Commonly asked questions about Par

Participating (Par) life insurance can be a popular choice for Clients. But many Clients and advisors still have questions about how Par products work. Here are answers to commonly asked questions about how Par works, about comparing different Par offerings and about the Sun Life Par Account – one of the oldest and most respected in Canada.

How do today's participating life insurance products differ from non-participating whole life products?

Both participating and non-participating whole life policies share a foundation of guaranteed premiums, guaranteed cash values and guaranteed death benefits.

One of the differences between participating insurance (Par) and non-participating insurance is that participating policyholders share the risk with their insurance company. This means Par policyholders also share the benefits when performance is better than expected. This sharing comes in the form of dividends. And although dividends aren't guaranteed, Sun Life has been paying dividends to its participating policyholders every year since 1877. Non-participating policies don't benefit from this risk sharing. Non-par policies don't benefit from positive performance and aren't penalized by poor ones.

We determine the guaranteed values for participating policies using relatively conservative assumptions for those risks shared with the policyholders, such as investment returns, mortality and expenses. Every year, we compare these assumptions with actual results and realistic (not optimistic) future expectations. When the actual results are better than our original conservative expectation, policyholders receive the earnings as dividends.

In Canada, insurance companies market a wide range of non-participating whole life products. The most basic are the T-100 type plans with guaranteed premiums payable for life. These provide a flat guaranteed death benefit with no cash values. The insurer bears the insurance risk completely. This means the insurer also absorbs any experience gains or losses (i.e., profit or loss).

In addition to this basic T-100 structure, insurance companies offer more complicated products. These involve cash values that are either guaranteed, or that grow with an associated investment account. The premium payments can be for a defined period. The death benefit can be indexed or provide growth through crediting that associated investment account.

Participating insurance has many unique characteristics. Par enjoys a high level of oversight and safeguards. For example, Sun Life's Board of Directors approves the Appointed Actuary's recommendations on the dividends available to distribute and the dividend scale used to allocate them. These reviews must occur annually, at minimum. The Appointed Actuary follows professional standards of practice set by the Canadian Institute of Actuaries. Every year the Appointed Actuary also reports to the Office of the Superintendent of Financial Institutions (OSFI), confirming that Par policies are being appropriately managed. Non-participating insurance, however, doesn't benefit from such oversight.

How do I compare one company's product to another?

Several Par products are available on the market today. The same industry-wide rules and oversight govern all Canadian products. All insured lives are underwritten in a similar manner, and each Par portfolio has the majority of assets invested in fixed-income instruments. All Par products should achieve the mandate of providing insurance at cost over the long term.

So what differences are worth considering when it comes to Par products? All of them have unique designs that you need to understand before making an informed Par product decision. All designs have their merits; the decision on which is best rests with the preferences or goals of the Client.

The industry offers two options that lean in one direction or the other. Some Par products offer fairly high, short-term liquidity and have cash values that exceed total premiums paid around the five-year mark. Other products have lower cash values for approximately the first 15 years and, in turn, provide greater growth over the long term. All things being equal, the lower the base premium the Par product has, the lower the dividends. But lower base premium products sometimes come with higher limits on additional optional premiums for those who want to continue putting money into an insurance policy.

All Par products disclose that dividends are dependent on the investment, mortality and expense experience of the Par block of business overall. What they don't fully disclose is the relative weighting of these three components, which will vary from product to product. There will be differences, especially on the investment side, which is generally considered the largest contributor to annual Par dividends. This apparent gap in disclosure has to do with the difficulty explaining intricate actuarial engineering principles.

The insurance sales illustration has been the tool of choice for many advisors when presenting product proposals. It's part of the equation, but an informed decision goes far beyond the sales illustration.

How stable has the participating account been over time?

