

# Answers about...

## Participating (par) life insurance



- What Canadian participating (par) policies are managed by Sun Life?
- What is par life insurance?
- What are the differences between policyholder dividends and shareholder dividends?
- What determines the dividend payable on a par policy?
- What is meant by “experience”?
- How are par premiums invested?
- How do par portfolio investments respond to market conditions?
- Is there investment risk associated with par insurance?
- What safeguards are in place to protect my interests as a par policyholder?



## What Canadian participating policies are managed by Sun Life?

Sun Life Assurance Company of Canada (Sun Life) and Clarica Life Insurance Company (Clarica) were at one time two separate mutual companies, owned by their participating policyholders.

Each company changed from a participating company to a publicly traded stock company in a process called demutualization. This process complied with rules and regulations that outlined the ongoing rights of par policyholders.

In 2002, Sun Life and Clarica amalgamated and formed one insurance company, "Sun Life Assurance Company of Canada."

The answers we are providing apply to the participating (par) policies issued by Sun Life, Clarica (formerly Mutual Life), and also the Canadian par policies, acquired by Clarica, several years ago, when it bought The Prudential Life Assurance Company of England (Canada) and the Metropolitan Life Insurance Company of Canada.

## What is par life insurance?

Life insurance involves the transfer of risk from an individual to a life insurance company. With participating insurance, a portion of the risk is

shared among the policyholders and the company. We call it "participating insurance" (or "par insurance") because the policyholder participates in the risk along with the insurance company.

As part of this risk-sharing relationship, par policyholders may also share in certain rewards when their policies perform better than originally expected. This reward may come in the form of a policyholder dividend, which is a portion of the earnings from the par account where the investments, expenses and other items related to the company's par policies are tracked. The right to receive policyholder dividends is described in your policy.

## What are the differences between par policyholder dividends and shareholder dividends?

Policyholder dividends are based on the experience of a company's par account. Shareholder dividends are based on a company's overall performance, including earnings from all its lines of business. Earnings from the par account, that can be paid to shareholders, are significantly restricted by regulation. This is described further in the section: "What safeguards are in place to protect my interests as a par policyholder?"

There is no direct relationship between these two types of dividends. That is why it is possible for policyholder dividends to decrease in the same year the company's shareholder dividends have increased or to increase when shareholder dividends have decreased.

## What determines the dividend payable on a par policy?

Policyholder dividends are not guaranteed. They can change from year to year.

Par policies are grouped based on certain factors such as the type of policy and when it was purchased. The experience of each group determines the dividends available to be allocated within the group. This approach, known as the "Contribution Principle," is used by life insurance companies in Canada to help ensure a fair distribution of earnings among par policyholder groups.

Each group has a dividend scale. The dividend scale is the outcome of a series of calculations and determines how the available earnings for the group will be allocated to each individual policy in the form of policyholder dividends.

## What is meant by "experience"?

Par policies are designed based on a set of assumptions about the risks to be shared with the policyholder. These risks include investment returns, mortality, expenses and taxes, inflation, and the number of policyholders cancelling their coverage.

Each year, the company compares these assumptions to the actual results and the anticipated future results for each group of par policies. This assessment defines the "experience" for the group. Experience that is better than our assumptions creates earnings that are available to be distributed as policyholder dividends. When experience worsens, earnings available to be distributed as dividends decrease. If experience is equal to or worse than these assumptions, dividends will be zero.

The following three key risks can be used to further explain how experience impacts the dividend scale and the earnings available to be allocated as policyholder dividends.

## Key risks

### Expense risk

- Like any business, an insurance company has expenses, such as the cost to develop, market, distribute and administer insurance products.
- Expense risk reflects the company's ability to control and reduce expenses, relative to the assumptions made in the dividend scale of the group.
- The impact of expense experience on par account earnings is relatively small, but changes can have a significant impact on smaller par policies.
- Periods of high inflation increase expenses.

### Mortality risk

- Mortality is the number of deaths expected to normally occur in a given group at a given age.
- Mortality risk reflects death benefits actually paid, relative to the assumptions made in the dividend scale for the group.
- The impact of mortality experience on par account earnings is gradual over time because mortality trends develop slowly.

