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Manulife Financial Corp. (MFC)

Investor Day

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MANAGEMENT DISCUSSION SECTION

Roberto Veloso

Head, Investor Relations, Manulife Financial Corp.

Good morning everyone and welcome to Manulife's 2018 Investor Day. It's so good to see so many people in the room, so many familiar faces. I see our new Chairman, John Cassaday hiding in the corner. I see many of our most important shareholders, our largest shareholders and I see many of our covering analysts. So I'm really glad that you're all here and I think we have an exciting day for everyone.

I'm Robert Veloso and I head up IR here for Manulife and I'll be your emcee for today. Before we get started, I'm the one who has to do the important legal notes. So, I draw your attention to the caution on our forward-looking statements and the use of non-GAAP financial measures in this presentation. Note that certain material factors and the assumptions are applied in making forward-looking statements and that actual results may differ materially from those stated. The slide also indicates where to find more information on these topics and the factors that could cause actual results to differ materially from those stated.

Agenda. In terms of today's agenda, Roy Gori, our President and Chief Executive Officer, will get us started with a presentation on our bold and exciting future. Phil Witherington, our Chief Financial Officer, will then start with a presentation on delivering strong results and driving expense efficiency. And following a brief break, Naveed Irshad, our Head of North American Legacy Businesses, will tell you how we are extracting value from our legacy businesses.

After our second break, we'll have Mike Doughty, General Manager of Canada to deliver presentation on how we win in our home market and he will be followed by Marianne Harrison, General Manager of the U.S. who will close the day with a presentation on how we're building next-generation protection and wealth solutions in the United States. There will be a Q&A session after each of the presentations and you'll have your opportunity to ask questions there. So, please wait until that happens.

And with that, I'd like to invite Roy Gori, our President and Chief Executive Officer to the podium, and we'll get started.

Roy Gori

President & Chief Executive Officer, Manulife Financial Corp.

Thanks, Rob. Good morning, everyone, and welcome to the 2018 Manulife Investor Day. We're delighted to have you here with us today and we're delighted to have an opportunity to talk to you about the bold new ambition that we're setting for the company and the roadmap that we've crafted to deliver against that game plan. There are six key messages that I'd like to leave you with today. The first is that as a leading global financial services company, we have an incredibly strong foundation and platform to build from. We have enviable growth platforms both in Asia and in our WAM franchise. We've delivered strong operating results over the last five years and we've now crafted a new bold ambition for the company and the next chapter of our history. We're focused – we're incredibly focused on delivering against our five key priorities and we're already demonstrating strong execution against these five priority areas.

So, let me start with our starting point. And effectively, the next chapter of our company's history is really beginning from a position of strength and a strong foundation. We are a top 10 global lifeco by market cap and we are incredibly well diversified with a strong presence across our three geographies. A third of our earnings come from here in Canada, a third from the U.S., and a third from Asia.

In fact, we've been in Asia now for over 120 years and we are a leading pan-Asian insurer. We're a top 25 global asset manager with more than $1.1 trillion in assets under management and administration. So as I've said, we really do have a strong foundation to build from and to embark on the next chapter of our company's history.

We see three powerful megatrends that are going to really shape our industry over the next 10 years. And I believe that we are incredibly well-positioned to take advantage of these megatrends. The first is that of a growing middle-class in Asia, the second is a global aging population, and the third is an increasing trend towards digitization.

So let me start with Asia's middle-class. There are currently about 1.4 billion people in the middle-class in Asia today and that's forecast to grow to 2.8 billion by 2025. In 2025, Asia will represent about 60% of the world's middle-class. Now, this growth in the middle-class is fueling Asia's GDP growth and the insurance protection opportunity. Asia represented about 60% of global growth over the last 10 years and China alone was about a third of global growth. We also know that insurance penetration in Asia is very low and Swiss Re's forecast the insurance protection gap to be north of $50 trillion.

Household wealth is also growing at an exponential pace being fueled by the growth of the middle-class. In fact, the forecast is for household wealth to grow by more than 2.5 times to 2025 and in fact will exceed household wealth in North America at that point. So, in addition to the absolute size of the pie growing, we're also seeing the composition of that pie change quite dramatically.

Today, about 50% of the household balance sheet and wealth in Asia is tied up in cash, and that compares to about 15% in the U.S. So, Asian consumers are also looking to diversify their asset portfolios and they're looking for better and more significant returns for their wealth. So, both of those really point to the fact that Asia is presenting a really big opportunity both in the wealth as well as in the insurance sphere.

Now, the exciting news for Manulife is that we are in fact already capitalizing on this opportunity. Over the last four years, we grew our sales at a CAGR of 27% and the leading industry peers grew their sales over that same period by about 16%. We're growing a new business value at a faster rate than sales. In fact, our new business value growth over that four-year period was a CAGR of 38%. And therefore, that's translating into a significant improvement in margin. In fact, 7 percentage points of margin improvement in four years.

Now, what's driving that? There are two key things that are driving the margin expansion for us in Asia. The first is that we're much more focused on high-return businesses, but we're also leveraging the scale of our operations. About four years ago, there were only three markets that had sales in excess of a $100 million, and today we've got more than seven businesses that are generating that kind of scale. So, Asia is not just a story about potential. For us now, it's a story about delivery and we've delivered core earnings growth since 2013 of 12% per annum. In fact, over the last two years, we've accelerated that growth momentum and are delivering 14% growth per year.

The second big global megatrend that we see is that of an aging population, and it really is creating demand for retirement as well as asset management solutions. There are 900 million people in the world today who are aged 60 or above and that represents about 12% of the world's population and the forecast is for that number to grow to 2 billion by 2050 and it will then represent about 22% of the global population. So, the retirement gap is projected to expand quite dramatically. In fact, the retirement gap today is forecast at about $70 trillion dollars and that effectively is the difference between what people need for retirement to sustain their existing lifestyles versus what they currently have in savings projected at an annual growth rate. So, that $70 trillion retirement gap today is forecast to grow to $400 trillion by 2050.

At the same time, we're seeing in North America the largest intergenerational wealth transfer in history. So, really the conclusion here is that we see a really significant opportunity for both retirement solutions and wealth and asset management. And again, that really plays to our strengths and specifically our capabilities as it relates to retirement given the strong presence that we have here in North America, both in the U.S. and in Canada, and in markets in Asia like Hong Kong and Indonesia.

So, like Asia, we are demonstrating success in capturing this wealth and retirement opportunity. Over the last four years, we've doubled our assets under management and administration as well as our core EBITDA and we've had 33 consecutive quarters of positive net flows. Over the same period of time, we've seen a significant improvement in our margin and that's again coming from the leveraging of our scale, and that is despite quite significant headwinds such as fee compression, regulation or the emergence of passive management.

The final megatrend that I'd like to leave you with is that of global digitization, and we really see a significant opportunity to capture the protection gap through digital behavioural insurance. Now, behavioural insurance is where customers are rewarded for healthy lifestyles and healthy behaviours. And you can see on the left of this slide that the life insurance market is not only a huge opportunity but the protection gap is significant, but it's also not closing. In fact, in the U.S. 40% of the population doesn't have life insurance and of the remaining 60% who do, 20% are underinsured. So, we really see that there's a very significant underserved segment across all the geographies that we operate in.

Customers at the same time are also demonstrating a preference to transact digitally and, therefore, we see our Vitality partnership in North America and our ManulifeMOVE program in Asia as game changing opportunities and are key to capturing these untapped segments.

In the U.S., 84% of people prefer John Hancock Vitality versus similar products where Vitality is not present, and 60% of people that we talked to when we explain how Vitality works are more interested in actually taking up or buying life insurance.

So, for us, the results and the early results are really very encouraging. Normally, life insurance companies interact with their customers once a year, maybe twice a year max, but with MOVE and with Vitality, we're now interacting with our customers up to 20 times per month, and that quite frankly is translating into a much more engaged customer and a customer that's more likely to deepen their relationship with us. And in fact, in the markets where we've launched behavioural insurance, we're seeing an uptake of incremental products in excess of 20% versus where we don't have behavioural insurance.

So, clearly there's a lot for us to be proud of and we're very excited about the opportunities that are present but at the same time we've really don't want to get complacent, and we can't get complacent. And there are both external and internal forces that really – are really requiring us to set a bold new course for the company.

Externally, the world is changing fast, consumers are embracing new technologies and quite frankly, they just won't accept complexity. The old days of a 16-page application form with 128 questions just won't cut it in today's day and age. So customers are really demanding simple, they're demanding intuitive and they're demanding instant. At the same time, we're seeing new agile startups enter our space. So, standing still quite honestly is just a recipe for failure.

Internally, we also have some challenges. Our legacy businesses consume a significant amount of capital and are generating insufficient risk adjusted returns, so that's a focus area for us.

At the same time, we have to be much more focused on expenses to drive better returns, but also to create greater value for our customers. And in parallel with all of that, we need to increase the speed of our execution. We need to be nimble, we need to be fast, we need to be agile so we can respond real-time to the needs and demands of our customers. So quite simply, we really must embrace transformative change and for our organization that time is now.

So, we've anchored our bold new ambition and the aspiration that we have for the company through the lens of the three key stakeholders of our organization and they are: our customers, our employees and our shareholders. And we've been very clear about how we're going to measure success against each of these areas.

For customers, our goal is to delight them and we're going to measure success through NPS, Net Promoter Score, and our goal is to improve our Net Promoter Score by 30 points. For our employees, we aim to be the best employer with top quartile employee engagement results. And then, finally for our shareholders, our goal is top quartile TSR in a consistent and repeatable way.