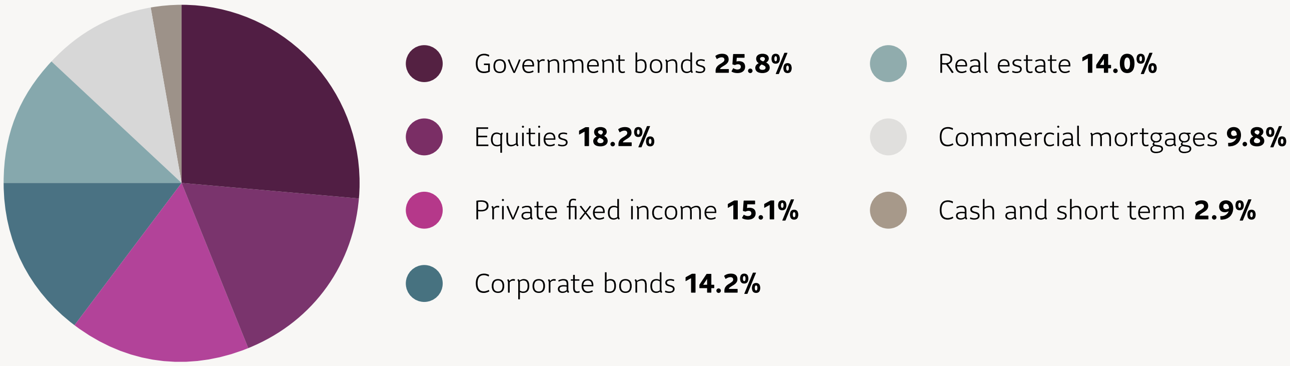
The standard deviation of the dividend scale interest rate is the measure of the degree of stability or volatility over time. Gains and losses are amortized within the participating account to smooth returns, which stabilizes the dividend scale interest rate over the long term. The Sun Life Par Account has a very low standard deviation even when compared to other conservative investments in the market, including the Government of Canada 10-year bond and other insurance companies' Par accounts.

Standard deviation (%) as of December 31, 2021*		
Time period	**25 years**	**30 years**
Sun Life dividend scale interest rate	0.83	1.17
Government of Canada 10 year bonds	1.67	2.34
S&P/TSX total return	16.33	15.74
Five year GIC	1.36	2.14
Consumer Price index	0.94	0.97

What is the asset mix of the underlying Par account? Will it continue to provide strong returns?

The Sun Life Par Account holds a higher percentage of private fixed income than the Par accounts of most other competitors. Private fixed income typically provides favorable spreads, better terms and a broader range of diversification opportunities than publicly issued bonds. The Sun Life Par Account also holds a high percentage of real estate, which protects against inflation and offers a hedge in low interest rate environments. Our bond portfolio is strong with 100% of holdings ranked as investment grade. We also use double-A and single-A issues, giving us the opportunity for an enhanced risk-adjusted return.

Invested asset mix of the Sun Life Participating Account as of December 31, 2021



Are negative mortality risks being introduced into the participating block?

The basis for Par is fairness, ensuring that all Clients pay their fair share to cover the risk they introduce to the participating group. There are some companies in the industry that could be increasing mortality risk through administrative practices. Things like rating reductions, joint ages that are aggressively set or allowing additional deposits at any time with no underwriting could erode mortality experience down the road. Par should be about ensuring fairness to all Par policyholders.

What is an 'open block' and a 'closed block' for Par?

In Canada, creating 'closed' and 'open' blocks within participating accounts results from before and after demutualization. Demutualization is how an insurance company transforms itself from a mutual company (owned by policyholders) to a stock company (owned by stockholders). Several Canadian insurance companies went through this process at the turn of the century, including Sun Life, Manulife and Canada Life.

When a company demutualizes, it groups participating policies sold before demutualization into their own sub-account of the participating account known as the 'closed block'. Over time, policyholders receive earnings generated in the closed block through the dividend process. Shareholders received the surplus from the 'closed block' at demutualization and policyholders received shares in the new public company, so the surplus for this block is now zero.

Policies issued after demutualization are grouped in the other sub-account called the 'open block'. Like the closed block, policyholders receive earnings as dividends.

At Sun Life, we pool assets for both the open and closed blocks with investment experience shared across both blocks. This means that **both the open and closed blocks have the same dividend scale interest rate.**

How much do the key components of the dividend scale contribute to the actual dividends credited?

