



## **Hollard Life's Principles and Practices of Financial Management (PPFM)**

### **1. Introduction**

The Crusader portfolio of with-profits business was purchased by Hollard in 1997 from Crusader Life. At that time Crusader Life was under judicial management. This is the only with-profits portfolio underwritten by Hollard and Hollard does not intend to transact this type of business in the future.

This document describes Hollard Life Assurance Company's (Hollard's) approach to using discretion in relation to the policyholders of the Crusader with-profits portfolio ("with-profits portfolio"). The Board of Directors ("The Board") is responsible for the principles and practices of using discretion. Principles are defined as enduring statements of the overarching standards that Hollard adopts in managing the with-profits portfolio. The principles are not intended to be changed, although The Board may change them by giving policyholders and the Financial Services Board ("FSB") three months prior notice.

Practices describe Hollard's specific approach to managing the with-profits portfolio and how we would respond to changes in the business and economic environment in the short-term. They are therefore our current approach of calculating policy values, allocating bonuses and using discretion where necessary to the with-profits portfolio. Practices may be changed without prior notice to policyholders, although notice will be given. Hollard has established an independent committee, the Actuarial Committee, which will ensure compliance with the PPFM.

### **2. The concept of surplus**

There are two main reasons why policyholders may reasonably expect surplus allocations to their with-profits policies. The first reason is that the premium rates of the with-profits policies include bonus loadings that were incorporated into the pricing before inception of the policies. The second reason is that the actual experience will be different from the anticipated experience included in the other aspects of the pricing as time passes by.

The aim of Hollard when determining the amounts payable to with-profits policyholders is to ensure that policyholders are paid at least a fair return.

That is, a return which reflects the smoothed experience of the assets backing their policy including the expense, mortality and taxation experience of the long-term business fund, over the term of their policy. Amounts payable are generally subject to certain contractually guaranteed benefits and also have regard to the reasonable expectations of policyholder.

The with-profits assets are held within Hollard's long-term business fund. The long-term business fund supports the liabilities of Hollard's non-profit business as well as those related to its with-profits business. Hollard's intention is to meet our aim of paying policyholders a fair return using only the assets of the long-term business fund, subject to the supporting guaranteed benefit.

Hollard determines the surplus amounts through experience investigations of the with-profits portfolio. Typically, surpluses will be allocated by reference to a policy's asset share. Asset shares are calculated by accumulating actual premiums received less deductions at the achieved rate of investment return. Deductions may include administration expenses, risk charges, cost of guarantees, taxation and cost of capital to support the business.

### **3. How much of the surplus is available for bonuses?**

#### Principle

Hollard's aim is to return on average 100% of asset share to policyholders over a rolling three year period. In order to do so, Hollard will consider the following:

3.1 Business risk

3.2 Charges and expenses

### 3.3 Cost of guarantees

### 3.4 Inherited estate

Each one of the above factors is discussed below.

#### **3.1 Business Risk**

##### Principle and Practice

With-profits policyholders do not benefit from profits arising from non-profits policies, nor are they liable to losses occurring from these sources.

#### **3.2 Charges and Expenses**

##### Principle

The charges applied to with-profits policies will be the charges deemed by The Board to be fair and appropriate. The Board will take into account the actual cost of administration of the with-profits portfolio, charges included within the premium rates, the charges deemed appropriate for similar contracts and the level of charges detailed in product literature. The charges applied to with-profits policies may be changed if The Board, having had regard to the advice of the Chief Actuary, considers a change appropriate.

The factor most likely to trigger a change to the charges applied to with-profits policies would be a sustained level of actual expenses different to those previously deemed appropriate for the purpose of calculating asset shares.

##### Practice

Quarterly expense investigations are conducted to monitor the actual cost of administration including contribution to management expenses. The investigations are presented to the Actuarial Committee for review. For asset share calculations the expenses are determined annually. Actual commission payments are used to reduce the asset share of policies.

