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

Thank you. Welcome to Manulife’s earnings conference call to discuss our third quarter and year-to-date 2023 financial and operating results. Our earnings materials, including the webcast slides for today's call are available on the Investor Relations section of our website at manulife.com.

Turning to Slide 4. We’ll begin today's presentation with an overview of our third quarter results and strategic update by Roy Gori, our President and Chief Executive officer. Following Roy’s remarks, Colin Simpson, our Chief Financial Officer, will discuss the company’s financial and operating results. After the prepared remarks, we will move to the live Q&A portion of the call. (Operator Instructions)

Before we start, please refer to Slide 2 for a caution and forward-looking statements. Note that certain material factors or assumptions are applied to making forward-looking statements and actual results may differ materially from what is stated. I would also refer you to Slide 35, for a note on
the non-GAAP and other financial measures used in this presentation, which includes an explanation of our use of transitional results for 2022 comparison.

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 & CEO**

Thanks, Hung, and thank you, everyone, for joining us today. Yesterday, we announced our third quarter 2023 financial results. Let me first share with you some quick thoughts on the quarter. We delivered growth across our global business, which is evidenced through the strong operating and new business results. In the third quarter, we saw double-digit growth in APE sales and new business value compared with the prior year quarter. We also generated solid growth in new business CSM of 6%, which contributed to an annualized organic CSM growth of 5% on a year-to-date basis. Since the adoption of IFRS 17, we’ve been delivering steady year-on-year growth in core earnings over the past 3 quarters, including a 35% rise in core EPS this quarter.

We also reported core ROE of 16.8% ahead of our medium-term target of 15% plus for the second consecutive quarter, and we continued to focus on allocating capital to our high-return businesses to drive ROE growth. Despite the impacts of the challenging macroeconomic environment on our net income, we grew our IFRS 17 adjusted book value by over $1 per share in the third quarter, which translated to a 4% increase year-on-year. And finally, enabled by our strong capital position, we continued to deploy capital to further enhance returns to shareholders through dividends and share buybacks.

Turning to Slide 7. We are driving profitable growth while focusing on the needs of our customers and returning capital to our shareholders, which contributed to a strong third quarter. Asia continued to build on the momentum of the previous quarter capitalizing on the return of demand from Mainland Chinese visitor customers and delivered strong new business results with APE sales and new business CSM growth of 20% and 16% year-on-year, respectively.

In Canada, we delivered impressive APE sales growth of 51% compared with the prior year quarter, driven by a large affinity markets sale and it translated into an increase in new business value of 72% in the segment. We’re also making decisions easier for our customers, notably to accelerate the growth of our global high net worth business. We launched a unified onboarding platform in the third quarter in Bermuda, Hong Kong and Singapore to deliver a consistent high-touch experience for both distributors and customers.

I’m encouraged by the continued growth across our global franchise. Now, let me speak to our continued journey on becoming a digital, customer leader and highlight some of the key initiatives across our businesses. Starting with Canada we continued our digitization efforts to meet growing demand for more personalized digital healthcare experiences for our group benefits members with a strategic partnership with League, a leading healthcare technology provider. This partnership will help our customers understand their health, focus on prevention, access care and better understand and optimize their benefits.

In Global WAM, we accelerated customer adoption of digital applications in Canada retirement through our "Say Goodbye to Paper" campaign, which contributed to a 165% increase in members converting to e-statements over the 3-month campaign period and an increase in satisfaction in their digital experience over the prior quarter.

Moving to Asia. We further automated our claims-handling process in Hong Kong to deliver a better customer experience and drive operational efficiency. Through continued leveraging of data to enhance our auto-adjudication engine, the initiative drove a nearly twofold increase in straight-through processed claims year-on-year.

In the U.S., we continued to optimize our digital capabilities to create a more seamless digital customer experience through various initiatives, including an enhancement of the interactive voice response authentication enabling 31% of inbound calls to be completed with no human interaction during the quarter.
These are just a few recent examples of how we are making decisions easier for our customers and meeting their personalized digital needs, and part of our investment of more than $1 billion since 2017 to digitize our business.

Looking ahead, we will continue to build on our strong digital platform while accelerating our adoption of new technologies such as generative AI. We are already piloting a number of initiatives that we will look to scale as we uncover their potential to generate top and bottom-line benefits.

Moving to capital management. We continued to maintain a strong capital position supported by a higher LICAT ratio in the quarter of 137%. We also generated stable growth in adjusted book value per share with a 4% increase year-on-year in the third quarter. Coupled with a financial leverage ratio that is close to our medium-term target of 25%, we are in a position of strength to weather the macroeconomic uncertainties and continue returning capital to our shareholders. In fact, we have returned approximately $7.7 billion of capital to our shareholders through dividends and share buybacks since we resumed our share buyback program in 2022, and our dividend per common share has grown an average of 10% annually since 2017. In summary, I am pleased with our strong results in the third quarter. While we continue to operate in a tough and uncertain environment that presents challenges, I see tremendous opportunities against a backdrop of higher rates and continued recovery in Asia.

Manulife is uniquely positioned to capture these opportunities given our financial strength, business and geographic diversity and a leading insurance business that will continue to benefit from higher rates.

Thank you. I'll now hand it over to Colin to review the highlights of our financial results. Colin?