So, the roadmap to achieve that bold ambition is as important as the ambition itself. And here, we're focused on two aspects. The first is the why, the why we exist, our noble purpose, our mission; and the second component is the what, what are our focus areas, what are the five strategic priorities that are going to command the lion's share of our time and attention.

And I'd like to take a minute just to share with you our new why, our mission statement and this mission is centered around making decisions easier and lives better. And it really has become a new internal rallying cry for all of our employees and it's refocusing our organization around the customer. So, let me share with you a quick video that brings this to life.

[Video Presentation] (00:14:39-00:16:10)

So, this new mission is really inspiring our 35,000 people and our 70,000 agents to a new way of working. It's really creating an inspired workforce that is driven against the transformation agenda that we're embarking on and the power of being the company that we aspire to be.

So, I'd like to reflect on our five priorities. This is the what, and this, again, will really command the lion's share of our time and focus over the next five years. Now, previous Investor Days, we've spent a lot of time focused on and talking about WAM and Asia, but at today's Investor Day, we're going to shift our focus towards portfolio optimization, expense efficiency, and the go-forward strategies for both our U.S. and Canadian division.

Naveed Irshad is going to discuss legacy. He's going to illustrate the ambition for portfolio optimization that we have as a company and how we're going to achieve that ambition. Phil Witherington will provide a financial update, and then he'll dive deeper into our expense efficiency initiatives that we're focused on.

Mike Doughty and Marianne Harrison will then discuss how the five priorities are informing the go-forward strategies for both Canada and the U.S. But before they start, I'd like to actually begin by highlighting a global ambition for each of these five key strategic priorities and the progress that we've made to-date.

So let me start with portfolio optimization. Portfolio optimization is really about putting our capital to its best use. Legacy businesses today represent about 50% of the capital of the company and about 40% of our earnings. Our legacy businesses do not generate a sufficient return for our capital, and quite frankly and quite honestly, this hasn't been a strong focus for us historically.

As a result, we're trading at a discount through our peers and this is because we haven't (a), been transparent about what legacy is; (b), we haven't clearly articulated our game plan for our legacy businesses; and then (c), we haven't demonstrated execution success. So our 2022 ambition is to free up $5 billion worth of capital and that represents about 20% of the equity that's allocated towards our legacy businesses. And by 2022, legacy will represent closer to 30% of our earnings.

What have we done so far? We've appointed Naveed and a dedicated capable team to focus specifically in this space. They have defined the perimeter for our legacy businesses and they've also articulated the game plan that we're going to be executing against over the next five years. And, again, Naveed is going to get up and talk about that a little bit later today.

In Q4 of 2017, we announced ALDA portfolio mix changes, which will result in $2 billion worth of capital release. In fact, we executed $300 million of that in Q1 of this year. We entered a reinsurance transaction for Canadian blocks in Q1 of this year, which freed up $240 million worth of capital. And lastly, in fact last week, we entered an agreement to sell Signator, our U.S. broker dealer business and we expect that to generate about $100 million worth of capital in Q4 of this year when the transaction closes.

Our second priority is expense efficiency and we, quite honestly, need to aggressively manage costs to create value and to be competitive. Our 2022 ambition is to drive for an expense efficiency ratio of less than 50%. And in doing so, generate savings of about $1 billion.

Expense efficiency is measured as expenses over core earnings before expenses, which is effectively a proxy for revenues. And from 2012 to 2016, our efficiency ratio was pretty stagnant at about 60%. In 2017, with improved focus and attention, we've reduced our efficiency ratio to 55% – or we improved our efficiency ratio to 55%.

Now efficiency, I would argue is a better way to measure success in cost management because it looks at not just your expense growth but it looks at it relative to your earnings growth. So it's a much better way to actually measure whether you're doing a good job in managing your cost or not.

It's also important to note that our targets are 50% and $1 billion worth of size are actually net of an incremental strategic investment over that same time period of about $1 billion in strategic initiatives and that's over and above existing strategic spend.

So what have we done so far? Over the last three months, we've announced significant cost saving initiatives. Last week, we announced the transformation of our Canadian business. We also announced our real estate consolidation both in the U.S. and in Canada and we're also consolidating our outsourcing of 17 legacy IT systems into a single, integrated and digital platform. The combined impact of all of those announced changes will generate $300 million worth of per annum pre-tax savings when we fully implemented them.

Priority three is about accelerating our high potential businesses, and it's critical that we invest in our growth engines and our sources of competitive advantage. Our high potential businesses include Asia and WAM, but also include our Canadian group benefits business as well as behavioural insurance, which effectively is Vitality and MOVE. And they are quite frankly our highest potential, highest return businesses across our geographic footprint. Today, those businesses represent about 54% of earnings and our 2022 ambition is for them to represent two-thirds of the earnings of our group.

What have we done so far? Well, Asia and WAM continue to demonstrate strong sales and earnings growth. In fact in Q1 of this year, both of those businesses generated earnings growth in excess of 20%. In behavioural insurance, we've expanded ManulifeMOVE in Asia to four countries and we've also expanded our Vitality solution to many more product offerings in North America. And in group businesses, we've been investing in new technology platforms to create better experiences for our customers and that's translated into a 30-point improvement in our NPS results in 2017 alone.

Priority four talks to our ambition of being a global, digital and customer-centered leader. We're really focused on putting customers first and we know that companies that delight their customers outgrow their competitors. In fact, NPS leaders outgrow their competitors by two times. At the same time, we know that promoters are 5 to 10 times more profitable than detractors.

Our 2022 ambition is to increase our Net Promoter Score by 30 points across all markets. Now, our industry has not done a great job in delighting customers. The Net Promoter Score, when you aggregate across all the geographies and all the businesses for the industry, is today negative 6%. Now, we are slightly better than that average, but we're not at a point of declaring victory and celebrating success. So our goal is to take that starting point and improve our results by 30 points and in doing so we see that we'll become a clear leader in customer satisfaction and in this sphere.

So what have we done so far? We're implementing NPS as a system across all our geographies. We're digitizing every experience that the customer has with us. And in Asia, we've been specifically focused on claims and servicing and in fact in Hong Kong and China, where we focused on digitizing the claims experience, we now have 30% of our claims being processed electronically and digitally, and that's up from just 12% at the beginning of this year, so quite a significant change in a very short period of time. We've demonstrated strong NPS wins in Canada with a focus around NPS and just a measurement around our results at each touch point. We saw our NPS results improving in Canada by 21 points. So we're very encouraged by the journey we've made so far but we still see clearly a lot of progress to be made.

And the final priority is that of developing a high-performing team, and quite frankly none of the above will be possible unless we have an engaged and high-performing team. Success, quite honestly, is not going to be possible without the right corporate culture. So we're working to attract, develop and retain the best talent and to engage them and excite them in the journey that we're embarking on as a company.

Engagement really does matter. It's not the warm and fuzzy stuff. Engaged employees go above and beyond. In fact, engaged employees are 20% more productive than non-engaged employees and they also deliver 80% better customer satisfaction. Our aspiration is to be a top quartile employee engagement company. And today, we're currently a second quartile organization as it relates to employee engagement.

What have we done so far? Well, the first thing that we did in September of last year was to align our old structure to our priorities. We created a Global Wealth and Asset Management business under the leadership of Paul Lorentz, who has now direct accountability for all of our WAM businesses globally. We've also set up a legacy structure under Naveed, who now again has direct accountability for the running of our legacy businesses.

At the same time, we're investing in our people to future-proof them for the changes that we need to make. We've trained more than 2,000 employees in agile ways of working, and that's really enabling us to be more nimble and more fast in actually executing against the ever-changing needs of our customer group.

I shared with you the mission that we've rolled out recently. At the same time, we're refreshing our values and in doing so, we're really creating a new culture that's underpinning a new energy that's going to drive this company to the next level.

So, in conclusion, the team and I are really excited about the journey that we're embarking on. We really have a strong starting point. We've set a bold ambition for the next chapter of our company's history. We have a clear game plan as to how we will achieve that bold ambition and we are already in execution mode.

So, with that said, I'm going to now hand over to Phil, who's going to provide a financial update and a deeper dive into our expense initiatives. Phil, over to you.

Philip Witherington

Chief Financial Officer, Manulife Financial Corp.

Thank you, Roy, and good morning, everyone. Now, there are two components to my presentation this morning. In the first part, I'll provide an overview of our financial performance over the last five years, and I'll summarize our medium-term financial operating guidance. In the second part of my presentation, I'll provide more detail on our expense efficiency program.

So, let's get started by looking at our financial performance. The key points that I would like to make are that we have delivered strong core earnings growth in recent years.

We are executing on our Asia and Global Wealth and Asset Management opportunities. We have exceeded our – excuse me, sorry, we are executing on our Asia and Global Wealth and Asset Management opportunities and our capital position remains healthy and provides for financial flexibility. Our shareholder returns and dividend growth are strong but we see an opportunity to create value by addressing our legacy businesses and slowing the pace of expense growth.

So, let's look at earnings in more depth. And you can see on the left-hand side of the slide that our core earnings have grown by 15% over a five-year period. This exceeds the 10% to 12% operating guidance that we had provided, albeit with some help along the way from a weakening Canadian dollar. Our growth in core earnings has been principally driven by Asia and Global Wealth and Asset Management, although there's been a contribution from reduced hedging costs, higher core investment gains and better policyholder experience.

