

Discovery Invest



WHO WE ARE

Discovery Invest aims to be South Africa's premier savings and wealth management solutions provider. Our investment model, built on the principle of shared value, encourages positive savings behaviour through strong financial incentives and client engagement in Vitality. The superior actuarial dynamics underlying this model manifest in above-market long-term outcomes for clients, as well as the sustainable profitability of our business.

Our shared-value approach to retirement income provision is unique in today's investment market. It encourages positive behaviour change and does not rely on additional charging structures or fees. It rewards clients for both healthy behaviour and sound financial decisions; for example, clients are encouraged to select sustainable income drawdowns and to maintain a healthy lifestyle through engagement in the Vitality programme. With low income drawdowns and healthier clients living longer, funds remain invested with Discovery Invest for longer. This allows us to earn additional asset management fees, which enables us to share this surplus with our clients in the form of income boosts.

For clients engaging in this system, the impact is significant. Before retirement, they are taking responsibility for their financial future by investing earlier, receiving significant upfront financial boosts, and having their investment grow for a longer period. By maintaining a conservative drawdown level in retirement and engaging in their wellness, clients are not only increasing their longevity, but also making their savings last longer, while receiving boosts that supplement their income every month.

During the year, the Association for Savings and Investment South Africa (ASISA) ranked Discovery Invest as one of the top 10 retail asset takers in the collective investment scheme industry. The ranking was mainly thanks to the Discovery Balanced Fund, which attracted the third-highest net flows in the South African multi-asset, high-equity sector (second quarter of 2017).

Performance highlights

DISCOVERY INVEST GREW ASSETS UNDER ADMINISTRATION BY

Δ 14%
YEAR-ON-YEAR TO R69.5 BILLION

DISCOVERY FUNDS MAKE UP

76%
OF LINKED ASSETS
which is indicative of growth in the Discovery linked investment service provider platform, as well as the growth in Discovery assets.

OPERATING PROFIT GREW TO

Δ R744 million

WHICH IS 12% HIGHER
than the same period in the previous year, indicating increased operational efficiency.

The business model of sharing economic value has manifested in over R644 million in fees paid back to clients and a further R425 million in accumulated fee benefits. Over R2.2 billion in upfront boosts have already been created, of which just over R200 million has already been paid out to clients. Through the Life Plan Optimiser, R2.05 billion will be channelled to boost our clients' retirement income.

During the period, Discovery Invest extended its innovation in the retirement market by making it possible for investors to convert Discovery Miles and Vitality points into their retirement plans. In doing so, Discovery Invest became the first provider in South Africa to offer zero administration fees on retirement provision with certain conditions. With over 259 000 policyholders, our market share increased by 80% in the retirement annuity and preservation funds market, and by 50% in the retirement income market.

Net flows are indicative of Discovery's growth in assets. Comparing this net flow with industry flows provides a view of performance, given current market conditions and investor appetite. Discovery Invest ranked in the fifth position as the largest retail net flow taker for the year to the end of June 2017, with flows of R4.1 billion. The total net flows exclude money market and fund of fund flows.

KEY FINANCIAL METRICS

	AUA* (Rbn)	AUM** (Rbn)	Net flows (Rm)	Operating profit (Rm)
2014/15	50.5	33.4	2 064	539
2015/16	61.0	49.9	2 413	665
2016/17	69.5	46.0	2 496	744

* Assets under administration (AUA): defined as the assets, including those in external funds.

** Assets under management (AUM): defined as assets earnings a second layer of fees in addition to admin fees.



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Material issues

This section outlines key issues and focus areas Discovery Invest managed during the year.

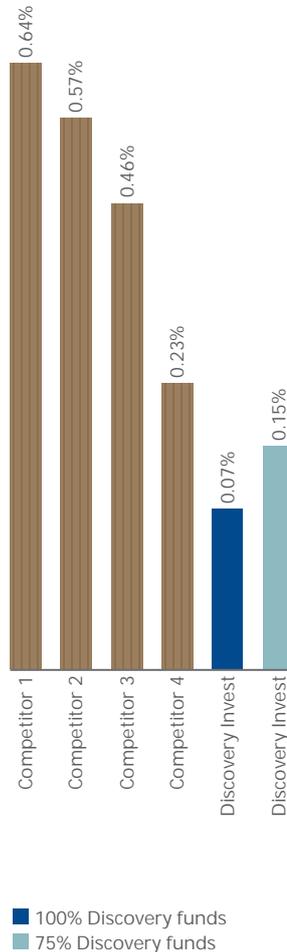
01 CURRENT ECONOMIC ENVIRONMENT AND MARKET CONDITIONS

Markets continued to be depressed in 2017, with the All Share Index (ALSI) offering gross total returns of 1.7% for the year to end June 2017, and the Shareholder Weighted Index (SWIX) returns over the same period at 0.3%. New business was up 3% at R2 496 million even in these volatile market conditions.

