METROPOLITAN

Principles and Practices of Financial Management for the Metropolitan Smooth Growth Fund

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Metropolitan Life Botswana Limited

Contents

1. Introduction

This document sets out the Principles and Practices of Financial Management ("PPFM") of the Metropolitan Smooth Growth Fund (SGF) underwritten by Metropolitan Life of Botswana 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.

The Metropolitan SGF is a partially vested smooth bonus portfolio which declares monthly final bonuses in advance, consisting of vesting and non-vesting components.

This PPFM applies to the Metropolitan SGF, including additional bonus series that may be launched under it.

1.1. Purpose of the PPFM

In terms of the insurance legislation, all long-term insurers that carry on discretionary participation business are required to define, and make publicly available, the Principles and Practices of Financial Management (PPFM) that they apply in the management of their discretionary participation business.

In managing discretionary participation business, insurance companies rely on their ability to use discretion, particularly in the investment strategy, as well as smoothing and bonus policies. The purpose of this document is to:

- explain the nature and extent of the discretion used by the Insurer;
- show how the Insurer manages conflicting interests or expectations of different groups of policyholders, and of policyholders and shareholders, to ensure that all parties are treated fairly;
- give advisers and policyholders a better understanding of the possible risks and rewards to be expected from taking out a discretionary participation policy.

Managing discretionary participation portfolios relies on a high degree of trust between policyholders and the Insurer. Decisions will be taken with the intention of being in the best interests of policyholders and the sustainability of the portfolios.

The Principles define the overarching standards, and describe the business model the Insurer adopts in managing discretionary participation portfolios, and in responding to longer-term changes in the business and economic environment.

The Practices describe the Insurer's approach to managing discretionary participation portfolios, and responding to changes in the business and economic environment in the shorter-term.

The Principles and Practices will be revised from time to time. The Insurer will inform policyholders of any changes to the Principles at least three months in advance of the effective date of the change, unless the Regulatory Authority has granted a waiver of this requirement. Policyholders will also be informed of any changes to the Practices within a reasonable period after such changes have taken effect.

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 portfolios. This document is intended only to provide information regarding the management of these portfolios and any individual/group considering this as an investment opportunity should still seek financial advice in this regard.

This document is available on our website at metropolitan.co.bw

1.2. Governance

The Insurer's Board of Directors is responsible for the governance of discretionary participation business. This includes the investment of underlying assets, the bonus distribution policy and the approval of any changes to the PPFM.

The Board ensures that these responsibilities, along with appropriate monitoring is done at designated management committees. The duties of these committees include:

- Consider the interests of discretionary participation policyholders and to monitor the Insurer's compliance with the PPFM.
- Approve new portfolio developments, or significant changes to existing portfolios, after considering aspects such as fairness, capital requirements and bonus philosophy.
- Review portfolios' bonus performance and asset allocations on a regular basis and report to executive management in this regard.
- Approve investment mandates, review them periodically, monitor performance against benchmarks and oversee the investment management process.

The bonus rates for the Metropolitan SGF are declared monthly. The Board has delegated the responsibility for approval of these bonus rates to the Statutory Actuary. The Statutory Actuary reports to the Board in this regard, at least annually.

2. Principles

The Insurer applies the following Principles in managing its smooth bonus business:

2.1. Contractual and legislative conditions

- The Insurer will adhere to the contractual obligations as set out in policy contracts, as well as to any legal and regulatory requirements. If there are any inconsistencies between these and this document, contractual and legal requirements take precedence.

2.2. Bonus declarations

- Monthly final bonus rates are set with the aim of providing a smoothed build-up of benefits over time.
- Vesting bonuses become guaranteed additions to the vested policy benefits.
- All policyholders will receive the bonus rate applicable to the bonus series in which they are invested.
- There will be no cross-subsidisation between different bonus series or portfolios.
- There will, however, be cross-subsidisation between different generations of policyholders within a particular bonus series. This is an implicit feature of smooth bonus portfolios.
- The bonuses declared for a particular portfolio will be independent of bonuses declared for any other portfolios.