On the right-hand side of the slide, you can see that net income has been more variable. This reflects some mark-to-market accounting impacts and also the impacts of some non-recurring items. In particular in 2017, net income was lowered as a result of our decision to reduce the weighting towards alternative long duration assets in our portfolios backing legacy businesses and also the impact of U.S. tax reform. These items give rise to a $2 billion benefit in the case of the older strategy change and an ongoing annual benefit of $240 million in the case of U.S. tax reform. We believe that core earnings and net income should converge and we recognized that we haven't delivered as consistently on net income as we have on core earnings. The actions that we are taking in our legacy businesses are one example of the things that we are doing to reduce the possibility of volatility in net income.

Moving on to new business value, which represents the present value of future expected profits from new insurance business written in an accounting period. You may recall that we re-introduced the new business value metric using local basis methodology during our 2015 Investor Day. This increased our comparability with our peers, in particular those with large businesses in Asia.

On the left hand side of the slide, you can see new business value in absolute dollar terms. We have delivered a strong momentum with compound growth of 28% in NBV, reflecting broad-based growth across Asia and also our focus on improving mix. Asia now represents 83% of new business value and 64% of annual premium equivalent sales, and has really become the growth driver of our global insurance business.

Our focus on new business value represents our desire to grow both at scale and in a profitable manner. The new business opportunity in Asia remains substantial. And as we highlighted at our Investor Day a year ago in Hong Kong and Vietnam, we have businesses across the region at scale to capture this opportunity.

On the right hand side of the slide, you can see new business value margins, and NBV margins in Asia have really been driven by scale benefits and re-pricing, reflecting our focus on improved mix. Distribution partnerships have been crucial to building scale and DBS as our flagship Asia Regional partnership has been a notable success.

Looking at the performance of our Global Wealth and Asset Management businesses, on the left hand side of this slide you can see that WAM, assets under management and administration has more than doubled with a compound growth rate of 20% to more than $600 billion, and WAM has now become the largest component of our total company, AUMA of $1.1 trillion. This is being driven by strong net flows, in fact 33 consecutive quarters of net inflows. We've also delivered strong investment performance with 79% of Manulife Asset Management funds exceeding the five-year performance benchmarks.

We have also acquired the retirement businesses of Standard Life in Canada, New York Life in the United States, and Standard Chartered in Hong Kong. In aggregate, these acquisitions have contributed $100 billion to assets under management and administration, and help to strengthen our leadership position in retirement.
Without these acquisitions, AUMA would still have grown and at a CAGR of 14%.

On the right-hand side of the slide, you can see WAM core earnings before interest, tax, depreciation, and amortization. EBITDA growth of 13% combined with our strong AUMA momentum demonstrates our resilience in an industry that has been challenged by net outflows and margin pressure. In our case, AUMA growth has outpaced EBITDA growth and this reflects changes in business mix as well as the investments that we have made to become more scalable and efficient.

So moving on to the balance sheet, our LICAT ratio is 129% in the first quarter of 2018 and that compares well to a supervisory target of 100%. 129% LICAT ratio is roughly equivalent to $16 billion in excess of our supervisory target and is similar to the excess that we held on an MCCSR basis. The transition to LICAT therefore has been a non-event from a capital strength perspective. As many of us will know, long duration business is treated less favorably under the LICAT regime, but it's also important to note that adjustable business is treated more favorably under the LICAT regime, and a large component of our business, particularly our new business in Asia is adjustable.

In the first quarter of 2018, we delivered a LICAT benefit of $240 million from the reinsurance of a legacy block of business in Canada, demonstrating our ability to successfully execute on portfolio optimization transactions. Also in the first quarter, we released capital of $300 million, reflecting the first steps in our execution of the alternative long duration asset strategy change. In the second quarter, we expect to report further progress including the impact of ceding assets to the Manulife REIT in Singapore. We have clear line of sight to the – to delivery of the remaining capital benefits in aggregate $1.7 billion by mid-2019, and that in aggregate is equivalent to 3.4 LICAT percentage points.

So looking at our leverage ratio, our leverage ratio is 30% compared to a medium-term target of 25%. We are not constrained by our leverage ratio. Our calculation is conservative and includes almost 5 percentage points from the inclusion of perpetual preferred securities that many would not consider to be leveraged. Nevertheless, we are committed to reducing our leverage ratio to the medium-term target of 25% and believe it prudent at this stage in the economic cycle to increase our balance sheet flexibility.

We can achieve our leverage target organically through the generation of capital from retained earnings – from retaining earnings over this period. And any capital that is generated from portfolio optimization activities could help us to accelerate the pace with which we reduce our leverage ratio. In the near-term, we expect the leverage ratio to remain in the current range although we will carefully consider the refinancing of any maturing debt in the context of our long-term debt management strategy.

So the overall strong financial performance has led to a progressive dividend increase over the last five years and strong shareholder returns. Dividends have increased at 11% per annum, but we still have some way to go to achieve the pre-2009 levels of dividend when we had an annualized dividend equivalent to $1 per share.
During this period, we have maintained our dividend payout ratio in the range of 30% to 40% consistent with our guidance.

From a total shareholder return perspective that you can see on the right-hand side of the slide, we've delivered an annualized return of 17.9% in the five years to December 2017. This outperforms our peers and the broader market. However, our shares continue to trade well below our all-time highs and our TSR over a longer period, over a 10-year period, lags that of our peers. We therefore look to achieve top quartile TSR on a more consistent and long term basis.

We have been clear in recent years about the importance of growing our high potential businesses, in particular Asia and Global Wealth and Asset Management to deliver improvements in total shareholder return. However, we now recognize that addressing our legacy businesses and improving our efficiency are also important drivers in unlocking value. Our legacy blocks consume significant capital and in aggregate generate inadequate risk adjusted returns, creating what we believe to be a valuation overhang. We have therefore set ourselves a portfolio optimization target to release $5 billion of capital by 2022. This is approximately 20% of the capital that backs our North American legacy businesses.

On the right-hand side of this slide, you can see that core earnings growth has been strong but we did not materially benefit from expense efficiency over this period. General expenses have grown approximately in- line with earnings albeit with some divergence in 2017 as we became increasingly focused on expenses. We see a notable valuation opportunity that we can deliver by slowing the pace of expense growth.

I will cover our expense plans in more detail in a few moments in the next section of my presentation, and Naveed will cover our plans to address the $5 billion capital target. But I would like to elaborate on what is included in legacy, in other words, where we have drawn the boundary.

There are three significant factors that we have considered when identifying what components of our business will fall into legacy and you can see those on the left-hand side of this slide. The first is strategic alignment. Are we still selling these products? If we are not, we've classified the business as legacy. The second is the financial impact. Are the returns that we're generating consistent with the returns that our investors expect? If they are not, we have classified the business as legacy. And it's important to note that a number of the portfolios that we have classified as legacy do date back to our heritage as a mutual insurer when there was less focus on returns. The third consideration that we have made is risk. And is the risk inherent in the business and the portfolios consistent with our current appetite for risk, particularly market risk and insurance risks? If not, then we have classified the business as legacy.

Now in the middle of the page, you can see the outcome of this assessment. Long-term care and variable annuity are not necessarily generating poor returns, but they do exceed our risk appetite. Legacy also includes a variety of life and fixed products. These have lower returns and are longer duration, but have a more manageable risk profile.

So to reiterate, we have set ourselves a target to release $5 billion of capital from – by executing on portfolio optimization activities by 2022. And this includes the capital benefit of the alternative long duration asset strategy mix change that we announced at the end of last year. This equates to approximately 20% of the capital backing our North-American legacy businesses. But it's important to note that we will not rely or we have not anticipated relying on a large-scale disposition to achieve that target. Although, we have anticipated, there will be reinsurance transactions.

I would now like to cover our medium-term financial operating guidance. As you can see on the slide, we are refreshing our existing financial targets. Earnings per share growth or core earnings per share growth of 10% to 12% is among the highest for North American lifecos that's unchanged from our previous guidance. While we have achieved a core ROE of greater than 13% in the first quarter of 2018, we are not declaring victory. Our goal is to deliver sustainable and scalable ROE at 13% plus, and you may notice the subtle inclusion of the plus that was not there in the past.

We also intend as I said a few moments ago to lower our leverage ratio to 25% over our planning horizon, so that's the medium term, and we have reaffirmed our target dividend payout ratio of between 30% and 40% of core earnings. We have also introduced some new financial targets to drive accountability around portfolio optimization and expense management. I will talk about our new efficiency metric later and Naveed will address our $5 billion capital target.

So, in summary, in terms of financial performance, we have delivered a track record of core earnings growth over the last five years. We are executing on our Asia and Global Wealth and Asset Management opportunities. Our capital position remains healthy and provides for financial flexibility, and we have delivered strong dividend growth and shareholder returns over the last five years, but see an opportunity to deliver top-quartile TSR by addressing our legacy and expense efficiency priorities.

So, I would now like to share more detail about our cost efficiency programs. The key points that I will make here are that we will drive greater accountability through the introduction of the new efficiency ratio KPI. We will improve our target – we'll improve our efficiency ratio to our target of 50% or better by 2022. And to get there, we estimate that we need to save or avoid $1 billion in costs or more by 2022, and that's the annual run rate of costs by 2022. We are already in execution and are taking actions to reduce our cost base and as a consequence, we expect to record a restructuring charge in the second quarter of 2018.

So, on the left-hand side of this slide, you can see the same chart that I had presented a few moments ago. It shows core earnings and expense growth on a constant exchange rate basis side-by-side. We have delivered strong core earnings but expense growth has kept pace with it. In the second half of 2017, you can see that the growth rates of core earnings and expenses have started to diverge and that does reflect some of the actions that we have been taking to address the expense base as well as strong revenue growth. We see an opportunity to drive scale by slowing expense growth at the same time as investing in our high opportunity businesses.