### Investment risk

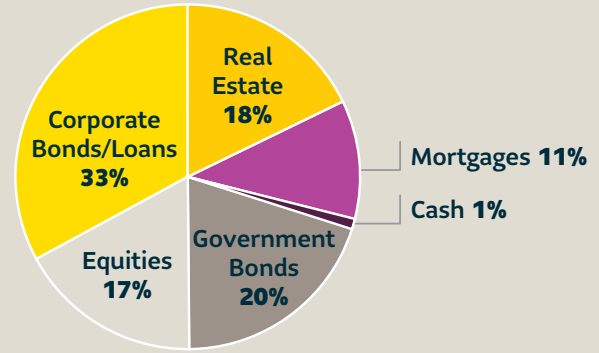
- Premiums from all par policies in the group are pooled. The funds not required to pay benefits, expenses, and taxes are invested to provide for future benefits.
- The investment risk reflects the company's actual returns on the invested funds, net of losses due to defaults, relative to the assumption made in the dividend scale for the group.
- Investment experience is usually the most important factor in determining annual par account earnings.
- Each par account has investments in a variety of asset classes and has a long-term investment strategy.



## How are par premiums invested?

The amount of premium that is not required to pay for current benefits and expenses is invested to provide for future benefits. This pie chart shows an example of the distribution of assets in a representative par portfolio.

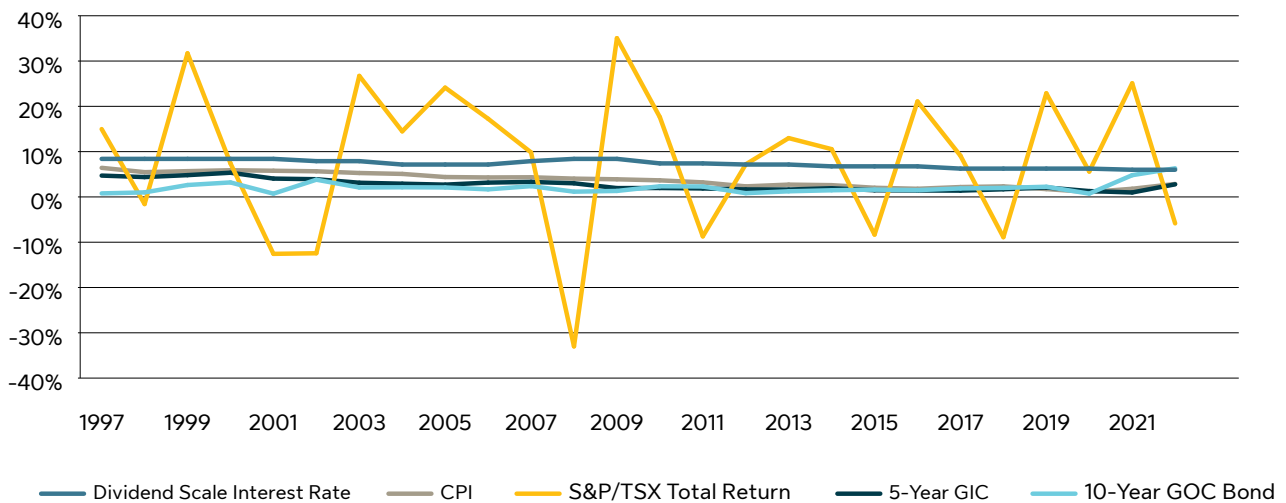
A par portfolio of assets



## How do par portfolio investments respond to market conditions?

The investment return experience is normally the most important factor that influences the earnings available to be paid out as dividends. We apply a long-term investment strategy that, together with a large, well-established par account, contributes to more stable investment returns. As a result, these investment returns tend to fall more slowly than actual interest rates and equity markets. They also recover more slowly when actual interest rates increase or equity markets enter periods of growth.