Colin Simpson - Manulife Financial Corporation - Chief Financial Officer

We have indeed delivered strong performance in the third quarter with growth in sales, earnings, book value and capital. I will go into a little more detail on our results before we move to Q&A. I will start with our top line on Slide 9. APE sales increased 21% from the prior year quarter as we continued to capitalize on the return of demand across Asia, in particular, Hong Kong. In Canada, we delivered APE sales growth of 51%, driven by a large affinity markets sale. The strong growth in sales translated into an increase in new business value of 15% and contributed to solid growth in new business CSM of 6%. This reflects increases in sales of Asia and Canada offsetting a decrease in the U.S., which experienced a slowdown in demand for accumulation products.

Global WAM saw net outflows of $800 million, entirely due to a large case pension plan redemption in our U.S. retirement business. Year-to-date, we have generated net inflows of $5.8 billion.

I am encouraged by the continued growth across our new business metrics compared with 2022 in the face of relatively difficult economic conditions, a testament to the demographic tailwinds in many of our markets, our broad product offering and our ability to execute.

Moving to Slide 10, which shows the strong growth in our profit metrics. Core EPS increased 35% as we grew core earnings and bought back shares. Now this growth was flattered by the hurricane-related charge in our P&C reinsurance business in the prior year quarter. But normalizing for this, core EPS still increased 12% despite a significantly higher credit charge.

As Roy mentioned, active capital allocation is a key priority for us, and it is encouraging to see our third quarter core ROE increase to 16.8%, ahead of our medium-term target of 15% plus for the second consecutive quarter.

Turning to Slide 11. Our net income was lower than core earnings this quarter caused by the challenging investment environment, but it is important to consider that some of this adverse result was offset by gains in other comprehensive income, or OCI, which contributed to the increase in our book value. Together with our contractual service margin, which also increased, we reported an adjusted book value per share of $30.67 up 4% year-on-year.

As Roy mentioned, active capital allocation is a key priority for us, and it is encouraging to see our third quarter core ROE increase to 16.8%, ahead of our medium-term target of 15% plus for the second consecutive quarter.

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Bringing you back to our core earnings results. Slide 12 shows our drivers of earnings analysis, presented relative to the prior year quarter to give you a sense of our progress. The first point to note is the recovery in the core net insurance service result. This was driven by the non-repeat of last year's $256 million hurricane charge, but also improved insurance experience. The second point is that higher interest rates continued to benefit
our net investment result through both higher expected investment earnings and higher returns on our surplus assets. These 2 factors were partially offset by higher debt costs included in “Other core earnings” along with higher performance-related costs and investments in technology across our businesses. Finally, the increase in expected credit loss or ECL this quarter was primarily related to certain electric utility bonds impacted by the Hawaii wildfires and a handful of private placement loans.

These factors drove a 28% year-on-year increase in our core earnings, as shown in the next slide, which I will move to and discuss our non-core items. The challenging macroeconomic environment led to a $1 billion market experience net charge in the third quarter. This included a $400 million charge from lower-than-expected returns on ALDA, a $273 million charge due to lower-than-expected public equity returns during the quarter, and a $266 million loss in derivatives and hedge accounting ineffectiveness driven by the significant increase in rates and steepening of yield curves, where the 10- and 30-year rates increased more than 70 basis points, while the shorter rates between 1 and 5 years rose on average 30 basis points.

We will continue to refine our hedge accounting programs to better align with the economic hedges. I will also note that given the interaction between the fair value through OCI option on our assets and liabilities, and derivative hedge accounting, it will be important to look at the impact on this line in conjunction with the movements in OCI to see the full picture of interest rate impacts. For this quarter, the impact was net favourable.

While we reported a net charge in ALDA reflecting lower-than-expected returns, the portfolio continued to generate a positive return in the quarter. Our long-term track record supports our ALDA return assumptions, but we should expect some periods such as now where it may underperform the long-term assumptions.

Commercial real estate was again the biggest driver of our ALDA underperformance as higher long-term risk-free rates are pressuring valuations. Although higher capitalization rates used by third-party appraisers lowered current valuations, these higher rates also indicate higher returns going forward, which further increases our confidence in achieving our long-term assumptions prospectively over time. It is important to reiterate that we continue to view a diversified ALDA portfolio as well-suited for insurance liabilities with attractive returns, and lower volatility relative to both credit and equity indices over a medium to long time horizon.

Outside of the market experience result, I would like to note that our annual review of actuarial methods and assumptions, or basis change, had a net neutral impact on net income attributed to shareholders. This year’s basis change resulted in a net favourable impact of $347 million pre-tax, reflecting a neutral impact to net income and increases in OCI and CSM. Further information on basis change is available in the appendix to the presentation.

Lastly, the $306 million gain in “Reinsurance transactions, tax-related items and other” reflects a one-off release of multi-year tax provisions.

The next few slides will cover the segment view of our results, starting with Asia on Slide 14. Both top and bottom-line performances were strong. APE sales increased 20% from the prior year quarter, reflecting a return of demand from Mainland Chinese visitor customers, which you can see in our Hong Kong results. As we have mentioned previously, the pace of economic recovery in Asia is uneven, and the strength of our diversified business in the region continued to shine through. The increase in sales contributed to a 16% and 7% growth in new business CSM and new business value, respectively. We delivered strong core earnings growth in Asia of 33% year-on-year, primarily driven by higher investment yields and business growth, as well as product actions, but I would add that core earnings also benefited from an increase in amortization of CSM in our Hong Kong business as a result of the basis change.

