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

The Directors' Report to Plan-holders

SLOC With-Profits Fund in 2019

Sun Life Financial of Canada

Introduction

This report explains:

- How we managed the SLOC With-Profits Fund (the "Fund") in 2019.
- Whether we complied with the Principles and Practices of Financial Management ("PPFM") that sets 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 2019.
- 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.

While the purpose of this report is to cover management of the Fund in 2019, it is worth noting that early 2020 investment market prices have changed significantly due to Coronavirus (COVID-19). In times such as these, when investment markets are volatile, we continue to monitor the Fund's investments to ensure these remain appropriate as well as monitoring the Fund's payout levels to ensure these remain fair to all the Fund's plan-holders.

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 2019:

- 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

The investment strategy of the Fund is to provide the highest potential investment return whilst preserving the financial condition of the Fund and paying any guarantees promised to plan-holders when these are due. To do this the Fund invests mainly in a diverse range of longer-term assets. These include 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 rent. Both of these types of asset have the potential to provide investment growth but also carry a higher risk of their value going up or down.

We increased the target for the portion of the Fund invested in company shares and property from 30% to 35% during 2018 due to the continued strength of the Fund, and have retained it at this level during 2019.

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

Table 1

Asset class	End 2018	End 2019
Fixed interest and other assets *	63.3%	61.6%
UK company shares	17.0%	19.8%
International company shares	7.4%	7.7%
Property [1]	9.9%	8.7%
Cash	2.4%	2.2%

* Other assets include plan loans.

[1] Cash held within the property fund is now presented in Table 1 as "Cash". It was previously included within the "Property" line.

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

The Fund's net return in 2019 was +9.0% (after tax and investment expenses).

Returns by asset class over 2019, before tax and any expenses, are shown below and compared to market performance.

Table 2

Asset class	Fund	Market
Fixed interest	8.2%	8.0%
UK company shares	20.4%	19.2%
International company shares	29.0%	22.2%
Property	2.8%	2.0%
Cash	0.9%	0.7%

Information for pension plan-holders

The investment strategy of the Fund in respect of pensions business is to provide a stable investment return through investment in fixed interest investments. It is necessary to take account of the financial condition of the Fund and the minimum guaranteed interest rates applicable to each type of plan during the period before retirement, and also the cash flow requirements of the plans. During 2019, we made no material changes to the investment strategy for the Fund's pensions business. It continues to provide a stable return through investment in fixed interest assets and cash. We continue to invest 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 invest in fixed interest bonds held in euros. This helps to 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.

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.

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

Calculating whole of life and endowment plan payouts – From April 2020, the final bonus rates for these plans will be slightly lower than last year. Bonus rates depend on both the past and expected future performance of the assets. Although the assets have performed well in the past year, long-term interest rates reduced in 2019. As a result, we expect future investment returns to be lower. This outweighs the strong performance in 2019 and means we need to slightly reduce final 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 whole of life and endowment plans, we use the prospective value of benefits to determine fair early exit values. Over 2019, early exit values were on average approximately 94% of the prospective value of benefits for all life plans. We are increasing exit values from April 2020 to aim closer to the prospective value.

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. A lower interest rate (currently 0% a year) applies to contributions paid in the first 12 months. [2] We have not changed this lower rate in 2019. We did reduce the higher interest rate, which is used for all other contributions, from 2.25% to 1.25% a year during 2019.

We did not change interest rates in 2019 for Individual Money Purchase plans. Interest rates on premiums paid before 1 April 2018 remain at 4.25% a year. Interest rates on premiums paid on or after 1 April 2018 remain at 2% a year for business written in the UK and 1% a year for business written in Ireland.

The interest rate for other plans also stayed the same (Individual Transfer Plan at 6% a year, Deferred Annuity at 4% a year and the Staff Additional Voluntary Contributions at 4.25% a year) where these rates are set to honour the minimum guaranteed interest rates.

All of these rates are reviewed every year and will remain unchanged from April 2020.

[2] If the contribution level increases later on, this lower interest rate also applies to the increased portion of the contribution for the first 12 months after the increase.

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 2019, we paid out 0.6% of the Fund in expenses.

Revisions to the PPFM over 2019

The changes to the PPFM over 2019 include:

- Removing references to the Pensions Consumer Guide. We will no longer be producing this because all of the key information contained within it can now be found in the improved annual benefit statements.
- Changing the description of the final bonus calculation to include an allowance for proceeds from unclaimed plans.
- Removing references to the cost of processing a surrender, because we no longer charge this directly to policyholders who surrender.
- Updating the wording of the investment strategy to better reflect current practice. There was no change to the strategy itself.
- Updating references to the outsourcing arrangement with Diligenta Limited following the expiry of a break clause in 2018.

Further information

If you would like a copy of the PPFM referred to in this report, 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 2019. 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.

The Fund continues to be managed on a fully prospective approach for all life business. Future distribution of the excess assets is now fully incorporated into this approach. Nevertheless, plan-holders should note that past excess 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 2019. 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.

I confirm that the Company has consulted me in relation to its ongoing monitoring during the investment market volatility post 31 December 2019 as a result of the Coronavirus pandemic. I am content with the Company's approach as set out in the Directors' report to the with-profits plan-holders.

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

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