

RESPONSIBLE  
INVESTMENT

MARCH 2017



# TRUSTED PARTNERSHIPS



## RESPONSIBLE OWNERSHIP REPORT

2016

DO GREAT THINGS



**OLD MUTUAL**  
INVESTMENT GROUP



# FOREWORD

## HYWEL GEORGE

DIRECTOR OF INVESTMENTS

We see three powerful forces converging which make responsible investing not only a necessary response to the changing nature of global risk and opportunity, but also an important evolution in the role and function of the asset management industry:

- 1.** A myriad of interconnected environmental, social and governance (ESG) issues present a material impact to stable, long-term economic growth at a local, national and global level<sup>1</sup>. Governments alone will not solve these issues and all sectors, including the financial sector, can and must play a role in addressing these issues. Coupled with this, expectations are changing across society as company stakeholders – employees, customers, shareholders, regulators, civil society etc. – increase their demands in respect of company ESG performance. In our connected world, how a company responds to these issues will influence its market competitiveness. The good news is that the evidence shows profitably and low carbon, socially inclusive and resource-efficient growth can co-exist.
- 2.** The asset management industry faces an existential crisis as critics question its societal value and push back against fees, while on the flip side there is a growing investor base seeking to align their portfolios with their personal values and make the world a better place. 77% of affluent US investors say that they want their assets to have a positive impact on society<sup>2</sup>. Responsible investment (RI) has the potential to serve as a powerful catalyst for realigning the industry with societal concerns while at the same time meeting investor expectations.
- 3.** Lastly, there is a growing understanding that continued short-termism is problematic at a systemic level. Primarily, short-termism undermines future economic growth due to the lack of long-term capital investment, which ultimately leads to slowing GDP, higher unemployment levels and lower future investment returns for savers<sup>3</sup> – implications that could hurt everyone. Global asset owners are now turning to RI as a means of driving long-term value creation.

A deep understanding of these secular trends, along with hands-on, tangible evidence of the positive value that can be derived from an analysis of material ESG issues, supports our view that RI can and does add value to long-term client outcomes.

<sup>1</sup> World Economic Forum 2016 Risk Assessment Survey - <https://www.weforum.org/reports/the-global-risks-report-2016>

<sup>2</sup> TIAA Global Asset Management Survey of Investors and Advisers 2016

<sup>3</sup> Focusing Capital on the Long Term 2015 Report

# INTRODUCTION

## ROBERT LEWENSON

HEAD OF ESG ENGAGEMENT

If there is one word which would describe 2016 it would be “change”. Not only change on a socio-economic and political level (the effects of which were felt throughout the year in investment markets) but from a Responsible Ownership perspective. We’ve seen improvements on every level of society in the demand for companies of all kinds to act responsibly and for the long term. Whether it has been the publication of King IV (extending governance best practices to all types of companies) or the 10-year anniversary of the United Nations-supported Principles of Responsible Investment (PRI) — with record numbers of signatories representing vast amounts of investment capital — of stewardship codes being adopted around the globe, the message is clear that responsible investment (RI) is now a mainstream investment practice.

To effectively capture these changing trends and to achieve our goal of leading RI in Africa, we have committed to a Responsible Ownership programme which focuses on outcomes. From our active ownership activities (which include proprietary governance research, proxy voting and engagements on important environmental, social and governance (ESG) matters with issuers) to championing change on thematic or sectoral issues, to providing thought leadership across the African continent, we’ve certainly been proactively involved across the broad spectrum of ESG themes. Our intention has been to build on the good work already accomplished and continue our goal to change investments markets for the betterment of society while achieving appropriate risk-adjusted performance for our clients. We also see our responsible ownership activities giving effect to the Code for Responsible Investing in South Africa (CRISA) and other applicable governance codes, with the aim of achieving a meaningful, positive impact for our clients’ listed investments during 2016.





