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## PRESENTATION

### Operator

(Operator Instructions) Please be advised that this conference call is being recorded. Good morning, and welcome to the Manulife Financial Third Quarter 2021 Financial Results Conference Call. Your host for today will be Mr. Hung Ko. Please go ahead, Mr. Ko.

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**Hung Ko** - *Manulife Financial Corporation - VP, Group Investor Relations*

Thank you, and good morning. Welcome to Manulife's Earnings Conference Call to discuss our third quarter 2021 financial and operating results. The earnings release, financial statements and related MD&A, statistical information package and webcast live for today's call are available on the Investor Relations section of our website at [manulife.com](http://manulife.com).

Turning to Slide 4. We will begin today's presentation with an overview of our third quarter highlights and update on our strategic priorities by Roy Gori, our President and Chief Executive Officer. Following Roy's remarks, Phil Witherington, our Chief Financial Officer, will discuss the company's financial and operating results.

After the prepared remarks, we will move on to the live question-and-answer portion of the call. We ask each participant to adhere to a limit of two questions, including follow-up question. If you have an additional question, please requeue and we will do our best to respond to all questions.

Before we start, please refer to Slide 2 for a caution on forward-looking statements and Slide 32 for a note on the use of non-GAAP financial measures in this presentation. Note that certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from what is stated. With that, I'd like to turn the call over to Roy Gori, our President and Chief Executive Officer. Roy?

**Roy Gori** - *Manulife Financial Corporation - President & Chief Executive Officer*

Thanks, Hung. Good morning, everyone, and thank you for joining us today. Yesterday, we announced our financial results for the third quarter of 2021. The diversity and resilience of our franchise was evident once again as we continue to execute against our medium-term targets and delivered core return on equity of 13.2% on a year-to-date basis.

Turning to Slide 6. We delivered solid core earnings of \$1.5 billion, a 10% increase from the prior year, with double-digit growth in Global WAM and Canada, and resilient core earnings growth in Asia. And we reported net income of \$1.6 billion, driven by strong investment-related experience, which more than offset a charge related to updated ultimate reinvestment rate assumptions issued by the Canadian Actuarial Standards Board. New business value increased 22% with contributions across all segments, including double-digit growth in Asia. This was a strong result, given some of the markets in which we operate such as Vietnam and Indonesia, experienced further COVID-19 restrictions during the quarter.

In addition, NBV margin for Asia increased by 7.3 percentage points from the prior year. In our Global WAM business, we achieved strong net inflows of \$9.8 billion, reflecting double-digit growth in retail across all geographies due to increased investor demand and solid investment performance, together with positive contributions from institutional and retirement.

Our financial leverage ratio improved by 1.2 percentage points compared with the prior year, demonstrating our continued financial flexibility to execute on our strategic priorities.

Turning to Slide 7 and the progress that we've made executing on our five priorities. Our highest potential businesses accounted for 63% of total company core earnings year-to-date 2021, and we're on track to achieve our target of 67% by 2022.

In September, Global WAM was accepted as a signatory to the U.K. Stewardship Code, which is regarded as one of the most comprehensive sustainable investment standards in the industry. This result is a testament to the strength of our investment approach and ability to pursue sustainable solutions for our clients.

In Asia, we continued to expand our footprint in China, as Manulife-Sinochem opened its 15th provincial branch in Shaanxi.

And in the U.S., we experienced strong sales momentum, which was supported by two spot-market ranking increase in brokerage as well as the highest quarterly sales of international products in the 17-year history of our high net worth business. Our ambition is to be a leader in our industry when it comes to digital capabilities and customer experience, and we're executing on our strategy to attract, engage and retain customers by delivering an outstanding experience.

During the third quarter, we continued to make progress on our digital journey across all our operating segments to better engage with our customers. In Asia, we launched Singapore's first flexible digital retirement plan with DBS Bank. The product offers customers multiple flexible options to tender a plan that best serves their financial and retirement needs.

In our Global WAM business, our Asia online investment platform, Manulife iFunds, continues to show strong momentum and increase in sales.

Turning to Slide 8. I mentioned earlier that the growth in our highest potential businesses is outpacing other businesses, and you can see that in our year-to-date Global WAM results. Our Global WAM franchise is diversified across three business lines, is at scale, and has a long history of consistently generating positive net flows, which have been supported by a proven track record of delivering solid investment performance.

As of the end of 2020, we were ranked the 27th largest global money manager by Pensions & Investments magazine. And over the course of 2021, we have continued to deliver tremendous results which demonstrates both the power of our global platform and the underlying potential of the business.

Core earnings growth has been very strong, exceeding the 15% medium-term growth rate discussed at Investor Day by 20 percentage points on a year-to-date basis, which has been supported by strong revenue growth of 19%. Our core EBITDA margin is above 30% for the fifth consecutive quarter. And given that we're seeing further opportunities for top-line growth and efficiencies, we are well positioned to drive margin expansion over the longer term.

AUMA has also seen strong double-digit growth of 19% year-to-date, well ahead of the five-year annual growth rate of 9%. We've also delivered strong growth of 30% year-to-date in our retail business, resulting in a more favourable business mix and creating a tailwind for core earnings and net fee income yield.

Finally, net inflows have been very strong, driven by \$21.7 billion of positive flows in our retail business, which has helped us gain notable market share in the U.S., moving up seven spots and maintaining our very solid market ranking in Canada. And we continue to be a market leader in the retirement space globally, with the number one ranking in the MPF market in Hong Kong and a number two ranking in the Canadian DC market, U.S. small-case market and Indonesian DPLK market.

We're very excited by the strong momentum of the business and the future growth outlook. And we're confident that as we continue to execute on the strategic priorities of our Global WAM business, and continue to grow our highest potential businesses, we will unlock significant value for our shareholders.

Turning to Slide 9. Expense efficiency is deeply embedded in our culture, and I'm pleased to see the benefits reflected in our expense efficiency ratio, which was 48.9% on a year-to-date basis and 51.3% in the third quarter. The ratio improved by 2.4 percentage points as year-to-date pretax core earnings growth of 27% exceeded core expense growth of six percent. We remain committed towards meeting our goal of consistently achieving a ratio of less than 50 percent.

On a cumulative basis, we've freed up \$6.3 billion of capital through our portfolio optimization efforts across multiple legacy blocks. Whilst we've exceeded our target of releasing \$5 billion of capital, our commitment to optimize Manulife legacy portfolio, especially LTC and VA remains. And we continue to seek opportunities to reduce risk and unlock value.

Our final priority is focused on our high-performing team. We launched our Fuel-Up Fridays initiative in September, which provides dedicated time on the second Friday of each month through to the end of the year for learning and refueling in ways that are personally meaningful to each of our team members. This helps us accelerate growth as we build a leading global culture distinguished by our values. In addition, it's worth noting that in October, Manulife was named a World's Best Employer by Forbes for the second year in a row.

Turning to Slide 10. In summary, our business continued a strong track record of performance this quarter, benefiting from diversification, scale, digitization and profitable products as evidenced by strong momentum in Global WAM and impressive resilience in Asia. Our Global WAM business continued to deliver tremendous results and strong contributions to our growth agenda. I believe the culture will be a sustainable, long-term competitive advantage, and we continue to focus on enhancing our high-performing team as one of our top priorities.

