Sun Life Assurance Company of Canada (U.K.) Limited

The Directors' Report to Plan-holders

SLOC With-Profits Fund in 2017

Sun Life Financial of Canada

Introduction

This report explains:

- How we managed the SLOC With-Profits Fund (the "Fund") in 2017.
- Whether we complied with the Principles and Practices of Financial Management ("PPFM") that set out how we manage the Fund, how we respond to long-term economic changes, and how we meet plan-holders' needs.
- How we made key decisions during 2017.
- Whether we took plan-holders' expectations into account appropriately.

We have taken advice from our With-Profits Actuary and there is a separate With-Profits Actuary's statement at the end of this report.

Summary

We considered the advice and reports of the With-Profits Committee and the With-Profits Actuary and are satisfied that for the financial year 2017:

- We managed the Fund in line with the PPFM.
- We made key decisions and used management discretion in a way that was consistent with the PPFM.
- We have taken into account all plan-holders and their rights, interests and expectations properly, as described in the PPFM.
- We have treated plan-holders fairly and where there are competing or conflicting interests and expectations of different groups of plan-holders, we have complied with the PPFM.

Investment management

Information for endowment and whole of life plan-holders –
Our primary aim is to make sure the Fund can pay any guarantees we have promised to plan-holders. The safest way to do this is to invest some of the Fund in government and other high quality bonds, which are loans to the UK and foreign governments and companies that are raising money. These assets are referred to as fixed interest investments because we know the income that we expect to receive from them, although their market value will change over time.

We also invest some of the Fund in company shares and property. Owning shares means that the Fund is a part-owner of these companies and so receives a portion of their profits. Property investments usually receive income in the form of rents. Both of these types of assets have the potential to provide investment growth but also carry a higher risk of their value going up or down.

The table below shows how much we invested in different types of assets for endowment and whole of life plans over the year.

Table 1

Asset class	End 2016	End 2017
Fixed interest and other assets *	64.9%	64.7%
UK company shares	14.4%	15.6%
Property	8.4%	9.5%
International company shares	6.2%	6.4%
Cash	6.1%	3.8%

* Other assets include plan loans.

We review these amounts regularly to make sure we continue to meet our aims.

The Fund's net return in 2017 was 7.4% (after tax and investment expenses). We outperformed the benchmark set for the Fund overall. The fixed interest return was 2.6% before tax. The company share return was 13.1% for UK shares and 13.5% for global shares before tax. The property return was 11.2% before tax.

Information for pension plan-holders
During 2017 we further reduced the potential for fluctuations in the financial strength of the Fund that can be caused by changes in economic conditions. We invested in derivatives that give the Fund a fixed rate of interest – this protects the Fund from fluctuations caused by changes in interest rates. We also replaced some of the longer-term fixed interest assets with short-term ones. Otherwise, we made no change to the investment strategy for the Fund's pensions business over the year. It continues to provide a stable return through investment in fixed interest assets and cash. We also invest in fixed interest bonds held in euros. This helps protect the Fund from fluctuations caused by changes in currency exchange rates, for Irish pension plans. Most pension plan-holders have benefits fixed at guaranteed levels, so are not affected by the investment strategy.

Management of payouts

A key part of management discretion is to decide the annual and final bonuses paid to plan-holders.

Bonuses for endowment plans to 31 March 2018 –
For endowment plans, we work out a plan-holder's fair share of the Fund using an amount known as an 'asset share'. This is the amount of the Fund available to each plan. We work this out based on past premiums, investment returns, guaranteed benefits and expenses.

We monitor the bonuses throughout the year to ensure we are meeting the PPFM objectives. For endowment plans, we aim to pay 90% of plan-holders 80-120% of their asset share when the plan matures. In 2017, 91% of maturity payouts on premium-paying endowments were in this range. We investigated payouts outside this range and found fair explanations for these.

Bonuses for endowment plans from 1 April 2018 – In November 2017, we wrote to everyone who has an endowment plan to explain a change we are making to the way we calculate bonuses from 1 April 2018.

We previously calculated the amount we pay out based on the past experience of the Fund. This method works well when there are many endowment plans in the Fund but these are now quickly maturing and the numbers remaining are getting low. We now calculate the amounts we pay out based on the expected future experience of the Fund. We work this out by estimating future premiums, investment returns, guaranteed benefits and expenses. The plan-holder's fair share of this is called the prospective value. This method works well when there are fewer endowment plans in the Fund.

This change helps us to keep future payouts fair and stable and to continue to manage the Fund proactively and responsibly for all plan-holders. It also incorporates the future distribution of the surplus assets.