## PROPRIETARY GOVERNANCE OF ESG RESEARCH

The RI team spent a great deal of time during 2016 creating proprietary governance scorecards for our investment boutiques, using publicly available information to assess the governance of ESG practices for all companies within the FTSE/JSE Shareholder Weighted Index (SWIX) and the Global Emerging Market team's share portfolio. The scorecard model is comprised of several pillars covering:



Each company has been scored accordingly on each pillar to obtain an overall score. Each company's score is then used to rank it within the index according to their governance of ESG factors. In addition, our SWIX scorecard model is a powerful tool with which to assess any South African-listed portfolio to identify material governance of ESG risks, and thereafter inform active ownership practices, such as proxy voting and engagement, which we discuss in more detail alongside.

**For more information, visit our proxy voting disclosure on our website at [www.oldmutualinvest.com](http://www.oldmutualinvest.com) in the About us/Responsible Investment section.**

## PROXY VOTING

One of our key responsible ownership principles is to vote all of our clients' shares on their behalf at company meetings. We recognise the importance of proxy voting in ensuring the protection of our clients' rights as shareholders (often in the minority). We are pleased to record that Old Mutual Investment Group voted all of its proxy votes during 2016 and the outcomes of its voting decisions are publicly available on the website (visit [www.oldmutualinvest.com](http://www.oldmutualinvest.com) and go to About us > Responsible Investment > Proxy Voting).

A summary of our 2016 voting record is shown below and highlights some key governance areas where we express our concerns as shareholders. Furthermore, often the protection of shareholder rights informs engagement with companies to improve the position (we summarise some of our key engagement takeout points in the next section).

**FIGURE 1: PROXY VOTE RESULTS FOR 2016**

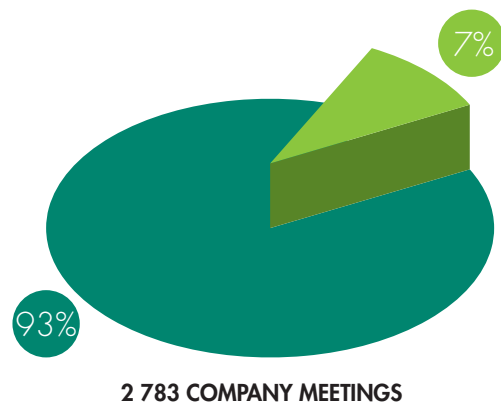
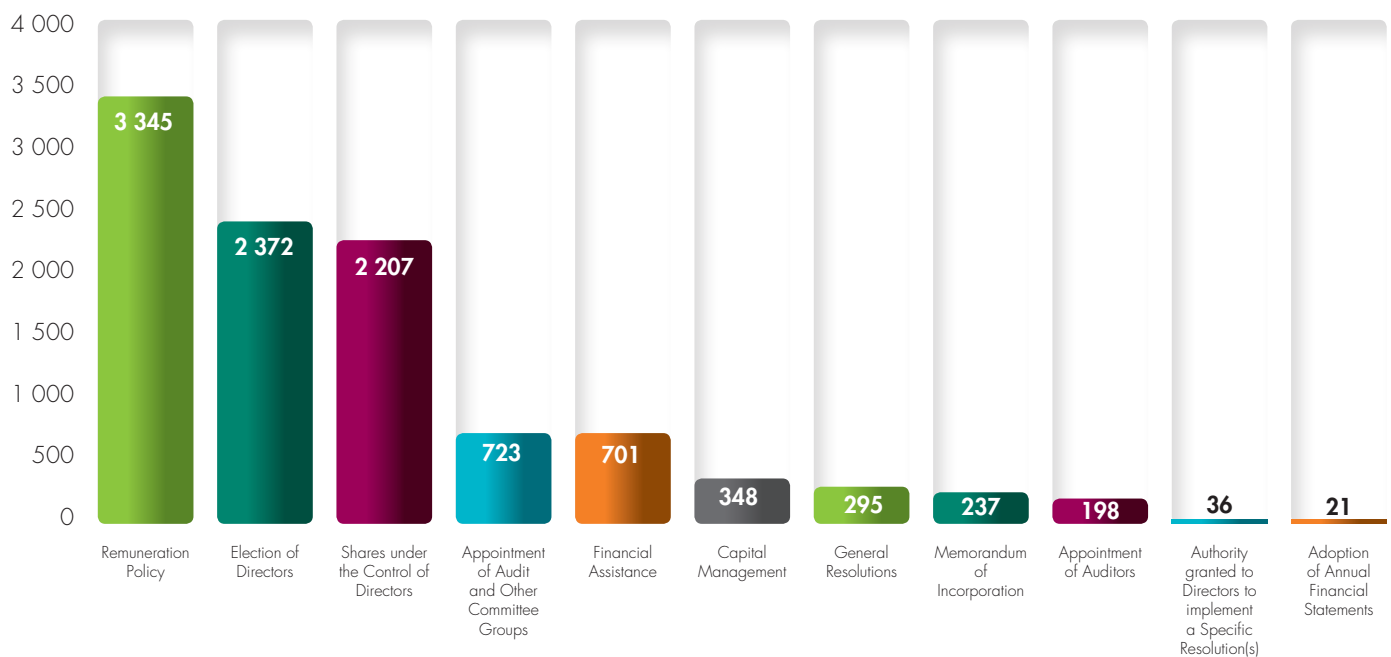