And finally, given our global footprint, we are uniquely positioned to capitalize on the mega trends that are shaping the global economy and remain confident in our ability to execute on the next phase of our strategy. Thank you, and I'll hand over to Phil Witherington, who will review the highlights of our financial results. Phil?

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**Phil Witherington** - Manulife Financial Corporation - Chief Financial Officer

Thank you, Roy, and good morning, everyone.

Turning to Slide 12. We generated core earnings of \$1.5 billion in the third quarter, up 10% from the prior year on a constant exchange rate basis. This was driven by a number of factors, the recognition of core investment gains in the quarter, higher net-fee income from higher average AUMA in our Global WAM business, higher new business gains, in-force business growth in Canada and Asia, and favourable policyholder experience in Canada.

These items were partially offset by a charge in our property and casualty reinsurance business for estimated losses related to Hurricane Ida and the floods in Europe and unfavourable policyholder experience in Asia and the U.S. Net income attributed to shareholders was \$1.6 billion in the third quarter, reflecting favourable investment-related experience, largely offset by a charge related to the updated URR assumptions issued by the Canadian Actuarial Standards Board, which is a component of the direct impact of markets.

Of note, we delivered strong investment-related experience gains of \$800 million in the quarter reflecting higher-than-expected returns on ALDA, primarily driven by fair value gains on private equity investments; the favourable impact of fixed income reinvestment activities and favourable credit experience. \$100 million of these gains were reported in core earnings as core investment gains with the remaining \$700 million reported outside of core earnings. The charge of \$582 million from the direct impact of interest rates was the result of a \$532 million charge related to changes to the URR which is in line with the estimate we provided in the second quarter and impacts of steepening of the yield curve in Canada and lower interest rates in China. These items were partially offset by widening corporate and swap spreads in the U.S.

We completed our annual review of actuarial methods and assumptions, resulting in a net charge to net income attributed to shareholders of \$41 million, consistent with the estimate that we had provided in the second quarter. The net charge was primarily driven by a review of lapse and mortality assumptions for our U.S. insurance business as well as a review of investment return assumptions.

This was largely offset by positive updates related to our company-wide expense review and corporate bond default study. This year's review also included a complete study of our variable annuity experience and assumptions in the U.S.

Slide 13 shows our source of earnings analysis. New business gains increased 14% from the prior year period, driven by higher sales volumes in the U.S., demonstrating favourable product mix, notably due to higher International Universal Life sales and higher sales volumes and favourable product mix shifts in Hong Kong and Singapore.

This was partially offset by lower critical illness sales and unfavourable product mix shifts in China, lower volumes in Vietnam, reflecting the impact of COVID-19 containment measures and lower COLI product sales in Japan.

The experience loss in the quarter included a \$155 million pretax charge in our P&C Reinsurance business for estimated losses relating to Hurricane Ida and floods in Europe.

Net policyholder experience in the third quarter was unfavourable, driven by continued lower lapse rates on protection products in North America due to the prolonged low interest rate environment and consumers placing higher value on life insurance coverage during the pandemic and premium persistency losses in Asia as well as adverse mortality experience in U.S. Life. This was partially offset by favourable claims experience in Canadian insurance. Long-term care policyholder experience was a modest gain.

Turning to Slide 14. We delivered core earnings growth of 18% in our Global WAM business, reflecting growth in net fee income driven by higher average AUMA from the favourable impacts of markets and net inflows and favourable business mix. Core earnings in Asia increased by 1% as in-force business growth and favourable product mix were offset by unfavourable policyholder experience and lower new business gains due to lower volumes in Japan, China and several emerging markets.

Core earnings in Canada increased by 11%, primarily reflecting favourable policyholder experience in individual insurance higher in-force earnings from our retail insurance products, and the nonrecurrence of a number of smaller unfavourable experience-related items from the prior year quarter, partially offset by lower investment income on allocated capital.

Core earnings in the U.S. increased by 4% primarily driven by higher new business gains and favourable tax benefits, partially offset by lower investment income on allocated capital and less favourable LTC policyholder experience.

Core losses in Corporate and Other improved by \$23 million primarily driven by the recognition of core investment gains in the quarter compared with nil core investment gains in the prior year quarter, lower interest on external debt and gains on sales of AFS equities and lower interest on allocated capital to operating segments.

These gains were largely offset by the charge in our P&C Reinsurance business and the unfavourable impact of markets on seed money investments in new segregated funds and mutual funds.

Slide 15 shows our new business value generation and APE sales. Our insurance businesses delivered new business value of \$539 million in the third quarter, an increase of 22% versus the prior year quarter.

In Asia, NBV increased 15% from the prior year quarter, driven by higher sales volumes in Hong Kong and Asia Other and favourable interest rates and product management actions in Hong Kong, partially offset by a decline in Japan COLI product sales.

In Canada, NBV increased six percent from the prior year quarter primarily due to the impact of higher margins in annuities and continued growth in individual insurance, partially offset by lower sales volumes in group insurance.

And in the U.S., NBV more than doubled the level of the prior year quarter, reflecting increased customer demand, driving higher sales volumes and favourable product mix.

In the third quarter, we delivered APE sales of \$1.4 billion, a five percent increase from the prior year quarter. Asia APE sales remained resilient with a modest two percent decrease. In Hong Kong, APE sales increased 12%, reflecting strong growth in our bank channel, demand from Mainland Chinese visitors through our Macau branch and an expanded agency force.

Sales, however, continued to be dampened by COVID-19-related restrictions on cross-border travel between Hong Kong and mainland China. Asia Other APE sales increased 8% as higher sales in bancassurance were partially offset by lower agency sales, which were adversely impacted by COVID-19 containment measures in markets such as Vietnam and Indonesia. These were more than offset by a 50% decline in Japan APE sales.

In Canada, APE sales increased by five percent, primarily driven by higher individual insurance sales and increased customer demand for our lower-risk segregated fund products partially offset by variability in the large case group insurance market.

In the U.S., APE sales increased by 58% due to higher customer demand for international domestic indexed universal life and variable universal life solutions.

Turning to Slide 16. Our global WAM business delivered strong net inflows of \$9.8 billion and gross flows of \$35.2 billion in the third quarter compared to the prior year.

In retail, net inflows were \$7.9 billion compared with net inflows of \$0.7 billion in the prior year quarter. The increase was driven by double-digit growth in gross flows across all geographies due to increased investor demand, solid investment performance and lower mutual fund redemption rates.

Institutional Asset Management net inflows were \$1.3 billion compared with net outflows of \$3.9 billion in the prior year quarter. The increase was driven by the nonrecurrence of a \$5 billion redemption in Europe in the third quarter of 2020 as well as higher sales of timberland mandates in the U.S. partially offset by lower gross flows of fixed income products in China.

In Retirement, net inflows were \$0.6 billion compared with net inflows of \$1 billion in the prior year quarter, reflecting higher plan redemptions, partially offset by growth in member contributions and new plan sales.

Overall, Global WAM's average AUMA increased by 20% compared with the prior year quarter driven by the favourable impact of markets and higher net inflows. And our core EBITDA margin increased 110 basis points driven by a combination of higher net fee income, operational benefits from increased scale and disciplined expense management.

Turning to Slide 17. We continue to maintain a strong balance sheet and capital position. We have \$25 billion of capital above the supervisory target and our LICAT ratio of 138% is strong. The one percentage point increase from the prior quarter was mainly due to favourable impacts from market movements and portfolio optimization initiatives, partially offset by a modest net unfavourable capital impact related to the annual review of methods and assumptions.