Moving over to Global WAM segment’s results on Slide 15. Our Global WAM business recorded net outflows of $800 million. This was driven entirely by a large-case pension plan redemption in U.S. Retirement, which more than offset continued strong inflows in our Institutional business. Excluding this large-case pension plan, net inflows were $4 billion for the quarter. Retail net outflows in the quarter reflected lower demand as investors continued to favour short-term cash and money market instruments amid market volatility and higher interest rates. Despite this backdrop, our U.S. Retail net flows outperformed the industry average. Our Global WAM business also delivered resilient core earnings supported by higher average AUMA, which increased 4% year-on-year and higher-than-usual Institutional performance fees. Our core EBITDA margin of 26.9% has improved sequentially since the first quarter of 2023, driven by steady growth in average AUMA and higher Institutional performance fees.
Heading over to our Canada segment on Slide 16, which had another strong quarter. APE sales increased 51% compared with prior year quarter, primarily due to a large affinity markets sale, which was the main contributor to our significant growth in new business value. I would like to remind you that the majority of the affinity markets sales are classified as premium allocation approach or PAA contracts, which do not generate CSM.

Core earnings increased by 4% compared with prior year quarter, mostly driven by more favourable insurance experience in our Group Benefits business.

Moving to Slide 17, which illustrates our U.S. segment’s results. In the U.S., lower APE sales were driven by the backdrop of a continued higher rate environment, adversely impacting our accumulation insurance products in particular, especially for our affluent customers. Lower sales contributed to the lower new business results. We are actively broadening our product base to mitigate the headwinds, including the recent expansion into the employer market by introducing a multi-life product. Our U.S. business delivered resilient core earnings, which decreased 2% compared to the prior year quarter, mainly reflecting the increase in ECL. Insurance experience improved year-on-year from net favourable claims experience, which provided a partial offset to the credit impact.

On to Slide 18. We continue to maintain a strong balance sheet and capital position. This underpins the commitment we make to our customers with every policy sold and gives us financial flexibility. At the end of the quarter, we had $22 billion of capital above our supervisory target ratio and our higher LICAT ratio of 137% remains strong. Our financial leverage ratio declined by 0.6 percentage points year-on-year, largely driven by higher adjusted book value during the quarter, and this continued to track closer to our medium-term target of 25%.

Enabled by our strong capital position, we continued to return capital to shareholders. We have returned approximately $7.7 billion of capital to shareholders through dividends and share buybacks since we resumed our buyback program in 2022 including approximately $420 million of buybacks or nearly 1% of our outstanding common shares during the third quarter.

And finally, moving to Slide 19, which shows how we are tracking against our medium-term targets. Our CSM growth metrics were below our medium-term targets, partly due to the impacts of market and foreign exchange movements. We continue to explore product and business enhancements to improve CSM growth and are still optimizing our performance in a post-IFRS 17 world. Our core EPS growth and core ROE have been strong in the first 9 months of 2023, and above our target ranges. All in, we have delivered strong operating and new business results, and echoing Roy’s earlier remarks as we continue to face an uncertain global macroeconomic and geopolitical environment, I am confident that we are well-positioned to deliver for our customers, shareholders and colleagues.

This concludes our prepared remarks. Before we move to the Q&A session, I would like to remind each participant to adhere to a limit of two questions, including follow-ups, and to re-queue if they have additional questions. Operator, we will now open the call to questions.

**Questions and Answers**

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

Your WAM business benefited from higher-than-normal performance fees in the Institutional business. I was hoping if you could provide us a little bit more colour in terms of what was driving that. And I was wondering if you could scale that in terms of dollars?

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**Operator**

(Operator Instructions) And the first question is from Meny Grauman from Scotiabank.

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

Your WAM business benefited from higher-than-normal performance fees in the Institutional business. I was hoping if you could provide us a little bit more colour in terms of what was driving that. And I was wondering if you could scale that in terms of dollars?
Paul Lorentz - Manulife Financial Corporation - President & CEO, Global Wealth and Asset Management

Thanks, Meny. It’s Paul here. Yes, in the quarter, we did have a strong performance fee. It was on our timber business. The performance fee was $23 million post-tax this quarter and helped contribute to the positive results. But if you look at the underlying core earnings, they were strong without the performance fee. If you compare them to Q2, if I back out the performance fee completely, core earnings would have been $338 million, up 6% from Q2. EBITDA margin would have been 25.6%, which is 100 basis points up from Q2, and that’s relative to average AUMA up 1% from Q2.

Now having said that, performance fees can be lumpy, but we would expect to generate a certain level on a regular basis. Historically, for us, that over the last 4 years, that’s been between, on average, $10 million to $15 million post-tax on a 12-month basis. This year, year-to-date, we’re sitting at $27 million post-tax, a little bit higher than normal. But if you’re trying to get a sense of run rate, you should include some portion of performance fees on an ongoing basis.

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

And then just wanted to talk about CSM, new business CSM growth and CSM balance growth, both year-to-date coming in well below medium-term targets. So I just wanted to revisit what’s driving that and then try and think through the implications in terms of earnings and book value growth going forward. So those would be the 2 questions on CSM.

Colin Simpson - Manulife Financial Corporation - Chief Financial Officer

Thanks, Meny. It’s Colin here. So we’re actually really pleased with our new business CSM growth in the quarter. 80% is coming from Asia, and Asia is up 16% year-on-year. So there’s good momentum coming from Asia, and that will feed through into the CSM balance growth. If you look at the CSM balance growth in the quarter, on an organic basis, it’s up 5% annualized. That’s year-to-date actually, annualized 5%. So we have got momentum in our CSM balance growth. It isn’t quite at the 8% to 10% target that we’re going for. But we’re very focused on this because as you know, this is our store of future earnings, and this will drive through into future earnings. So really nothing new to say on our target. We continue to operate in an IFRS 17 environment. There’s only three quarters of reporting. So we’re still getting used to that as a reporting regime, but remain very confident in our medium-term targets.