Figure 1 shows the total number and percentage of votes for and against recorded in 2016 at 2 783 company meetings.

Figure 2 shows the number of votes against for each specific resolution category. From a governance perspective we place a large emphasis on quality boards and the link between company performance and value creation. By voting appropriately in respect of director appointments and remuneration we ensure as far as possible the appointment of quality directors to company boards and linking the remuneration of executive directors to value creation.

**FIGURE 2: 2016 VOTES AGAINST PER CATEGORY BREAKDOWN**



## ENGAGEMENT

In 2016 we undertook 42 engagements with companies and industry associations on approximately 70 unique ESG issues. Engagements with companies on material ESG issues through a range of activities – email, phone calls and meetings – are our primary and, in our view, most effective way of driving change in the management of ESG risk. Our focus is to find ways to unlock value creation in those companies beyond financial performance. Furthermore, a growing body of research is starting to show the correlation between targeted engagement on specific material ESG issues in poorly performing companies and financial performance post engagement.

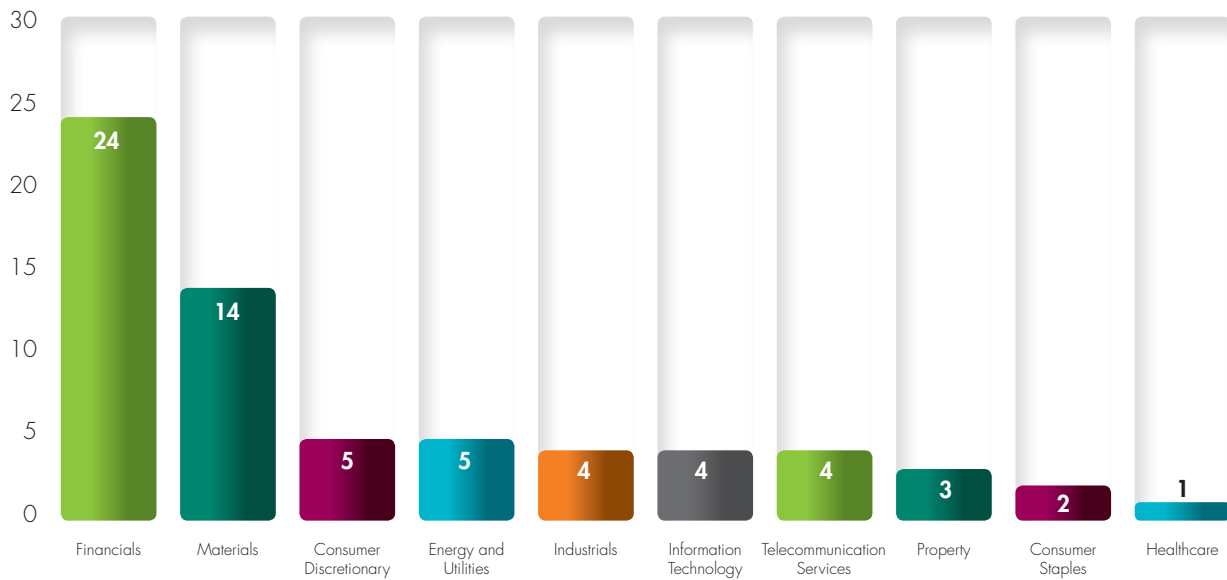
We therefore see it to be in our clients’ best interests to research which ESG factors are material. We define material as the ESG factor which is most likely to affect the long-term financial performance of the company and broader stakeholders. When the precise impact of this material factor is researched, analysed and discussed between the ESG analyst and portfolio manager, an engagement with the company may follow to best take advantage of the opportunity to enhance performance.