Our financial leverage decreased 0.4 percentage points from the prior quarter to 25.5%, driven by an increase in retained earnings and the favourable impact of a weaker Canadian dollar. The financial leverage ratio is now close to our 25% medium-term target but the ratio is subject to variation period-over-period due to the timing of financing activities.

Turning to Slide 18 and our financial performance for the third quarter of 2021. As mentioned, the global diversity and resilience of our franchise is evident once again in the third quarter through double-digit core earnings growth in Global WAM and Canada, and resilient core earnings in Asia, which resulted in core earnings of \$1.5 billion.

Solid growth in new business value and robust APE sales growth and our strong balance sheet as evidenced by our LICAT and leverage ratios provides us with financial flexibility to deliver on our strategic and capital deployment priorities.

Slide 19 outlines our medium-term financial targets and recent performance. On a year-to-date basis, core ROE and the expense efficiency ratio met our medium-term targets and our dividend payout ratio remains within our target range. We remain confident in our ability to deliver 10% to 12% core EPS growth over the medium term.

This concludes our prepared remarks. Operator, we will now open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) And the first question is from Tom MacKinnon from BMO Capital. Please go ahead.

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### Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst

Thanks very much. Good morning. I'm just wondering if you have any kind of update for us in terms of the potential variable annuity transaction? I think you had made mention of that at your Investor Day and in the last quarter saying that it might be possible by the end of 2021. And then as a follow-up, just outlook in terms of sales in Asia, there was some -- just due to some containment measures with respect to COVID -- did impact some sales, particularly, I guess, in China and Vietnam and Indonesia. And maybe you can tell us what you're seeing so far in the fourth quarter in that regard. Thanks.

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### Roy Gori - Manulife Financial Corporation - President & Chief Executive Officer

Good morning, Tom, Roy here. I'll start with your first question, and I'll provide a few comments on sales and then hand over to Anil to provide more texture on the Asia sales story. As it relates to VA, we continue to believe that a deal is possibly in 2021. We've said that in the past, and we continue to feel confident that, that is a transaction that we can get across. Obviously, we'll only do a transaction if it made sense. But our view remains that we still feel quite confident that we can execute the transaction this year.

That's -- that would be it on the VA front. On sales, I would just highlight that the resilience of our business in Asia has been absolutely tremendous but the fact that our new business value has increased by 15% in the quarter despite the incredibly challenging circumstances is a true testament to the diversity of our business; but also the efforts of our Asia team to really digitize our business. We've really done a lot on that front, and we now have more than 80% of our new business digitally submitted, 82% is auto underwritten, and that has really helped us navigate a very difficult period over the last 18 months. Obviously, you know, we've seen COVID cases increase in certain markets, and that's affected our performance in some of those jurisdictions, but in general, I feel really good about the resilience that the team has demonstrated and our ability to navigate quite a tough time, but, Anil, you might want to provide a little bit more flavour.

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**Anil Wadhvani** - *Manulife Financial Corporation - President & CEO, Manulife Asia*

Thanks, Roy. And thanks, Tom. So Tom, before I provide comments on quarter four, allow me to give you a little bit of colour on quarter three because that will form the basis of our outlook in quarter four. So, we saw a significant impact on account of the resurgence of COVID in the Southeast Asian market, and that had an impact on two levels. One, we saw our sales volume get impacted; and the second, we experienced adverse policyholder experience specifically coming out of markets like Indonesia and Philippines.

But despite some of the significant challenges that we face, I do want to underscore the point that our core earnings continue to be resilient, and we grew our new business value by 15% year-on-year. What was this different this time around was that Vietnam that had not experienced any impact of COVID in 2020, experienced the impact of COVID in a big way in quarter three. And that again had an impact on volumes as well as on our core earnings, given the fact that Vietnam is a significant contributor to the core earnings for Asia. I do want to underscore at this point that we remain the market leader in Vietnam. And given our market-leading position and given just the potential that Vietnam has to offer, we believe that we are in a very good position to be able to address the growth opportunity in that very important market.

Moving to China and just to provide you a little bit of colour on China. So in China, we are transitioning to the new CI regulation and pretty much in line with what the industry has experienced, the demand for CI product has declined. And just an illustration of that, the CI mix for us in quarter three for China was 24% as compared to 45% a year back.

Additionally, what we are witnessing in China is that at the industry level, we are seeing a contraction of the agency force. And we believe that is attributable to the regulators putting a lot greater emphasis on quality. And while the industry is seeing 20%-plus decline on agents, we have seen a far lower rate of decline year-on-year on the agency force and this is, again, largely on account of the fact that we have been focusing on quality agents and driving activity and productivity.

Hong Kong and Singapore, I must illustrate and emphasize had very strong performance. Hong Kong as you heard Phil say, double-digit performance across sales, new business value, core earnings. And again, Singapore continues to see very solid performance. And again, quarter three was no different, where we saw strengths coming out of both our DBS partnership as well as MFA. With that as the background, if I look at quarter four in terms of outlook, we believe that while the containment measures will relax in quarter four on account of the abatement of the COVID cases in Southeast Asian markets. We don't believe that the recovery is going to be immediate. We believe the recovery is going to be gradual. And again, what we have experienced in Asia from time to time is that there is the resurgence of COVID and the containment measures do come back and have an impact on volumes.

Having said that, as I said, we have experienced challenges now in 2019, in 2020, and continue to win market share in both '19 and '20 and pretty much through the first half of 2021. And again, given our market-leading position, and just the secular trends that govern Asia, we feel very confident to be able to address the growth opportunity that Asia presents and stay committed to the 15% core earnings target that we had committed on in the recent Investor Day communication in the medium term.

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**Tom MacKinnon** - *BMO Capital Markets Equity Research - MD & Analyst*

Thanks for that.



**Operator**

Thank you. The next question is from Meny Grauman from Scotia Capital. Please go ahead.

**Meny Grauman** - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Hi. Good morning. We're likely to get an announcement from OSFI, later today on buybacks and dividend increases and I just wanted to check in with you, Roy, in terms of updated thinking on that and your intentions specifically for the buyback in particular.

**Roy Gori** - *Manulife Financial Corporation - President & Chief Executive Officer*

Good morning, Meny, good to hear from you. We intend to resume dividend increases when the regulatory restrictions are lifted. We've said that in the past, and we remain committed on that front. And we, more broadly remain committed to our dividend payout ratio of 30% to 40%, something that we've been very focused on over quite some time.

I will just also remind everyone that we did have our most recent dividend increase in Q1 of 2020, and that was a 12% increase. And we've regularly increased dividends over many, many years, and that's something that we feel is an important capital priority for us and one that we will continue.

I'll also say that if restrictions are lifted as it relates to dividends and buybacks, we also intend to look at share buybacks to continue to generate value for shareholders as we've done in the past.

**Meny Grauman** - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Roy, you show Slide 17 quite often in terms of capital over the supervisory target. How much of that is actually deployable capital of that \$25 billion that you're showing there? How much of that is actually something that you can deploy?