#### **3.3 Cost of Guarantees**

##### Principle

Hollard does not currently charge the with-profits policyholders for any guarantees, but reserves the right to charge, prospectively, for the cost of these guarantees on the advice of the Chief Actuary. Any charge would be an overall reduction in the annual returns credited in the calculation of the asset share. Affected policyholders would be notified of the introduction of any charge for guarantees as a change in the practice of the PPFM.

##### Practice

Hollard does not currently charge the with-profits policies for any guarantees.

#### **3.4 Inherited Estate**

##### Principle and Practice

This with-profits portfolio was under judicial management prior to Hollard taking it over from Crusader Life in 1997. A special vesting bonus was declared by the judicial managers to the with-profits policyholders as a minimum final bonus. Hollard did not receive the inherited estate but received the assets equal to the with-profits policyholder liabilities. Therefore, the surplus build-up used for bonus declaration is calculated from the date Hollard took over the with-profits portfolio. The with-profits policyholder liabilities have been and are supported by Hollard shareholder capital to fulfil the regulatory requirement of holding sufficient solvency capital and working capital. The Board determines in consultation with the Chief Actuary the size of the shareholder capital to efficiently manage the with-profits portfolio.

## **4. How are the amounts payable determined?**

### **4.1 Method**

##### Principle

When determining the amounts payable Hollard will aim to meet the reasonable benefit expectations of all policyholders, treating different classes and generations of policyholders fairly.

One aspect of fairness is the need to ensure that the interests of remaining policyholders are protected against the impact of policyholders voluntarily exiting the fund. Voluntary exits are those arising where policyholders do not complete the full terms and conditions of their policies. This might be, for example, by ceasing to pay premiums, by altering the policy or by surrendering benefits.

Benefit payouts are smoothed in order to ensure that over the longer term the amount paid on maturity and death claims is on average equal to the asset share subject to a minimum of the guaranteed benefit. Maturity payouts and death claims will be calculated by adding a final bonus, which may be zero or positive, to guaranteed benefits.

The method of determining payouts may be changed in the future but in the event of any such change a formal process will be followed requiring the decision of The Board in consultation with the Chief Actuary.

Some approximations in calculating payouts are made, including adoption of a common bonus series for endowment and whole life policies in some policy classes and for policies of different sizes. For classes of policy where asset shares are not or cannot be calculated the payout may be determined by methods which provide an approximation to asset share.

#### Practice

Where practical, asset share calculations for specimen policies are used as a guide to determine bonus rates and the amounts payable to with-profits policyholders. Hollard aims to pay policyholders on average 100% of asset shares on maturity when determining final bonus payments. The amounts payable on maturity in any year, or to any particular policyholder may be more or less than 100%, due to the effects of smoothing, guarantees, and grouping of policies. The approach for non-guaranteed surrender values is to target an average payout for each group of policies of 100% of asset shares in any three year period on surrenders, subject to policy conditions.

Where available, the directly calculated asset share for specimen policies will be used as a basis for calculating the amounts payable on surrender. Alternatively, a formula approach for surrender values may be used in order to achieve the asset share payout target on average. Individual policies may receive more or less than the average payout percentage of the group. The bases are reviewed on a quarterly basis or more frequently if there is a significant change in investment conditions, and may be adjusted specifically to reflect movements in asset values.

The asset shares of this with-profits portfolio are calculated from the date Hollard took over the with-profit portfolio from the judicial managers of Crusader Life rather than from inception. Asset shares are in general, the accumulation of:

Assets equal to the policyholder liabilities when Hollard took this portfolio over  
 plus premiums paid  
 plus investment returns  
 less the costs of administering the business  
 less the cost of death or other risk benefits  
 less a taxation charge  
 less transfer to shareholders – up to 10% of investment return

## **4.2 Setting Regular Bonus Rates**

### Principle

Regular bonus rates are set with the aim of providing a progressive build up of guaranteed benefits over the lifetime of the contract with an overall aim of retaining sufficient surplus to provide an appropriate margin for final bonus.

Regular bonus rates may be changed prospectively to reflect circumstances including past investment performance, changes in expected long-term investment returns, and any guarantees in the contracts to which they apply.

