PRODUCT DESIGN OPTIONS FOR HNW CLIENTS

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WEALTH FOR GENERATIONS

Sun Life Financial®
INTERNATIONAL

International Life HNW market – Private Bank Segment (USD)

- Market metrics
  - Circa USD 6 billion in premiums (excludes PPLI business, North American business)
  - Annual growth >20% 2010 – 2014
  - Growth flattened in 2015, especially in Singapore
    - Turbulent markets
    - Bank financing more expensive
  - Primarily financed by private banks
- Geographic mix

International HNW Life Insurance Market – Product Share 2015

- >75% Traditional Universal Life
  - Guaranteed investment return
  - Guaranteed death benefits to older ages (on single premium basis)
  - Transparent charges
  - Book value redemption
- 5%-15% Whole Life
  - Guaranteed death benefits for life
  - Attractive history on bonuses
  - Book value redemption
- <5% VUL
  - High projected investment returns = low premium deposits
  - Investment options
- <10% IUL
  - High projected investment returns = low premium deposits
  - Principle protected
  - Guaranteed return upon surrender

Product features difficult to manufacture

Book value redemption

- One way option for customer
- Insurer challenge
  - Stay liquid enough to cover potential “run on the bank”
  - While generating enough yield to compete

Investment guarantees

- 2% to 3% annually for perhaps 50 years
- Insurer challenge
  - Meet the minimum guarantee regardless of return environment
  - Hedge costs
  - Does customer have payment flexibility?

Competitive investment returns

- Performance often based on going out the risk spectrum
- Insurer challenge
  - Balance return vs capital costs

Traditional Universal Life Product

- Book value redemption
  - No adjustment for changes in market value for assets
- Guarantees
  - Lifetime interest rate guarantee currently range from 2% to 2.5%
- Transparency
  - Visibility for product charges
- Credited interest rates
  - Current market rates >150 bps above 10 year treasuries

