Principles and Practices of Financial Management

Sun Life Assurance Company of Canada (U.K.) Limited
SLOC With-Profits Fund

Sun Life Financial of Canada

Contents

1. Introduction

Principles and Practices of Financial Management (PPFM)

The PPFM sets out how a firm manages its with-profits business. The PPFM is intended to secure an appropriate degree of protection for plan-holders, as part of a firm's obligation to treat its customers fairly, which the Financial Conduct Authority (FCA) requires to be made publicly available.

The Board of Directors of a firm carrying on with-profits business has to produce a report each year for with-profits plan-holders stating whether, throughout the financial year to which it relates, the firm believes it has complied with the PPFM.

The with-profits principles within the PPFM must:

- be enduring statements of the overarching standards the firm adopts in managing with-profits funds; and
- describe the business model used by the firm in meeting its duties to with-profits plan-holders and in responding to longer-term changes in the business and economic environment.

The with-profits principles are not expected to change often. If they are changed, plan-holders must be informed at least three months in advance, unless the FCA has granted a waiver of this requirement.

The with-profits practices within the PPFM must:

- describe the firm's approach to managing with-profits funds and to responding to changes in the business and economic environment in the shorter term; and contain sufficient detail to enable a knowledgeable observer to understand the material risks and rewards from effecting or maintaining a with-profits plan with the firm.

Subject to the with-profits principles, a firm's with-profits practices are expected to change as the firm's circumstances and the business environment change, with some alteration every few years. Plan-holders must be informed of any such change within a reasonable time period, although this notice may be given in arrears. Sun Life Assurance Company of Canada (U.K.) Limited intends normally to inform its with-profits plan-holders of any such change by including the required information with their annual statements.

A firm carrying on with-profits business is required to appoint a With-Profits Actuary to advise on key aspects involving the use of discretion as this relates to the fair treatment of with-profits plan-holders. Sun Life Assurance Company of Canada (U.K.) Limited has, in addition, established a With-Profits Committee, which is an advisory committee to the Board, to monitor amongst other things compliance with the PPFM. The Committee's purpose is to bring independent judgement to the assessment of compliance with the PPFM and to how competing or conflicting rights and interests of plan-holders and shareholders have been addressed.

The Consumer Guide for pension plans, and the annual benefit statement for life plans, provide in clear and non-technical language the information plan-holders need to make effective decisions about their plans. If there is any inconsistency between these and this PPFM, then the version detailed in this document will apply.

Background to the SLOC With-Profits Fund

Sun Life Assurance Company of Canada is incorporated in Canada. On 22 March 2000, the Company was demutualised. The demutualisation involved eligible with-profits plan-holders being issued with shares in the new controlling company in exchange for relinquishing their existing ownership rights.

In connection with the demutualisation, the U.K. business of Sun Life Assurance Company of Canada was reorganised. In the U.K., Sun Life Assurance Company of Canada had written its with-profits business through its U.K. branch. Also included in the U.K. branch was the Confederation Life Fund, a separate sub-fund within the long-term business fund. On demutualisation, all the business of the U.K. branch was transferred to Sun Life Assurance Company of Canada (U.K.) Limited ('the Company'), an existing insurance subsidiary of Sun Life Assurance Company of Canada. This transfer was in accordance with the requirements of a Scheme under Schedule 2C of the Insurance Companies Act 1982, which was approved by the High Court on 21 September 1999 ('The Scheme').

Under the terms of The Scheme, on 22 March 2000 the Company established three separate sub-funds within its long-term business fund. These are the With-Profits sub-fund, the Non-Profit sub-fund and the Confederation Life sub-fund (in this PPFM, these three sub-funds are referred to respectively as the SLOC With-Profits Fund, the Non-Profit Fund and the Confederation Life Fund). Within the SLOC With-Profits Fund separate pools of assets are deemed to back the life business and the pensions business. On 31 March 2015 the Confederation Life With-Profits plans were converted to Non-Profit, and, as a result, the Confederation Life sub-fund no longer exists.

Under the terms of The Scheme, when the value of assets in the SLOC With-Profits Fund falls below £100 million (adjusted for movements in the Retail Price Index since March 2000), it need not be maintained as a separate fund and, subject to the approval of the relevant UK regulator(s), it may be amalgamated with the remaining Non-Profit Fund.