Roy Gori - Manulife Financial Corporation - President & CEO

Yes. Meny, I might just add in as well. I think Colin summarized it well. But we’re still very much committed to our medium-term targets for both new business CSM and CSM obviously, we’re still in the early days of IFRS 17, and it’s a challenging environment, as Colin highlighted, but there’s a lot for us to be encouraged by, particularly the fact that our new business CSM for Asia was 16% in the quarter and 12% year-to-date. And as Colin highlighted, more than 70%, in fact, 80% of our new business CSM is coming from Asia. So we still feel very confident in our medium-term targets, which are through the cycle, and there’s a lot to be optimistic about as we look to the next year and beyond.

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

And just a follow-up in terms of, obviously, you’re reacting to a market environment, but is there anything -- any levers that you can pull internally in order to boost those growth numbers. So curious about some actions that you can take or are taking to do that.

Colin Simpson - Manulife Financial Corporation - Chief Financial Officer

I think many -- for us, it’s really about more customers through the door, more sales and better margin. If we get that taken care of, then everything else flows from there. So that’s really what we’re focused on.
Operator
The next question is from Doug Young from Desjardins Capital Markets.

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst
Just maybe starting with Asia. It looks like there was -- lapse was an issue again in Vietnam. I think that's been the case for a few quarters now. I mean, can you maybe delve into a bit of what the issue is, and the reserves need to be adjusted on that business? And then I guess on the flip side, in Asia, it also looks like there was some negative claims experience and taking this from just Slide 25, if you can kind of dig into that a little bit, what drove that?

Phil Witherington - Manulife Financial Corporation - President & CEO, Manulife Asia
Doug, this is Phil. I'll make a start and then hand over to Steve Finch, who may wish to comment further. But to your first point on Vietnam, the market has been experiencing challenges, and we've referenced this in previous quarters. But it really is a reflection of the underlying challenging economic conditions in Vietnam. And we're seeing that translate into lower new business volumes, but also lower levels of persistency. And when you look at the movement in policyholder experience in the CSM, that's really a reflection almost in its entirety of the challenging persistency that the entire industry is seeing in Vietnam, and we're seeing that as well in our business. You also referenced policyholder experience or experience elsewhere. And in the P&L, you do see a negative $20 million in Asia.

I do want to clarify that, that exclusively relates to maintenance expenses. So our policyholder experience, there are positives and negatives across the region, but it all balances out to a net neutral position. And when you look at the impact of expenses and compare the overall expense position relative to the third quarter of 2022, what you'll notice is there's been a reallocation of unattributed expenses to maintenance expenses. So that $20 million is actually geography rather than a deterioration in the expense position. But I will hand over to Steve to see if he wants to comment further, particularly on the balance sheet impact.

Steve Finch - Manulife Financial Corporation - Chief Actuary
Sure. Thanks, Phil. And also adding the claims was neutral for Asia across the region overall. Specifically, Doug, with respect to your question on reserving. As Phil noted, the persistency challenge across the industry in Vietnam, that's expected to be short-term in nature. We don't think it's a structural issue and we've got a strong position there. So it's not really a long-term assumption balance sheet issue, and that's why it's not reflected in the basis change.

Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst
Okay. And then Steve, while I've got you. Just on the long-term care insurance, I know it was a net modest positive, exactly like last quarter, a little negative in the P&L a little positive in the CSM. Can you unpack a bit about what's going on through the P&L through what through the CSM -- what you're seeing? Is it exactly the same as last quarter? And is this something that we should expect to continue for this block of business where we see a little drag in earnings, but a little bump in CSM? Just trying to understand how to think about the moving pieces with this business.

Steve Finch - Manulife Financial Corporation - Chief Actuary
Yes. Sure, Doug. Yes, on long-term care in total, which is really how I think we need to look at experience to understand the drivers. LTC was a modest positive. It's also been a modest positive since the assumption review in 2022. And just take the chance to emphasize, you know how we've been managing this business over time, regularly updating to reflect experience, and we've been doing that for a couple of decades, whereas under the new U.S. GAAP standards, that's a new requirement. So we've been managing it that way for years. In terms of specifically what's going
on in the quarter, we do -- what goes through net income is cash variances. So it's higher utilization for customers on claim, but that's more than offset by favourable incidence and termination experience. And that particular trend is likely to continue over the short-term. But again, I look at the experience in aggregate, which has been positive.

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

And just the termination when you say favourable termination, is that more lapse? Is that...

Steve Finch - Manulife Financial Corporation - Chief Actuary

It's the combination of lapse and mortality, or active life and those on claim.

Operator

The next question is from Tom MacKinnon from BMO Capital Markets.

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

Two -- One quick question on the affinity sale. Can you quantify the amount?

Naveed Irshad - Manulife Financial Corporation - President & CEO, Manulife Canada

Tom, it's Naveed Irshad here. So this was our largest affinity sale ever. It was the Ontario Medical Association; 36,000 new customers, $150 million to $160 million of premium.

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

Sorry, $150 million to $160 million?

Naveed Irshad - Manulife Financial Corporation - President & CEO, Manulife Canada

Between $150 million and $160 million of premium.