### Collaborative engagement

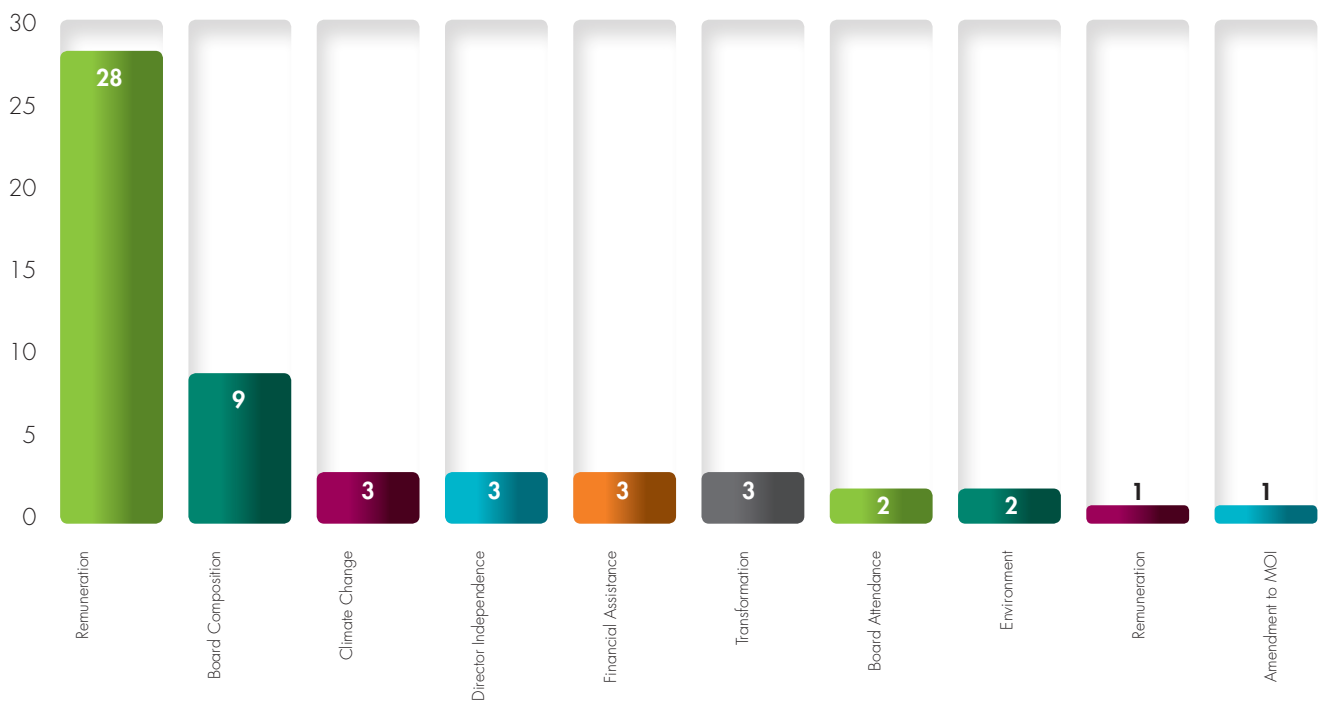
In addition to our own set of engagements with companies where appropriate, and taking into consideration legal requirements, we will reach out to other large shareholders in a company to investigate the opportunity for a collaborative engagement on a material ESG issue. We see such collaborative engagements as having the potential to be a greater driver of change with the support of other key investors. Macro-thematic ESG matters such as climate change and social inequality lend themselves to concerned investors acting as a collective to address the issue and to achieve positive outcomes.

Figures 3 and 4 show in which sectors the companies we engaged with are classified and which ESG factor we engaged on most regularly with those companies.