On any such amalgamation, all of the surplus remaining in the Fund, after deducting any conversion costs and payments allowed under The Scheme, will be allocated to the existing plans by way of bonus or benefit increases, and the plans will become Non-Profit.

Further to the above consideration, such an amalgamation is mandatory once the value of assets in the Fund falls below £10 million (adjusted for movements in the Retail Price Index since March 2000).

Surplus arising in the SLOC With-Profits Fund accrues exclusively for the benefit of the plan-holders in that fund. No transfers of surplus can be made from the SLOC With-Profits Fund to the Non-Profit Fund.

The Appointed Actuary's report on The Scheme contained an appendix setting out the Principles of Financial Management for With-Profits Business, which formed the framework within which the Company undertook to manage the with-profits business in order to determine future bonus levels.

The SLOC With-Profits Fund consisted initially of the with-profits business transferred from the former U.K. branch of Sun Life Assurance Company of Canada, excluding the Confederation Life Fund. Further business continued to be written in the fund until it was closed to new business in October 2000.

The Scheme and changes to this PPFM

The Directors are obliged at all times to manage the with-profits business of the Company in accordance with the terms of The Scheme. Accordingly, changes may not be made to the principles or practices set out in this PPFM if they would result in the PPFM being inconsistent with the terms of The Scheme, unless The Scheme is also modified to correct that inconsistency. However, The Scheme may only be modified or added to with the approval of the High Court and the consent of the Prudential Regulation Authority (PRA) and/or FCA (although in the event of certain changes in legislation which cause The Scheme to operate in a materially different manner from that originally envisaged, The Scheme may be modified with the approval of the PRA and/or FCA, but without the need for High Court approval, in order to limit the effect of such a change on the operation of The Scheme).

It is possible that either market practice or FCA requirements in respect of the PPFM, at some stage in the future, may conflict with the provisions set out in the terms of The Scheme. In such circumstances, the PPFM would not be changed to comply with such market practice or requirements unless and until the terms of The Scheme were changed in the manner described above.

If there is any inconsistency between the PPFM and the terms of The Scheme, the terms of The Scheme will apply.

The business covered by this PPFM

This PPFM covers the business written in the SLOC With-Profits Fund, which comprises both life and pensions business. The life business consists of conventional with-profits whole-life and endowment assurances together with attaching benefits. The pensions business consists of with-profits individual and group deposit administration pensions business in deferment. There is no unitised with-profits business.

The SLOC With-Profits Fund consists mainly of business written in the U.K., although there is also a small amount of business written in the Republic of Ireland. The business written in the Republic of Ireland is subject to the same principles and practices of financial management as the business written in the U.K.

The information given in this PPFM relates to the SLOC With-Profits Fund generally, except where the sub-headings 'Life' or 'Pensions' are used to denote information that applies solely to life business or pensions business respectively.

2. Amount payable under a with-profits plan

a. Methods used to guide determination of amount payable

Principles

The principles by which the Company will manage the with-profits business in order to determine future bonus levels, and hence the amounts payable to with-profits plan-holders, were set out in the Principles of Financial Management for With-Profits Business, which formed an appendix to the Appointed Actuary's report on The Scheme.

The general principles stated in that appendix were as follows:

- Bonuses will be determined equitably between different cohorts of plan-holders and product lines.
- Bonus levels will take account of the capital position of the SLOC With-Profits Fund.
- Any future change in methodology will be implemented gradually and only to the extent consistent with these general principles.

The methods used by the Company to guide its determination of the amount payable to with-profits plan-holders follow the above principles, and were also described in that appendix, so that it is envisaged that those methods would be changed only gradually and only to the extent justified by changing circumstances. Any such changes would be approved by the Board, having received the advice of the With-Profits Actuary. The financial condition of the SLOC With-Profits Fund is, however, the dominant criterion used in determining the amount payable to with-profits plan-holders. Some of the factors considered in assessing the financial condition of the SLOC With-Profits Fund include the relative values of the assets and the liabilities, together with the nature of the liabilities and the degree of matching of the guaranteed benefits under the plans.

Life

For with-profits life business, the method used by the Company to guide its determination of the amounts payable involves an investigation into the values that could fairly be attributed to each plan to reflect the actual experience of the Company's with-profits life business.

The amount payable on maturing endowment plans and on death for whole-life plans is based on the prospective value of these plans and how these compare to these plans' proportion of the SLOC With-Profits Fund's assets (subject to a minimum of the guaranteed benefits). The amount payable takes account of both the need to smooth the rate of change of the amounts payable and the financial condition of the SLOC With-Profits Fund.