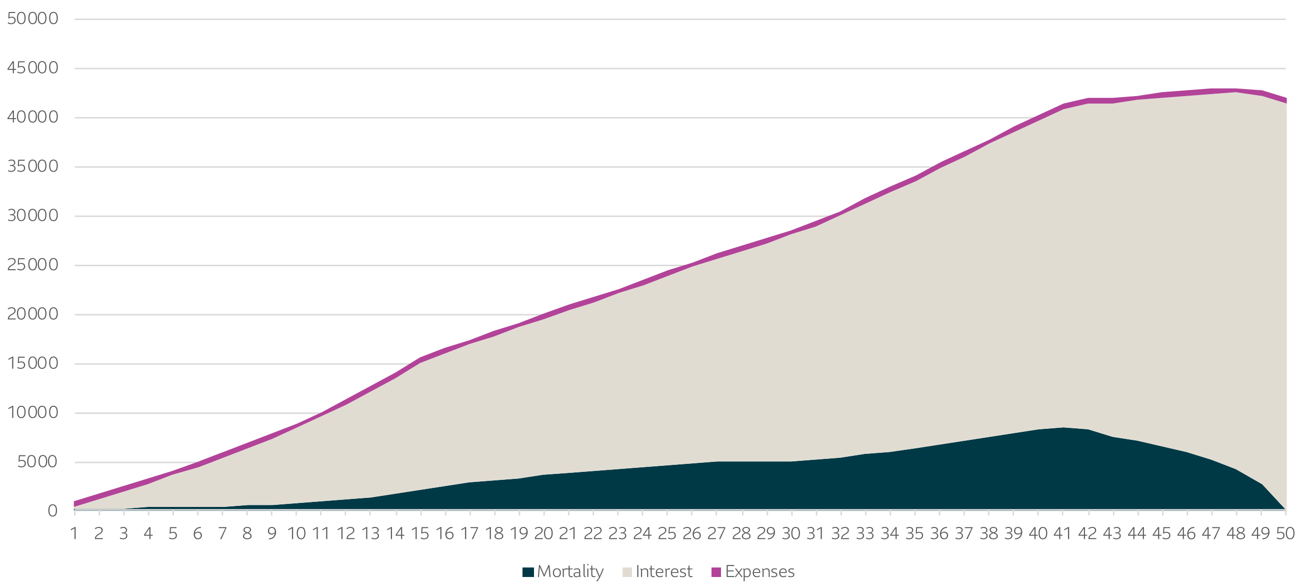
We base policyholder dividends on the difference between the actual experience of the block of participating insurance and assumptions made for the key risks we share with policyholders. Examples of these key risks can include: investment returns from the Par account, mortality (i.e., claims experience), expenses and lapses.

The impact any of these components will have on a dividend will vary by many different factors including:

- Product design
- Issue age and risk class
- Length of time a policy has been in-force (duration)
- How past dividends have been allocated (e.g., cash vs. paid-up additions)
- The level of conservatism in the original assumptions used to establish the guarantees

Here's an example of the proportion of the key components that make up the dividend:

Dividend breakdown

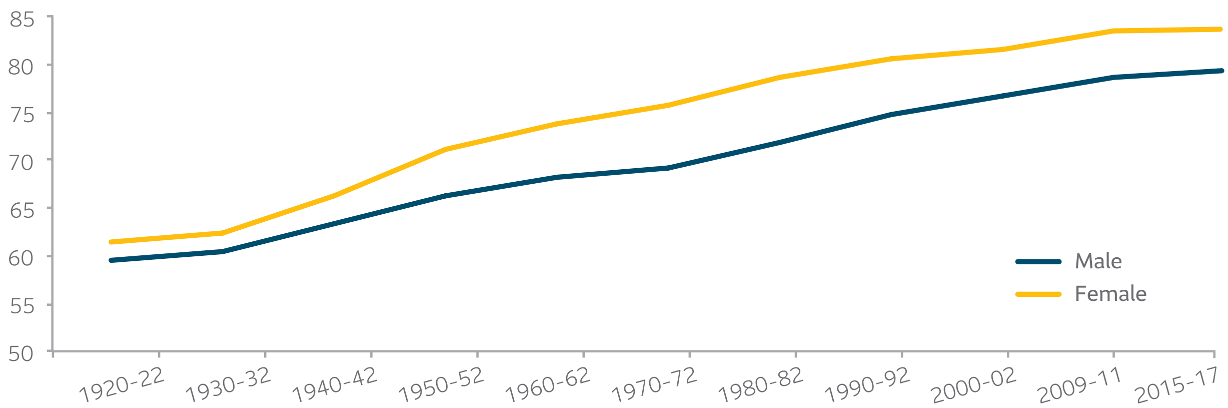


Sun Par Protector II, Life Pay, Male non-smoker age 50, $1M face amount, current dividend scale.
This example is for illustrative purposes only and may not reflect an actual policy's dividend performance.