### Asset returns as of December 31, 2022.



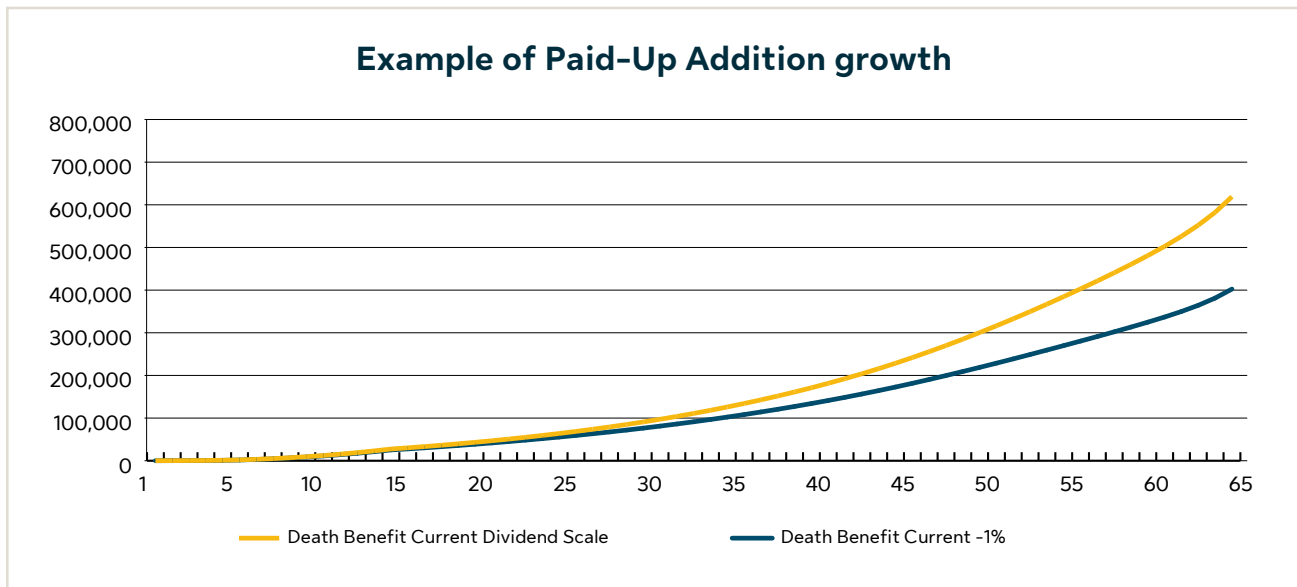
#### NOTES:

- Portfolio returns are representative of a participating portfolio.
- Government of Canada bond returns are nominal yields to maturity taken from Statistics Canada. Table 10-10-0122-01 Financial market statistics, December 31, 2022, Bank of Canada.
- S&P/TSX composite total returns include the reinvestment of dividends.
- Five-year GIC returns are nominal yields to maturity taken from Statistics Canada. Table 10-10-0145-01 Financial market statistics, as at Wednesday, Bank of Canada.
- Consumer Price Index is taken from Statistics Canada. Table 18-10-0004-01 Consumer Price Index, monthly, not seasonally adjusted.

## Is there investment risk associated with par insurance?

Yes, particularly if you have planned to use policyholder dividends to help you pay future premiums. There is also risk involved if you have planned to use policyholder dividends to increase your policy's cash surrender value or to increase your death benefit. Because policyholder dividends are not guaranteed, the more you rely on them to help meet a projected future need, the higher your investment risk. Products, such as those that rely on dividends to purchase additional coverage or to pay future premiums, are very sensitive to changes in the dividend scale and dividends allotted.

When reviewing an insurance illustration of your policy, you will note the policy values are projected into the future and that these projections assume the current dividend scale will not change in the future. However dividend scales will change from time to time, which means these illustrated policy values cannot be guaranteed. When a new dividend scale for a group of policies is implemented, future projections for each individual policy will change. Updated illustrations are available to demonstrate how your non-guaranteed policy values may be affected by a change in the dividend scale.



- Short-term impact on projected policy values may be slight.
- Long-term impact on projected policy values may be more dramatic.

Here is an example. Some policies use policyholder dividends to purchase additional insurance each year. The additional insurance is called Paid-Up Additions (PUAs). This graph compares the

projected purchase of PUAs for the same policy using two different dividend scales. This example is for illustrative purposes only and may not reflect your policy's features and benefits.