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

That's great. And with respect to the U.S., like we're having some negative sales momentum here. If I look back in the history of Manulife, it was a second to die, no-lapse guarantee then moved into Vitality. The consumer is changing here, just rate environment is changing. Your sales are slipping here. What is it that you -- what are you trying to do in order to revamp sales? And what is your competitive advantage?

Brooks Tingle - Manulife Financial Corporation - President & CEO, John Hancock

Sure, Tom. It's Brooks Tingle. Thank you so much for the question. Over the past few years, we've really worked to significantly improve the new business profitability, the profitability of our new business franchise. And notably, we've been able to grow sales during that period, and that was really on the back of our unique differentiator, Vitality, which you mentioned. So we've had a few years now steadily increasing margins, increasing sales; this year in Q3, in particular, has definitely been a challenging market.
And Colin touched on it earlier, people buy life insurance in the U.S., generally for 2 reasons: protection against loss of income or estate taxes, what have you, or accumulation, particularly wealthy people that may have maxed out their 401(k) and so forth, will put money into life insurance and accumulate it for retirement. Higher interest rates, which obviously good for our business in a range of ways, challenge those accumulation sales. There are attractive alternatives for wealthy people to put cash right now. So protection sales have held up pretty well, but our accumulation sales have really been hit hard, and that’s been a strength for us in the high-end of the market.

I will say we’ve maintained margins throughout all of that, and we actually feel really good about our competitive position coming out of COVID. Vitality continues to be extremely popular both with brokers and consumers. And specifically in terms of what we’re doing, Colin touched on a notable action as we enhance and revamp our product lineup to reflect the current market. We launched this multi-life solution, which is a protection-based solution with Vitality integrated in it. And we’ve seen a very, very positive and strong market reaction to that, and feel quite good about our ability to deliver profitable growth in our new business franchise in the U.S.

Roy Gori - Manulife Financial Corporation - President & CEO

Tom, I might just also add that despite the challenging quarter, NBV for our U.S. business year-to-date is up 4%, core earnings is up 6% year-to-date. And as Brooks highlighted, our Vitality proposition actually is a significant differentiator for us and has allowed us to outperform the market over actually quite a number of years. So we feel really good about our U.S. business challenging market at the moment with higher rates as Brooks highlighted, but we feel optimistic about the outlook there as well.

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

And if I could just -- a quick one with respect to the actuarial review, lapse continuing to be an issue in the U.S. Did you do -- did you revisit the lapse assumptions for your no-lapse guarantee or secondary guarantee products in the U.S.? Was that part of that review? Or does that come next year?

Steve Finch - Manulife Financial Corporation - Chief Actuary

Thanks, Tom. It’s Steve. So the U.S. lapses were not part of the review this year. They are part of next year’s review. And let me give you a little context for what we’re seeing. A reminder that before the pandemic, our lapse assumptions were up-to-date, experience was consistent with our assumptions prior to the pandemic. During the pandemic, we saw lapse rates on protection products drop in Canada and the U.S., and that would include NLG and other protection-oriented products. What we -- what I expected to see over time is that those lapse rates would trend back to pre-pandemic levels. And indeed, that is what has happened in the Canadian level cost of insurance UL products, which is quite similar to the U.S. no-lapse guarantee.

It’s happened in seg funds and variable annuities. And then in the U.S., while lapse rates remain low, in the past couple of quarters, we have seen on some of our protection products, those lapse rates trending up. So that -- all of this informs my expectation that over time, we do expect the lapse rates to return to pre-pandemic levels. And this type of phenomenon is also something that we observed in the global financial crisis, and coming out of the global financial crisis.

Operator

The next question is from Gabriel Dechaine from National Bank Financial.


I just have one question actually about the ALDA portfolio, another negative performance period here. We get what’s going on with CRE, in particular. My question is about the -- when would you start to review the expected investment income, the thing that goes through your DOE, the component
that’s tied to ALDA, it looks like you assume a 9%, 9.5% return going forward. And historically, that’s fine. It’s supported by that, but those were ultra-low interest rate periods. And you do give some sensitivities about 10% sudden drop.

My question is, what if you brought that return down to 8% instead of 9%? Would I just apply that decline to the $40 billion alternative portfolio and divide by 4, and that would be the reduction of your expected investment income?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

Gabriel, it’s Scott. Thank you for the question. We, over time, expect the ALDA returns to be somewhat volatile. We’re not going to hit our expected return every quarter. And as you mentioned over time, we have achieved those returns that we put into core. We will have periods, however, of underperformance and periods of overperformance. And if you look over history, about half the time, our performance is above, about half the time, the performance is below. We’re in one of those periods right now where the performance is below, the last 5 quarters, we’ve been a bit below. Now our gross returns are still positive. We just have not achieved the long-term target returns. The 8 sequential quarters before that, returns were above our long-term targets. So we think those long-term targets are still appropriate (technical difficulty) sorry, something happened to my mic. But so let me wrap this up a bit.

The big driver in the last 5 quarters of the underperformance has been our real estate portfolio, as you mentioned. It’s about 2/3 of the underperformance. And it’s -- what’s driven that are a couple of things. One, office, as we know, has performed poorly, but the second big driver and the big driver more recently has been rising cap rates, reflecting the higher interest rate environment. And as cap rates go up, that does depress current returns, but it portends higher returns into the future. And to your point, we did benefit from lower cap rates historically over the last 10 years.