Typically, the investment component will have the largest impact on dividend performance over time. Although mortality experience tends to have a smaller effect on dividends, it has demonstrated stable and continuous improvement in Canada over the last century. This improvement gives the dividend scale some added stability. It also hedges against other, less predictable risks shared by the policyholders such as long-term interest rates.

Mortality experience also has an impact on the future performance of dividends. Life expectancy has generally been improving over the last 100 years creating opportunities for enhanced mortality experience. This can have a positive impact on dividends over time.

Life expectancy



Source: Statistics Canada – Canada Life expectancy at birth

Lapses could have a negative impact on future dividends when they occur at very early durations. That impact depends on the plan type, payment period, risk class and dividend option. If a policy is cancelled in a later duration (approximately the 8th – 12th), the built up reserves will sustain the lapse, without negatively impacting dividends. When lapses are greater than expected in the early years, there may be a negative impact to dividends for policies with large upfront cash value designs.

Does the dividend scale interest rate reflect the annual growth of the total Cash Surrender Value (CSV)?

No, it doesn't. We don't credit the dividend scale interest rate to an account value. It's used in a formula to calculate the investment component of the dividend credited to policyholders.

Two components make up the total cash surrender value. The guaranteed cash value is one. The other is the cash value created when the policyholder puts dividends back into the policy through dividend options such as paid-up additions.

Guaranteed cash values are part of the product's design. Some plans provide higher cash values at the earlier durations, while others focus on the potential for higher long-term growth. This guaranteed component of the cash value isn't related to the dividend scale interest rate. It's based on relatively conservative assumptions for the guaranteed mortality and interest assumptions used when designing the products.

The remaining cash values result from dividends reinvested back into a policy through dividend options like paid-up additions.

The dividend scale interest rate is one of the components of the dividend scale and represents the investment experience of the participating account. Other factors can include mortality and expenses. Therefore, while correlated with the dividend scale interest rate, the growth in cash value cannot be calculated using this rate. The dividend scale interest rate will never be negative and cash values will never be lower than the previous year's cash value once it has been vested (assuming the Client has not selected withdrawals, surrenders or premium offset).

On the other hand, Universal Life (UL) provides investment options that can credit interest directly to the account value (positive or negative returns). For UL, this interest rate directly relates to the change in the account value on a daily basis once the cost of insurance is deducted.

Is it possible to predict the dividend scale over the short period or long term?

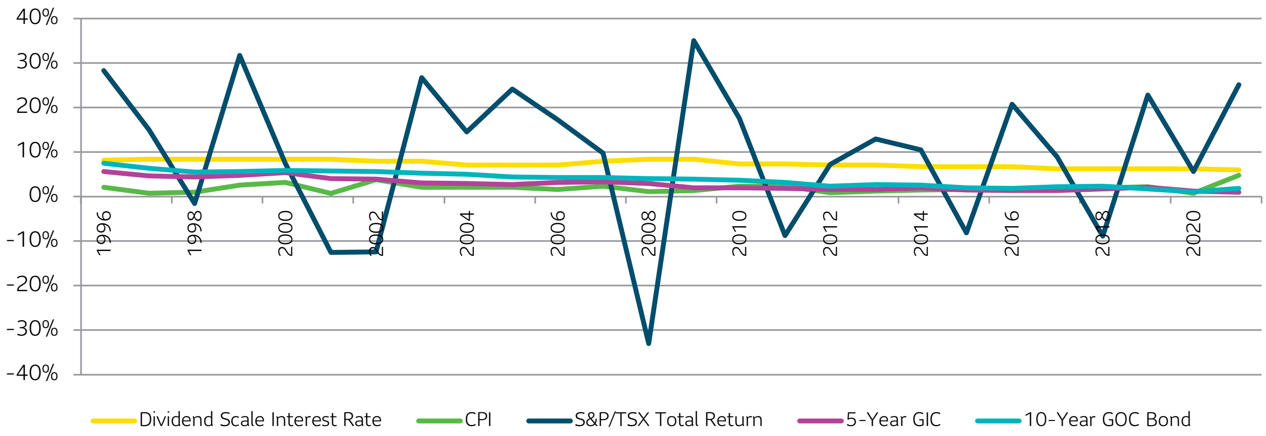
Dividend scales don't change often or dramatically over short periods when compared to other market indicators.