Regular bonus rates will be smoothed, to limit the effect of changes in these rates from year to year.

#### Practice

Regular bonus declarations take into account the rates which Hollard expects to be able to maintain over the terms of existing policies based on best estimates. This is achieved by projecting current asset shares for specimen policies each year for a range of future investment returns on the with-profits assets, and choosing a target regular bonus rate which aims for an adequate margin for final bonus. Suitable allowance will be made to finance final bonuses, and to reduce the risk of asset shares falling below initial guaranteed benefits plus previously declared bonuses.

Part of the surplus is allocated to regular bonuses. At any time Hollard may pay more or less than the asset share depending upon actual experience.

In normal conditions, regular bonus rates will be reviewed once a year.

Although changes are smoothed, there is no maximum amount by which prospective regular bonus rates would alter.

### **4.3 Setting Final Bonus Rates**

#### Principle

Final bonus rates are set with the aim of distributing the balance of the distributable surplus earned over the lifetime of the policy, to the extent that such surpluses have not previously been distributed by way of regular or other bonus additions. Final bonus rates are also smoothed to a certain extent.

#### Practice

Final bonus rates are set to achieve the overall aim of returning to maturing with-profits policyholders as a group on average 100% of asset shares in the long term, given the regular bonus rates. They are set so as to achieve the smoothing objectives described in section 4.4.

Final bonus rates are influenced by the total return on investments and so are reviewed in the light of prevailing financial conditions. In normal conditions, final bonus rates will be reviewed at least once a year. However, we may change final bonus at any time during the year.

Final bonuses, where applicable, are payable on all claims arising on death, maturity, retirement and surrender under the terms of the contract for with profits policies. The final bonus rate could be zero.

### **4.4 Smoothing**

#### Principle

In order to provide an element of stability in the returns to policyholders at maturity, smoothing is applied by spreading profits and losses from one year to the next. It is intended that the long-term cost of smoothing is broadly neutral across generations of policyholders. No smoothing is applied to surrender values.

#### Practice

The Board has not set a predetermined period over which smoothing is expected to be neutral. The current practice is that the claim value should be within 20% of the asset share for maturities.

The current practice is to apply the same approach to smoothing for all policy types on claims of all sizes and terms, irrespective of the date on which they joined the with-profits portfolio.

In certain circumstances, it may not be possible to remain within the parameters set by the current smoothing policy. In such circumstances, The Board will set bonus rates with the additional aim of being within the smoothing parameters within three years.

## 5. Investment Policy

### Principle

The aim of the investment strategy is to maximize the long term return on investments for with-profits policyholders whilst recognising the need for the fund to meet its contractual obligations and commitments to policyholders.

The Board, upon receiving advice from the Chief Actuary, may split the with profits' liabilities of the fund into separate components and the investment strategy for each such component may be determined separately. The assets backing the with-profits funds are held within the long-term business fund.

### Practice

The Board is responsible for Hollard's investment policy. The investment committee has been appointed by The Board to review Hollard's investment strategy and asset allocation on a regular basis, to manage relationships with external fund managers and review performance against benchmarks.

Other functions of the investment committee include:

- Reviewing investment management agreements and mandates
- Setting credit and counterparty limits
- Setting the risk appetite
- Consideration of the economic outlook and the expected returns of different asset classes in the long and short term.

The investment strategy is reviewed from time to time by the investment committee which meets monthly.

### 5.1 Asset Allocation

#### Principle

The long-term business fund invests in a wide range of assets. In determining the mix of assets between different asset classes, the investment strategy will take into account the nature of the with-profits policyholder liabilities, Hollard's ability to meet its Capital Adequacy Requirements in all reasonably foreseeable circumstances, the long term expected return available from each asset category and the observed and expected market volatility of each asset class.

In considering the range of assets in which to invest, derivatives and other financial instruments may be used within the limits determined from time to time by The Board. In order to reduce the risk of loss resulting from the failure of a third party The Board sets limits for exposure to various counterparties taking into account their credit rating.