**Roy Gori** - *Manulife Financial Corporation - President & Chief Executive Officer*

Yes. So let me start on that, and I'll hand over to Phil, Meny. Our focus on capital has been an agenda item for us for at least four years. We declared in 2017, our focus on portfolio optimization, and our goal to free up \$5 billion worth of capital. That's been not only an area of focus, but it's been an area of execution strength, where we actually exceeded our target three years ahead of the schedule that we had articulated.

In fact, as at Q2 -- sorry, Q3 of this year, we're already up \$6.3 billion that we've freed up. And we look at not only the amount of capital we have over and above the supervisory minimum, but we also look at the capital that we have over and above our upper operating range. And again, we articulated last quarter that we see that as having excess \$10 billion over and above our operating range. And that continues to be the case in Q3 of this year.

I think it really pays to be in a strong capital position. I think that would -- it certainly helped us navigate the uncertainties of the pandemic and it put us in a good position to really get on the front foot. We continue to believe that organic deployment of capital to our highest potential business is the best way to deploy capital. But as I've also said, we are open to looking at M&A transactions if they make sense, I think we're in an enviable position in that we don't need M&A transactions to deliver against our medium-term targets.

But we will transact if that's something that we believe we can create value from. And I'd just remind everyone that over the last 18 months, we have actually deployed capital inorganically. We've extended our banca agreement with Bank Danamon in Indonesia. We entered a 16-year partnership with VietinBank in Vietnam. We acquired the Aviva portfolio. We formed a JV with Mahindra in India.

So again, a strong capital position has really certainly put us in a position of confidence as we've navigated the uncertain times of the pandemic. We've got plenty of opportunity to deploy our capital organically, but we won't shy away from inorganic transactions if they make sense and if they're on target.

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**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Roy, and this is Phil. Just to supplement, the -- to narrow the \$25 billion down, Roy made a key point that the capital that we have in excess of the upper end of our internal operating range is \$10 billion. We provided that disclosure earlier in the year to provide some clarity on our overall financial flexibility. But I do want to highlight in addition to that, the leverage ratio is in a really strong position, 25.5%, it's very close to our medium-term target level, and that does provide supplementary significant financial flexibility on top of what's in the LICAT ratio.

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**Meny Grauman** - *Scotiabank Global Banking and Markets, Research Division - MD of Financial Services Equity Research & Analyst*

Thanks, Phil.

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**Operator**

Thank you. The next question is from Gabriel Dechaine from National Bank Financial. Please go ahead.

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**Gabriel Dechaine** - *National Bank Financial, Research Division - Analyst*

A quick one on the LTC experience in the U.S. It was unfavourable, can you just give a bit more context on the nature of what was happening? Is it claims too high, mortality not high enough, something like that?

And then on the IFRS 17 question, last week, a couple of U.K. banks provided disclosure on the impact to their insurance subsidiaries, HSBC and Lloyd. They said their earnings and insurance could drop by about 1/3, if not more. One of them, HSBC is a somewhat similar business profile to yours, very new business case heavy. I'm wondering if you put any additional thought on impact from IFRS 17?

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Thanks, Gabriel. It's Steve here. I'll tackle the LTC question, and I'll pass it over to Phil on the IFRS 17. Our LTC experience in the quarter was actually positive. It was favourable.

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**Gabriel Dechaine** - *National Bank Financial, Research Division - Analyst*

Oh.

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Yes. And I can describe what we saw going on there. We continued to see the impact of mortality on elevated mortality on LTC on both our active lives and for those customers on claim, not as significant as we had seen in some quarters during the pandemic, but still evident. And then in terms of incidents and going on claim, we saw incidence levels that had been tracking back towards pre-pandemic levels. That reversed a bit in Q3, but we also saw customers that had suspended care, resuming care. So I think we had favourable experience overall. It was less favourable than we had last year. I think that's probably what you were looking at.

**Gabriel Dechaine** - National Bank Financial, Research Division - Analyst

Got it, okay, yep.

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**Steve Finch** - Manulife Financial Corporation - Chief Actuary

And we do continue to hold significant IBNR for customers that we believe will seek care again. So we did not change the IBNR this quarter.

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**Gabriel Dechaine** - National Bank Financial, Research Division - Analyst

So what is the negative expense in the policyholder experience in the U.S., not LTC?

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**Steve Finch** - Manulife Financial Corporation - Chief Actuary

So the overall policyholder experience?

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**Gabriel Dechaine** - National Bank Financial, Research Division - Analyst

Right.

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**Steve Finch** - Manulife Financial Corporation - Chief Actuary

Yes. So I think, Gabe, if I give you -- I think I need to give the broad perspective on policyholder experience because on the claims, broadly, we continue to see offsets in our portfolio as we have done throughout the pandemic. You know, policyholder experience in 2020, a total company was a positive and year-to-date, in 2021, is less than \$10 million loss. So we did have negative policyholder experience in Q3. On the claims front, we saw the continued diversification. So we saw losses in U.S. life. We saw losses in -- on mortality in Indonesia and the Philippines.

But that was offset by gains in annuities and gains in long-term care that we just discussed. And Canada bucked the trend, we saw gains in retail mortality experience as well as in group experience. So claims were largely neutral but with some moving parts. And then lapse experience, what we saw when the pandemic started as Phil mentioned in his prepared remarks, we saw customers really valuing their insurance products so we saw a drop in lapse rates. And that has driven some losses that we're seeing come through. About half or a little over half of those losses are economic impacts on our North American protection products but the other remaining almost half is a deferral of release of margins, which will come through in the future. And the only -- the other point of context I'd give here on lapses is in the global financial crisis, a different shock but a shock to the system. We saw similar things happen where customers stopped making decisions, we saw lapse rates on protection products drop, and those rates trended back to pre-global financial crisis levels after the shock was over. And that's my expectation of what we'll see as we come out of the pandemic, that lapse experience will trend back to more normal levels over time.

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**Phil Witherington** - Manulife Financial Corporation - Chief Financial Officer

Great. Thank you, Steve. And Gabe, this is Phil. I'll touch on the IFRS 17 question. And just to underscore upfront, a reminder of something we said at Investor Day, that IFRS 17 doesn't impact the fundamentals of our business.

It's really accounting that impacts when, where and how items are recognized in the financial statements. But to your point on the development that we saw over the course of the last week, where some of the U.K. banks have provided a bit of -- provided an indication of the impact of IFRS 17 on earnings.

I do want to highlight that the current accounting standard, IFRS accounting standard for insurance contracts, IFRS 4 permits a continuation of prior practices until such time that IFRS 17 is in place. And what that means for some of the U.K. banks is that embedded value is the basis for accounting on the balance sheet, and that results in present value of in-force business and intangible asset being recognized, internally generated intangible asset being recognized, with unpadding new business value flowing through the income statement.

We don't do that. It's a very different valuation basis to the Canadian CALM valuation basis and therefore, I don't believe that it's a good reference point in order to estimate the impact of IFRS 17 for Manulife.

As we continue the process of preparing for adoption of IFRS 17, we will continue to have dialogue with you. We started that process at Investor Day, and we intend to expand on that as we go through 2022.

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**Gabriel Dechaine** - *National Bank Financial, Research Division - Analyst*

Okay. So their new business gains are higher because they are unpadding? I think I get that. Is that it?

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**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

That's one of the key differences. That's right.

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**Gabriel Dechaine** - *National Bank Financial, Research Division - Analyst*

Okay.

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**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

The best estimate liabilities without pads.