Historial average returns as of December 31, 2021*				
Time period	**1 year**	**5 year**	**10 year**	**25 year**
Sun Life dividend scale interest rate	6.00	6.20	6.56	7.37
Government of Canada 10 year bonds	1.80	2.15	2.22	3.81
S&P/TSX total return	25.09	10.76	9.73	9.13
Five year GIC	0.98	1.55	1.59	2.68
Consumer Price index	4.80	2.43	1.88	1.94

Participating insurance, like most other permanent insurance products, is intended for Clients wanting a relatively long-term commitment, lasting 30 years or more in many instances. So, while there has been little volatility, short-term expectations of returns on a participating insurance policy may not be an important consideration.

Over the long term, dividends and the dividend scale interest rate have demonstrated stronger and more stable returns than other investment options. However, it's not possible to predict accurate long-term returns for any investment.

The following graph demonstrates the Sun Life Participating Account dividend scale interest rate's stability compared to returns on Government of Canada (GOC) 10-year bonds, the S&P/TSX index, five-year guaranteed investment certificate (GIC) returns and the Consumer Price Index.*



What is the recent history of the yield of the assets in the participating account?

Par accounts are managed to provide quality, stable returns over the long term. Bonds are usually held to maturity, equity investments are more passively managed and the overall mix of investments doesn't dramatically change over shorter periods of time. Returns are smoothed to reduce volatility.

The policyholder dividend isn't a direct function of the portfolio's market yield but rather the dividend scale interest rate.

The dividend scale interest rate is a reflection of both smoothed returns over the recent past and the realistic, perhaps conservative, expectation of investment returns looking forward.

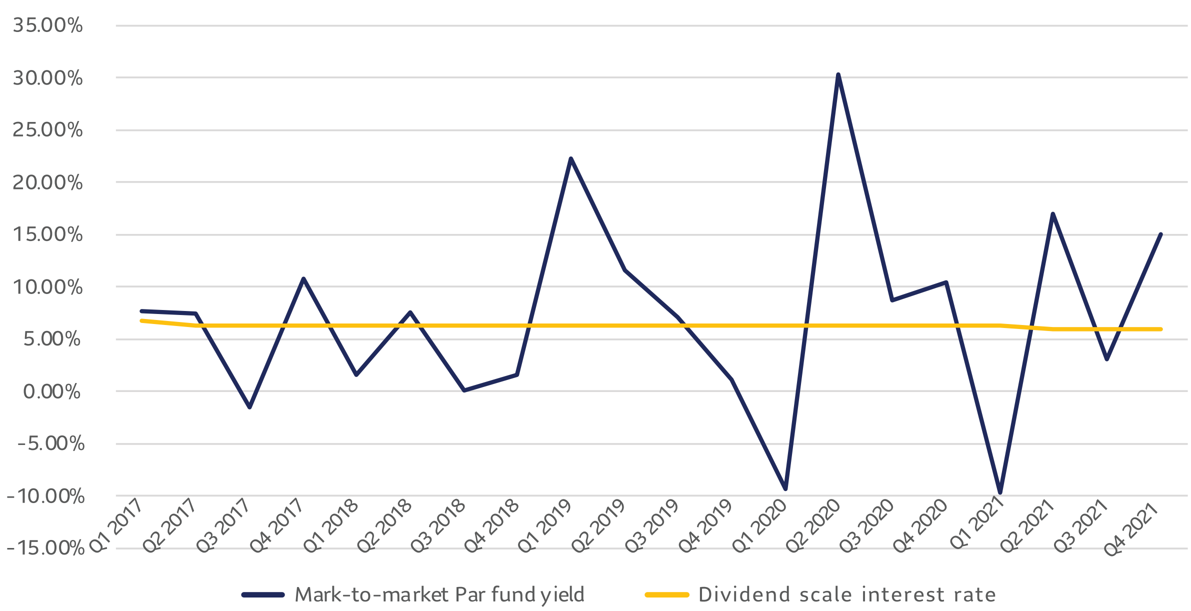
Par is a permanent insurance product with investments managed for the long term. A short-term mark-to-market yield may not accurately reflect the behaviour of the dividend scale interest rate, while also potentially setting inappropriate expectations over the short term.

As an example, in an environment where interest rates are decreasing, the market value of bonds will increase. However, Par portfolios, in many cases, will hold bonds to maturity. A decreasing interest rate environment could indicate future decreases in the dividend scale interest rate, all other things being equal. If interest rates were to rise, this could indicate future increases in the dividend scale interest rate, however because of smoothing the increases or decreases in the dividend scale interest rate will happen gradually. A market yield may make this expectation difficult to understand.