On the right-hand side of the slide, you can see our expense base in absolute dollars and the dollars speak to the scale of the meaningful opportunity that exists. General expenses are greater than core earnings in dollar terms and therefore, an improvement in expenses can have a greater proportionate impact on core earnings.

Our new KPI, the efficiency ratio, would drive accountability and transparency of our progress. Given our strong growth profile and absolute reduction in expenses is unreasonable, as we will continue to invest in our growth businesses in the future. We, therefore, believe that the efficiency ratio is the best measure of our progress. The ratio is similar to the efficiency ratio in the banking industry, but given the complexity of defining revenue in insurance accounting, we're using core earnings plus expenses as our proxy for revenue.

Our expense ambition is to improve our efficiency ratio to 50% or less by 2022. And what is important here is the progression or the operating leverage that we're achieving. Reducing expense efficiency ratio means that efficiencies are dropping to the bottom line. We will primarily track our progress using the efficiency ratio but we're also providing a dollar figure so that you can size the scale of our ambition.

To achieve a 50% efficiency ratio, we estimate that we need to reduce or avoid $1 billion in annual costs by 2022. This means slowing general expense – the growth in general expenses by approximately one-third and focusing on the scalability of our operations. We will deliberately continue to invest in our growth by focusing on deploying resources in an optimal way to become a digital customer-centric market leader. Our North American businesses and our group overhead expenses will be subject to prudent expense management and are expected to grow at or below the rate of inflation.

So to put some context around what the target means I'd like to highlight three points. The first is that to achieve a cost efficiency ratio of 50% by 2022, we need to deliver a marginal efficiency ratio over this period of 38%. That means for every $4 of incremental expenses, we're required to deliver $6 of incremental core earnings or $10 of incremental revenue or proxy revenue. The second point that I'd like to highlight that you can see in the middle of the slide is that our target is net of additional strategic spend of $1 billion over the five-year period. This is in addition to existing levels of strategic spend on key initiatives and is intended to accelerate the pace with which we're able to execute on the five priorities that Roy has set out.

The third point that I would like to highlight, you can see that on the right of the slide, our Asia and Global Wealth and Asset Management segments are expected to grow the fastest, whilst the ROEs for these businesses are the strongest, the efficiency ratios are the highest or least favorable. So we intend to lower the consolidated efficiency ratio at the same time as growing those businesses with the relatively higher efficiency ratios. So in that context, it is clear that specific action is needed on expenses if we are to achieve the targets that we have laid out. I don't believe that these are outcomes that could be delivered passively.

We see various categories of expense opportunity. The first and most important is that we really need to instill a culture of expense discipline. That means including expense efficiency as a consideration in day-to-day decision making at Manulife. The second opportunity that we see is the opportunity to optimize our real estate footprint. We've already announced significant plans in the U.S. and Canada to create a more engaging work – optimizing our workflows. For example our global optimization project in WAM and that's something I'll talk about in more detail in a moment. Valuation systems transformation in our actuarial and finance functions, robotics, claims management and the list goes on, lots of opportunities in digitization.

And the fifth opportunity that we see is to realign the organization to drive scale benefits. For example, consolidation of shared services to maximize those scale benefits. These are all levers that will help drive down the costs in our organization and in particular in our legacy businesses. We do have a proven track record in the execution of major initiatives that give rise to cost benefits at the same time as improving customer experience and improving employee engagement.

I'd like to walk through an example with you. So Global Optimization, or GO, refers to our project to create a Global Wealth and Asset Management operating platform. Before GO, WAM was a patchwork of decentralized platforms across multiple businesses and geographies. We were manual, we were not scalable, and had limited tools for our clients. By digitizing and reimagining the way we do things we've been able to create a client centric operating model and by doing that, we've been able to deliver cost savings, real time data access for our customers, and creating a more engaged workforce by using best of breed tools and eliminating low value work.

But we're not only driving our costs without stepping back and looking at the bigger picture. Expense efficiency is correlated with improvement in customer satisfaction and improvements in employee engagement. Expense efficiency also helps to improve our competitiveness, and therefore supports the growth of our high opportunity businesses. So what we can see is that cost efficiency, not only is it a pillar of our five priorities, it helps enable all of the five priorities we have laid out.

We are already in execution when it comes to the delivery of our cost efficiency ratio target and our absolute dollar cost target. Earlier this quarter, as Roy said, we announced the consolidation of our head office footprint in the United States. All of our Boston-based employees will transition to a single campus over the next nine months, improving collaboration and vacating an entire office building. We also announced our plans to consolidate our IT infrastructure and vendors in the U.S. This converts a significant portion of our IT costs from fixed to variable, and therefore enables our expenses to fall in line with the maturity and decline of our legacy businesses.

Last week, we announced our plans to transform our Canadian business. This included a program to digitize and consolidate parts of our back office to create – resulting in a workforce reduction of 700 roles. We also announced our plans to combine our real estate footprint in the Kitchener-Waterloo Region into a single location from two, creating a workplace that better fosters collaboration and innovation.

On the far-right hand side of this slide, you can see that we have made a decision to introduce a voluntary early retirement program to eligible employees across North America. In aggregate, these actions deliver an ongoing benefit to core earnings of $300 million before tax, the vast majority of which we expect to be achieved on a run rate basis by the end of 2019.

As a consequence of that, we expect to incur a pre-tax restructuring charge of $250 million in the second quarter. After-tax that's equivalent to $200 million. The restructuring charge includes the estimated costs of severance, real estate optimization, and the write-downs related to our legacy IT infrastructure. And we believe the charge is well justified in the context of rapid delivery of $300 million in annual saves in the run rate by the end of 2019.

So, in summary, we are serious about aggressively managing costs and showing bottom line benefits. We will drive greater accountability and improve our efficiency ratio to 50% or better by 2022. And in order to get there, we set ourselves the ambitious target of saving or avoiding $1 billion in annual costs by 2022. We are already in execution and in the second quarter, have taken strategic decisions that will enable $300 million of pre-tax run rate savings to be achieved by the end of 2019.

So, with that, I would like to hand back over to Rob to coordinate the Q&A process.

Roberto Veloso

Head, Investor Relations, Manulife Financial Corp.

Thank you, Phil. We'll now have a Q&A session covering both of our morning's topics. And joining Roy and Phil on the Q&A panel, we have Steve Finch, our Chief Actuary; Linda Mantia, our Chief Operating Officer; Anil Wadhwani, our General Manager of Asia; and Paul Lorentz, our Head of Global Wealth and Asset Management.

This year's Investor Day's program does not include specific presentations on digital transformation, Wealth and Asset Management or Asia. So if you have questions on those exciting areas then this is your opportunity to ask those questions.

We will have mic runners to bring you a microphone, please wait for someone to do so. And we also ask that when you do have the mic please limit yourself to one or two questions in an effort that we can have as many questions as possible. And also please let us know who you are, and where you're from for the transcript. And with that, I'll let the – let's get started.

QUESTION AND ANSWER SECTION

Gabriel Dechaine

Analyst, National Bank Financial, Inc.

Q

All right, good morning. Thanks for the presentation. My name is Gabriel from National Bank. Got a couple of questions here, first on the $5 billion capital free up, you do lift the expense efficiency and ALDA adjustments that you took last year in the bullets below that figure, is that included in the $5 billion and hence we've already – we're kind of working towards that way already, sorry?

Philip Witherington

Chief Financial Officer, Manulife Financial Corp.

A

Yes, so the $5 billion capital target does include $2 billion related to the execution of the alternative long duration asset strategy change. We have clear line of sight to delivery of that, so in effect there's an incremental $3 billion target on top of what we had previously announced, and Naveed will provide more colour on our plans to achieve that later.

Gabriel Dechaine

Analyst, National Bank Financial, Inc.

Q

Okay. Great. And then...

Roy Gori

President & Chief Executive Officer, Manulife Financial Corp.

A

And that $5 billion again does not include any significant divestitures, so includes perhaps some of the smaller ones that we might do or reinsurance, but does not include significant divestures, which would be therefore over and above the $5 billion.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Understood. And then I've got to ask the obvious question on the $1 billion cost savings. I can run the numbers once I get back to my computer there, but hoping you can help me out here in terms of how much of that is – it's a gross figure, how much of that is earmarked for reinvestment versus how much is earmarked for bottom line towards the 10% to 12% effectively, EPS growth?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Yeah. So Gabriel, you'll be able to see that we'll primarily measure our progress based on the cost efficiency ratio and we can only lower the cost efficiency ratio to the 50% target if we allow those costs – the cost saves to drop to the bottom line. So the $1 billion is in effect after reinvesting an incremental $1 billion over the five-year period to accelerate strategic growth. So we've been very, very careful to make sure that the bottom line benefits of our current cost efficiency program are visible in the metrics and the progress that we'll be demonstrating.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.
A

Another way to think about that, Gabriel, is that our expense growth rate that we've had historically will reduce significantly. And that $1 billion is the net reduction from that reduction in the growth rate. But it does again include an incremental $1 billion worth of strategic initiatives that were planned back into the business. So, it's net of that.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Okay. Perfect. Thank you.

David Motemaden
Analyst, Evercore Group LLC
Q

Hi. David Motemaden, Evercore ISI. Just wanted to confirm, I guess, the $5 billion capital reduction, that's a gross number. And I know that the $2 billion also had a $1 billion capital charge that was taken. I guess, how should I think about the net capital freed up from your optimization activities?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Yeah. So, we're looking at it prospectively from January 1, 2018, to provide a clean start to the program. So, I think if you look at it from, I suppose, a net basis including the charge that we had taken in the fourth quarter of 2017, then you'd be looking at $4 billion. So, it's $5 billion net from January 1, but if you relate it back, it would be $4 billion.