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**Gabriel Dechaine** - *National Bank Financial, Research Division - Analyst*

Got it. Thanks.

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**Operator**

Thank you. The next question is from Humphrey Lee from Dowling & Partners. Please go ahead

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**Humphrey Lee** - *Dowling & Partners Securities - Research Analyst*

Good morning and thank you for taking my questions.

My first question is related to U.S. sales, especially since we've seen a very strong demand, which is a little bit unsurprising given the industry-wide sales seems to be seeing recovery from a year-over-year basis but is not particularly strong. So just wondering what you are seeing in terms of driving that strong demand for your life insurance products in the U.S.?

And then my second question is maybe for Steve. Just trying to see if you can provide some more detail in terms of the assumption updates that have taken -- that you have undertaken?

**Marianne Harrison** - *Manulife Financial Corporation - President & CEO, John Hancock*

So I'll get started, Humphrey. It's Marianne. Thank you for the question around the sales. The market actually in the U.S. was quite strong in the quarter. The market was up about 17%. We were up 24%, so higher than the market.

As Roy had talked about, our market share rank in Q2 actually improved as well from nine a year ago to seven this year. We have seen a lot of strength. A lot of it too relates to COVID, I'm sure, in terms of, as people are looking at the impacts COVID has had, has made people much more aware and I think that's been true for the whole industry. We've been stronger than the industry, and a lot of our strength has to do with some of our differentiators like Vitality. Our Vitality sales are up 84% on a year-over-year basis. And Vitality has been great from a consumer perspective because they're concerned about mortality, they're concerned about their health, and that really brings both of those two things together, so, we've seen strong sales as it relates to that. So that was on our brokerage side. International sales, just as a reminder, rolls up into the U.S. as well and we had a really strong quarter. Roy mentioned it. We had a record in Q3. We're on track to have a record year. Our Q3 record just so you know, beat our previous record by 22%, so, very strong sales and we've probably had the most diversified product lineup that we've ever had in the international business right now, and we're seeing a healthy pipeline. And we've done quite a bit internationally as well to automate things. We have about over 70% of our applications are coming through the producer portal. So it is good to see that we've done a lot of things on the digital front, which are really helping sales. So overall, sales have been strong. My outlook as we look forward is to continue to see some of this. We still have a healthy pipeline. So we're hoping Q4 is another strong quarter as well. Thanks.

**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Thanks, Marianne and thanks, Humphrey. I'll touch on the assumption review and I'll give a brief tour through it if there are areas that you want to drill down further, we can certainly do that. So as Phil noted, modest net charge of \$41 million.

We reviewed a variety of assumptions as we normally do a comprehensive study. Variable annuities, we saw a modest charge as we updated all of the assumptions. Some of the drivers were lapse rates as well as reflecting on policies that move into effectively a payout annuity stage, reflecting the fact that we will earn some spread on our investment strategies.

On mortality, there were a few drivers there. We updated mortality experience for one particular block of our U.S. business and reflected higher older age lapse mortality rates. We saw a modest strengthening in Indonesia on nonmedically underwritten business to reflect emerging experience as well as updating our assumptions on options around reinsurance.

We took a modest charge through the basis change but saw capital benefits from those changes. Lapse, the biggest driver was in U.S. insurance, where we reflected emerging experience up to the end of 2019, so pre-COVID.

And what we've seen there over time is in this very prolonged interest rate environment, we've seen customers value the protection value of the guarantees in those products, and we reflected the emerging experience that we saw. Those lapse rates, they were below 1% and we lowered them further. So that's some context for just how low these lapse rates are. And over time, as we've strengthened our lapse assumptions, we have seen experience come more into line with our assumptions.

Expenses, we -- what we're seeing there is really a reflection of our -- the execution of our strategic priorities and the medium-term targets that we've set. We've seen benefits from -- scale benefits in our investment expenses, and the benefits of expense initiatives across our businesses. A key thing is we've only reflected expense initiatives through 2021.

If -- as we execute on our strategy and drive further cost efficiency, that would be a tailwind. And we did not change our margins. We hold margins towards the high end of the range on our expenses, and that could be a further potential tailwind.

On the investment-related updates, we updated our corporate bond default study to reflect -- we reflected Moody's experience. Our experience has been more favourable than Moody's data over time, but we did not go all the way, leaving prudence in our assumptions. And we thought it was prudent to reflect current outlook and reduced our Canadian real estate return assumptions. So I'll pause there, but happy to drill in further on any of those.

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**Humphrey Lee** - *Dowling & Partners Securities - Research Analyst*

That's very helpful. I guess just in the interest of time, for the assumption updates, any kind of changes to expected profits going forward?

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

At the total company level, no material change in expected profits. Asia saw a bit of a bump up and Canada saw a bit of a bump up and U.S. saw a bit of a bump down, but not overall terribly material and not at the company -- not materially at company level.

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**Humphrey Lee** - *Dowling & Partners Securities - Research Analyst*

Got it. Thank you.

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**Operator**

Thank you. The next question is from Scott Chan from Canaccord Genuity. Please go ahead.

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**Scott Chan** - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Good morning. Maybe two questions for Anil on Asia. First, specifically on Japan, I saw earnings were relatively strong this quarter compared to past quarter, but insurance sales, including COLI, were down significantly. So maybe help us reconcile those two themes in the quarter? And going forward, and just on overall Asia, we've talked about sales being down with lockdowns in certain regions, but like how has competition been like in Asia in general during the pandemic? And has that affected pricing, in any effect? Thanks.

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**Anil Wadhvani** - *Manulife Financial Corporation - President & CEO, Manulife Asia*

Thanks for the question. And let me start with Japan. So -- before I launch into talking about Japan, if you look at Asia at a more portfolio, at a country portfolio level, our growth emphasis has been on Asia Other and on Hong Kong and towards that, for example, Asia Other in 2020 contributed to 36% of core earnings as opposed to only 16% in 2015.

In Japan, our primary focus, as we've communicated earlier as well, has been on in-force and on expense efficiency. On account of the measures that we have taken on both these fronts, you can see that translate into the six percent growth on core earnings in quarter three for Japan.

If you were to kind of look forward, our focus again in Japan will be primarily on in-force and on expense efficiency. The decline on sales that we witnessed was largely on account of COLI. And COLI has now seen successive tax rule changes that have impacted the COLI value proposition and the latest one was introduced in quarter three of this year. So the product mix that we're going to be driving in addition to our focus on in-force and expense efficiency in Japan is going to be very different from what we had experienced in the past. And just as an example, COLI was only 12% of our sales mix in quarter three as opposed to 50% plus a year back, same quarter.

To your question around competition and pricing. So, I did mention in the outlook remarks that if I were to kind of even trace back to 2019 when we experienced significant disruptions, for example, in Hong Kong, and then transition into 2020 where we felt the full backlash of COVID, and

even when we kind of transition into 2021, throughout these years, we have been able to gain market share in many of our geographies. And that's on account for a few reasons. One, we have made significant investments in growing our agencies. So if you go back to 2017, our agency force was approximately 70,000. Now, we are at approximately 118,000 agents. Our 10 exclusive bank partners. I think that they add significant level of strength and diversity to our sales mix. And as Roy alluded in his opening comments, we have made specific investments in modernizing our technology, which has impact on both customer experience but also on distributor experience, enabling distributors to become a lot more productive and a lot more customer focused.