**FIGURE 3: ENGAGEMENTS PER SECTOR FOR 2016**



**FIGURE 4: ENGAGEMENTS PER ESG THEME FOR 2016**



Many of these engagements are ongoing, are continually monitored and are potentially sensitive in nature.

In Table 1 we list a few examples of successfully concluded engagements. These show the company engaged, the ESG objectives sought and the outcome achieved.

**TABLE 1: A SAMPLE OF ENGAGEMENTS CONCLUDED IN 2016**

COMPANY ENGAGED	ESG THEME AND OBJECTIVE	OUTCOME OF ENGAGEMENT
<b>Anglo American plc</b>	<b>Climate Change</b> Company to include in their non-financial reporting important information for shareholders on their efforts to combat climate change.	Old Mutual joined the Aiming for A Coalition and committed its shareholding in Anglo to support the resolution to be tabled at the annual general meeting (AGM) and, as a result, the requisite shareholder proposal threshold was achieved. The resolution was tabled and passed at the AGM by an overwhelming majority.
<b>British American Tobacco plc</b>	<b>Remuneration</b> Propose changes to remuneration policy of the company to align with shareholder interests and company strategy.	Questioned proposed change to Long-Term Incentive Plan (LTIP) performance criteria and motivated for the company to introduce non-financial performance measurements into the annual bonus measurement and for the Remuneration Committee (Remcom) to consider introducing ESG criteria into performance measurements. Company sent updated engagement response letter, which included additional changes to performance criteria per our discussions.
<b>Barclays Africa Group Limited</b>	<b>Remuneration</b> Seek a follow-up engagement from previous discussions on remuneration disclosure.	Company has confirmed that it will better disclose remuneration practices post disengagement from Barclays, as different regulatory standards would apply and remuneration will be restructured accordingly.
<b>Exxaro Resources Limited</b>	<b>Board Composition, Remuneration, Sustainability</b> Engage with board on its composition and changes ahead for 2016, namely capital approval process, remuneration and sustainability.	Succession planning was a key task for the board in 2016 and three directors were to have their independence re-tested during the board evaluation process. We stressed that it was particularly important to find suitable candidates, as a number of long-tenure directors have important technical skills in the company. The company implemented a risk management framework to ensure these risks are addressed. In respect of the capital approval process, learnings from two recent transactions have been incorporated into capital approval decision-making going forward. In terms of sustainability, both financial and non-financial risk are managed via a risk matrix approach. Non-financial key risks are identified and escalated via the various reporting structures to the Social and Ethics Committee. The company has been proactive, with on-the-ground visits and community engagement where areas for improvement have been identified.
<b>Gold Fields Limited</b>	<b>Health and Safety, Climate Change, Labour Management</b> Obtain company feedback on management of ESG risks, specifically environmental and social issues.	Company provided a comprehensive summary of management of ESG risk in terms of their Integrated Annual Report (IAR). In respect of the silicosis case and health and safety of workers, the matter was being managed by an association of mining companies that had created collaborative legacy funds for such cases. Health and safety scored highest for material issues affecting the company's long-term strategy. Company is reporting on climate impact in terms of the Global Reporting Initiative and has published latest figures in the report. Increased water use is attributed to the increase of mine dump treatment at South Deep. While South Deep had experienced a service delivery protest, the company nevertheless engaged with the surrounding community via a taskforce to deal with issues raised.