Sample Traditional UL policy projection

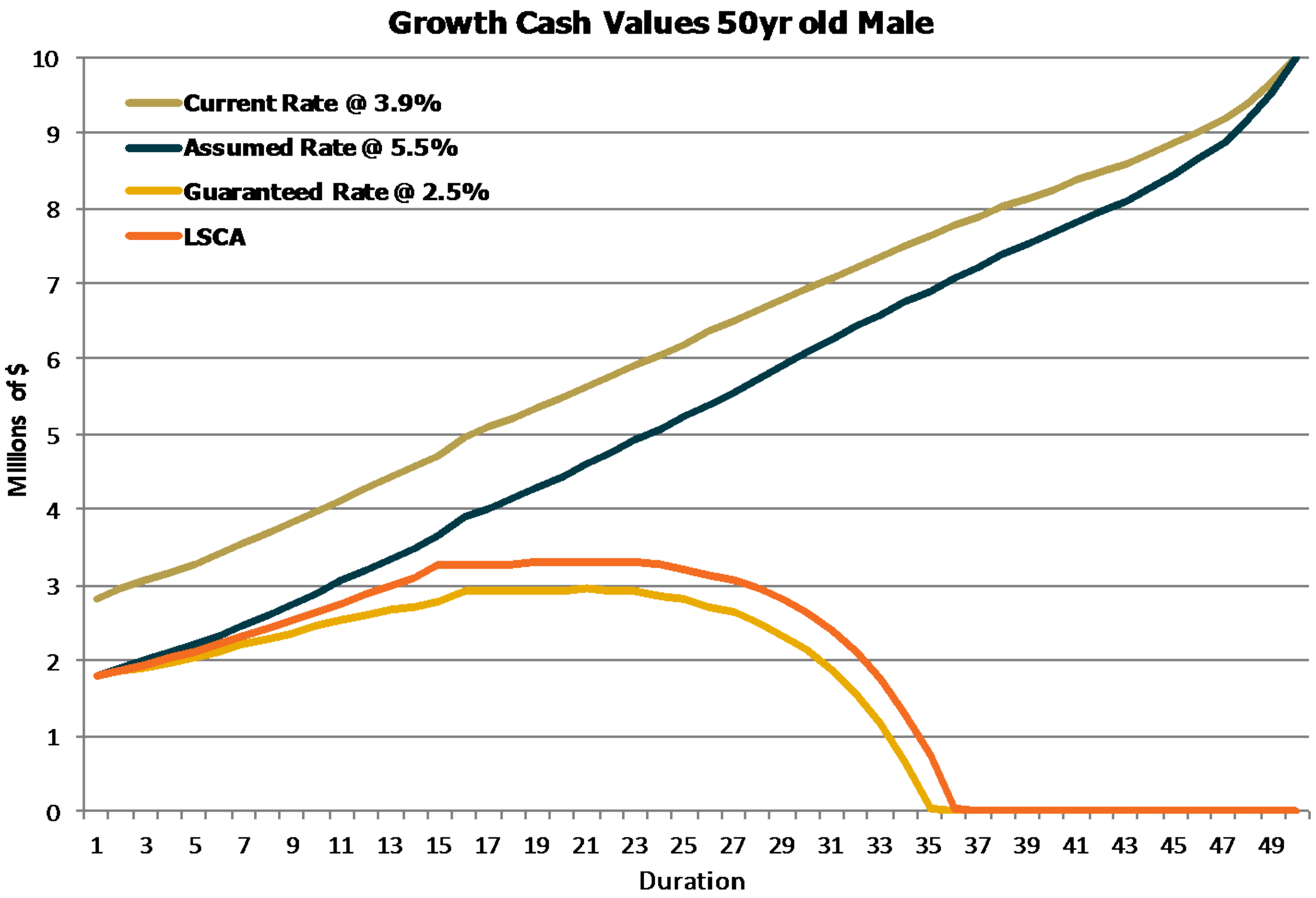