#### Practice

Hollard aims to maintain a closely matched position for the with-profits portfolio with regards to the nature, term and size of the policyholders' liabilities. Returns are derived from the performance of the Hollard Stable Fund. The fund invests in equities, bonds, and cash. The asset allocation at 31 March 2007 was:

Equities 44%

Bonds 50%

Cash 6%

Note: The equity content is low comparing to a fund that is open to new business, because this with-profits portfolio has been closed for at least ten years. In addition, this portfolio carries significant guarantees which are best managed by a prudent investment approach.

The return of each asset class is then used to determine the weighted average return that is used for asset share calculations.

Appropriate credit quality of the investments of the with-profit portfolio is maintained by specifying the credit ratings in investment management agreements.

The with-profits portfolio invests mainly in listed investments in order to maintain a sufficient level of liquidity. Investment management agreements specify limits on the level of investment in securities that

are not listed. Cash and deposit-type investments are also used to back current liabilities to provide a greater level of liquidity within the with-profits portfolio than would otherwise be achieved by investing solely in longer-term assets. This also ensures a sufficient level of liquidity to pay policyholder benefits as they fall due.

## **5.2 Investment in Related Parties**

### Principle

There are no restrictions other than those specified by the Financial Services Board on the long-term business fund holding assets invested in related parties.

### Practice

There are currently no assets of the with-profits fund invested in related parties.

No investments will be made in related parties unless a proposal has been made and approved by The Board or the committee responsible for investment strategy.

## **5.3 Investment in Negative Rand Reserves**

### Principle

Investments to fund non-profit policies or with-profit policies with negative asset shares are allowed. The Board aims to pay a notionally derived return based on actual returns achieved in various asset classes on such investments.

### Practice

There are currently no assets invested in negative rand reserves.

No investments will be made in negative rand reserves unless a proposal has been made and approved by The Board or the committee responsible for investment strategy.

## **5.4 Investment in illiquid, unlisted and strategic assets**

### Principle

There are no restrictions other than those specified by the Financial Services Board on the long-term business fund holding assets that are not listed provided that the fund also holds sufficient liquid assets to meet its requirements. Any such holdings are reviewed on a regular basis to ensure compliance to such restrictions.

### Practice

There are currently no assets of the with-profits fund invested in these types of assets. No investments will be made in these assets unless a proposal has been made and approved by The Board or the committee responsible for investment strategy.

## **5.5 Hedging**

### Principle and Practice

Hollard does not follow any hedging strategies for the with-profits portfolio.

## **5.6 Investment in Treasury Shares**

### Principle and Practice

Investment in Treasury shares is not allowed for the with-profits business.

## **5.7 Investment in Collective Investment Schemes**

### Principle

There are no restrictions other than those specified by the Financial Services Board on the long-term business fund holding assets invested in Collective Investment Schemes.

### Practice

Currently, the with-profits assets are not invested in any Collective Investment Schemes.

No investments will be made in a new Collective Investment Scheme unless a proposal has been made and approved by The Board or the committee responsible for investment strategy.

## **6. New Business**

This with-profits portfolio is closed for new business and will continue to be closed in the future.

## **7. Conflict of Interest**

In some circumstances conflicts of interests may arise between with-profits policyholders and shareholders. An example might be the allocation of administration expenses:

An allocation that is too high may unduly advantage the shareholders, an allocation that is too low may unduly advantage with-profit policyholders.

Hollard has implemented the following to deal with possible conflicts of interest:

- The Chief Actuary conducts quarterly experience analyses to monitor the experience of the with-profits portfolio
- The Actuarial Committee, a sub-committee of The Board which includes at least one non-executive director, reviews actual experience, the bases for valuation purposes, the declaration of bonuses and the determination of policy values
- The Investment Committee, a sub-committee of The Board which includes at least one non-executive, sets the investment strategy and reviews the asset allocation on a quarterly basis
- Independent actuarial consultants are appointed to deal with complex scenarios where possible conflict of interest may arise