But you may recall that in 2018, we did reduce those assumptions that we put through core to reflect even though we had hit the target returns, we were less confident we would achieve them going forward given the cap rates have come down. We’re actually now in the opposite situation. And the underperformance in the last few quarters, is largely due to these rising cap rates, and that will lead to higher returns going forward. So as Colin mentioned in his introductory remarks, we’re more confident than ever of achieving those long-term returns.


Yes, I get that. I’m just -- if we are in a higher for longer rate environment or moving towards that, it seems to be the case today anyway. Some of these asset classes, not just CRE, might not be able to generate the returns you have historically. And if investors want to take a more conservative view, I’m just trying to mechanically figure out what would your expected investment income look like if the ALDA portfolio return was lowered from 9% to 8%. Is there any way you can ballpark that?

Colin Simpson - Manulife Financial Corporation - Chief Financial Officer

Yes, Gabe, it’s Colin here. We’re very transparent about our ALDA sensitivity. You will see the number in the -- and you actually pointed it out. So you can take a rule of thumb and divide that 10% sensitivity by however much you want to do to analyze the impact of a reduction in expected long-term returns on ALDA.

Roy Gori - Manulife Financial Corporation - President & CEO

The other thing I would add, Gabriel, is that our ALDA portfolio is a diversified portfolio. We’ve got real estate. We’ve also got private equity timber, agriculture, infrastructure, energy, so the diversification of our portfolio is very helpful. And yes, higher rates are certainly providing a headwind from a cap rate perspective on the commercial real estate portfolio, which as Scott highlighted, should actually give us more confidence around our return assumption in the future. A lot of our -- the other components of our ALDA portfolio actually benefit from a higher rate environment.
And in fact, in 2005 and 2006, we saw higher rates as an environment, and our ALDA portfolio outperformed assumptions. So again, I'd just remind you that ALDA is a long-term assumption, it's through the cycle, and we have strong conviction with our assumption.

Operator
The next question is from Paul Holden from CIBC.

Paul Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research
First question, continuing with ALDA is maybe you can give us a sense of how much cap rates have been revised, whether it's year-to-date or sort of over the next 12 months, just to give us, I guess, also a sense of how much further they may or may not change?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer
Sure. Paul, it's Scott again. Yes. So far year-to-date, we've seen in North America, cap rates rise about 60 basis points, and we're now at nearly 6% on go-forward cap rates. And if you think about the return on the portfolio, it should be the cap rate plus the growth. And so with that sort of math, we are above our long-term expectations. Our long-term expectations for real estate are among the lower ones we have. So they're below that 9% sort of on average return that we have. Now going forward, it's a good question. What are cap rates going to do from here. And well, I don't have a crystal ball. I would say that if rates stay high, we probably will see continued pressure on cap rates. I think the appraisers sort of need to get confident that central banks are going to start to reduce rates. And once they get that, I think you'll see the cap rates stabilize and at some point, probably compress.

Paul Holden - CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research
And then just looking at the core expected returns and then kind of comparing it to the investment income reported on the income statement, there's a pretty big difference in the year-on-year growth rates, right, 24% on the core per DOE versus a 5% increase in the income statement. I think about that, and I look at the 24% for what I think would be a long-duration fixed income book. It seems high. So I'm just wondering how I can reconcile the 2 and really understand the rapid or significant increase in core investment income year-over-year.

Colin Simpson - Manulife Financial Corporation - Chief Financial Officer
Yes, Paul, it’s Colin again. It’s a good question. If you look at interest rates, the actual interest rate impact coming through that line is only $43 million year-on-year. There is quite a large component from business growth. And then there's a couple of ins and outs from as we adopted IFRS 17. So there's a lot of things going through that business line, but the combination of interest rates and growth is really driving the overall increase.

Steve Finch - Manulife Financial Corporation - Chief Actuary
Just adding that -- the go forward, we're at a good jumping off point, and that will continue to grow as our business grows as the balance sheet grows.

Operator
The next question is from Lemar Persaud from Cormark Securities.
Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst

I want to turn to the credit losses. Would it be fair to suggest that you're adequately reserved for both the electric utility bonds and private placement loans? Or could there be additional losses on these exposures moving forward? And then can you provide some additional colour on the nature of these private placement loans, like what's the size of the portfolio, what's your provisioning against that? Any additional colour would be helpful.

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

Sure, Lemar. It's Scott. Thanks for the question. So yes, ECL was a bit higher this quarter than we normally would expect. And I'll just remind you that when we look at ECL, we're not looking at gross credit losses under IFRS 4. We looked at credit losses versus expectations. So you should expect to see credit losses on an ongoing basis. That's sort of why we put it into core. It doesn't net to 0. So you should expect some credit losses. This quarter, it was a bit high. And you pointed out the primary reason was Hawaii Electric and its subsidiaries. And so that was about half of the increase, and that was due to Hawaii Electric getting downgraded significantly. And so move to stage 2 lifetime reserve. And is that enough? Our experience with senior utility bonds, I don't think we've ever had a loss on senior utility bonds, went through a fairly similar experience with Pacific Gas and Electric and ended up with a complete recovery after they actually filed for bankruptcy because of the wildfires. So I think -- so we feel good about it.

With that said, you can never be sure as to what happens here. But we feel pretty adequately provisioned at this point. The rest of the provisions, I would say are on a variety of different, none of them are extremely large and are kind of more in the normal course. And I would say we tend to be conservative when we put up provisions or downgrade securities. So I feel very comfortable with where we have the ECL at this point.

Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst

And these private placement loans, are they kind of related to the electric utility bond? Like is that -- are these like separate exposures?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

No. These would be separate. There'd be a bunch of different bonds across the portfolio.

Lemar Persaud - Cormark Securities Inc., Research Division - Research Analyst

And then my next question, is it plausible that we could go through 2024 and 2025 with ALDA continuing to drag down reported EPS. So we should kind of think of the starting point for reported EPS to be below core or it's plausible for it to be below core for an extended period of time. And then of course, you layer everything in on everything else that impacts all the rest of the macro factors in and above that starting point for an ALDA charge. Is that the right way to think about the gap between reported and core, looking forward for the next couple of years?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

So I would suggest that it's hard to forecast the future, of course. And the shorter your time period, the harder it is. We feel very confident in the long-term that reported in core will be the same with our ALDA experience. I guess I would be a little concerned for the next quarter or 2 that we see cap rates go up and continue to weigh on the real estate portfolio beyond that. My hope and expectation unless we see a recession or something like that, that we would get back to our long-term returns.

Operator

The next question is from Darko Mihelic from RBC Capital Markets.
Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

Just a couple of questions on Asia. Maybe if you could provide a little bit of colour. I just want to -- this is more of a modelling question actually. The basis change that ended up creating a higher CSM amortization. Maybe if you could provide a little colour on that? And is this new higher level sustainable? And similarly, I believe you did some pricing action, but I just want to make -- I just want to confirm that (technical difficulty).

Phil Witherington - Manulife Financial Corporation - President & CEO, Manulife Asia

Okay. Darko, this is Phil. Thank you for the questions. I’ll make a start, and then hand over to Steve with respect to the basis change, and I think what you’re getting at is the very strong contribution to core earnings. Colin referenced this in his remarks, we’ve seen a 33% growth in core earnings in Asia in the quarter. That’s 13% sequentially. And one component of the growth there was the impact of changes in actuarial methods and assumptions. But I think it’s really important to put that into context that of the 33 percentage points of growth, it was about 7 percentage points of growth that was coming from basis change items.

The remainder of the growth was coming from commercial factors. And I think what we see in the third quarter is a very good foundation to project from -- for the future. And when you reflect on our year-to-date core earnings growth for Asia, that’s been 10%. And I do think there is upside to that 10% rate of growth from factors such as the opportunity for stronger productivity in our agency channel, as well as the continued emergence of the MCV channel post-pandemic. I think there are, of course, always headwinds. We’ve talked about the ongoing challenges that the industry has seen in Vietnam. We’ve seen new regulations coming from the regulator in China, which we expect to impact short-term banca momentum. But overall, I do feel positive about the sustainability, not just at Q3, but also growth from there. Steve, did you want to touch on the basis change factors?

Steve Finch - Manulife Financial Corporation - Chief Actuary

Sure. Thanks, Phil. And thanks, Darko. The -- what we’re seeing in Asia from the assumption review, falls in that bucket that we called other methods and assumptions. And what this primarily relates to is under IFRS 17, we’ve been refining some of our models and in particular, the cost of guarantee calculation on par, which is a new requirement under IFRS 17. So through the year, we actually changed how we manage the business in terms of how we pass experience back through dividends to customers. We updated the models. We reflected higher interest rates, and that resulted in a net release of liabilities, a large portion of which is coming through the CSM.

So as Phil noted, the basis change is impacting positively the Asia earnings through a higher CSM balance and slightly faster amortization of CSM. That was more mechanical as opposed to anything that we did on the amortization.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

Sorry, Steve, just to follow up on that. So the faster amortization of CSM is a permanent thing? Or is it just -- did it just affect this quarter?

Steve Finch - Manulife Financial Corporation - Chief Actuary

No, that would be an ongoing run rate.

Operator

The next question is from Nigel D’Souza from Veritas Investment Research.
Nigel D'Souza - Veritas Investment Research Corporation - Senior Investment Analyst

I wanted to dig into the actuarial review this quarter. And I noticed that when it comes to experience, the experience since the COVID-19 pandemic I believe, was excluded from the review. And I'm just trying to get a sense of how you determined, which experience since 2020 was an outlier versus what could be more indicative of post-COVID experience and how that factored into the review this quarter?

Steve Finch - Manulife Financial Corporation - Chief Actuary

Thanks. Nigel. It's Steve. So how we dealt with COVID in the review is for long-term insurance products where we felt that the experience during COVID was not indicative of long -- what long-term trends would be, we excluded that experience. And that's consistent with industry practice. And I'd just point to a comment that I made on one of the earlier questions.

For instance, in Canada, the Level COI lapse study that we did, we did not include the COVID experience there. But as I noted, experience has already trended back towards the pre-pandemic levels. Where we did reflect more recent experience was on certain morbidity assumptions where we believe that the experience more recently is indicative of future trends. And that actually strengthened reserves on the morbidity side in Vietnam and was partially offset in Japan. So that's the approach that we took. And as I noted, it's consistent with industry standards as well.

Nigel D'Souza - Veritas Investment Research Corporation - Senior Investment Analyst

Any comments on mortality, as you cover lapse and morbidity, but any thoughts on the mortality experience since 2020?

Steve Finch - Manulife Financial Corporation - Chief Actuary

Yes, sure. And in -- so the review that we did in U.S. Life, we updated mortality assumptions. That was based on our own experience before the pandemic as well as an additional industry study. I would remind you that -- it was a modest change in my view, in total. I would remind you that we have a really diversified book of business when it comes to longevity versus mortality, and we saw that through the pandemic with higher claims in life insurance fully offset by gains in long-term care and annuities from the mortality trends. So just a reminder that we're well matched on mortality overall.