Against this, we placed an even greater emphasis on maximising value for clients through boosts offered on Discovery Invest products. Based on positive financial and health behaviours, we can offer enhanced value to clients independently of market conditions, for example, by offering clients who are on Vitality statuses below Silver the opportunity to receive higher boosts (at Silver Vitality status level) on their retirement income for two years. This special offer ran from April to the end of June 2017. It gave retired clients a large income boost upfront, while they can increase their Vitality status over time. Assets in the Linked Annuity Retirement Income Plan grew by 25% and now account for 13% of the total assets under administration.

Introduced in the previous period, the Retirement Upfront Investment Integrator and the Retirement Income Investment Integrator have paid out R22.3 million in benefits over two years, with a further R497 million in accumulated benefits. In response to market conditions, we also focussed on developing solutions that will help our clients protect their wealth. Through our model, some of our lump-sum retirement plans offer clients reduced administration fees and the option to use boosts in income to offset 100% of their administration fees from day one. With a reduced fee structure or zero fees, these plans offer clients more growth in investment, and places Discovery Invest competitively when comparing administration fees with the average in the market.

Lowest administration fees over a 10-year term



* R1 million invested; no Discovery Miles invested.



02 MANAGING LAPSE RATES

Difficult market and economic conditions have seen an increasing rate of withdrawals across the industry. Withdrawals from discretionary products across the industry averaged 20% for the period under review.

Our withdrawal rate was in line with the general industry trend over this period; however, lapse rates still remained below the expected value at the financial year end. New initiatives that offer more value through integration with other Discovery products, such as Vitality and Discovery Card, and unique savings vehicles that target the cost of medical scheme premiums in retirement also aim to strengthen client persistency. We continue to monitor product structures and fees to ensure they are providing value to clients.

03 ADDRESSING SAVINGS BEHAVIOUR IN SOUTH AFRICA

One of the most pressing challenges facing South Africa and the rest of the world is that of effective provision for retirement. Over 11 million South Africans are over-indebted and do not save enough. The National Treasury indicated in 2015 that less than 6% of South Africans are adequately prepared for retirement. This is exacerbated by the fact that, due to enhancements in medical technology and increased access to healthcare, people are living longer and spending a larger portion of their lives in retirement. Furthermore, as people get older, they often become sick more frequently and for longer periods of time, necessitating higher levels of retirement provision.

Discovery Invest has focussed on addressing this trend and meeting clients' specific savings needs. During the year, one area of particular focus was to encourage provision for medical scheme costs in retirement. The Discovery Medical Investment Funds were launched in November 2016 and aim to provide returns that track the cost of medical scheme cover for 20 years in retirement.

Gross flows into voluntary contribution products across the linked investment service provider (LISP) industry were R255 billion for the year ending June 2017, which is only R8 billion less than gross flows into retirement products. Net flows from discretionary products for the year were R24 billion, compared with R96 billion in net flows into retirement products. In future developments, we will aim to encourage longer investment durations on these products to ensure clients benefit appropriately from market returns.

04 CONTINUED PRODUCT INNOVATION

A key innovation during the year was introducing the conversion of Discovery Miles and Vitality points into savings in clients' retirement plans. The Savings Booster provides upfront integrator benefits on sporadic contributions to retirement annuities.

Three portfolios have also been created (with RisCura) based on different risk appetites. In addition, financial advisers can bring their own model portfolios onto the Discovery platform, and benefit from the integration benefits that Discovery Invest provides. These innovations were introduced in April 2017, and are seeing positive traction in the market.

Product and other developments will remain focussed on addressing the changing landscape of client and financial adviser needs. Developments within our distribution channel will focus on identifying ways to offer digital servicing solutions, and broadening the reach of the distribution network.

05

THE IMPACT OF CHANGING LEGISLATION OR REGULATIONS AND INDUSTRY DYNAMICS

To ensure compliance with the Financial Intelligence Centre Amendment Act, which came into effect in April 2017, additional client on-boarding and servicing requirements have to be developed. We will manage any effects of these requirements on clients and our service levels.

We continue to engage with the Financial Services Board on regulations around the Retail Distribution Review, and are well-positioned to respond to any required changes.

Changes to the handling of excess expense tax losses will affect our endowment product in the future. In response to this, all products are being reviewed and adapted to fulfil similar client needs as alternatives to the endowment product.