Pensions

The with-profits pensions business is essentially managed on a deposit administration basis.

The aim of the Company is that the amount payable represents broadly the value that could fairly be attributed to each plan (subject to a minimum of the guaranteed benefits). It reflects the investment return on the underlying assets, after allowing for the amounts charged for the expenses of administering the plan, but taking account of the financial condition of the SLOC With-Profits Fund.

Practices

Life

For with-profits endowment and whole-life plans, the amounts payable on maturity (where applicable) and death are determined by equating the prospective value of future benefits of in-force plans to these plans' proportion of the SLOC With-Profits Fund's assets. The prospective value is calculated using best estimate assumptions for the rate of investment return less an adjustment to allow for risk. The prospective value explicitly takes into account the value of future benefits including future sustainable bonuses plus future expenses; from this, the value of future premiums is deducted. The combined endowment and whole-life proportion of assets was based on the assets allocated to them at demutualisation and is now determined to be the total assets of the SLOC With-Profits Fund less the amount set aside for the pensions business.

Prospective values for endowment and whole-life plans have been increased due to the distribution of the SLOC With-Profits Fund's Inherited Estate (for an explanation of the term Inherited Estate see 'Management of the Inherited Estate'). These increases are not guaranteed and may be withdrawn in sufficiently adverse circumstances.

Pensions

Pensions contracts are essentially deposit administration contracts. The amount payable at retirement, subject to the financial condition of the SLOC With-Profits Fund, is equal to the amount deposited, after deductions for expenses and commission, accumulated with interest credits. These interest credits reflect the investment return obtained on purchase of the assets acquired with the premiums invested in the plan, and the minimum guaranteed interest rates. The amount payable will also, if relevant, take account of the minimum guaranteed annuity option rates included in the terms and conditions of some plans. The income guarantee for the Individual Transfer Plan is guaranteed for those who retire at their declared normal retirement age and the current practice for those who retire earlier or later than their declared normal retirement age is to pay an age-adjusted portion of the income guarantee.

b. Annual bonuses

Principles

Life

Bonuses are added annually to with-profits life plans by the addition of reversionary bonuses, which once added are guaranteed additions to the benefits payable under a with-profits plan on maturity or death.

Reversionary bonus rates take account of the financial condition of the SLOC With-Profits Fund and the overall level of guaranteed benefits being provided. The rates are targeted to allow for the potential payment of a bonus on termination. Regard is also paid to the yields currently available on fixed interest securities. The financial condition of the SLOC With-Profits Fund is, however, the dominant criterion in setting reversionary bonus rates.

Reversionary bonuses are declared using a two-tier scale, with separate rates on sum assured and on attaching reversionary bonuses. The rates of reversionary bonus may be nil.

Separate reversionary bonus scales may be declared for endowment and whole-life plans, or for continuing and paid-up plans, depending on the experience of the SLOC With-Profits Fund under such plans.

Pensions

Bonuses are added annually to pensions contracts in the form of interest rate credits. The interest rate credits are based on the investment return obtained on the assets invested in the plan, subject to the financial condition of the SLOC With-Profits Fund and the minimum guaranteed interest rates applicable. Separate rates can apply to different types of contracts.

Practices

Reversionary bonuses and interest rate credits are declared annually for each year commencing on 1 April, and are added to a plan on its plan anniversary in that year. Interim bonuses are not paid.

In normal conditions, reversionary bonus rates and interest rate credits would not be expected to differ by more than 0.5% from the rates at the previous declaration. In adverse circumstances, the financial condition of the SLOC With-Profits Fund is the dominant criterion in setting reversionary bonus rates.

Life

The Company's current approach to setting reversionary bonus rates on life contracts is to moderate the growth of guaranteed benefits so that the with-profits life business can maintain a reasonable exposure to equity-type assets. In the current low interest rate environment, reversionary bonus rates are unlikely to be increased in the near future.

Normally the same rates of reversionary bonus apply to endowment and whole-life plans. Separate rates may be adopted depending on the experience of the SLOC With-Profits Fund. The rates for some paid-up plans are different from those for continuing plans.

Pensions

For each type of pension contract, an annual interest rate is credited, based on the investment return on the underlying assets, subject to the financial condition of the SLOC With-Profits Fund and the minimum guaranteed interest rates applicable.