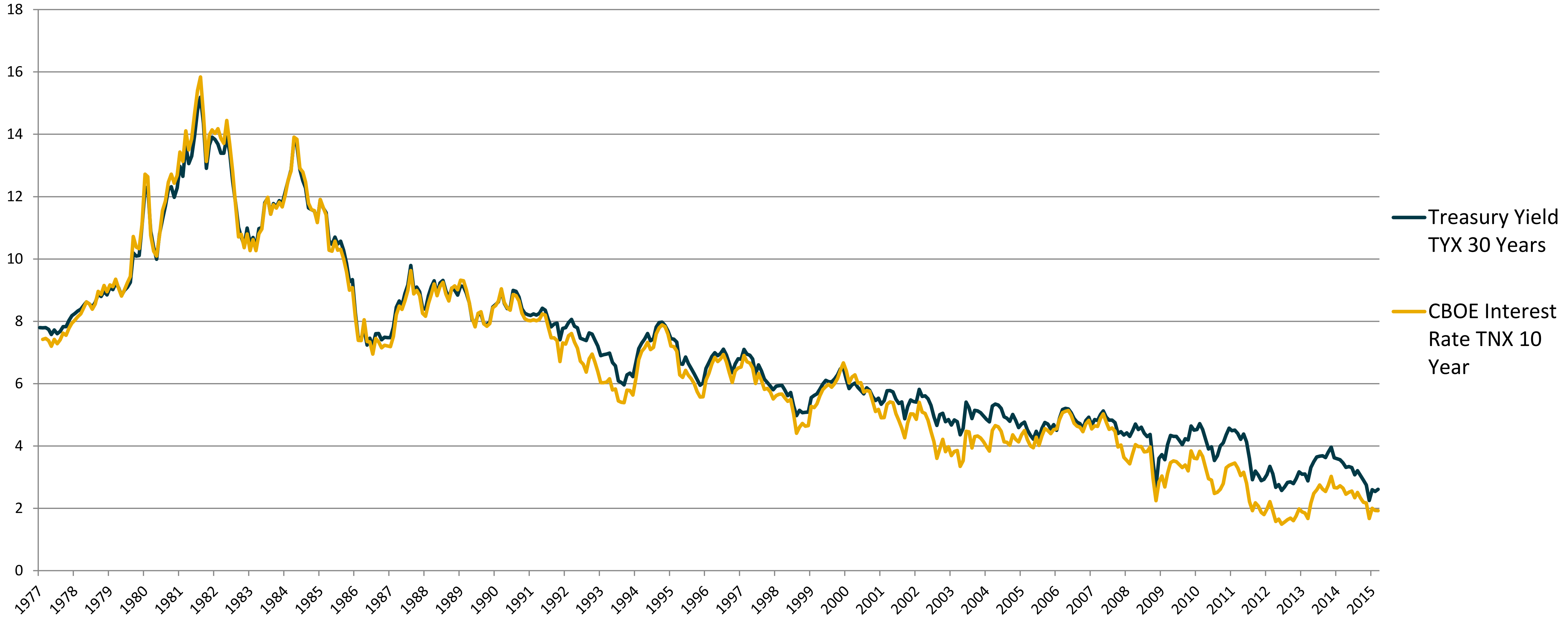


Chart is for hypothetical use only.