If your policy has guaranteed cash values and a guaranteed death benefit, then these guaranteed values won't be affected by changes in policyholder dividends allocated to your policy.



## How do changes to the dividend scale affect “premium offset”?

Premium offset is a non-guaranteed premium payment method that, under certain circumstances, may allow you to use future policyholder dividends and some of the value accumulated in your policy to help pay future premiums. The length of time you must wait until your policy is eligible for premium offset and the length of time your policy can remain on premium offset are extremely sensitive to changes in the dividend scale. Any reduction in the dividend scale may significantly delay the date when your policy is eligible for premium offset or cause it to be ineligible for premium offset. If your policy is already on premium offset, a decrease in the dividend scale may require you to resume regular payments to cover your premium obligations.

## How do changes to the dividend scale affect a policy with a premium reduction option?

An alternative use for dividends is to use them to reduce the policy payments required to pay your premiums. In some cases, this feature is automatically included in the design of your policy. Other policies may offer premium reduction as an option.

When dividend scales decrease, you may be required to increase your policy payments. When dividend scales increase, your required policy payments may decrease.

## What safeguards are in place to protect my interests as a par policyholder?

### **Par account is kept separate**

As required by law, the company maintains an account for its par policies that is separate from the accounts for its non-par policies and other businesses. The par account records the assets, liabilities, premiums and any earnings for the par policies only.

### **Sun Life Board of Directors (The Board) involvement**

The Board decides when policyholder dividends will be paid and the dividend scale that will be used to allocate them. Par policyholder dividends are reviewed at least annually.

The Board considers the par policyholder dividend recommendation of Sun Life’s Appointed Actuary who applies sound actuarial principles and practices in their determination. Before declaring the annual par policyholder dividend, the members of the Board review a written report that includes a signed opinion from the Appointed Actuary stating that the policyholder dividends being considered are in accordance with Sun Life’s dividend policies.





### **Dividend management process**

When we demutualized, eligible policies that were issued before demutualization were grouped together and placed into their own separate sub-accounts within the par account we referred to as “Closed Blocks.” If your par policy was issued after demutualization, it is maintained in a separate sub-account within the par account we referred to as an “Open Block.”

There is a separate Closed Block of par policies issued by Sun Life Assurance Company of Canada and a separate Closed Block for Clarica’s pre-demutualization par policies. Similarly, there is a separate Open Block of par policies issued by Sun Life Assurance Company of Canada and a separate Open Block for Clarica’s post demutualization par policies.

Over time, all earnings within the Closed Blocks will be passed, in the form of policyholder dividends, to par policyholders in the Closed Blocks. When distributing these policyholder dividends, our aim is to ensure the fair treatment of all policyholders in the Closed Blocks. For example, we would not want the last remaining par policyholders to unfairly benefit at the expense of those who are no longer in the Closed Blocks, nor would we want to penalize those remaining in the block by paying out earnings too soon.

Earnings within the Open Blocks are identified separately. Laws restrict the amount of these earnings that may be passed to shareholders. For example, the current limit for Sun Life allows less than 3% of the dividends paid to Open Block par policyholders in the year to pass to the earnings for the shareholders. Currently the Open Blocks are smaller than the Closed Blocks. This is because both Clarica and Sun Life suspended participating insurance sales in Canada shortly after each company demutualized (Clarica in 2002 and Sun Life in 2003). In 2010, Sun Life resumed sales of participating life insurance. These policies are part of the Sun Life Participating Account Open Block. We continue to manage the earnings of each Open Block separately.

### **We report to the federal government regulator (OSFI) each year**

Sun Life’s Appointed Actuary follows professional standards of practice set by the Canadian Institute of Actuaries. The Appointed Actuary prepares a detailed report on the Closed Blocks and provides a signed opinion to OSFI on an annual basis confirming that the par policies are being appropriately managed according to the demutualization plans, it’s own internal rules and the rules created by OSFI prior to demutualization.





## Need more answers?

It's important to review any life insurance policy regularly and consider:

- Have your longer-term goals changed?
- Is your current coverage enough?

Your advisor can help answer your questions or help you review your coverage.

A copy of this booklet and other information is available on our website: [sunlife.ca](https://sunlife.ca).

Life's brighter under the sun

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