COMPANY ENGAGED	ESG THEME AND OBJECTIVE	OUTCOME OF ENGAGEMENT
<p><b>JSE Limited</b></p>	<p><b>Remuneration</b> Clarify aspects of the company's proposed remuneration policy prior to its AGM.</p>	<p>Specific items raised and company response</p> <ul style="list-style-type: none"> <li>i) Qualitative measures of short-term incentives (STI) — the company runs a staff engagement survey, which is externally assured, and results feed into staff engagement strategy</li> <li>ii) Independent assurance of performance criteria — certain performance criteria are independently assured, for example, BEE and LTI measures are externally audited for each item. STI looked at but not assured</li> <li>iii) Large increase in chairman's fees — the increase in chairman's fees was benchmarked against the sector but remains below the financial sector average</li> <li>iv) Restraint of trade and other payments to executives, and change of control provisions — six individuals were awarded payment of performance shares for restraint of trade payments. Needed to revert on change of control provisions</li> <li>v) Attendance of certain directors — board attendance of a member satisfactorily explained.</li> </ul>
<p><b>Nedbank Limited</b></p>	<p><b>Director Independence, Board Composition, Remuneration, Financial Assistance</b> Receive feedback from the company on progress towards greater board independence, following previous engagement on recent board changes and succession planning, on changes to the remuneration policy post previous engagement, and on changes made to the financial assistance provision prior to the AGM.</p>	<p>Board independence was strengthened in 2015, such that the majority of board members were independent at the time of the AGM. Independence of Remcom has also been strengthened and previous engagement concerns were addressed. Succession processes and planning are in good shape. While long-term incentive (LTI) targets are largely unchanged from 2015, the company has increased the proportion of Group Executive Committee (Exco) members' performance-based LTIP awards. From 2016, all share awards will be subject to both malus and clawback. Company acknowledged that FINI 15 may not be the correct benchmark and suggested replacement of index calculation with DHEPS growth target. Remcom also introduced strategic initiatives measure to align to long-term group value creation and growth in transactional banking. Overall, changes are positive and we were satisfied with the company post our engagement.</p>
<p><b>Standard Bank Group Limited</b></p>	<p><b>Remuneration, Risk Management, Board Composition</b> Follow up with company on changes to LTIP as proposed at previous engagement, and receive feedback from company regarding its ability to effectively manage recent controversies which have led to fines being issued, and on any upcoming board changes.</p>	<p>Overall, in respect of the changes to the performance criteria for the LTIP, we were satisfied that changes made were an improvement. However, we did not agree that an appropriate stretch target for ROE measure was in place and we will continue to engage the company. In respect of risk management, the chairman's view was that the controversies were actually discovered via their risk management functions in the country and therefore their risk management process is robust and the controls in place picked up the issues. Lessons learned from the incidents have been communicated throughout the organisation and to the board. The chairman's view is that risk management expertise on the board is adequate and there has been director involvement in each country's particular matter, and assurance was received from each country's board of how the issue in that country was managed. The company has also strengthened its internal compliance and risk functions. We noted the efforts made thus far and mentioned we'd continue to monitor how the company responds to jurisdictional risk. In respect of board composition, the chairman mentioned that there may be changes to the board depending on the outcome of certain shareholder developments.</p>

COMPANY ENGAGED	ESG THEME AND OBJECTIVE	OUTCOME OF ENGAGEMENT
<p><b>Vodacom Group Limited</b></p>	<p><b>Climate Change, Privacy and Data Security, Remuneration</b>                      Discuss energy efficiency programme with the company and obtain feedback on whether specific carbon emission reduction targets have been set, determine whether Group privacy protection framework policy and compliance with South African Protection of Personal Information Bill (POPI) extend to non-South African Group operations, query remuneration received by retiring director during financial year.</p>	<p>Company stated it had aggressively pursued energy efficiency programmes, particularly at its base stations (with use of renewables) but as yet had not set specific reduction targets for greenhouse gas emissions. Chairman indicated he would raise the matter at his next Social and Ethics Committee meeting for due consideration. Company complies with all aspects of POPI and is particularly concerned with the abuse of its networks by governmental organisations, such that any misuse of clients’ personal information by employees is a dismissible offence. The Group applies the same protection of information practices throughout its operations. Remuneration was paid to director in respect of his six-month notice period in terms of contractual arrangement for guaranteed pay and it was not an ex gratia payment. Overall, we were satisfied with the outcome of the engagement and the board’s willingness to raise ESG issues such as climate change and implement strong consumer protection management.</p>
<p><b>SASOL Limited</b></p>	<p><b>Remuneration, Climate Change</b>                      Discuss changes to remuneration policy with board and impact of increased cost of Lake Charles Project (LCCP), and propose changes to remuneration with climate change reduction targets.</p>	<p>SASOL board explained changes to the FY2017 remuneration policy:</p> <ul style="list-style-type: none"> <li>• Base pay: Nine broad pay bands with positions benchmarked at market median (new benchmark group);</li> <li>• STI: Only changes were lower production volume growth benchmark and introduction of energy efficiency measure (reduce energy intensity by 1% — further detail to be provided in IAR);</li> <li>• LTIP: Number of changes — introduction of minimum share ownership by executives, proposal that all awards now be equity settled (subject to shareholder approval), clawback policy implemented, increase in maximum bonus percentage for CEO and Exco, change from growth in attributable earnings to three-year average ROIC (excl. assets under construction) at 1.3 times WACC;</li> <li>• Impact of LCCP on remuneration: Important personnel changes to project team – Stephen Schoeman new head with three new people under him;</li> <li>• Senior executive remuneration: No clawback of LTIP, however, for STI performance of LCCP features, and Remcom will exercise their discretion to reduce David Constable’s STI by 40% and Stephen Cornell’s STI by 25% in addition to formulaic outcome (furthermore two years of Stephen’s sign-on bonus not paid yet, which is linked to LCCF milestones);</li> <li>• Annual increase of non-executive directors’ fees under review — chairman’s feedback: Board will not accept further cost increases on LCCP, introduced oversight committee to be involved in specific project phases, joint and several responsibility on management for performance of LCCP;</li> <li>• Climate change link to costs of LCCP: Proposed the introduction of long-term goals in management’s response to climate changes into LTIP criteria. We were pleased to see the introduction of a performance metric, following our discussions, linked to a reduction in energy intensity. However, we addressed a letter to the board dealing with specific questions to the company on climate change and response received, which is being evaluated in light of actual outcomes reported by the company.</li> </ul>