For Individual Money Purchase Plans and Individual Transfer Plans, an average rate is declared and applied to all plans of the type of contract concerned. These rates have for many years exceeded current market interest rates owing to the relatively high level of guarantees. For Personal Pension Plans and Group Deposit Administration contracts, a separate rate is declared each year in respect of the cashflows arising in that year.

c. Final bonus

Principles

Life

For endowment and whole-life plans, rates of final bonus, or terminal bonus, are set such that a prospective value of future benefits is equal to their proportion of the SLOC With-Profit Fund's assets in aggregate (subject to a minimum of the guaranteed benefits). This prospective value will take into account the need to smooth the rate of change of the amounts payable and the financial condition of the SLOC With-Profits Fund.

The rates of terminal bonus may be nil on either endowment or whole-life plans.

Pensions

For all pensions contracts the Company has not applied terminal bonus rates in the past, and has no intention to do so in future.

Practices

The Company carries out a review of terminal bonus rates each year, and a new scale of rates is introduced for plans becoming claims from the following 1 April.

The Company regularly monitors movements in the market value of assets in the SLOC With-Profits Fund. When significant changes have occurred in the asset values since the previous scale of terminal bonus rates was introduced, the Company may carry out an additional review of terminal bonus rates and may introduce a new scale of rates applicable to plans becoming claims from the effective date of the new scale.

Life - Maturity and death values

The aim of the Company is that, subject to the financial condition of the SLOC With-Profits Fund, the amounts payable on maturity for endowments and on death for whole-life plans are in aggregate 100% of the endowment and whole-life plans' proportion of the SLOC With-Profits Fund's assets.

Terminal bonuses are set so that the value of the plan's future benefits equates to the plans' proportion of the SLOC With-Profits Fund's assets, taking into account the financial condition of the SLOC With-Profits Fund, the need to smooth the rate of change in the amounts payable, and the need to be equitable between different cohorts of plan-holders and product lines. For endowment and whole-life plans, long term terminal bonus rates have been established for these two product lines and for various outstanding durations to the expected claim date. In reviewing terminal bonus rates, the long term terminal bonus rates will be scaled up or down such that in aggregate, the prospective value of the benefits payable on death or maturity for an endowment plan and on death for a whole-life plan is equal to the value of the plan's proportion of the SLOC With-Profits Fund's assets. Scaling the long term terminal bonus rates may be required when there is a change to future expected experience, including future investment returns, or when actual experience is different from the assumptions used in the previous review of terminal bonus rates. In both situations, any variation from expected will be spread over the future lifetime of the plans.

Life – Surrender values

The calculation bases for surrender values are normally reviewed each year. Subject to the financial condition of the SLOC With-Profits Fund, the aim of the Company is to pay an average of 100% of the benefit for maturities and deaths, less an allowance for the cost of processing the surrender. Surrender values may be reviewed more frequently than annually should investment conditions change.

To achieve this aim, the amount payable on surrender is set equal to the prospective value of the benefits payable on death or maturity for endowment plans and on death for whole-life plans, with appropriate allowance for the cost of processing the surrender. For those whole-life plans with Guaranteed Minimum Death Benefit ("GMDB"), any additional GMDB premiums are excluded in determining the amount payable on surrender. GMDB only applies on death.

The Company does not have any unitised with-profits plans, so the SLOC With-Profits Fund does not apply a market value adjustment when calculating surrender values.

If a significant bulk surrender endowment request is received from a single source, we reserve the right to adjust the surrender values for the relevant cases as necessary to prevent any loss to the SLOC With-Profits Fund.

Pensions

The Company does not apply terminal bonuses to pension plans, and has no intention of doing so in future. With-profits pension plan-holders may take their plans' proceeds in accordance with prevailing legislation.

d. Smoothing

Principles

Life

Terminal bonus rates for life contracts are set so that on death or maturity for endowment plans and on death for whole-life plans, the prospective value of future benefits in aggregate equals the plans' proportion of the SLOC With-Profits Fund's assets. In the short term, as a result of subsequent movements in underlying asset values, the amounts payable may diverge from these targets. However, terminal bonus rates are reviewed, and changed as necessary, so that these targets are broadly met, subject to the financial condition of the SLOC With-Profits Fund and the need to smooth the rate of change of the amounts payable. This smoothing of the fluctuations in investment and other experience is an essential feature of with-profits business.