2.3. Charges

- A capital charge is levied on the underlying assets of a portfolio to provide the Insurer with a return on its capital employed to support the guarantees inherent in these portfolios. The capital charge may be different for different portfolios and policy conditions.
- An investment management fee is also levied to compensate the Insurer for the services provided in the management and administration of the smooth bonus portfolios.
- In addition to the investment management fee and capital charge described above, management fees and performance fees may be payable by the Insurer to the managers of the underlying assets as set out in agreements between the Insurer and the managers.
- Charges can be amended subject to the provisions of the policy contracts.

2.4. Surplus sharing

- All surplus arising within the smooth bonus portfolios will be retained for the sole benefit of existing and future policyholders in the smooth bonus portfolios. The Insurer is not entitled to any surplus arising within the smooth bonus portfolios.
- Portfolios are managed on a stand-alone basis and do not participate in the profits or surplus of any other area of the business.

2.5. Investment strategy

- Underlying assets of the smooth bonus portfolios are invested in a broad range of asset types which may include equities, bonds, property, cash and alternative investments.
- The allocations to different asset types will reflect the return objectives and guarantees of the different smooth bonus portfolios.
- Each portfolio's assets will be held separately from other portfolios and will be clearly identifiable.
- The availability of suitable assets will influence the investment strategy.

2.6. New business and inflows

- A portfolio / 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 holdings in the portfolio / bonus series will be unacceptably high.
- If a portfolio / 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.

2.7. Partial or full termination

- Market value adjustments may be applied on full or partial termination. This is done to protect the interests of the remaining policyholders.
- Any surplus arising within a portfolio on termination will be retained for the benefit of existing and future policyholders in the portfolio. In this context surplus is defined as the excess market value remaining once a policyholder's fund value has been paid out on termination.
- The terms applicable to both full or partial termination 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.

2.8. Transfers between portfolios

- Policyholders may transfer their fund values between different portfolios.
- Part of or all of the difference between the policyholder's fund value and market value may be transferred with the fund value.
- Part of any accumulated surplus that has arisen from previous terminations may be transferred with the fund value. The transfer of any accumulated surplus will be done such that the transferring portfolio will not be prejudiced by the transfer.
- Transfers into a portfolio will be subject to the Principles applicable to new business and inflows.
- The terms applicable to transfers will be as set out in the policy contracts.

2.9. Merger of portfolios / bonus series

- The Insurer may merge different portfolios when the funding levels, investment objectives and the nature and level of guarantees of the respective portfolios are sufficiently similar to allow them to be managed as a single portfolio.
- The Insurer may merge different bonus series of a portfolio when the funding levels of the respective bonus series are sufficiently similar to allow them to be managed as a single bonus series.

3. Practices

3.1. How are policies administered?

A separate fund value is held for each policyholder in a portfolio. A policyholder's fund value is increased by premiums and bonuses and decreased by benefits, partial terminations, full termination and charges. A policyholder's fund value may also be decreased by the removal of non-vesting bonuses under certain conditions (see section 3.3).

A separate market value is also held for each policyholder in a portfolio. A policyholder's market value is made up of premiums, benefit payments, partial terminations, full termination and charges accumulated with returns on the underlying assets of the portfolio. The policyholder's funding level is defined as the policyholder's market value divided by the policyholder's fund value.

3.2. When and how are bonuses declared?

Final monthly bonuses are declared in advance and consists of a vesting component and a non-vesting component. Monthly total and vesting bonuses are subject to a minimum of 0%, net of the investment management fee. Bonuses target long-term inflation related returns which are then adjusted by taking into account the underlying experience as implied by the portfolios' current funding levels.

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. 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 portfolios. 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; and
- respond to the experience of the portfolio.