## IMPACT

In our view, the impact of our active ownership activities extends beyond the financial value created, to a broader definition of value creation. Value creation in this context includes fulfilling fiduciary duties; obtaining more in-depth insight of investee companies; increased collaboration between portfolio manager and analyst teams and ESG analysts; raising companies' awareness of ESG concerns by their investors; improved relationships with investee companies, and the transformation of investee companies' corporate behaviour.<sup>4</sup>

We believe that our active ownership activities during 2016 have had a materially positive impact on the way our investee companies conduct their business as corporate citizens. As our engagements are focused on achieving a constructive outcome, often there will be a number of engagements on a specific topic to ensure a favourable result in the long term. It is the outcome of value creation that matters most to us, as invariably the positive impact will be felt by both the company and the socio-economic regions in which it operates.

## CHAMPION OF CHANGE

One of the most important ways we act as a responsible owner is by promoting and protecting shareholder rights through participation in and development of policy, regulation, and standards governing our investments. We were heavily involved in the draft King IV Code revision process and provided feedback to the drafting committee throughout this process as to what principles, practices and outcomes the new Code should contain and what specific areas of governance it should focus on developing. When we were afforded the opportunity to comment on the draft Code, we were pleased to see that many of our suggested areas of focus had already been included and therefore our commentary mostly consisted of clarifying certain practices in the drafting.

However, from a responsible ownership perspective, we felt one key area had not been adequately addressed in the draft Code. This was shareholder "say on pay" - in other words, the enforcement of the principle of responsible executive remuneration by companies by giving shareholders a binding vote on remuneration policy proposals. While we acknowledged that the draft Code did include many commendable proposals to achieve responsible remuneration, our view is that shareholders should be able to enforce their rights to vote in favour of remuneration policies only where they present transparent and direct links between the proposed remuneration packages of executives and value creation by the company.

While the final version of King IV did not contain a recommendation for a binding vote on remuneration, it does enable enhanced mandatory engagement with companies that receive a large vote against their remuneration practices. We see this as a positive outcome which will place fair and reasonable remuneration at the heart of a company's interactions with its stakeholders. As the JSE looks to incorporate the principles of King IV into its issuer Listing Requirements, we will furthermore continue to engage with the industry building on our experience of best practice in this area.

We continue to drive the uptake of ESG integration in South Africa through our participation on CRISA Committee, which is positioning itself to focus on the application of the CRISA among endorsees and becoming the leading South African body dealing with RI matters. One of the key issues which have been debated is whether or not the current regulatory environment is sufficiently supportive of ESG integration across the investment universe, especially as to what fiduciary duty means for the entities to which the regulations apply.