It is intended that the accumulated underpayments and overpayments on maturing endowment plans, and on death for whole-life plans, compared to their proportion of the SLOC With-Profits Fund's assets, should balance out in the medium term.

The Company will, as far as possible, adopt a similar smoothing policy for all contracts and for all types of claim. The Company does, however, reserve the right in exceptional circumstances to make changes to the basis for determining surrender values other than solely to reflect changes in underlying asset values, in order to maintain the financial condition of the SLOC With-Profits Fund and to maintain equity between those plan-holders who continue their plans and those who surrender them.

Pensions

Issues concerning smoothing do not arise for pensions contracts, since the Company does not apply terminal bonus rates to these contracts.

Practices

Life

Smoothing has been applied in order to maintain equity between different generations of plan-holders, and to avoid weakening the financial condition of the SLOC With-Profits Fund.

The smoothing objective is to mitigate the volatility of investment performance and to reduce the impact on with-profits plan-holders of sharp changes in the market values of underlying assets over short periods, while remaining true to the aim of paying out 100% of the assets supporting endowment and whole-life plans (less an allowance for the costs of processing surrenders and claims) in the longer term.

For endowment and whole-life plans smoothing is also intended to limit year-on-year changes in amounts payable on death on similar plans to less than 10%, but this is subject to the financial condition of the SLOC With-Profits Fund and any guaranteed minimum death benefits.

3. Investment strategy

Principles

The investment strategy of the SLOC With-Profits Fund takes into account the aim of paying satisfactory future bonuses to with-profits plan-holders, whilst at the same time protecting the financial condition of the SLOC With-Profits Fund, particularly bearing in mind the existing and expected future levels of guaranteed benefits under the plans. It is also necessary to take into account the fact that the SLOC With-Profits Fund is currently closed to new business, as well as the future pattern of maturities and expected claims by death or surrender.

When the SLOC With-Profits Fund was established, it did not contain any assets that would not normally be traded, with the exception of loans to which with-profits life plan-holders are entitled under the terms of their plans. It is not expected that the investment return from these loans will have any significant effect on the overall investment return on the SLOC With-Profits Fund.

Separate pools of assets are deemed to back the life business and the pensions business in the SLOC With-Profits Fund, and the investment strategy of the SLOC With-Profits Fund is different for each of these classes of business, as described below, owing to the different nature of the two types of business.

Derivative investments may be used where they either reduce the risk profile of the SLOC With-Profits Fund or enhance the expected return whilst not materially increasing risk exposures. Maximum limits exist for exposure to derivatives and to corporate bonds issued by any one counterparty. The limits for derivatives involve both the market value of the derivative and the potential exposure.

Life

The investment strategy of the SLOC With-Profits Fund in respect of life business is to provide the highest potential investment return consistent with the need to preserve the financial condition of the SLOC With-Profits Fund and the need to pay the guaranteed level of benefits under the plans when due. To this end the SLOC With-Profits Fund is invested in a diverse range of predominantly longer-term assets which includes government fixed interest securities (gilts), corporate bonds, mortgages, equities and property.

Pensions

The investment strategy of the SLOC With-Profits Fund in respect of pensions business is to provide a stable investment return through investment in fixed interest securities. It is necessary to take account of the financial condition of the SLOC With-Profits Fund and the minimum guaranteed interest rates applicable to each type of contract during the period of accumulation prior to retirement, and also the emerging cashflow requirements of the underlying liabilities.

Practices

The Board is responsible for the investment strategy of the SLOC With-Profits Fund, taking account of the principles outlined above. Investment strategy proposals are reviewed by the With-Profits Committee and the Investment Management Committee, a committee established by the Company's management, prior to being considered by the Board for approval.

The Investment Management Committee reviews the investment policy and the financial condition of the SLOC With-Profits Fund regularly. In exceptional investment conditions it will do so more frequently. It comprises experienced senior managers who are qualified to review investment policy, evaluate the various classes of assets and understand their effect on the financial condition of the SLOC With-Profits Fund and plan-holders' future benefits.

The investment policy of the SLOC With-Profits Fund is subject to the investment risk management policies of the Company and associated operating guidelines. These provide a framework of processes, controls and reporting requirements with respect to each class of asset. These investment risk management policies are reviewed by the Risk Committee, a committee of the Board.