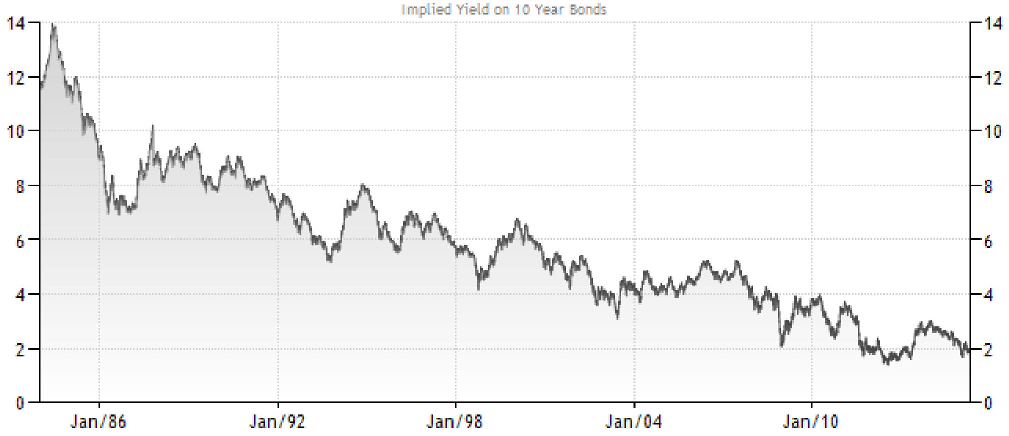
Treasury Yield and Interest Rates



Government Bonds 10 Year Yields

UNITED STATES GOVERNMENT BOND 10Y

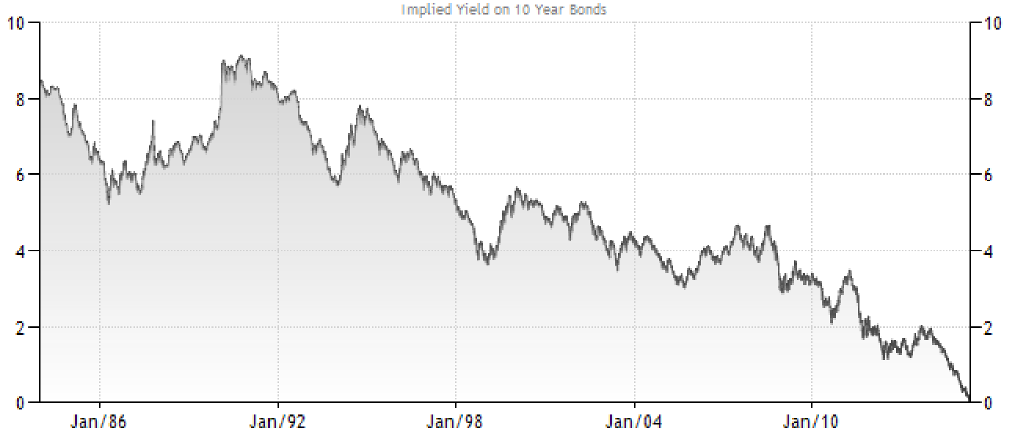
Implied Yield on 10 Year Bonds



SOURCE: WWW.TRADINGECONOMICS.COM | U.S. DEPARTMENT OF THE TREASURY

GERMANY GOVERNMENT BOND 10Y

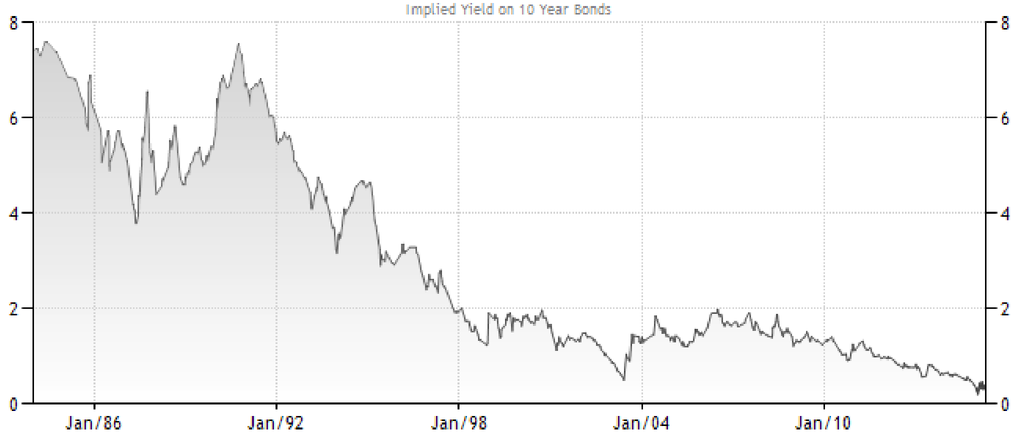
Implied Yield on 10 Year Bonds



SOURCE: WWW.TRADINGECONOMICS.COM | GERMANY DEPARTMENT OF TREASURY

JAPAN GOVERNMENT BOND 10Y

Implied Yield on 10 Year Bonds



SOURCE: WWW.TRADINGECONOMICS.COM | JAPAN DEPARTMENT OF TREASURY

Key consequences of low rate environment

- Higher liabilities and capital for existing business
  - Under IFRS
  - Varies considerably by jurisdiction
- Lower profitability
- Higher sensitivity to interest rates
- Higher required capital for new business
- Lower crediting rates
- Higher cost of hedging risk

Methods to generate yield above US risk free rates

- Credit risk
- Liquidity risk
  - Illiquid assets generate yield but increase risk
- Duration risk
  - Longer duration higher yields but increases “book value risk”
- Currency risk
- Mismatch risk
  - Assets other than investment grade fixed instruments
  - Typically assets relying on capital gains rather than predictable annual cash return

Factors affecting investment policy

- Solvency regime for parent company
  - Significant variance in how various regimes treat risk
  - Expected to converge over time
- Rating Agency perspectives
  - If certain risks are pervasive on the balance sheet, additional such risk of concern
  - S&P has proprietary risk based capital formulae
- Parent company risk management philosophy

Regulators and Why it Matters

- OSFI (Canada)
  - Based on IFRS
  - Investment policies & ALM
  - Capital & reserves
  - AML and ATF
  - Accounting principals (mark to market in Canada)
  - Solvency concerns – the Winding Up Act*
- Canada vs other jurisdictions
  - Capital and liabilities can vary a great deal
  - Restrictions on allowable investments can vary

* An insolvent Canadian insurance company would be subject to the Winding-Up and Restructuring Act (Canada) (WURA). Generally, the WURA places the claims of policyholders ahead of unsecured creditors, subordinated debt holders, and holders of preferred and common shares. The WURA does not guarantee that policyholders will be credited. Information on the WURA is informational and should not be considered legal advice. Clients with specific questions concerning the WURA should consult private counsel.

Regulatory regimes – International HNW carriers (I of II)