And a combination of these factors, in my view, have resulted into the market share gains that we have now witnessed for several quarters. On the pricing front, I mean, this is part of our normal discipline, and we have been experiencing or living in the low interest rate environment for some time now. And on the back of that, we have taken a number of measures. We have been repricing our products. We have been driving a different product mix more towards higher-margin products, as well as have been very disciplined on expense efficiency.

And all these factors is kind of resulting into the new business value margin growth that we are witnessing in Asia. And as I said, despite the pressure that we witnessed on sales in quarter three, we were still able to grow our new business value by a healthy 15% year-on-year.

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#### **Operator**

Thank you. The next question is from David Motemaden from Evercore ISI. Please go ahead.

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#### **David Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Hi, thanks, good morning. I had a question just in terms of the potential VA transaction that was discussed earlier. I was wondering maybe if we could talk about what are some of the sources -- or what are some of the uses of the capital that could be potentially freed up from that transaction. And specifically, I'm wondering about the need to reduce leverage after that, if that would be a potential use of the proceeds.

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#### **Roy Gori** - *Manulife Financial Corporation - President & Chief Executive Officer*

Yes. Let me start there, David. Thank you for the question. And I guess the first comment I'd make is that I don't want to get too far ahead of ourselves on speculating on what we would do. We -- our first priority is to actually execute a transaction, and that's something that we're focused on. Obviously, we also feel that it's important when executing a transaction that we'd be clear on the deployment of capital. And obviously, we have various options available to us once regulatory restrictions are lifted, buybacks will be certainly one opportunity for us, but we also see opportunities to deploy our capital inorganically as well. So I'd sort of probably just leave it at this stage.

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#### **David Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

And then I guess just another one on IFRS 17 for Phil. Could you just remind me if this will have any impact on the cash flow generation of the business as a whole?

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#### **Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, David. This is Phil. So we're not expecting IFRS 17 to have significant impact on cash flow generation from our operating units at all. The key thing on IFRS 17, there are accounting changes that, of course, as I said earlier, impact how and when and where we report the emergence of earnings but from a total consolidated capital position, we anticipate that the impact at the industry level here in Canada will be neutral. That's consistent with the message that OSFI has given. And then, as I said earlier, from an operating subsidiary perspective, I think Canada is somewhat distinctive in that IFRS drives the basis for capital treatment in our other businesses around the world to a large extent, the capital basis is separate to the accounting basis.

**David Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Right. And I guess that's sort of my question because I know that at least in Asia, which produces a lot of the new business gains, I believe a lot of that business has been reinsured into Barbados, which utilizes -- does not utilize local accounting, Hong Kong accounting and Japan FSA accounting, it's on Canadian IFRS in Barbados. And so my thought was, is there a risk to capital generation because the impact of new business gains will be going away?

**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

And just to clarify though, David, I don't expect -- I don't expect IFRS 17 to materially impact remittances from operating subsidiaries, including the reinsurance structures that you touch on there. So that's not something that worries me, and in fact, when I look at the underlying free surplus generation that supports remittances from operating subsidiaries around the world, including Asia, I do actually feel good about the remittance profile both in the short term, the medium and the long term.

**David Motemaden** - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Okay, great, thank you.

**Operator**

Thank you. The next question is from Doug Young from Desjardins Capital Markets. Please go ahead.

**Doug Young** - *Desjardins Securities, Research Division - Diversified Financials and Insurance Analyst*

Good morning. Just maybe back to Steve on the lapse discussion in the annual review of actuarial assumptions. I mean, lapse has been a headwind for most LifeCos for the last 10-plus years in terms of charges. And so you took charges up to experience at the end of 2019 but you had negative lapse experience at the U.S. division in the quarter. And then you also mentioned in your remarks that you do expect that lapse will trend back more favourably as conditions improve and we get out of what we're in today. So I'm just trying to kind of reconcile what we're seeing today and -- did you not take enough in terms of the lapse charge? Or is the lapse experience that you're seeing different than what you looked at within the assumption review and how you're thinking about that?

**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Thanks, Doug. Yes, I can clarify that. So with all of our studies, we reflected experience up to 2019. Longer-term implications of COVID are not entirely clear and as I've stated before, we think we've got a lot of diversification and offsetting impact as we've seen coming through our results. That approach is also consistent with how others in the industry, whether it's Canada, U.S. or more globally, are looking at their assumption updates in terms of long-term business. What we saw, to be more clear, when the pandemic hit, we saw lapse rates drop materially. It was very notable once the pandemic became a very clear in-the-news risk item. People valued their insurance coverage in this time. We also saw interest rates drop further, which I think drove at the margin, these lapse rates as well. This experience, again, is consistent with -- from talking to many in the industry, consistent with what other industry players are seeing.

And my point around the global financial crisis and a shock to the system is that over time, I would -- I very much expect, lapse rates to trend back to levels before the pandemic hit. Now what -- I think what it will take to do that is the pandemic to be not in the news item every day, more in the rearview mirror. And potentially, if interest rates were to rise, I think that would be another driver of lapse rates moving back to pre-pandemic levels, which, as I said, is my expectation.



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**Doug Young** - *Desjardins Securities, Research Division - Diversified Financials and Insurance Analyst*

So you're assuming -- just to clarify, you are assuming that lapse rates -- within your reserving, there's an assumption that lapse rates go back to pre-pandemic levels to some degree?

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Correct.

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**Doug Young** - *Desjardins Securities, Research Division - Diversified Financials and Insurance Analyst*

Yep.

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

We've reflected the experience through 2019. We've reflected those lower lapse rates in our assumptions and the experience pre-pandemic lines up really well with those assumptions, and that is the expectation of what the long term will be.

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**Doug Young** - *Desjardins Securities, Research Division - Diversified Financials and Insurance Analyst*

Okay. And then on the other side, you made some interesting comments just around the expenses. And one that I just caught was the margins on your expenses are more at the high end of what you're required to hold. And I don't know if you can do this or not, but I figured I'd throw it out there. But if you were to change your margins on expenses to the midpoint of the range, I mean, would you be able to justify that? But could you quantify what the implications would be? So I'm just wondering if there is some cushion left in the expense side as well?

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

Sure, Doug. So the -- as I said, as we execute on the strategic priorities in terms of growing our Asia franchise, growing scale, and on the cost efficiency targets that we've set, what we'll see, we would start to see maintenance expense gains. As we move along that path, I would certainly, as the uncertainty around what could pan out emerges, that is a scenario where margins would be adjusted to be more midpoint of the range. And the expense margins that we hold in total are quite significant at a little bit under CAD 2 billion.

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**Doug Young** - *Desjardins Securities, Research Division - Diversified Financials and Insurance Analyst*

Right. Appreciate it. Thank you.

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**Operator**

Thank you. The next question is from Paul Holden from CIBC. Please go ahead.

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**Paul Holden** - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Thank you. Good morning. I have a couple of questions for you related to U.S. VA, and I guess, the first is I want to get a little bit of a better understanding around how VA has impacted some of the non-core earnings items over the last year, if at all. There's obviously been a lot of quarterly

volatility and market-related impacts for obvious reasons. And then also big swings in investment-related experience outside of core. So, just maybe you can bring some sense of how the U.S. VA business has impacted those items, if at all?