Nigel D'Souza - Veritas Investment Research Corporation - Senior Investment Analyst

Great. And just last question on this. Any colour you have on if they were some of the trends that end up being a bit more persistent, maybe not indicative of future trends, but just maybe a slight adverse or favourable change from pre-COVID trends. Any sense of what the net impact might have been or could be, just to gauge what the sensitivity would be to some of these COVID trends?

Steve Finch - Manulife Financial Corporation - Chief Actuary

Yes. As I noted, the mortality trends, we've got good offsets. The lapse experience is generally trending back towards pre-pandemic levels. So I'm not going to quote a number. We do provide some sensitivities in the MD&A on our liability assumptions. And as you know, we regularly and routinely update based on emerging experience and our view of the future. So we'll continue to do that and be transparent about what judgments that we're making.

Operator

The next question is from Mario Mendonca from TD Securities.
Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Quickly first on Wealth Management. I obviously among other things, focus on the operating leverage in that segment. And while it's been improving, it's also been negative now for some time because expense growth has been so high. It's not the top line. The top line looks pretty solid. So could you speak to what these expenses are? And is there a period when we'd expect expense growth to return to something more sort of normal in the mid-single digits?

Paul Lorentz - Manulife Financial Corporation - President & CEO, Global Wealth and Asset Management

Yes. Thanks for the question, Mario. It's Paul here. Just on the overall margin, just relative to last year, just a couple of things that we mentioned on last quarter's call that are just impacting the year-over-year. One is just a reduction in repatriation of seed capital in some private assets that brought down the core earnings, and then the step-up acquisition of our China JV Manulife Fund Management also had an impact overall on the margin year-over-year. The third impact was expense growth. As you noted, coming out of COVID, we did see an increase in expense growth to support the growth of our business. But we recognize that in Q1 of this year, and just looking at the uncertain markets, started taking actions then internally here. And you've seen that come through the expense growth since then it was down from Q2 to Q1 and Q3 was pretty flat with Q2.

What I will say is that expense growth is a continued focus for us in the business. That's something that we're looking at how do we get leverage out of the global franchise. And more importantly, you've heard Roy talk about our digital ambition and the investments we're making there, and we expect that to pay dividends for us. So we are expecting to have more muted expense growth go forward for our business based on those efficiencies that we see, and then just looking forward from a margin perspective, we can't control markets obviously, and that drives a lot of our fee income. But if you look at some of the other metrics, the top line, as you mentioned, has been very strong, $5.3 billion year-to-date, 12 out of 13 years. And then the other thing I'd say is our net interest fee yield has also been pretty stable. So when we look at that, our focus on expenses and net flows, we feel very optimistic that we'll continue to improve this margin over time.

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

Moving to ALDA again, and it's a different kind of question, depending on which economist you speak to -- we'd expect rates to start to come down, like overnight rates that are coming down, say, around April or May. The question is how soon after rates start to drop the short end of the curve or the long end of the curve, how soon after do you actually start to report some gains on the ALDA, like returns that are above your long-term expectations? Is that a reasonable expectation as rates start to fall?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

Yes. Mario, thanks. So it's not all about interest rates, but interest rates obviously have been pressuring returns this year. And to the extent the Fed does start to lower rates, that will certainly be helpful. And I think appraisers will actually reflect that pretty quickly or even based on sort of market expectations. So yes, I would think on the real estate side, you should see that sort of reversal. Of course, there's other factors at play, how the general economy doing and so forth that will also have an impact.

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

Operator, do you have any further questions?

Operator

The next question is from Tom MacKinnon from BMO Capital Markets.
Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst

Just a follow-up on ALDA discussions. I mean we’ve been focusing here talking a lot on cap rates. But obviously, the return on the portfolio is not just the cap rates, it’s the growth and as the dynamics of sort of commercial real estate are changing, what are your thoughts on that growth? I mean it hasn’t been -- it’s a different world post-COVID here now in terms of commercial real estate. So how does that factor in? Just your comments with respect to that?

Scott Hartz - Manulife Financial Corporation - Chief Investment Officer

Yes. So as I talked about earlier, for commercial real estate, cap rates plus growth, to your point, are what drive the total returns. And our portfolio is office, industrial, multifamily. And I would say on the office side, I would say growth could be challenged. It’s hard to say for sure. This return to office is still not played out, but that’s something we’re keeping a watching brief on. But our office has become a pretty small part of our ALDA portfolio. The U.S. office is only 5% of the overall ALDA portfolio at this point. Whereas I think the other property types really have pretty good tailwinds behind them. In industrial, we’ve seen a lot of growth there. We’d expect that to continue. And then on multifamily, there’s certainly a shortage of housing, which I think bodes well in the long run. So I’m feeling pretty positive on the growth of 2 of the 3 sectors that we have, and for office, I think the jury is still out.

Roy Gori - Manulife Financial Corporation - President & CEO

Tom, Roy here. I might just also chime in and add that our real estate portfolio is actually quite globally diverse as well, 38% is in the U.S., 33% in Canada and 29% in Asia, and we’ve seen on the point of valuations, Asia hold up actually quite well. So the diversity of the portfolio is also another factor that just needs to be in the back of people’s minds.

Operator

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

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

Thank you, operator. We’ll be available after the call if there are any follow-up questions. Have a good day, everyone.

Operator

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