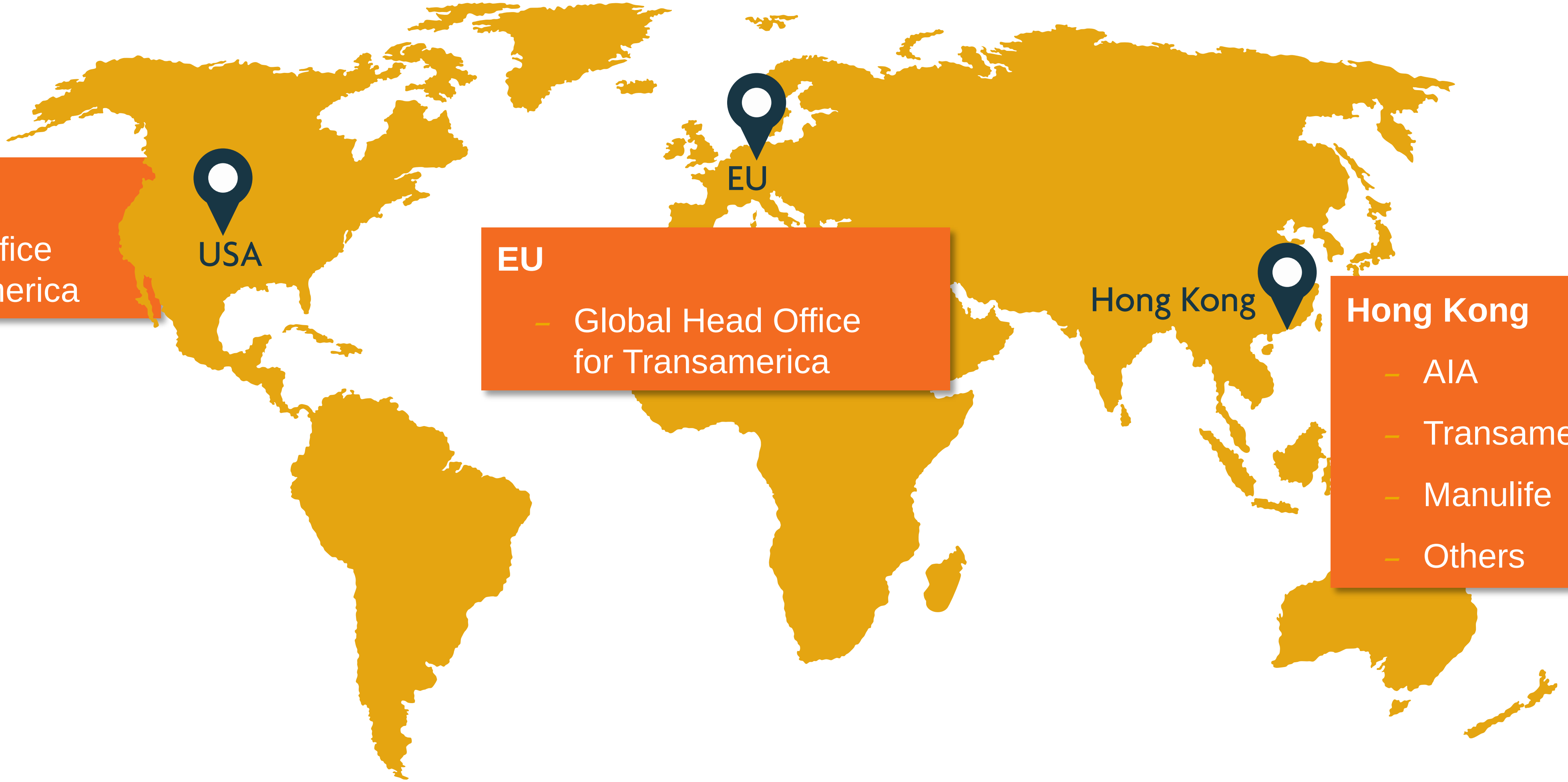
Canada

- Sun Life
- Manulife

Singapore

- AIA
- Transamerica
- Manulife
- Others

Regulatory regimes – International HNW carriers (II of II)



USA

- US Head office for Transamerica

EU

- Global Head Office for Transamerica

Hong Kong

- AIA
- Transamerica
- Manulife
- Others

History of Universal Life (General Account)

- Over 30 years of experience in North America
  - Risk management practices
  - Hedging and ALM know how
    - Strict liability matching by duration
  - Regulations designed for UL
- Less than 5 years in Asia
  - Risk management/ALM/Hedging varies by carrier
  - Regulators still gaining knowledge
    - Wide set of rules by jurisdiction
  - Investment pools likely differ by solvency regime

Hedging considerations – North American carriers

- Assets dominated by fixed instruments
  - Other assets bring prohibitive capital costs
- Hedge position for interest rate guarantees
  - Interest rate floors
  - NLG
- Hedge positions for book value redemption option
  - Surrenders, full or partial
  - Loans
  - Capital losses when interest rates rise

Hedging considerations – Asia based carriers

- Based primarily on parent company risk philosophy
- Local regulatory environment designed for lower risk environment and product design
  - In Singapore this will change when their version of Solvency II introduced 1/1/17
    - Risky assets will be capital intensive
  - Hong Kong rumored to follow suit
- Convergence by country expected to continue

The future – scenario 1 – economic climate reverts to pre-’08 crisis

- Well received product features more sustainable
- New entrants encouraged to enter market
- Incumbents share market with new entrants

The future – scenario 2 – current economic climate persists

- Interest rate guarantees continue to decline
- Crediting rates continue to decline
- Questions
  - Does market growth continue in a world of sub 3% crediting rates & 1.5% guarantees?
  - Does product mix shift to IUL & VUL?
  - In a flatter interest rate world is financing still attractive?
  - If financing is not attractive, how much does the market shrink?

The future – scenario 3 – interest rates climb to pre-1990 levels

- New competitors enter
  - Competitive advantage over incumbents w/o legacy assets
  - Product mix unknown
- Sales traction may depend on advisor motivation
  - If equity markets are booming, success in managing assets may displace interest in holistic wealth planning
- Incumbents challenged on managing back book
- Banks & brokers challenged on servicing back book

Preparation for all scenarios – diversification & quality partners

For Carriers

- Broad product spectrum
- Nimble product platform
- Design of hedging policies

For Brokers

- Continue to focus on fundamental needs analysis
- Continue to focus on annual customer reviews
- Accelerate training on holistic wealth planning

For Banks

- Continue to increase focus on holistic wealth planning
- Choose your providers carefully

THANK YOU

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