David Motemaden
Analyst, Evercore Group LLC
Q

Got it. And also just – you had the LICAT slide. Just wanted to just get an update just on capital generation post-LICAT, and how you're thinking about remittances post-LICAT.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Okay. So, from a LICAT perspective, we're not seeing any material impact on our remittance generational capability. The point on remittance is it really depends on the capital position of our subsidiaries and earnings generation of our subsidiaries around the world. And our remittance position remains strong.

And we don't anticipate any impact on our dividend distribution capability. And that's why we have the confidence to reaffirm our 30% to 40% target range. And what we expect is to be pretty much at the midpoint, about 30% to 40% range in the foreseeable future.

Sumit Malhotra
Analyst, Scotiabank

Q

Hi. It's Sumit Malhotra from Scotia Capital. This might be in Naveed's section, so I'll ask you now. If you want to wait, we can do that. Just to go back to the ALDA book. So, when that initial divestiture was announced in December, caught me little bit off-guard, because it didn't seem like ALDA was necessarily at the top of the priority list, especially after the review that you had conducted in the fall.

So, Phil, I didn't hear you mention the changes that are coming in IFRS. How are you thinking about the future of the ALDA book, especially as the capital treatment of long-duration assets becomes more punitive as we go forward? Should we be expecting further reductions and that portfolio's changes occur on the capital and accounting front?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

So, the first thing I would say is that when it comes to alternative long-duration assets, we stand by our belief that these assets were good economic match for the liabilities that we have. And we anticipate ALDA will remain a very important component of our portfolio, so that we can achieve that strong and robust asset liability match. So, the changes we had announced in the fourth quarter of 2017, really, were all the changes that we had anticipated. We have no further plans to further adjust the strategy mix beyond what will be delivered between now and mid-2019.

On IFRS 17, it's early days. We have the standard that was finalized last year. We're in the process of working through that and interpreting the standard along with our peers in the industry. So, it's too early for me to comment at this point what the impact of IFRS 17 might be, but we can cover that at a future event.

Sumit Malhotra
Analyst, Scotiabank

Q

Okay. Well, we'll come back to that. I guess, it's halfway through your 2022 targets that we'll see those changes. So, obviously, it's going to play a role.

Last one for me, just on your efficiency metrics that you provided us here. Asia, at 52%, that's obviously been a key source of your growth, and sounds like it's going to continue to be of your geographic business lines. Looking at that efficiency in particular, is the higher number relative to Canada and the U.S. largely related to the increased cost of distribution that Manulife has had in Asia, or are there other factors at play here that you think have kept that number higher? And specifically, I know, we're not focusing on Asia today, but what's going to be the key factors that drive that number lower?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

So, maybe I clarify the numbers and hand over to Anil to talk a little bit about what's being done in Asia to drive scale and efficiency benefits. So, the point that I will make is that it can be difficult to compare between different types of business when it comes to the cost efficiency ratio. Asia certainly is in growth mode, and when businesses are in strong growth mode, there are costs associated with that. So, as you pointed out, costs associated with maintaining a distribution force, for example.

If you compare that to our businesses in North America, and particularly, the U.S., where we have a large closed block of business, we're able to drive costs more efficiently or drive costs down. And that's something that has been done in recent years, this opportunity to go further. But that's really been quite significant in driving the overall cost efficiency ratio down for those businesses.

And it's similar in WAM, that WAM is a growth business. And so, whilst it may look when you compare it to our U.S. insurance business or our Canadian insurance business, it may look as if it's inefficient. It's actually hard to compare directly. So, I think what we need to look at here is relevant benchmarks for each of those divisions. We set ourselves targets, and all of our reporting segments will have a role to play in the achievement of the 50% cost efficiency ratio.

Let me hand over here to Anil to talk about what's being done in Asia.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Thanks, Phil. So Sumit, we are investing in expanding our distribution, both across the agency, and specifically investing in the bancassurance partnerships. And if you think about – let's say, DBS, as an example. We are only in the third year of the execution. We still have 15 years – the total contract is 15 years, so we have still 12 years left. And as we drive greater penetration and greater scale, you will start to see that kind of filter down to the cost efficiency ratio. So, that's point number one.

Point number two, you are starting to see some of the scale benefits already translate into the margin improvements that we are seeing in Asia. So, as we start to get bigger in Asia, you will see the translation of that going to fall down to the bottom line.

And the third piece I would argue is, we have, and we are making significant investments in client experience and improving our technology infrastructure. As we do that, as we get a lot more paperless and a lot more straight through, the cost to serve model is dramatically going to change between now and the next three to five years.

So, you will again see a translation of that kind of falling down to the bottom line. So, while Asia remains a growth mandate, and yes, we will need investments, you will see a translation of both scale and automation fall down to the bottom line and to the cost efficiency ratio.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah. So, let me just add a couple of points, but I think it's a great question quite honestly. And as we look at driving expense efficiency one of the big things that we're focused on is making sure that we don't starve the growth engines of our franchise.

And a couple of comments that I'd leave you with, first is that a higher efficiency ratio or a less favorable efficiency ratio for Asia and WAM is not a problem. In fact, that's exactly what you'd expect, as you're investing in those businesses to deliver core earnings in the future. So, you're actually front loading your expense growth, so that you can actually deliver a sustainable long-term engine of earnings in the future. So, that's sort of what you'd expect to see, and that's what we actually see in the numbers today.

The second comment is we don't see that there is any part of our business that doesn't have an opportunity to drive greater efficiency. We are manual in Asia as much as we are in North America, so we need to drive greater efficiency in digitization of our processes, which will ultimately translate into cost savings across all of our geographies. So, that, I don't see is harming our growth agenda, it's just driving a more efficient way of running our franchise, and ultimately, delivering great saves.

And the final point is that when we do yield those saves, we need to plough them back. And we want to plough them back into growth-driving initiatives that are going to fuel profitable outcomes in the future. And obviously our high-return businesses, our high-potential businesses are going to get the lion's share of that.

So, again, when we we'll talk about the efficiency ratio of 50% and a slowing of our expense growth, that's the gross number, but you'll see the composition of that vary quite significantly. Even though we're going to reduce the growth, we're going to see more of that obviously going through our high-potential businesses. And as Phil said earlier, the legacy businesses and our other blocks will grow at a very low – or maintained or contained pace.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Thanks. So Paul Holden, CIBC. So, first question going back to the expense efficiencies is, you expect $1 billion in total of expense efficiencies with $300 million from actions already announced. How should we think about how that $700 million is realized? Is it going to be over the next five years, or is that $700 million coming after 2019? So, in other words, could we see $300 million plus some additional amount by 2019?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Yeah. That's a good question. In order to get to our 50% target, we do not anticipate in leaving it to the last minute and having the hockey stick delivery. So, we're anticipating fairly smooth delivery between now and 2022 of those cost efficiencies. The actions that we've announced this quarter, if you like give us a kick start, we've been very clear to make some very significant strategic decisions that allow us to take cost out between now and the end of 2019.

We don't only stop there between now and the end of 2019, so I think it is fair to assume that we will continue to drive efficiencies over this period from other initiatives. But it's hard for me to be precise about exactly what our progress will be by the end of 2019. But I think a smooth and stable delivery towards that $1 billion target, 50% cost efficiency ratio is a fair assumption.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Okay. And then second question, and again, this is directed to you Phil, primarily. You mentioned one of the objectives of the firm is to close the gap between core EPS and IFRS EPS. Some of these initiatives, expense initiatives, like the ones announced today and some other measures, I assume, that you're going to take to reduce capital, some of those are going to come with charges, IFRS-type charges. So, how do you balance those two objectives?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Of course, it's regrettable that we've announced that we have the restructuring charge. In the second quarter, we expect to report a restructuring charge. However, the lens that we're looking at it through is that from a justification perspective, by taking the charge of $200 million after tax, we're able to achieve significant cost saves. In fact, the $300 million pre-tax, to make that comparable, $250 million charge pre-tax,$300 million of cost benefits pre-tax. And that's the lens that we will look through when we look at driving cost efficiency.

If we look to the remainder of 2018, we don't anticipate any further restructuring charges. Don't anticipate any material restructuring charges. We've taken the lion's share in the second quarter of what we believe needs to be executed in 2018. Beyond 2018, we have really the opportunity to pull some other levers to reduce costs, that's things like the third-party costs that I referred to, but also the impacts of natural attrition. And that with a turnover of our people of more than 4,000 positions per year, we actually have the ability to manage our workforce between now and 2022, without creating restructuring charges and doing it in a way that is not disruptive to our organization. So, of course, from a restructuring perspective, I think that can be relatively straightforward, we can show the payback.

From other elements of potential volatility or differences between net income and core earnings, investment volatility can be more difficult to predict, and there will be, of course, differential from quarter-to-quarter. But we believe that over the medium term, as you look at longer periods of time, that volatility will balance out. We're satisfied with the assumptions that underlie our assets and liability models.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

It's Meny Grauman from Cormark Securities. Just a question in terms of that run rate savings and how it's spread across geographies or business lines. It seems like, and it sounds like the $300 million is virtually all North America, so I just wanted to confirm that. And then if you look at the next $700 million, how do you see that being split up? Does North America bear a disproportion part of that burden as well?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

So, let me make a start on that. And I think it may be appropriate for me to hand over to Linda as well to talk about some of the digitization initiatives. They're very much global in nature.