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**Steve Finch** - *Manulife Financial Corporation - Chief Actuary*

It's Steve. I can make a start on that, and then Scott may want to chime in. We've got a very effective hedging program on our -- on that U.S. VA business. So experience has been -- investment experience or market experience has been quite well managed. However, there is some quarterly noise that we see through modest amounts of hedge inefficiency or from basis risk between the underlying hedge assets and the investments that we hold. I think in -- when the market has really moved and when there's a lot of volatility, that's when we can see some dislocation.

Scott, I'll pass it over to you to see if you have any additional comments.

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**Scott Hartz** - *Manulife Financial Corporation - Chief Investment Officer*

Sure. Steve, that's exactly right. We've been at this hedging business for a long time and really refined it so that it does keep the volatility quite low. But you can't eliminate it and in a typical quarter, there will be a little bit of noise. And this past quarter, it was a slight gain due to the underlying funds outperforming our benchmarks. One of the quirks of volatility.

The other sort of volatility, as Steve mentioned, is when markets move dramatically, it does -- they're going up and down, they're volatile and not necessarily directional, that is hard to hedge and does create some losses. So our worst quarter in a long time was the first quarter of last year, the start of the pandemic when we saw really extreme volatility in the markets and that did create in the quarter, roughly a \$300 million charge in non-core.

We recovered some of that because some of that was the underperformance of the underlying fund as well as to volatility. We did recover some of that over the balance of the year. But that's kind of maybe paints a picture for you in a very extreme quarter, how bad it can get.

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**Paul Holden** - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay. Thank you for that. That's helpful. And then second question I have on -- specific to U.S. VA is related to where those earnings flow into? Just trying to get a sense if it's all going into the U.S. business segment or if the fees earned on the separate funds flow into the Wealth and Asset Management segment. And if I am correct there is sort of -- it's going into the two segments, if you can provide sort of a rough split, that would be helpful.

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**Marianne Harrison** - *Manulife Financial Corporation - President & CEO, John Hancock*

It's Marianne here. The -- sorry, the earnings are flowing into the U.S. segment, not the WAM segment.

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**Paul Holden** - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay, thank you.

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**Operator**

Thank you. The next question is from Lemar Persaud from Cormark Securities. Please go ahead.

**Lemar Persaud** - *Cormark Securities - Equity Research Analyst*

Thanks. So, my first question, is probably for Anil. Can you talk to what drove the positive core earnings growth in Hong Kong specifically? And if that level is sustainable? I guess it seems to be a material step up this quarter over what we've seen over the past year and I'm just a little bit surprised given some of the travel restrictions in the country.

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**Anil Wadhvani** - *Manulife Financial Corporation - President & CEO, Manulife Asia*

Thank you for your question. So, Hong Kong has been a consistent performer for us and has been an area of significant strength even as you said, if you go back to 2019 when we are facing challenges and during the COVID period, and suddenly rebounded exceedingly strongly in the first half of 2021.

We have continued to gain market share in Hong Kong, and that is attributable largely to the investments that we've made in creating what we believe is a best-in-class agency force in Hong Kong. And we address the domestic demand and the domestic customers quite effectively on account of the agency force that we have. We have the DBS relationship that adds to our channel mix as well as very strong broker relations in Hong Kong.

In addition to that, I do want to underscore the point that we derive significant brand strength on account of our #1 position in the NPS business. And that, in combination with the distribution strength, the digital capabilities, and the significant investments that we've made to modernize our technology has been instrumental in Hong Kong gaining market share sequentially now, as I said, for multiple quarters.

We believe and feel confident that this is sustainable. And in fact, the -- as and when the borders open up, we believe that we can participate and capture a greater share of the MCV business, which historically we haven't had such a large share in. So that actually would go and complement to the strength that we have in the local Hong Kong market, and we are already kind of, as I said, making investments to be able to address that opportunity as and when the borders open up. So we feel very confident, and it's just kind of, as I said, underpins the quality of the franchise that we have in Hong Kong.

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**Lemar Persaud** - *Cormark Securities - Equity Research Analyst*

Okay. So there's nothing specific you'd point to in Q3 because like when I look at your slide back here, \$248 million, and if I look at the prior four quarters, it's kind of around, like, call it, the \$215 million, there's one quarter of \$230 million. So nothing one type of nature in Q3 '21?

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**Anil Wadhvani** - *Manulife Financial Corporation - President & CEO, Manulife Asia*

As I said, it's 17% growth, largely driven on the back of some strong sales, so 12% growth, and this is even before you account for the borders opening up. We've been very disciplined on repricing, very disciplined in driving product mix as well as Hong Kong has done a superb job in managing their expenses. So, despite the growth that you're seeing, the expense discipline in Hong Kong has been very, very solid. So a combination of these factors is translating to the core earnings jump that you're witnessing in Hong Kong.

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**Lemar Persaud** - *Cormark Securities - Equity Research Analyst*

Okay, thanks, so then my next question is for Phil. I just want to circle back on the capacity of the leverage ratio. Is 30% the right way to think about the top end of what you'd let that get to?

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**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Lemar, for the question. This is Phil. I don't think that 30% is necessarily the cap but I think it's a good indication of a good measure of flexibility that we have from 25% -- currently at 25.5%. And if you go back as recently as 12 months, you'll have -- 12, 18 months, you'll have seen

the leverage ratio close to 30%, quite comfortable to go there. And in fact, at sometimes, it makes absolute sense to go there so that we can take advantage of favourable markets in order to reposition our overall debt portfolio.

So yes, the substantial flexibility above 25%, 30% is a good short-term reference point to understand where we'd be prepared to go without being concerned about that.

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**Lemar Persaud** - *Cormark Securities - Equity Research Analyst*

Right, thank you.

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**Operator**

Thank you. The next question is from Mario Mendonca from TD Securities. Please go ahead.

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**Mario Mendonca** - *TD Securities Equity Research - MD & Research Analyst*

Good morning. Roy, I'd like to kind of go right to the heart of the matter, about why this stock just doesn't work or hasn't worked in some time now. And one of the first things that I want to address is, you know, you've got a company with a big Asian business, a big wealth business, you'd think you'd be looking at a much more valuable company. But ultimately, what's happening is investors just aren't going to move with all this legacy business sitting around. So you've talked about the VA business and that you're confident that it can be sold. Can you talk -- put anything around that to give investors comfort that it really can be sold? Like, what makes you confident? Are there bidders? Are there real legitimate more than one bidder? Are there any meaningful impediments in Canada that would keep you from selling the VA business?

I just think the stock doesn't work with all this baggage and I think it's important that the company address it.

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**Roy Gori** - *Manulife Financial Corporation - President & Chief Executive Officer*

Yes. Good morning Mario, thanks for the question. A couple of things that I would say, firstly, we see incredible opportunity to unlock shareholder value from two lenses. The first is the tremendous growth opportunity that we have and the enviable position that we have from a perspective of our footprint and our platform. And we've talked about the fact that Asia is an incredible platform for us. We've been in Asia for 120 years.

We've demonstrated success in several years back, our Asia business was the sixth largest Pan-Asian player. And now we're the third largest Pan-Asian player. We're growing at a much faster pace than many of our competitors, gaining share, growing margin, growing profitability. So that opportunity is still hugely significant, and we feel very excited about that in the medium to longer term. Obviously, there are going to be some periods of challenges as we navigate COVID, but we feel very optimistic about that. We think continuing to execute against that agenda is going to unlock a lot of value.

