



**Sun Life Financial
of Canada**

**The Directors' Annual Report
to the Plan holders**

**Sun Life Assurance Company of
Canada (UK) Limited**

With-Profits Fund

Introduction

This annual report explains how we managed the With-Profits Fund in 2008. It includes a report from our With-Profits Actuary.

Summary

The Directors considered the advice and reports of the With-Profits Committee and the With-Profits Actuary to satisfy themselves that for the financial year 2008:

- We have managed the With-Profits Fund properly in line with the Principles and Practices of Financial Management – which we call the ‘PPFM’ in the rest of this report.
- Our use of management discretion is provided for by the PPFM framework.
- There has been an appropriate degree of protection for all plan holders and we have taken into account their rights, interests and expectations 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.

This report describes how we used our management discretion when making key decisions during 2008, with advice from the With-Profits Actuary.

Management Committee

The Management Committee continued to meet regularly to:

- Make sure we give the With-Profits Committee and the With-Profits Actuary enough information to meet their regulatory and reporting responsibilities. The With-Profits Committee of the Board met four times during 2008, with an additional meeting specifically to consider the methodology change for whole-life plans.
- Make sure all decisions are carried out properly.
- Review and update the PPFMs and ‘customer-friendly’ versions of the PPFMs to ensure they give a good description of how we manage the funds.

The Board of Directors approves these documents and the Management Committee will continue to review them each year. These documents are available on our website and on request.

Management of Payouts

A key part of management discretion is to decide the annual and final bonuses.

We monitor the bonuses through the year to ensure we meet the PPFM objectives. This includes making sure the resulting endowment payouts at maturity are within 10% of asset shares in normal circumstances and that we treat different groups of plan holders fairly.

We also review the surrender values to make sure they stay on average within 10% of asset shares for endowments, less the cost of processing the surrender claims, and within 10% of the prospective value of benefits for whole-life plans in normal circumstances to meet the PPFM objective.

Market conditions during 2008 were turbulent and extremely difficult, so at times payouts (both surrenders and maturities) were more than 10% higher than asset share

In determining bonus rates, we adopt a formal process of smoothing investment returns. The aim is to ensure that plan holders are not exposed to the full impact of sharp changes in market values from year to year. This smoothing process meant that we held back some of the investment return earned before 2008, where investment performance was above average. Investment returns in 2008 and in the first quarter of 2009 were negative. The smoothing process allows us to pay more to maturing plans from 1 April 2009 than would be possible if we reflected the full impact of movements in market values in the amounts payable. The smoothing process is consistent with treating different groups of plan holders fairly.

Despite continuing to apply the smoothing process, the deterioration in investment conditions, particularly in the final quarter of 2008, obliged the With Profits Committee to approve and implement two interim reductions to payouts in order to meet the PPFM objectives and ensure fairness for continuing plan holders. These interim reductions were implemented on 28 October and 8 December

The bonuses which take effect from 1 April 2009 allow for a new method of calculating whole-life plan payouts, which is explained in the PPFM. We have introduced this new method to maintain a fair balance between payouts for plans becoming claims on death and plans remaining in the fund and recognise the difference between endowment and whole-life plans. We will introduce the changes gradually, so 2009 whole-life terminal bonus rates will be mostly based on equivalent endowment terminal bonus rates. We sent letters in December 2008 to whole-life plan holders explaining the changes to the PPFMs.

The With-Profits Actuary provided advice to the With-Profits Committee about the impact of the recommended bonus scales, and the change to the methodology for whole-life plans. KPMG LLP also provided advice to the Company on the whole-life methodology change.

Investment Management

There was a significant change in the asset mix of the With-Profits Fund during 2008 due to a combination of market movements and sales of equity and property holdings. The fund held approximately 43% of its assets in equities and property investments at the end of 2008 compared to 53% at the end of 2007. We sold equities and property during the first half of the year as part of our policy to move to more secure assets as the fund matures. The falls in the market values of these assets also contributed to the change in asset mix. Fixed interest assets also fell in value as a consequence of reduced investor confidence, particularly for corporate bonds issued by private sector companies. The net return on the fund (after tax) for the calendar year 2008, was -13.4% and the return for the first three months of 2009 was also negative.

We used derivative investments in the With-Profits Fund at the end of 2008 to reduce the exposure of the fund to further falls in UK equity values. To offset the cost of the derivative protection, exposure to large rises in UK equity values will also be limited.

During 2008 we selected new investment managers to take over the management of particular asset classes.

- Credit Suisse continues to manage the UK equities, cash and property asset classes, having provided consistent performance in these particular asset classes.
- Goldman Sachs Asset Management has taken over the management of fixed interest bonds. It has extensive experience and impressive techniques for adding value in this asset class.
- MFS Investment Management has taken over the management of international equities. Its specific investment style and strategy fits well with the objectives of the fund.

These changes will ensure that we provide our customers with a good selection of investment managers in an efficient and flexible structure.

Pension Plans

We reviewed the basis for calculating interest credits in 2008 to make sure they continue to meet the PPFM principles. Due to reductions in interest rates on government bonds and a more uncertain environment for corporate bonds we are reducing the interest credits from their current level by between 0.25% and 0.5% from 1 April 2009.

During 2008 Sun Life Asset Management took over management of the pension plans' assets with the aim of maintaining the stable investment return with minimal risk through investment in fixed interest investments such as bonds (loans to the Government or companies) and cash deposits.

Management of Expenses and the Inherited Estate

In line with the PPFM, and with the advice of the With-Profits Actuary, we charged the With-Profits Fund a fair apportionment of the Company's ongoing costs in 2008.

We charged total maintenance expenses of £8.1 million to the With-Profits Fund in 2008.

During 2008, we transferred our business outsourcing contract from Vertex Life and Pensions Limited to Diligenta. The With-Profits Fund is being charged its proportion of the costs of reviewing the business outsourcing contract.

We charged to the Inherited Estate only a small portion of the costs of administering and paying redress to plan holders who complained about their with-profits mortgage endowment plans. The charge was only made for the first few months of 2008 when it did not prejudice plan holders' reasonable expectations. This is consistent with our PPFM and our commitment to treat customers fairly.

We continue to keep ongoing expenses as low as possible, however, as the number of plans in the fund reduces, it is likely that the expense for each plan will increase. To alleviate this, we plan to build up an expense equalisation reserve within the Inherited Estate of the fund which will be released gradually in future to reduce the rate of increase in administration costs charged to plan holders. During 2008, the amount that had been set aside in the expense equalisation reserve up to 31 December 2007 was used to increase the security of the fund.

During 2008 we suspended the distribution of the Inherited Estate. This led to further reductions in terminal bonus rates (over and above reductions due to falls in market values) and was done to support the fund in meeting future plan holder expectations. We intend to restart the distribution of the Inherited Estate once the expense equalisation reserve has been replenished to a sufficient level.

Report from the With-Profits Actuary

In my opinion as the With-Profits Actuary, the discretion exercised by Sun Life Assurance Company of Canada (UK) Limited during 2008 has taken the interests of the with-profits plan holders into account in a reasonable and proportionate manner.

I base this view on the information and explanations provided to me by Sun Life Assurance Company of Canada (UK) Limited, who have given me complete access to all management information. The information in this report gives an accurate and reasonable summary of the main issues affecting the With-Profits Fund during 2008.

Colm Fagan
Fellow of the Institute of Actuaries
26 March 2009

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