But you're absolutely right that in the actions that we have announced in the second quarter that give rise to the $300 million of benefits, the vast majority of those are North American. There is a small element that is Asia, but it's really somewhat inconsequential relative to the $300 million. So, that doesn't mean that we're not addressing costs in Asia. And Anil is very focused on efficiency, but as Roy said, we'll be investing strongly along the way, so that we have a really strong line of sight to further business growth in Asia as well as Global Wealth and Asset Management. Digitization is particularly important to achieving our efficiency targets. And I think it would be appropriate for Linda to elaborate on that.

Linda Mantia
Chief Operating Officer, Manulife Financial Corp.

A

Yeah. Thanks, Meny, for the question. I think as we've talked about our efficiency ratio, this time, it's really that efficiency, and some of it is cost avoidance. So, if you look at our efforts, I'll pick up on the third-party spend lever that we've talked about, some of the savings are to help our legacy businesses move off of fixed costs into variable costs. And that was in the $300 million, what we did in North America. A big part of our focus in Asia is to support the growth and drive that efficiency. So, as we're growing in certain markets, moving out of the expensive data centers, servers, et cetera, and building into the cloud, that will really reduce the third-party costs and allow a much lower variable cost with each transaction.

And then as Anil mentioned, on driving our scale benefit, we're looking at the customer experience as we want to grow and investing in an accelerated way on a front-to-back experience, so that it's digital, digital-enabled, again reducing the variable cost on each sale, and where it's not a big effort or a big product, leveraging robotics again to take that variable cost down. So, the efficiency exercise is really global, very nuanced in support of the strategies that we've talked about here today to support legacy and business that's declining differently than our growth areas.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah. May I just add that we've got a clear game plan to deliver against the $1 billion target that we've set. We're not going to disclose how we're going to get there by geography or by business unit, but we do want to illustrate, on a regular basis, the progress that we're making. So, we're hoping to be able to demonstrate at our quarterly updates that we're executing against that game plan. And to the point earlier, we're not expecting this will be at the end of 2021 that we'll unveil the $700 million, but rather, it will be a continuous process.

But we've got very clear plans, we've got that articulated in targets for each unit and each business. In broad strokes, we think that there are big opportunities across a variety of areas, from just the stronger cost culture, to a much tighter management of our suppliers, to a strong focus around digitization. I referenced earlier the fact that in Hong Kong and China, we now have 30% of our claims being processed electronically and digitally. And that was just 12% in the beginning of this year.

So, we're seeing those efforts really translate into, a) better cost saves; but b) a tremendous improvement in the experience that our customers actually have. And internally, we're actually targeting a number that's bigger than the $1 billion that we're obviously disclosing today, so that we can be confident we can deliver that number.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

Thanks. And then just as a follow-up. I understand connecting those cost saves to the efficiency ratio. But it'd be interesting to hear how that connects more to your EPS targets. And just, I would have expected maybe the EPS targets to move higher on the back of the $1 billion. So, just wondering how do you think about that?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Let me tackle that, and I'll hand over to Phil. So, we think that the EPS targets that we have today are actually quite ambitious and aggressive. In fact, if you look at some of our peers, we're probably at the higher end of the target-setting spectrum. And what I'd say is that the goals that we now have lined up on the expense front give us much, much greater confidence that we can deliver against the 10% to 12% EPS growth that we've historically established than we're today committing to. And at the same time, we feel that gives us greater confidence in delivering a sustainable return on equity of 13-plus percent in a continuous way.

Phil, would you add anything to that?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Yeah, I'd supplement that by saying that the 10% to 12% EPS guidance has been out there for a number of years, and we have achieved that guidance. Even if you look on a constant exchange rate basis, we've operated in that range. But it is worth acknowledging that there has been some tailwinds along the way for us, so we've benefited from lower macro hedging costs over that period; we've benefited from higher core investment gains flowing into core earnings; and also, through our growth in Asia, we've benefited from higher new business gains. So, those tailwinds have certainly helped us to achieve the targets in the past.

If we look forward, the impact of some of those tailwinds will be less. For example, macro hedging costs are already close to zero. It's hard to predict what will happen to new business gains in the future. And we're already recognizing, certainly, if you look at 2017, there's a full $400 million per year of core investment gains through core earnings. So, we really need to look for other sources of growth in order to sustain 10% to 12% earnings.

And expenses are an important component of that growth.

Roy Gori
President & Chief Executive OfficerManulife Financial Corp.

A

The only comment I'd make is that the beauty of an efficiency target is that it brings core earnings into the play. So, if we're not delivering core earnings as we forecast, then you won't get to your 50% by just delivering the $1 billion. So, we can't declare victory on the $1 billion, if our core earnings haven't also grown at the pace that we're anticipating. In other words, if our core earnings growth slows, then our target for expenses becomes harder. And we need to dig deeper with finding greater cost saves than what we're articulating today to deliver that 50% goal. So, that I think it is an important point to make as well.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.

A

The next question...

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Tom MacKinnon, BMO Capital. If we look at the $300 million. And I think, you guys, we've advanced around this for a while, and I think you've summarized at it. Sort of just embedded in this 10% to 12% medium-term...

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

...EPS growth objective, is that the way we should be looking at rather than just say, okay, we'll move our numbers up now by $0.12 in 2020 as a result of this. Is that...

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

I think that's the right way to look at it, Tom. 10% to 12%, we think, is an ambitious target. We think it's a good target. We have delivered that in the past. But clearly, that longer sustainable period is not an easy goal by any stretch of the imagination. So, the expense goals that we're setting give us great confidence that we can actually deliver against that.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

All right. And then, I think, Phil, you said, in terms of defining what a legacy business is, as you said, are the returns consistent with what investors expect? So, years ago, the company got out of Par business in Canada, because they said their returns aren't consistent with what investors expect. And now, we're getting back into Par business in Canada. Maybe you can square that for us, because you only get a real small percentage of the earnings get out of that block. So, help us understand why you're getting back into that business if it presumably has legacy-type returns, or does it not?

Robert Veloso
Head, Investor Relations, Manulife Financial Corp.

A

Tom, can we address the Par question on the last panel, when Mike Doughty's on the stage?

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Okay. Then maybe, is that the lens you look through for everything that you do then? And what is that return that you believe investors expect?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Well, what I'd say, the macro level is that our goal of 13% target for the company, there are some businesses that are going to be clearly above that and others that are below it, but anything that's dragging our goal of 13% is a business that we'll look at more thoroughly. We'll talk about Par when Mike gets up. But clearly, there are other factors that we consider when we looked at reentering the Par business, the size of the market here in Canada and the allocation of costs to a business, and therefore, the profitability dynamic that, that brings to other businesses in the...

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Can we see more legacy businesses going forward, if in – because you're always writing new business and stop writing older business. Does that mean that we could see more legacy business coming in the future? If it doesn't hit the return that people expect?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah. Tom, what I'd say is that at this point, with what we can see, we think that we've got the perimeter of our legacy businesses well defined. So, we don't see other businesses that have got the potential to move into legacy beyond what we've got today.

Darko Mihelic
Analyst, RBC Dominion Securities, Inc.

Q

Hi. It's Darko from RBC Capital Markets. Just a couple of questions here for Phil. I think you mentioned that currently, the legacy business represents about 40% of earnings. That would be according to last year's $4.6 billion of core, somewhere in the neighborhood of $1.8 billion. Then you mentioned that by 2022, that'll drop to 30% of earnings. However, by that point, earnings is going to be much bigger. And I actually calculate that somehow, throughout all this work, despite pulling out $5 billion of capital that the earnings in the legacy business will be up by 2022. Am I right in that math? And can you help me square how that actually occurs?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Okay. It's actually correct that the earnings contribution from our legacy businesses is projected to continue to grow. One thing to recognize is that on the Canadian basis of accounting, I suppose, the provision for adverse deviation that have built up over time are also released over time. We're satisfied with the best estimate assumptions, and that means that the PfADs will unwind as profitability. So, it is an important component of expected future profits.

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

And just adding to that. Phil's right, it's the release of PfADs that's driving the growth. And it's a little different than other accounting bases, which, like a U.S. GAAP, where you expect a smoother pattern. It's as the risk releases, that's when the PfADs release. So, it's a function of the risks unwinding in the legacy business. And it's sort of a natural growth that we'll get as that risk unwinds.

Darko Mihelic
Analyst, RBC Dominion Securities, Inc.

Q

Still the implication is that if you're removing $5 billion of capital from the existing capital base on the legacy business, it seems like the earnings that go with that $5 billion is extremely low. Would that be a fair characterization? In other words, I just can't square the math. And lastly, maybe just – maybe we can square that math during Naveed's presentation. But Roy, you mentioned, or you almost stressed that it does not include a significant disposition? Are you contemplating significant dispositions?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

No. So, our plans today are that we want to manage these businesses largely organically. And again, in Naveed's presentation, you'll see that we got a robust plan to not only deliver against the $5 billion, but in doing, so reduce our risk and improve our returns.

So, again, we'd probably hold that for a little bit, Darko, to the next section. But having a very solid game plan against our legacy businesses, understanding the perimeter, and then our go-forward strategy is, in my mind, absolutely paramount. And we believe that the strategy that we put in place today will deliver against our ambition.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Hi. It's Alex Scott from Goldman Sachs. I had a question along the same lines. This is the last one. You mentioned some of the legacy businesses are more related to risk profile, as opposed to the returns that they're generating. So, I'm just wondering on the, I guess, incremental $3 billion of capital freed up that you discussed, can you give us some color on what portion of it would be related to maybe variable annuities and things that do generate a better return versus some of the lower return businesses?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Alex, we're going to cover exactly that in Naveed's presentation, so I don't want to steal Naveed's thunder. I suggest that we hold to that session, if that's okay.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Sure.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.