While challenging, short-term volatility in the markets shouldn't be a key consideration for a Client when buying or keeping a Par policy. More importantly, one should understand such considerations as the Client's risk profile, their needs and their long term expectations.

The quarterly mark-to-market return is shown in the chart below:

Par fund yield vs the dividend scale interest rate



The correlation coefficient of the mark-to-market Par fund yield to the dividend scale interest rate is very low at -0.11. We haven't disclosed our annual yield historically as it's not the return that Clients can expect to see in their policy. A better indicator to consider is the standard deviation of the dividend scale interest rate, which will show the stability of the fund over time, and the correlation to Government bonds.

The mark-to-market return isn't used when determining the amount of dividends to be distributed annually. We employ smoothing techniques which are used to help determine what dividends are eligible to be paid.

Industry wide, the calculation of disclosed yields doesn't seem to be consistent. There are those that use average bond yields, while using mark-to-market yields of other assets. Others may disclose a 'smoothed yield', but don't indicate how that smoothed formula is determined.

Do Par portfolio mixes change over time to reflect current market realities?

Sun Life has a well-diversified and high-quality asset portfolio that adheres to a research-based process conducted by more than 200 experienced professionals and support staff. This means we buy only what we know about. And we make sure our investments are diversified in various industries, companies, asset classes and financial instruments.

We continue to invest in assets with maturity dates of 20-plus years to align with our liabilities. This helps to minimize interest rate risk. We take an active investment approach that's consistent and disciplined. This helps us identify, measure, monitor and manage risk. Our general investment philosophy hasn't changed over the last 30 years. We've been providing value to our policyholders since 1877, with dividends distributed every year.

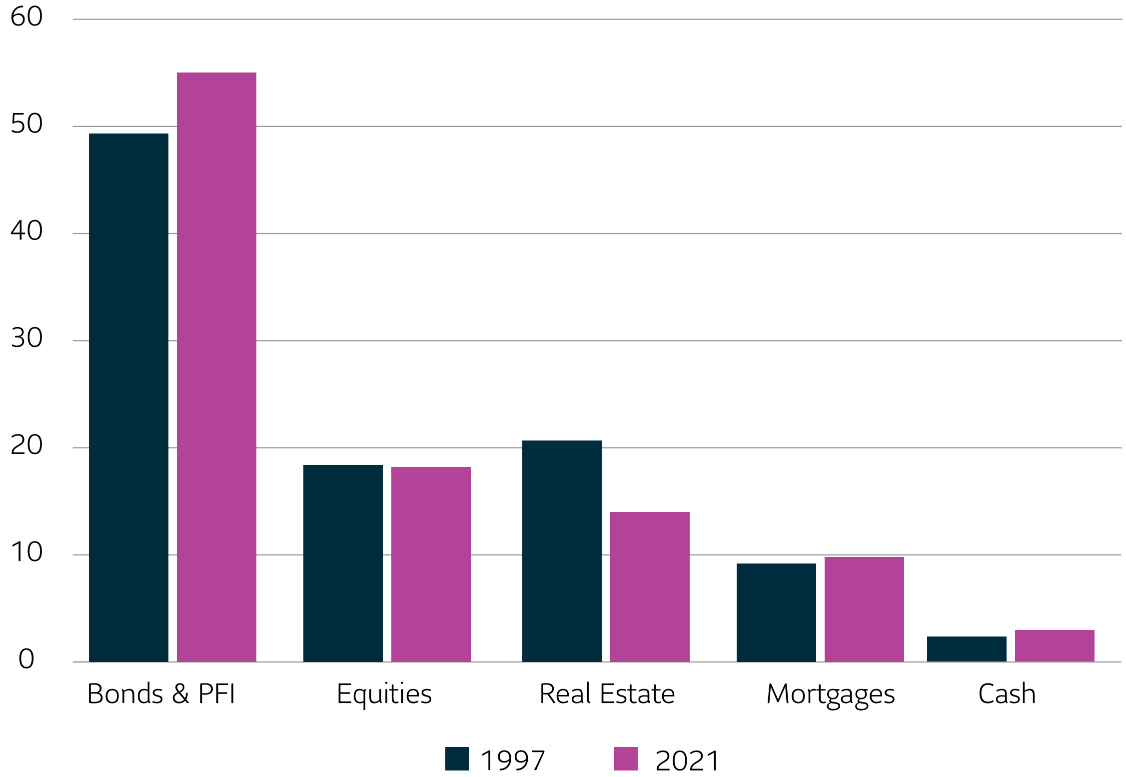
For each asset class, there's a tactical range and strategic target for how much we invest. These ranges and targets are the Sun Life Par Account's asset allocation model. The investment teams monitor the tactical ranges of each asset class to make sure that they stay within these ranges. They create these ranges by setting the optimum mix of assets needed to meet our liability obligations. These ranges are reviewed at least annually.