Success of our business model

Improving clients' financial future

Our strategy of focusing on retirement funding has yielded results for Discovery Invest and our clients. We have seen positive evidence of clients starting to invest earlier for retirement (on average two years earlier) and draw down less of their capital in retirement to benefit from higher boosts (on average 2% less).

This results in policyholders having 50% more capital in their funds 10 years into retirement.

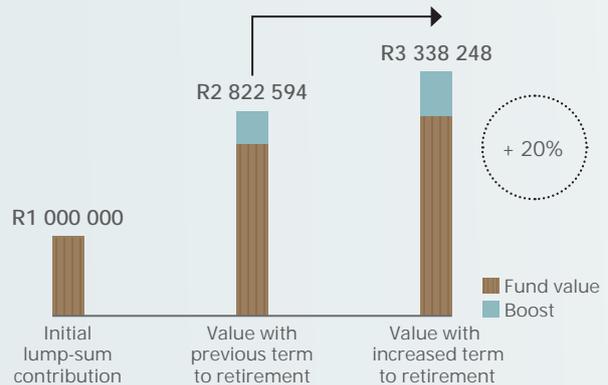
By investing earlier, clients are receiving a higher upfront boost and their investments grow for a longer period. This results in clients arriving at retirement with an extra 20% fund value.

Term to retirement



The graph above shows the change in the average term to retirement, from December 2015 to December 2016.

Fund value and boost



The graph above illustrates the impact of investing earlier on a client's fund value at retirement. The positive change in behaviour enables clients to grow their retirement funds more.

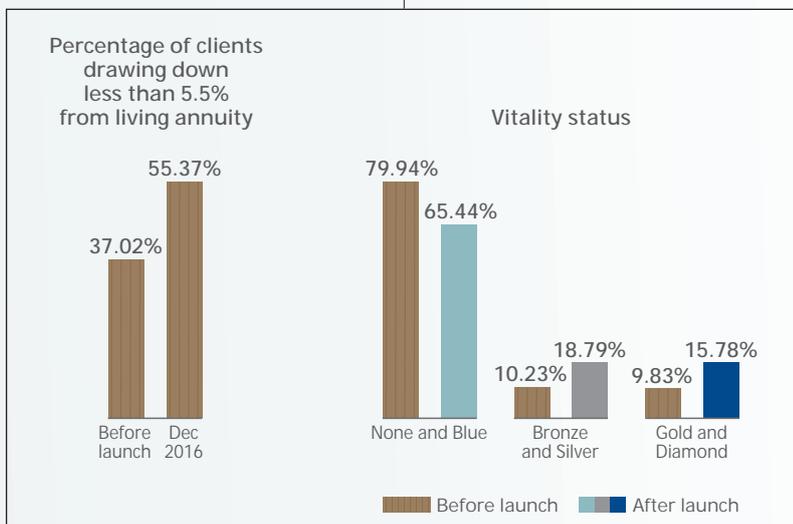
Improved financial decisions

A reduction in annuity income drawdown rates has been evident on the Linked Retirement Income Plan since the launch of this product in September 2015. The below graph shows the change in the proportion of clients in each of the annuity income drawdown bands, before December 2016. It shows that there is an increasing number of clients drawing lower annuity income percentages. The proportion of clients in the Linked Retirement Income Plan who are withdrawing an annual annuity income of less than 3.25% of their fund value has increased by 10%. Currently, 55% of clients are withdrawing an annual income of 5.5% or less, up from 37%. There has been an increase in the percentage of clients falling within income drawdown bands below 5%, which indicates a positive behaviour change.

Percentage of clients



If this trend of reduced income drawdown rates continues for the full first 10 years in retirement, clients' retirement funds are expected to grow significantly larger than they otherwise would have.



OUTLOOK

Discovery Invest aims to be a leading savings solutions provider. Over the next year, we will build on the existing Shared-Value Insurance model to continue providing outstanding value to our clients. To do this, we aim to:

- Extend our shared-value methodology to discretionary investing through a refreshed Flexible Investment Plan, which will be integrated with Vitality and Retirement Annuities.
- Expand and enhance the product and fund range offered to clients to holistically support investment needs. This will include offering share trading and porting of share portfolios onto our platform, as well as offering a Discovery hedge fund. Our new Purple range will offer high-net-worth clients rates that are cheaper than clean pricing on retirement portfolios, among other benefits. Lower minimums and tailored boosts will be introduced to create easier access to our product range for graduates and younger investors.
- Continue to offer our clients seamless digital service with an enhanced online platform.
- Deepen penetration of distribution into the market.
- Continue to adapt and respond to regulatory changes.