A

If there's any questions on Asia, Wealth Investment Management, digitization, this is your opportunity to ask those questions. We'll take a question from here. And then if there's a question on that side of the room, happy to address it.

John Aiken
Analyst, Barclays Capital Canada, Inc.

Q

Unfortunately, no. It's on cost. John Aiken with Barclays. Phil, on your slide about the expense initiatives that you're expecting, your first ballpoint is the culture of expense discipline. Now, I'm assuming that this is pretty much a drastic shift for Manulife. But when you're talking about the boots on the ground, how do you plan on shifting this culture? And I guess, equally as important, how was the compensation of the executives at this table going to be changed to make sure that the expense culture is embedded in the organization?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Okay. Thank you, John, for the question. And you are right, it is a shift to the organization. And I think the organization has made progress in recent years on recognizing that cost management is important. I think now though we are really strengthening that, so that cost efficiency is something that's really embedded in our day-to-day thought process. And it does take time, and it takes a cultural shift, but certainly, with the transformation the company is going through, it's now possible to work through some of the previous resistance that existed.

And just a simple example, when we talk about real estate space, a few years ago, it was extremely sensitive when we were talking about how much space every individual would have and how large the offices were. Now, the conversation is not about how large the offices are, but whether it should be a bench or a workstation. It's really been a significant cultural shift, and I think the external environment and the need to work more closely together in innovation have really helped with that.

Linda Mantia
Chief Operating Officer, Manulife Financial Corp.

A

And maybe if I could just add one point. And I think it really reflects the digital and agile environment we're trying to create is reuse around the world, like really connecting our employees working on similar activities, so that the view is, let's not reinvent the wheel, let's build on each other. Again, culturally, digitally, the tools are ready now. We can build things that can be plugged in, enhanced by different groups. And that's a big part of a cultural shift, as we move to a more integrated global company.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Right. Culture is, John, you're right, a very important part of the agenda we're embarking on as a company overall, but absolutely, front and center, as it relates to expense initiatives. And it starts from the top. And what I'd say is that, a, my entire leadership team, and in fact, their direct reports now having their scorecards a cost goal, and therefore, compensation is directly impacted by our efforts, our success or failure in this space. And that's filtering down to the next levels of the organization as well.

And it is a change, but at the same time, the response has been very positive. People are seeing that this is an agenda to drive a winning culture in the company, and that's something that people are actually getting on board with, which is probably the biggest difference between what we're doing now, and what we've done in the past with E&E. People have often asked, well, what's the difference between what you're focusing on now and E&E. And for me, the biggest difference is that E&E was viewed as a project with a start and an end date. And this is a culture, this is a way of doing business, this is a new way of operating, and that really is the large part of the difference.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Humphrey Lee from Dowling & Partners. While I do have questions for Naveed about the Legacy business, but I hold off, I'll ask a question on Asia and WAM just to step up to the plate. So, when I look at, I guess, the efficiency ratios, Asia and WAM definitely elevated because of some of the investments and growing to a scale. If we were to think about, like if once those kind of investments were to level off over time and kind of you get to the scale that you want to be without additional actions, how should we think about the efficiency ratios at those two segments, in Asia and WAM, respectively?

Paul Lorentz
Head, Global Wealth and Asset Management, Manulife Financial Corp.

A

It's Paul. Thanks. I'll start with WAM. I guess, how we look at it, as Phil talked about the go initiative, where we're trying to automate and digitize the back office, middle office, and we're still working through that. So, we haven't seen the benefits come out of that investment yet, and it's a multi-year investment and a big one for us. But it does not only give us benefits from where we are today, it gives us a platform that's scalable going forward.

The other opportunity for us is with Global WAM coming together, while we've had a lot of growth and a lot of collaboration historically, now that the direct accountability is with Global WAM and one P&L. We're able to look at that business prioritized globally, rather than locally, and really having the IT investments. The operation teams roll up to an IT leader for Global WAM. That provides a new lens as we're investing in technology, to Linda's point, to make sure that if we are going to invest in digital services or tools as it relates to retirement business or participants, that we look at that with a global lens to say let's build it in a technology stack that we can use across multiple businesses.

And I'd say, just getting alignment between the different businesses in retirement that were run on a local basis, and having a consistent and agreed to view of our global strategy as it relates to WAM and how retail retirement and our institutional businesses all fit together, it's going to drive some leverage for us. I think the balance in terms of the ratio itself will come back to organic opportunities in terms of additional investment, where can we go faster. And that's more of a capital question around how much do we want to invest in the different businesses across the globe.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

So, for Asia, to be thinking about it is, trying to kind of curate some of the high-impact processes that impact customers. So, you heard about the fact that we're still largely paper, largely not straight through. And if you then kind of think about some of these high-impact processes, and we kind of illustrated one where we've kind of simplified the entire claims process, and you can see some of the kind of outcomes kind of come through, that has to not only be done in Hong Kong, but it has to be done pretty much across the 12 markets that we have in Asia, and both across the insurance and the wealth management businesses, and back to front, right.

So, automation and digitization is not only about curating client experiences at the front-end, it's also how you can wire your organization back to front. That's really where you're going to start to kind of see not only the client experience benefit, but how that kind of really kind of filters down to the cost efficiency piece. And to be able to do that in one market and then kind of replicate in the other 11 markets, there's fair amount of work that's ahead of us. So, this is not a next six month or next year project, this is a multi-year journey that we have to kind of execute against to be able to both improve our client experience and our cost efficiency.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

I guess just, quickly, follow-up. So, have you done similar analysis with some of your kind of best-in-class competitors or peers, like where would they stand in terms of these efficiency ratios? And I guess, that's maybe indications of where you could potentially get to eventually. I think that may help us to think about those two segments.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Yes. Shall I pick that one up? So, in setting the 50% cost efficiency ratio target, we have looked at research from independent parties, including some of the research that's done by analysts in the room. We've also done our own benchmarking analysis. And what it shows is that we actually compare quite favourably, at this point, in some ways, to some of our peers, but really the benchmark is not what our peers in Canada are doing at this point. Our benchmark would be take into consideration what that the best-in-class in the world would be. But actually, if we think about where we need to be in 5 years' time or in 10 years' time, given the backdrop of digitization and the threat of disruption, we're setting ourselves the more ambitious target. So, we are already a very large scale global organization, and it's really about maximizing those scale benefits to become a global leader in expense efficiency.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah. So Humphrey, the benchmark has been incredibly helpful and useful, but we haven't been blindly following the benchmark as the guide of what we think is possible. We think that our industry hasn't actually done a really good job with driving efficiency and a focus around cost management. So, we think we can demonstrate leadership in this by just an example of Canada.

Last year, we had 100,000 of our transactions processed by robotics. This year, our target is to process more than 1 million transactions through robotics. The use of IVR for our call centers is, in many markets, less than 5%. If you look at banking as a standard, more than 50% of calls are answered by an IVR in an automated way.

So, we really think that there is significant opportunity across every aspect through which the customer actually engages with us to really drive cost out, and in doing so, actually create a better customer experience. Again, I just want to reiterate that. People often think that cost is the enemy of the customer, or cost focus is the enemy of the customer. Actually, the opposite is true. Our efforts to take cost out are all about digitizing and creating better customer experiences, which ultimately, translate into more business.

Vijay Viswanathan
Director of Research & Portfolio Manager, Mawer Investment Management Ltd.

Q

Vijay Viswanathan from Mawer Investment Management. Roy, in your remarks you talked about the mission, the why, as well as strategic priorities, the what. And I guess, my question specific for you, what role are you, specifically as CEO, going to play with respect to the implementation of this strategy? Where do you think you add the most value within the senior management team? And I guess, finally as a shareholder, how do you think I should assess your effectiveness?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.
A

Well, through the targets what we set is the first answer to that question. But I see that my role is, firstly, to create the right culture within the organization, to inspire the entire organization around the journey that we're going on, and to set a bold ambition for the company that we want to be five years from now. We're not setting a target to be marginally better than we are today. What we've done as a leadership team, and where we are in as a leadership group is the transformation to becoming the company of the future that we have sort of articulated in some detail today.

So, first and foremost, it's about stretching the company's vision of what it can be and setting a bold ambition. The second component is creating a culture and fostering a culture throughout the entire organization that is aligned to that ambition. And the final piece is driving accountability. And I clearly need to be held accountable, and I'm happy to be held accountable. And at the same time, internally, we've got to drive a sense of accountability for every part of our business. And that includes business reviews, processes to really look at the infrastructure and the process that we're making in delivering against the ambition that we're setting.

And if we are on track, then obviously, understanding why we're on track, and what we need to do to reinforce and support that, and where we're not delivering against targets that we've set, ensuring that we understand why we're not, and what we're going to do to pivot to ensure that we can actually course correct. So, I think that's clearly the role that I play in my entire leadership team.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.
A

Question here. We'll have one more question after this one.