Targeted asset mix

	Strategic	Tactical range	
	Target %	Min %	Max %
Cash and short term	**0.5**	**0**	**4**
Fixed income			
Public fixed income	41.0	33	49
Private fixed income	12.5	5	20
Commercial mortgages	12.0	4	20
Total fixed income	**65.5**	**43**	**89**
Real estate	17.0	12	22
Public equities	12.0	8	18
Private equities	5.0	1	7.5
Other assets	0	0	2
Total non-fixed income	**34.0**	**21**	**49.5**
Total assets	**100**		

Here is the Sun Life Participating Account's investment mix at the end of 1997 and 2021. The investment mix has changed very little over this period even though there's been significant volatility in Canadian investment markets and changes to interest rates.

Par account asset mix



What role does surplus play in a participating account? And why has Sun Life's Par surplus increased so substantially since 2015?

There are many major applications of the Par surplus. It helps:

- Support costs associated with new business sales
- Allow for the smoothing of returns and stabilizes the dividend scale interest rate over time
- Support the stability of the dividend scale from claim and cash flow fluctuations
- Ensures companies meet obligations to participating policyholders
- Ensures financial strength and stability and is a key measure of solvency

Various factors influence surplus levels, including:

- Contributions from in-force business, which can lead to surplus increases
- Strain from selling new business, because commissions and administrative costs can decrease surplus
- Experience gains and/or losses that may not be passed back every year in which they are experienced, leading to either increases or decreases in surplus
- Smoothing of the dividend scale interest rate

Since Sun Life re-entered the Par market in June 2010, we've had increasingly strong new business sales. We're now one of the top manufacturers of Par insurance in Canada. A relatively new open Par account that's growing quickly may have more strain in its surplus levels. This is mainly due to the upfront expenses of selling policies. Our open block has grown substantially because of high new business sales. And our Par account is aging. This means over the last few years the larger inforce block adds more to the surplus than any strain from new business sales.

Also, the total liabilities and the surplus must equal the assets of a Par account every year. In 2016 and 2018, the calculation of the provisions we hold for risk led to fewer liabilities (e.g., investment, mortality, lapse and expense experience). This decrease in liabilities also increased the surplus.

Surplus levels

End of year	2015	2016	2017	2018	2019	2020	2021
Surplus ($M)	39	265	472	753	926	1,123	1,399

As of December 31, 2021, assets backing the open block in the Sun Life Par Account were $6.71 billion.

Why do expense loads on additonal deposits vary by company?

The expense load on the Plus premium benefit (additional deposits) for Sun Par policies is 10%. This charge covers costs such as commissions, premium tax, investment income tax, firm fees and administrative expenses. All companies have similar expenses and we're ensuring that those costs are properly accounted for.

Some others in the industry may not initially charge enough to pay for all of these expenses. This means they'll have to pass back any shortfall to cover for these expenses to policyholders in the form of lower dividends later on. This could impact dividend growth in the future. At Sun Life, we want to appropriately charge all expenses, but if there's any excess we'll pass it back to the policyholders as a positive input to dividends.

Notes:

1. *The dividend scale interest rate is based on the Sun Life Participating Account. It isn't guaranteed and is based on factors that are certain to change. The dividend scale interest rate is neither an estimate nor a guarantee of how the products will perform in the future.*
2. *Government of Canada bond returns are nominal yields to maturity taken from Statistics Canada. Table 10-10-0122-01 Financial market statistics, December 31, 2021, Bank of Canada.*
3. *S&P/TSX composite total returns include the reinvestment of dividends.*
4. *Five-year GIC returns are nominal yields to maturity taken from Statistics Canada. Table 10-10-0145-01 Financial market statistics, December 31, 2021.*
5. *Consumer Price Index is taken from Statistics Canada. Table 18-10-0004-01 Consumer Price Index, monthly, not seasonally adjusted.*

Sun Life

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