The bonus smoothing process results in monthly bonuses being different from the monthly returns earned on the underlying assets. 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. The period over which the surplus is distributed, or deficit recovered, is dependent on the funding level and the smoothing philosophy of the particular portfolio. Surpluses or deficits can arise from a number of contributory factors, including but not limited to market movements and the impacts of inflows and outflows.

3.3. Are bonuses guaranteed once declared?

Vesting bonuses are fully guaranteed and cannot be removed. The Insurer may however remove non- vesting bonuses (in whole or in part) if a portfolio's funding level falls below the 100% level and there is no reasonable prospect of restoring it to an acceptable level within a reasonable period of time.

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 portfolios and prevailing investment market conditions. The percentages transferred may be different for different portfolios.

3.4. Charges

Investment management fees and other fees and charges are specified in the policy contracts. The investment management fee and capital charge are set to remain stable over the long term and are only expected to be changed infrequently. In addition to the investment management fee and capital charge, management fees and performance fees may be payable by the Insurer to the managers of the underlying assets as set out in the agreements between the Insurer and the managers. The declared monthly bonuses are gross of the investment management fee but net of the capital charge and the additional management fees and performance fees that are paid directly from the underlying assets (where applicable).

3.5. Surplus sharing

Any surplus arising in a portfolio / bonus series will remain within that portfolio / bonus series. Such surplus may be held as a separately identifiable reserve in the portfolio.

3.6. How are the underlying assets invested?

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 existence of non-vesting bonuses within certain portfolios implies that the investment strategy of such portfolios may have significant exposure to equities and property versus fixed interest investments.

The portfolios are based on an investment philosophy which in accordance with the defined portfolio construction approach and within a rigorous risk management framework systematically combines various asset classes, investment strategies and mandates (which can include external asset managers) in such a way to manage the return and risk profile of the portfolio to target the defined inflation-related objective over the investment horizon of the portfolio.

The underlying assets can be managed using a combination of active, passive, smart beta, listed, unlisted and alternative strategies with the aim of achieving the portfolios investment objectives over their investment horizons. The underlying assets of the smooth bonus portfolios are managed in accordance with investment mandates and guidelines specified by the Insurer. The areas of importance covered by the investment mandates may include:

- Investment and risk objectives and investment horizon;
- The approved asset classes that must be invested in to ensure an appropriately diversified investment strategy;
- Portfolio percentage allocations for each of the asset classes (which may be varied from time to time);
- Benchmarks against which the performance of each asset class is measured;
- Limitations on credit and counterparty exposures;
- Regulatory requirements; and
- The use of derivatives.

Derivative instruments or liability driven investment strategies can be used to reduce risk and improve the management of the portfolio.

Securities lending can be used to enhance the investment returns on the underlying assets subject to regulatory limits. Any losses arising from these transactions are borne by the shareholder, while any income arising (net of associated expense) will be shared between the shareholders and policyholders.

More information about the asset allocation of the Metropolitan SGF is available on the portfolio's fund fact sheets.

3.7. New business

The funding level of a portfolio will rarely be equal to 100%. Inflows into a portfolio with a funding level that is different from 100% will result in cross-subsidies between new and existing policyholders. Although such cross-subsidy is an inherent and accepted feature of smooth bonus portfolios, the cross-subsidy must be kept within reasonable limits. This can, in part, be achieved by closing a portfolio to further inflows from new and/or existing policyholders.

A portfolio is likely to be closed to new inflows when the funding level is significantly above or below 100%. The portfolio will typically be reopened again when the funding level has moved closer to 100%. Different closure rules may apply to different portfolios.

A new bonus series in the same portfolio may be opened for new inflows if an existing bonus series is closed to new inflows. This new bonus series will be treated as a separate portfolio in terms of this PPFM. The multiple bonus series under a portfolio will be merged once the funding levels of the bonus series have converged sufficiently.