On the WAM side of our business, again, we see a lot of excitement and a lot of opportunity. Our year-to-date results on WAM, I think, are a testament to the tremendous platform that we have, spanning three broad geographies, but also three business lines in retail, institutional and retirement. And again, our WAM business this year has grown 35% earnings and our core EBITDA margin above 30%. It was only a few years back that we were looking at 25% consistently. Now we're -- we've had five consecutive quarters where we've delivered core EBITDA margin above 30%, and this quarter was no exception. So again, we see that as a huge opportunity. And one that will capitalize on, a., the growth in the balance sheet of Asian consumers but also the aging population where people are looking for retirement.

So there's certainly no shortage of opportunity for us and growth potential to unlock value. But the other side of that coin, when you touched on this, is what's holding us back. And we've specifically focused on legacy. We focused our efforts through portfolio optimization to free up capital of our legacy businesses. I think the team has done a tremendous job on that front.

But we need to do a better job, and we need to be sharper, more specifically to focus on LTC and VA. At our Investor Day this year, we talked about a new target for the company, and that is to having our LTC and VA businesses go from 25% contribution to core earnings to 15% organically. And this is not over 10 years. This is by 2025. So this is in the not-too-distant future. And we also articulated that we believe that we can get their contribution down to 10% or less when we're supplementing our organic efforts with inorganic efforts.

So we feel reasonably confident that we can see a path towards not just the 15%, but also the 10%. We've articulated that in the current environment, there are many more buyers that are willing to talk about transactions than they were two to three years ago. And again, we've reiterated our confidence that a VA transaction as an example, is certainly possible in 2021.

We wouldn't do anything that didn't create value, and that will be a disciplined approach that we follow. But the short answer to your question, Mario, is that there's a tremendous opportunity with our franchise to unlock value for shareholders. And we think there are two sides of that coin. One is the big opportunities that we have from a growth perspective and from a profitability and margin improvement perspective. But we also have to focus in on the legacy businesses beyond the broader agenda to being more sharp on LTC and VA, and I feel very optimistic there, not just on inorganic efforts but also organic efforts, to really improve profitability, buybacks, for example, are another way that we're going to be able to reduce that contribution. But that's a broader agenda. We're going to need to demonstrate progress on that to unlock value. And again, I feel confident about that.

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**Mario Mendonca** - TD Securities Equity Research - MD & Research Analyst

The second thing I want to address is also related to sort of what's happening with the stock and why it's not working. Ultimately, what we're seeing here is the gap between Manulife's ROE and your peers, Sun Life in particular, but the same is true, for Great West Life and Industrial Alliance. The gap between Manulife's ROE and your peer ROE has been widening meaningfully over the last little while. And I think a lot of it relates to the issues we've just talked about, the mix of business.

But one reason in particular that I've tried to address on a few occasions is just this unallocated overhead expense that -- over \$500 million likely this year, almost nine percent of the company's pretax earnings. That number is not something you see at any other LifeCo, both in Canada and the U.S.. There's no LifeCo that I look at or bank, frankly, with an unallocated overhead. That's like having an additional nine percent tax rate on pretax earnings. That's what it kind of feels like to me.

So could you talk about what's in the unallocated overhead? And why it's not allocated. What does it relate to? Like, should that be a part of like should that be allocated to new business? So your new business gains aren't really that high. Does it relate mostly to Asia? What is this big unallocated expense number?

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**Roy Gori** - Manulife Financial Corporation - President & Chief Executive Officer

Yes. Thanks again for that question, Mario. Let me start, and then I'll ask Phil to chime in as well. I guess on the first point, as it relates to ROE, this is again, has also been a really important area of focus for us and we reiterated several times our commitments to our medium-term target of delivering an ROE north of 13%. And we saw great progress on that front in the years leading up to the pandemic. We'd achieved actually 13% plus in 2018 and 2019 after consistently delivering less than 13% in the past.

What's very exciting for us is that if you look at our return on equity year-to-date this year, we delivered 13.7% ROE. And I do feel the key drivers that are going to continue to help us drive ROE improvement will be the growth agenda that I articulated, continuing to grow our high-potential businesses, which are also our high profit and high-margin businesses at a much faster pace than the rest of our business.

In fact, year-to-date, those businesses have grown 21 percentage points faster than the rest of our business. So as we grow Asia, as we grow WAM, which have significantly higher ROEs, they are certainly going to help lift our ROE to a new plane. At the same time, really reducing the contribution of our legacy businesses, VA and LTC, and getting them to less than 10% is also going to be a force multiplier with helping our ROE.

So we see a really clear path to continuing the progress that we made on ROE and actually seeing further upside improvement there.

On cost, again, this is an area that we've been very focused on. And I think if I sort of take a step back and look at the total cost platform for the franchise, what I think is really important to remember is that you've got to look at efficiency. Cost containment for the sake of cost containment isn't necessarily a good thing. If we grow expenses at 0%, but then grow revenues on the top line at 0, that's not something we want to be celebrating. We want to be growing our top line at a much faster pace than our expenses, and that's when you're going to get the real uptick in earnings, ROE and so on. So we don't have a problem with growing our expenses, but we want to make sure that we're growing the top line at a much greater pace and that will actually contribute to an efficiency improvement. The efficiency for the franchise, we have a target of 50 percent. Again, this has been an area of focus throughout our strategic cost management efforts.

Our efficiency year-to-date this year is 48.9%, which is lower than that target. We think that there's continuous areas for us to improve on our efficiencies to drive even greater improvement. We've done a lot on the digital front. That's ultimately translated not just into cost efficiency, but actually better experiences for customers.

Our NPS scores are actually up 19 points from where we were three years ago, which, again, really is a testament to the fact that, that digitization has translated into benefits for the customer. So cost is a focus for us. We've driven, I think, tremendous improvements in efficiency. That's not a journey that's ended. We're continuing to focus on expense efficiencies and we see further upside potential improvement on that front. But I'll ask maybe Phil to chime in, specifically to talk about our corporate expense center and the costs that are included in those numbers.

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**Phil Witherington** - *Manulife Financial Corporation - Chief Financial Officer*

Yes. Thanks, Roy. And thanks for the question, Mario. From -- I'm looking at our corporate costs, we do take those into account when we complete our expense studies that then inform the assumptions that we make in each of our businesses around the world, both for in-force and new business. So that's not a gap that is a cause for concern. Our approach for determining what to recharge has really been informed by not just the absolute cost amount, but also sources of revenue, the components of core earnings in the Corporate and Other segment.

And there are contributors to earnings in this segment. Of course, we have the P&C Reinsurance business. But we also have -- it's where we recognize the excess investment gains, the core investment gains that flows through into Corporate and Other. So it's something we'll do review periodically, but we do have that historic practice of looking at it really on a core earnings basis.

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**Mario Mendonca** - *TD Securities Equity Research - MD & Research Analyst*

Thank you.

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**Operator**

Thank you. There are no further questions registered at this time. I'd like to turn the meeting back over to Mr. Ko.

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**Hung Ko** - *Manulife Financial Corporation - VP, Group Investor Relations*

Thank you, Operator. We will be available after the call if there are any follow-up questions. Have a nice morning, everyone.

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**Operator**

Thank you. The conference has now ended. Please disconnect your lines at this time and thank you for your participation.

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