Smoothing – In determining bonus rates, we use a process known as 'smoothing', which provides a cushion against the short-term ups and downs of investment markets. We do this by reinvesting some of the profits from 'up' years to smooth out any losses in the 'down' years. Smoothing, however, cannot protect against the impact of persistently low investment returns. The smoothing process has meant that we held back some of the investment return earned during 2017 when setting the final bonus rates from 1 April 2018.

Distributing the Fund's surplus assets – Since 2016, we have distributed all of the Fund's surplus assets to plan-holders by enhancing the benefits for all whole of life and endowment plans. It is possible, in adverse circumstances, that we could reverse these enhancements.

Calculating whole of life plan payouts, and endowment plan payouts from 1 April 2018 – The final bonus rates for whole of life and endowment plans were higher than last year. Bonus rates depend predominantly on the past investment performance of the assets held in the Fund, together with that expected for the future. Investment performance has been strong in the past year primarily from company shares and property assets in the Fund. We also changed some of our assumptions to more closely reflect expected future economic conditions, which had a positive effect on bonus rates.

Early exit values for whole of life and endowment plans – We review early exit values to make sure they meet the PPFM objectives. For premium-paying endowment plans up to 1 April 2018 we base the early exit value on the asset share. We aim to pay on average within 10% of asset shares, less an adjustment for ending the plan early. For whole of life plans, and for endowment plans that are no longer paying premiums, we use the prospective value of benefits to work out the early exit value. Over 2017, early exit values were on average within 9% of the asset share for premium-paying endowment plans and within 4% of the prospective value of benefits for whole of life plans and for endowment plans that are no longer paying premiums, less an adjustment for ending the plan early.

The With-Profits Actuary gave advice to the With-Profits Committee about the impact of the recommended bonus scales and basis for early exit values.

Pension plans

We use two different interest rates for Personal Pension Plans. The first is on contributions paid in the first 12 months, or for 12 months after increasing the contribution rate. We did not make any changes to this interest rate in 2017. We did reduce the interest rate for all other contributions during 2017 and we will reduce this rate further in 2018. The interest rate for other plans stayed the same. In 2018 we will reduce the interest rate for future premiums for Individual Money Purchase plans. We honour any minimum guaranteed interest rates.

Management of expenses

In line with the PPFM, and with the advice of the With-Profits Actuary, we continued to charge the Fund for its fair share of the company's ongoing costs in 2017. In 2017, we paid out 0.6% of the Fund in expenses.

Revisions to the PPFM over 2017 and from 1 April 2018

We did not make any changes to the PPFM during 2017 but have made changes from 1 April 2018.

The changes to the PPFM include:

- Changes to the way we calculate the endowment payouts, described earlier in this report.
- Adding references to distributing the Fund's surplus assets to plan-holders by enhancing the benefits for all whole of life and endowment plans.
- Removing some references to the investment return on pension plan assets.
- Showing that most pension customers receive guaranteed benefits.
- Removing the dates when we may need to make changes to the way the Fund is run. Changes will need to be made to ensure we can continue to distribute profits fairly as the Fund gets smaller.

Further information

If you would like a copy of the PPFM referred to in this report or the Consumer Guide for pensions customers, or the latest bonus notice, which briefly explains how we manage the Fund, please visit our website sloc.co.uk or call us on 0345 072 0223 (or 01256 841414 from a mobile phone).

Report of the With-Profits Actuary of the Fund to the with-profits plan-holders

The FCA Handbook of Rules requires the With-Profits Actuary to report to the with-profits plan-holders as to whether the annual report of the firm and the discretion exercised by the firm takes the interests of the with-profits plan-holders into account in a reasonable and proportionate manner.

This is my report for the year ended 31 December 2017. I have based my opinion on the information and explanations provided to me by the Company, having regard to the Principles and Practices of Financial Management ("PPFM") of the SLOC With-Profits Fund. I have also had regard to the relevant Technical Actuarial Standards issued by the Financial Reporting Council.

As noted in the annual report to the with-profits plan-holders from the Company, with effect from the bonus declaration in respect of 2017, the Fund is now managed on a fully prospective approach for all life business. Future distribution of the surplus assets is now fully incorporated into this approach. Nevertheless, plan-holders should note that past surplus asset distributions are not guaranteed and can be reversed in the event of sufficiently adverse circumstances.

I am satisfied that the Company has complied with the PPFM for the year ended 31 December 2017. I am also satisfied that the Company's report and its exercise of discretion over the period has taken the with-profits plan-holders interests into account in a reasonable and proportionate manner.

John A Jenkins
Fellow of the Institute and Faculty of Actuaries
Partner KPMG LLP
With-Profits Actuary

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