The investment guidelines state what types of investments are permitted, and set out limits applicable to individual holdings and classes of asset. In addition, the guidelines cover credit quality and liquidity. The minimum credit quality for bonds (other than gilts) purchased by the SLOC With-Profits Fund is 'BBB' investment grade, while the average credit quality for such bonds should be at least equal to 'A' grade. Where bonds are subsequently downgraded to below investment grade, constraints are imposed on the maximum proportion of fixed interest assets that may be comprised from below investment grade holdings. For life business, there is a requirement that the bond portfolio should include a minimum level of gilts. Liquidity is measured by readily saleable assets and is covered by the requirement to hold a minimum level of gilts, as well as (in respect of the life business) a minimum level of net current assets. These are reviewed by the Investment Management Committee and changed from time to time.

Investment in derivatives to manage risk exposures is permitted by the guidelines, subject, for each type of derivative, to a number of detailed conditions regarding their use. In practice, any such investments would be discussed in advance with the Investment Management Committee, the With-Profits Committee and the Risk Committee. New derivative investment strategies require the approval of the Board.

The Company keeps its investment management arrangements under review and has adopted a multi-manager strategy. Currently, the asset classes of the SLOC With-Profits Fund (equities, bonds, property and cash) are managed by internal and external specialist investment managers under the terms of separate investment management agreements.

The Company routinely monitors its overall exposure to all counterparties and sets limits on its exposure to any one counterparty.

4. Charges and expenses

Principles

Life

The Scheme (as defined in the Introduction) described the costs that may be charged to the SLOC With-Profits Fund. The overall aim of the Company is to apportion expenses fairly to the plans in a manner that reflects the terms of The Scheme.

The expenses apportioned to with-profits life plans for investment management and for ongoing plan servicing will be in accordance with the terms of The Scheme. Any regulatory levies, mis-selling liabilities or other exceptional expenses charged to the SLOC With-Profits Fund may in principle be apportioned to with-profits life plans, subject to individual consideration of the item concerned by the With-Profits Actuary.

Pensions

Expenses will continue to be apportioned to with-profits pensions plans in line with the plan conditions of those plans.

Practices

In accordance with the terms of The Scheme, the Company expects to charge expenses to the SLOC With-Profits Fund at an amount equal to actual costs incurred in managing that fund.

The Scheme established the basis for charging fees to the SLOC With-Profits Fund for ongoing plan servicing. This basis is a fair apportionment, in the opinion of the With-Profits Actuary, of the Company's renewal costs between the SLOC With-Profits Fund and the Non-Profit Fund. The Company will continue its efforts to avoid undue increases in the costs incurred in managing the SLOC With-Profits Fund, and the fees charged to plan-holders. There is also an ongoing requirement for the With-Profits Actuary to confirm each year that the fees charged to the SLOC With-Profits Fund represent a fair apportionment of the Company's costs.

Ongoing plan servicing is provided through an agreement with Diligenta Limited. The fees paid under this agreement for servicing the with-profits business, together with the share of the central overheads of the Company attributable to the SLOC With-Profits Fund in the opinion of the With-Profits Actuary, are charged to the SLOC With-Profits Fund.

Under The Scheme, regulatory levies may be charged to the SLOC With-Profits Fund on a fair apportionment basis, as determined by the Company and reviewed by the With-Profits Actuary.

The agreement with Diligenta Limited provides ongoing plan servicing, giving the Company the option for a break after an initial ten-year term ending in 2018. The Company may terminate this agreement by giving 12 months' notice.

The Scheme also established the basis for charging fees to the SLOC With-Profits Fund for investment management. Investment management services to the Company are provided through agreements with specialist investment managers, with the appropriate proportion of the fees being charged to the SLOC With-Profits Fund.

The Company may terminate the agreement with any of its investment managers by giving the agreed notice period. This period varies between one and three months' notice depending on the individual investment manager contracts that reflect the specific characteristics of the different asset classes.

The Company may also terminate any of the above agreements, with a shorter period of notice, on the occurrence of certain events, including material breaches of the agreement. The Company will review the agreements each year, and may consider alternative options for the provision of these services, and the associated costs.

It is not permitted to charge any regulatory fines to the SLOC With-Profits Fund nor any liabilities in respect of mis-selling arising after 31 July 2009.