3.8. What happens if policyholders want to terminate their policies?

If a policyholder's funding level equals or exceeds 100%, all payments are guaranteed at the policyholder's fund value for both full and partial terminations. However, if a policyholder's funding level is below 100%, then the full or partial termination value may be subject to a market value adjustment.

3.9. What happens if policyholders want to transfer their fund value to another smooth bonus portfolio?

A policyholder may transfer his fund value to some of the other smooth bonus portfolios operated by the Insurer. The list of the smooth bonus portfolios to where transfers are allowed may change from time to time and can be obtained from the Insurer.

The policyholder's vested and non-vested fund values will be transferred to the receiving smooth bonus portfolio. Part of or all of the difference between the policyholder's fund value and market value may also be transferred with the fund value.

Part of any accumulated surplus that has arisen from previous terminations may be transferred with the fund value. The transfer of any accumulated surplus will be done such that the remaining policyholders in the portfolio transferring the policyholder will not be prejudiced by the transfer.

Transfers into a portfolio are subject to any normal restrictions that may apply to new business and inflows.

3.10. Merger of portfolios

Portfolios / bonus series may be merged under the following circumstances:

- If a portfolio has reduced to a size that makes it unviable for it to continue to be managed separately. It will then be in the best interest of the policyholders as a group that the portfolio is combined with a larger portfolio that is sufficiently similar in terms of return objectives, guarantees and mandate.
- When a portfolio is closed to new inflows, the Insurer may open a new bonus series under the same portfolio to accommodate new inflows. Two bonus series of the same portfolio will be merged once the funding levels of the two bonus series have converged sufficiently.

4. Glossary of Terms

Board – means the Board of Directors of the Insurer.

Discretionary participation business – This includes portfolios which have features that rely on the ability of the insurer to use discretion to manage them, in particular over the underlying assets, smoothing and bonus policies. These portfolios are typically ones where premiums are invested in a pooled fund made up of a range of assets, a significant portion of which are usually in the form of equities, and where allocations to policies are smoothed to cushion policyholders from short-term fluctuations in asset prices or other possible experience variations. Guarantees may furthermore apply, which may increase over the lifetime of a policy.

Insurer – Metropolitan Life of Botswana Limited.

Investments returns – Realised and unrealised gains in the market value of underlying assets, as well as income from underlying assets including interests, dividends and rent.

Market value adjustment – refers to a reduction in the policyholder's fund value that may occur on full or partial termination.

Non – vesting bonuses – are non-guaranteed bonuses. The Insurer may remove these bonuses if a portfolio's funding level falls below the 100% level and there is no reasonable prospect of restoring it to an acceptable level within a reasonable period of time.

Policyholder's fund value – is made up of the policyholder's premiums and benefit payments, partial terminations, full termination and charges, all accumulated with the bonuses of the portfolio.

Policyholder's funding level – is the policyholder's market value divided by the policyholder's fund value.

Policyholder's market value – is made up of the policyholder's premiums and benefit payments, partial terminations, full termination and charges, all accumulated with actual returns on the underlying assets of the portfolio.

Portfolio's fund value – is made up of all premiums, benefit payments, partial terminations, full terminations and charges of the portfolio, accumulated with the bonuses of the portfolio.

Portfolio's funding level – is the portfolio's market value divided by the portfolio's fund value.

Portfolio's market value – is made up of all premiums, benefit payments, partial terminations, full terminations and charges of the portfolio, accumulated with actual returns on the underlying assets of the portfolio.

Regulatory Authority – is the Non-Bank Financial Institutions Regulatory Authority established under the Non-Bank Financial Institutions Regulatory Authority Act.

Statutory Actuary – is the actuary appointed as the valuator by a long-term insurance company in terms of section 19(1) of the Insurance Industry Act, 2015.

Surplus – is the excess of a portfolio's market value over a portfolio's fund value. A surplus can also be negative, i.e. a deficit.

Vesting bonuses – are bonuses that are guaranteed and cannot be removed.

For more information, speak to one of our financial advisers or call us on +267 362 4400.

Together we can

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