We were fortunate to be invited to share our views on possible ways improvements could be made to enhance the regulatory environment by the PRI, United Nations Environment Programme (UNEP) Finance Initiative and Generation Foundation on the South African Roadmap, of their international project "Fiduciary Duty in the 21st Century". We look forward to the practical proposals of their report being well received by regulatory authorities, which in turn will result in tangible change or clarity in the requirements for RI in South Africa.

## THOUGHT LEADERSHIP IN AFRICA

During the first half of the year, the inaugural class of participants attending the Africa Directors Programme (a governance training course for African directors held by the University of Stellenbosch Business School and INSEAD in collaboration with Old Mutual Investment Group) received their certificates for the successful completion of the course. The participants will put their recently acquired governance skills learned during the programme to good use in improving governance on the boards they sit on, thereby creating positive change in the market.



<sup>4</sup> Engagement: unlocking the black box of value creation – Niamh O'Sullivan & Jean-Pascal Gond (June 2016) Sustainalytics and Cass Business School (City University London)

The Africa Directors Programme ran again in August 2016. All applicants were thoroughly screened beforehand, resulting in a well-balanced group of programme participants consisting of 16 people from three African countries, equal in gender, diverse in background, and also representative of private, public and social sector institutions. The outcomes at the conclusion of the Programme by the participants were: 1) exercising the duties of a director with self-awareness, professionalism and sound judgement, 2) contributing with fellow directors to a board culture characterised by effective collaboration, integrity and sound decision-making, 3) exercising effective board leadership in matters of corporate conformance, performance, strategy and risk management and, finally, 4) overseeing public accountability for sustainable and responsible business development. Enrolment for the 2017 course has begun. For details visit <http://www.usb-ed.com/Courses/Pages/Course-details.aspx?Course=Africa-Directors-Programme&CID=99>

Other notable events included the Integrated Reporting Council of South Africa's "Reporting on Outcomes in an Integrated Report" event at the JSE, at which we were invited to speak from an investor perspective, about how we use integrated reporting to inform our active ownership activities. This was followed by a Q&A session that was well attended by a broad range of industry players. The key message we delivered was that, as a responsible investor, Old Mutual Investment Group takes its responsible ownership activities very seriously.

We were also proud to present to about 350 representatives from the pension fund industry at the Zimbabwe Association of Pension Funds' 41st annual conference held in Johannesburg, on responsible investment and trustees' fiduciary duties. The audience was very keen to hear how they would need to protect the long-term interests of their beneficiaries as institutional investors and as fiduciaries, and how responsible ownership activities could be used to manage long-term risk. Our message was that the same principles we apply to active ownership in South Africa could be used to drive market change in Zimbabwe.

Later in the year, we were invited to present at two prestigious events in Johannesburg – the Finance Indaba Africa and the 6th Africa ESG Forum. The Finance Indaba attracted approximately 5 000 delegates and our presentation was delivered on the topic "The new standard: Unlocking value through responsible investment" covering why sustainability matters, and the global context to RI. It also analysed what the evidence shows around the consideration of ESG issues, Old Mutual Investment Group's application of RI and suggested how CFOs should respond to these important issues.

At the Africa ESG Forum, we participated in a panel discussion on the topic "Codifying Corporate Governance and Disclosure for Companies and Investors – The Case of Africa" in a room filled with representatives from various industry bodies, trustees of pension funds and other ESG practitioners. This resulted in some healthy debate between members of the audience and panellists on important ESG matters. Breakaway discussion groups followed, with each group wrestling with a specific ESG topic.

2016 was definitely a year where the topic of RI attracted a significant amount of interest from various areas of society.

## LOOKING FORWARD TO 2017 AND BEYOND

Our goals over the next few years are to continue to focus on material companies, looking for opportunities to collaborate with other institutional investors to proactively address market ESG risks, and deepen our research and evidence base in respect of the link between responsible ownership and long-term value creation. We look forward to sharing some of these insights in upcoming publications.

**For more on our Responsible Investment resources and activities, visit: [www.oldmutualinvest.com](http://www.oldmutualinvest.com) and go to [About us > Responsible Investment](#).**

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### Regulatory information

#### Regulatory information

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