Life

The expenses described above are those charged to the SLOC With-Profits Fund. Expenses are apportioned to endowment and whole-life plans' proportion of the SLOC With-Profits Fund's assets, to guide the determination of the amounts payable under the plans. The expenses currently so apportioned consist of investment management fees on the basis currently payable, together with charges for ongoing plan servicing. These latter charges represent the fees paid to Diligenta Limited, together with the share of the central overheads of the Company attributable to plans in the SLOC With-Profits Fund in the opinion of the With-Profits Actuary.

Pensions

The expenses charged to the deposit funds of with-profits pensions plans consist of an annual plan fee in the case of Individual Money Purchase Plans, and the charges defined in the plan conditions in the case of Group Deposit Administration contracts. There is no explicit expense charge for Individual Transfer Plans. The annual bonus rates for all pensions contracts are set after deducting a margin for investment expenses.

5. Management of the Inherited Estate

Principles

When the SLOC With-Profits Fund was established, sufficient assets were allocated to the SLOC With-Profits Fund in order to meet the reasonable expectations of plan-holders in normal circumstances.

Additional capital support assets were also allocated to the SLOC With-Profits Fund when it was established, in order to provide long-term support for the reasonable expectations of plan-holders, if required in adverse circumstances. These assets are referred to as the Inherited Estate. Since establishment, these assets have been supplemented by past profits and been partially distributed as reversionary or terminal bonuses to with-profits life plan-holders as they have terminated.

The Company has now largely allocated the Inherited Estate to with-profits life plan-holders and is distributing it in a fair manner over time to terminating plans by increasing terminal bonuses. These increases are not guaranteed and may be withdrawn in sufficiently adverse circumstances. The Company will maintain a modest level of undistributed Inherited Estate in order to meet the relevant regulatory capital requirements.

Under the terms of The Scheme, when the value of assets in the SLOC With-Profits Fund falls below £100 million (adjusted for movements in the Retail Price Index since March 2000), it need not be maintained as a separate fund and, subject to the approval of the PRA and/or FCA, it may be amalgamated with the remaining Non-Profit Fund. On any such amalgamation, all of the remaining surplus in the SLOC With-Profits Fund will be allocated to the existing plans by way of bonus or benefit increases, and the plans will become non-profit. If the Company has continued to maintain a separate SLOC With-Profits Fund, it must be wound up in this way once the value of assets in the SLOC With-Profits Fund falls below £10 million (adjusted for movements in the Retail Price Index since March 2000).

Practices

The Inherited Estate distribution is implemented by means of increasing prospective values for endowment and whole-life plans. These increases are not guaranteed and may be withdrawn in sufficiently adverse circumstances.

None of the Inherited Estate is allocated to pension plan-holders. This is judged to be fair and reasonable as pension plan-holders have no exposure to fluctuating terminal bonuses, most receive guaranteed benefits from the SLOC With-Profits Fund in the form of minimum investment return and most have guaranteed terms for converting their plan's cash value at retirement into an income for life.

It is intended that the SLOC With-Profits Fund will be managed without recourse to other funds in the Company. However, if, in extreme adverse economic circumstances, any previous Inherited Estate distribution is withdrawn and this still proves to be insufficient to meet the reasonable expectations of plan-holders, the SLOC With-Profits Fund will have recourse to the Segregated Non-Profit Sub-Fund which was set up within the Non-Profit Fund under the terms of The Scheme.

In these circumstances, on the recommendation of the With-Profits Actuary, and in accordance with the provisions of The Scheme, the Board, mindful of its obligation to treat customers fairly, may transfer assets from the Segregated Non-Profit Sub-Fund to the extent necessary to meet the guarantee costs expected to arise in the SLOC With-Profits Fund over the next 12 months. No circumstances have yet arisen where such transfers have been deemed necessary.

The purpose of this Segregated Non-Profit Sub-Fund is to provide support only in extreme adverse circumstances, and not to enhance plan-holder returns. The existence of the Segregated Non-Profits Sub-Fund offers plan-holders a degree of protection from the cost of, or charges for, guarantees that might otherwise be levied were the Segregated Non-Profit Sub-Fund not to exist. The Scheme sets out the basis on which the investment income of the Segregated Non-Profit Sub-Fund may be transferred to the remaining Non-Profit Fund. The capital of the Segregated Non-Profit Sub-Fund may also be released to the remaining Non-Profit Fund, in line with any reduction in the volume of with-profits business, subject to the approval of the With-Profits Actuary. At any time after 22 March 2010, the whole of the capital of the Segregated Non-Profit Sub-Fund may be released to the remaining Non-Profit Fund, subject to the approval of the PRA and/or FCA, if, in the opinion of the With-Profits Actuary, it is no longer required to support the SLOC With-Profits Fund.

