- 3.2.6 There will, however, be cross-subsidisation between different generations of policyholders within a particular bonus series. This is an implicit feature of with-profit annuity products.
- 3.2.7 The bonus philosophy aims to provide a return that is fair relative to the investment performance of the underlying assets over the long term.
- 3.2.8 There are no interim or terminal bonuses payable and all bonuses declared on the products are fully vesting.

### **Practices**

- 3.2.9 Annual bonuses are declared in advance and are effective 1 January to 31 December each year.
- Increases awarded depend on the bonus declared and the post-retirement interest rate (PRI) specified by the client, as follows:
- $$\{(1 + b - c) / (1 + d)\} - 1 \text{ (subject to a minimum of zero)}$$
- where:
- b* is the rate of bonus, net of investment management fees, declared annually by the Insurer on the respective products.
- c* is a risk charge dependent on the valuation interest rate, and
- d* is the post-retirement interest rate.
- 3.2.10 Policyholders will only receive increases if the declared bonus rate, less the risk charge, exceeds the PRI selected.
- 3.2.11 Declared bonuses can never be negative.
- 3.2.12 A bonus smoothing formula is used to assist in the declaration of bonuses. The purpose of the formula is to provide an element of objectivity in the bonus declarations.
- 3.2.13 The structure of the smoothing formulae used will be reviewed and adjusted when necessary to ensure that they continue to meet the objectives of the respective products.
- 3.2.14 The smoothing process will result in lower bonuses to policyholders in times of above average investment returns, as some of the investment returns will be held back for future distribution, and will increase bonuses to policyholders during times of below average investment returns.

### **3.3 Charges and Expenses**

#### ***Principles***

- 3.3.1 Expected future expenses are priced for and included in the purchase price.
- 3.3.2 A capital/risk charge is levied on the underlying assets of a product to provide the Insurer with a return on their capital employed to support the guarantees inherent in the product. The capital/risk charge may be different for different products and policy conditions.
- 3.3.3 A management fee is also levied to compensate the Insurer for the services provided in the management and administration of the with-profit annuity products.

#### ***Practices***

- 3.3.4 Expenses included in the purchase price are initial commission, initial administration expenses as well as renewal expenses.
- 3.3.5 Expenses are recovered through a combination of initial and ongoing charges. The ongoing charges are calculated and deducted on a monthly basis.

### **3.4 Profit Sharing**

#### ***Principles***

- 3.4.1 Profit/surplus is defined as the excess of the assets over the liabilities. Surplus can arise from investment and mortality profits.
- 3.4.2 Products are managed on a stand-alone basis and do not participate in the profits of any other area of the business.
- 3.4.3 All profits (as defined above) arising within the policyholder funds will be retained for the sole benefit of existing and future policyholders.
- 3.4.4 Any surplus arising in the product, either from investment return or mortality profits, remains in the product and is distributed to policyholders according to the smoothing policy.

#### ***Practices***

- 3.4.5 Any surplus may be held within a separately identifiable reserve.

## **3.5 New Business**

### ***Principles***

- 3.5.1 A product / bonus series may be closed to new policyholders or inflows from existing policyholders, if it is deemed that the cross-subsidy between new policyholders or inflows from existing policyholders and existing investments in the product / bonus series will be unacceptably high.
- 3.5.2 If a product / bonus series has been closed to new policyholders or inflows from existing policyholders then a new bonus series may be opened for new policyholders and/or inflows from existing policyholders. This new bonus series may be merged with the old bonus series once their funding levels are within acceptable limits of each other.
- 3.5.3 The Insurer will only write new business on terms that will not unfairly prejudice the existing policyholders.

## **3.6 Investment Strategy**

### ***Principles***

- 3.6.1 The underlying investment strategy followed aims to achieve long-term real returns to enable competitive pension increases to be awarded.
- 3.6.2 The investment strategy has regard to the following:
- Expected returns of different asset classes;
  - Provide an appropriate level of diversification by investing in a number of different asset classes;
  - The nature and term of the liabilities;
  - Regulatory and legislative constraints.
- 3.6.4 Each product's assets will be held separately from other products and will be clearly identifiable.

## **Practices**

- 3.6.5 The investments underlying the with-profit annuity product are managed by various asset managers in accordance with investment mandates and guidelines specified by the Insurer. The areas of importance covered by the investment mandates include:
- The approved asset classes that must be invested in to ensure an appropriately diversified investment strategy;
  - Target percentage allocations for each of these asset classes;
  - Asset allocation ranges - the minimum and maximum limits for each asset class that the investments must comply with;
  - Benchmarks against which the performance of each asset class is measured;
  - Limitations on credit and counterparty exposures; and
  - The use of derivatives.
- 3.6.6 Derivatives can be used to reduce risk and improve the management of the portfolio.
- 3.6.7 Sufficient liquid assets are held to enable the products to meet the monthly pension payment requirements.
- 3.6.8 Counterparty exposure limits will be maintained within the limits set by the Insurer and the regulatory authorities.

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