6. Volumes of new business and arrangements on cessation of writing new business

Principles

The SLOC With-Profits Fund is currently closed to new business.

Practices

Since 2001 no new with-profits life plans can be taken out. No new with-profits pensions business has been written since 1991, with the exception of new entrants to existing schemes.

7. Business risk

Principles

The Company has an overall risk management framework that is consistent with the worldwide policy of Sun Life Assurance Company of Canada. This risk management framework is reviewed annually and ratified by the Board. Risk management is considered across all the Company's operations including the SLOC With-Profits Fund.

The Company aims to manage the exposure of the SLOC With-Profits Fund itself to business risk, bearing in mind plan-holder expectations, the levels of guaranteed benefits under the plans, and the need to protect the financial condition of the SLOC With-Profits Fund. There is currently no intention to take on any new business risks within the SLOC With-Profits Fund. The main business risks to which the SLOC With-Profits Fund is currently exposed are essentially those inherent in maintaining the existing with-profits plans as they run off over time. Any costs arising as a result of these business risks would be met as described under Practices below.

Practices

The Company, through its Risk Committee, identifies and manages those risks considered most relevant to the operation over its planning horizon. These risks are identified and reported to the Board, along with specific mitigating actions identified. As a result of the Company's risk management principles, as described above, any business risks known to exist within the SLOC With-Profits Fund are regularly monitored. Experience has shown that the type of risks to which the SLOC With-Profits Fund is exposed have remained stable. The SLOC With-Profits Fund is not directly exposed to any risks associated with non-profit business, the taking on of any new business, or through investment in subsidiary Companies.

Underpinning this top-down risk approach are detailed, functional area risk registers. These are carried out at a more detailed level, and are reviewed on a quarterly basis. Where the operational responsibility for the risk now sits within an outsourced partner, reviews actively involve that outsourcer. Risk strategies and policies within outsource partners are monitored to ensure that they match the standards set by the Company's own policies. The business risks to which the SLOC With-Profits Fund is exposed include risks that are natural to with-profits plans. Some of these risks are intended to be borne by the SLOC With-Profits Fund. These include, for example, any short-term cost of smoothing the rate of change of the amounts payable under the plans, or the cost of meeting guaranteed benefits that exceed their proportion of the SLOC With-Profits Fund's assets for endowment and whole-life plans.

Some other business risks that are natural to with-profits plans are borne for endowments and whole-life plans by the proportion of the SLOC With-Profits Fund's assets, and would therefore automatically be taken into account in determining the amounts payable under the plans. These risks include investment risk, although the effect of this is managed to some extent by the investment strategy of the SLOC With-Profits Fund. Other such risks are the level of expenses and taxes to be charged the prospective value of the endowment and whole-life plans in the future, and the effect of mortality. In addition, charges for the cost of meeting guaranteed benefits under plans may be made to the proportion of the SLOC With-Profits Fund's assets in future, if approved by the Board on the advice of the With-Profits Actuary.

Because the SLOC With-Profits Fund is currently closed to new business, it could be exposed in future to the risk of being unable to continue to deliver effective investment management and ongoing plan servicing at a reasonable cost. These services have therefore been obtained through outsourcing agreements, which are regularly monitored.

8. Equity between the SLOC With-Profits Fund and shareholders

Principles

Under the terms of The Scheme, surplus arising in the SLOC With-Profits Fund accrues exclusively for the benefit of the plan-holders in that fund. No transfers of surplus can be made from the SLOC With-Profits Fund to the Non-Profit Fund. There is no expectation of using the Non-Profit Fund to support the SLOC With-Profits Fund. However, as explained under Management of the Inherited Estate, if, in extreme adverse economic circumstances, the SLOC With-Profits Fund proves to be insufficient to meet the reasonable expectations of plan-holders, the SLOC With-Profits Fund will have recourse to the Segregated Non-Profit Sub-Fund within the Non-Profit Fund.

The tax attributed each year to the SLOC With-Profits Fund is the same as the tax that would be calculated if that fund were a separate mutual life insurance company.

Practices

In practice the SLOC With-Profits Fund is run in accordance with the Principles above.

SL3551-06/18
MC00000055/0717