Scott Chan
Analyst, Canaccord Genuity Corp.
Q

Yeah. Thanks very much. Scott Chan from Canaccord Genuity. Just on the chart with the four growth objectives to get to two-thirds of core earnings. Just on the behavioral insurance side with Vitality and MOVE, how do we, and where are you – you talked about the 20 data push points for customer versus before, but what other metrics for us that we can track or look at to help see that it's a high core earnings, and how it's potentially getting to your target?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.
A

Yeah. So look I'll ask Anil to talk about ManulifeMOVE in Asia, but just at the very high level, what I'd say to you is that, firstly, we're very happy with the profitability that we're generating in this space. Having a product that resonates more with consumers means lower acquisition cost. So, when we're trying to talk to customers about the insurance offering, when it's a simpler conversation, and it's easier and more intuitive, that means customers are more willing to take up the product and that translates into a lower CPA typically. We're rewarding customers for good behavior, which ultimately translates into reduced risk for us. If the customers are healthier and they're living healthier lifestyles, we benefit, but so does the customer. So, there's a strong alignment, and we believe that that's an important dynamic in the profit equation.

And then finally, when we're engaging with these customers more frequently, they're more excited and happier about the product that they are getting. And at the same time, they've got a much better propensity to take on other products. And again, Anil will talk to this, but we're seeing that the cross-sell ratio for customers where we've sold them behavioral insurance is actually significantly higher than standalone products where we've set a traditional product and we don't talk to them for three years. But I'll let Anil elaborate a little bit more on the progress that we're making in Asia with MOVE.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.
A

So, if you look at insurance, right, I mean, customer engagement and just kind of owning the customer seems like a very, very big opportunity. And again, if I draw parallel to some of the other industry, how do we really kind of have an engagement tool that really kind of engages the customer pretty much through the life cycle of the relationship that the customer has with us is a significantly large opportunity for our industry, and specifically for Manulife. And I guess MOVE is a great example, where we got feedback from our customers that, give us something very simple, and we design MOVE, which is very easy to understand, and you can see that translated into some significant adoption of it.

Today, we have MOVE in four markets and we have an adoption rate of 140,000 customers. Not only that, what we've seen is it gives more opportunities for our customers to kind of interact with us more frequently, which effectively means it gives us more opportunity to deepen and broaden relationship with our clients. And what we have seen is if you compare customers who engage with us through MOVE versus those who don't, one out of five either buy a new product or a different – a higher value proposition from us over a period of time. So, I think this is a significant opportunity and to the extent that we can convert some of this engagement to be able to deepen and broaden relationships, I think that kind of augurs well for the way we're thinking about our strategy.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.
A

We'll take one last question.

Katia Ivanova
Analyst, Foresters Asset Management, Inc.
Q

Katia Ivanova from Foresters Financial. I just wanted to follow up on with respect to the cost savings and the restructuring charges. It looks like the one that's coming through this quarter, the $200 million in relation tothe $300 million in savings, how should we think about this going forward with the remaining $700 million towards your $1 billion target. I think you alluded to that in an earlier answer that perhaps it should necessarily be at the same kind of ratio or pace, but how do you think about that?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Yes. So, I'd sort of elaborate a little bit on what I said earlier. We wanted to make some of the tough decisions upfront and to the extent that we feel that there are decisions that require material restructuring charges such as this one, we wanted to get those out in Q2 at the beginning of this program. We clearly do have – beyond the initiatives that we've announced in Q2 we've got a lot more work to do to achieve our efficiency targets. But we do think that the bulk of the progress that we can achieve over the next few years will be less intense in terms of restructuring charges, so, taking advantage of natural attrition, taking advantage of the opportunities that we see in procurement. So, at this point, we don't expect any material restructuring charges. There'll be some small items along the way as we restructure the business but I think we've got the lion's share out of the way.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.
A

Yes. Well, thanks everyone. We'll now take a short 15-minute break. We ask that everyone come back into the room at 10:00 AM on punctually, so we can get started at that point. Thank you.

[Break]

Roberto Veloso

Head, Investor Relations, Manulife Financial Corp.

If everyone could take a seat, we'll be starting back with the webcast in just one moment. Welcome back everyone. Our next speaker is Naveed Irshad who heads our North American Legacy business and he's going to discuss how we're extracting value from our Legacy business. After Naveed, we'll have a Q&A panel, and at that point you can ask your questions. Naveed?

Naveed Irshad

Head, North America Legacy Business, Manulife Financial Corp..

Okay. Thank you, Rob, and good morning everyone. I hope I can live up to the hype. So, I'm happy to provide transparency on our Legacy business and why we think that there's a significant opportunity to create shareholder value within these businesses.

By the end of my presentation today you will understand that we take the management of these businesses very seriously and we have a dedicated strong focused team leading these businesses; that not all long-term care blocks are created equally; that our long-term care block has favorable characteristics versus peers and more importantly we were satisfied with the level of reserves; that our variable annuity business is well-hedged; that our life and fixed annuity blocks represents some of the greatest potential to unlock capital; and that we set a very ambitious target of CAD 5 billion of capital release over the next five years using a combination of both inorganic and organic opportunities.

We've clearly defined the scope of our Legacy business. So, we use three key considerations in doing so. So, first the strategic alignment – does the business meet our long-term objectives? Are we writing new business? If we're not writing new business, clearly it would be part of Legacy. The financial impact – what are the core earnings, capital allocated, the ROE? Does it meet our return requirements in the current environment? If it does not, it would be part of Legacy. And then the risk profile of the business – what is the risk of the business relative to our risk appetite, especially for things like equity risk, interest rate risk and insurance risk?

On slide 4, you can see a summary of our Legacy block across North America. There's four broad product categorizations for Legacy. So, first you have a long-term care business in the U.S., then you have the variable annuity business across both Canada and the U.S. except for one low-risk variable annuity product currently offered in Canada. You have certain closed life insurance blocks in Canada and the U.S., including the long duration guaranteed insurance businesses such as Universal Life with secondary no lapse guarantees. And then you have the fixed annuity blocks across both countries. These are the pension-risk transfers, structured settlements and payout annuities. Altogether, there's CAD 23 billion of allocate equity on a LICAT basis covering these businesses. That's over 50% of the allocated equity across the company. These businesses represent 40% of the core earnings of the company and an ROE around 9%.

Now it's really important to not think of these businesses as a bad bank. There's a variety of businesses included in the Legacy block, some have lower risks and lower returns and others have higher risk and satisfactory returns. Let's start now with a deep-dive on the long-term care business in the U.S. The market started in the 1970s when insurance companies identified a need for a product to help people pay for care when they're unable to provide for themselves. Benefit triggers on long-term care were typically triggered when an individual could not conduct two or more activities of daily living. By activities of daily living, think of what you do when you get out of bed every morning. You get out of bed, you go to the washroom and wash yourself, you get dressed, you eat breakfast, those are all the activities of daily living.

Initially, life insurance companies used life insurance assumptions and life insurance underwriting approaches with the provision that prices could be increased if warranted. The market really started to take off in the 1990s due to tax incentive changes and you saw companies clamor for market share in this growing market by offering more and more generous features. So, things like lifetime benefits and compounding inflation protection up to 5%.

By 2000, underwriting had started to improve specifically around cognitive testing – testing for cognitive impairment. We saw prices on new business increase and companies claw back some of the riskier features. The market peaked in 2003 at US$ 1.2 billion in sales. As for John Hancock, we entered the market in 1987, but our average issue year is 2004. In 2008, we filed the first of several rounds of inforced price increases – actually four rounds so far. And in 2013, we launched a highly de-risk par like pass-through version of the product. The volumes though were insufficient and in 2016 we closed to standalone new retail business.

This chart on slide 6 shows how we stack up versus the four leading direct writers of long-term care in the U.S. on two key characteristics which are really the major risk factors on long-term care. First, we have a lower proportion of lifetime benefits than our peers. Lifetime benefits are riskier not just because the open benefit period, but also the policyholder behavior impact. People on lifetime benefits tend to start claims sooner and stay on claims longer than those without lifetime benefits. So, 16% of our individual policies have lifetime benefits. Now, if you include our group business that 16% drops to 11%. And if you do the calculation based on maximum daily benefit, so which is more of a risk weighted measure, that overall number drops from 11% to 9%.

Similarly, our individual business has a lower proportion of compounding inflation protection. So, inflation protection clearly increases the benefit amount and the ultimate liability. 40% of our individual business has compound inflation protection and just over half of that is the riskier 5% level. We've had good success through offering landing spots which has reduced our exposure to inflation protection. So, landing spots are when clients elect reduced benefits in lieu of premium increases. So, we've had success with people dialing down the level of compound inflation or not having compound inflation altogether.

So, as a reminder, we operate under a consolidated Canadian IFRS reporting basis. That requires us to use best estimate assumptions that are kept current and margins on each of these assumptions. We do triennial deep-dives on all the insurance assumptions, and we have an independent professional consulting actuary peer review our assumptions and report directly to the board of directors. Our last deep-dive was in 2016 and since then experience has been neutral on average. We've had higher than expected claims costs, but this has been offset by higher than expected lapse rates.

The provisions for adverse deviations or the PfADs can be viewed as a buffer and the present value of future profitability. The PfADs are constantly reset so we always expect future profitability. At the end of Q1 2018, the PfAD was US$ 10.5 billion. That's almost a 50% buffer over the best estimate reserves. The total IFRS reserves of US$ 32.6 billion are 30% higher than U.S. statutory reserve requirements. The reserves are expected to grow as we collect new premiums and are expected to peak in 2030.

To give you an idea of regularly reviewing our assumptions, our ultimate reinvestment rate reflects the current interest rate environment. So, it's at 3.2% risk-free rates. We do use ALDA to back long-term cash flows. Right now, ALDA makes up about 15% of the assets backing long-term care reserves. For over 10 years, we've been making a distinction for lifetime benefits on our morbidity assumptions. So, we have an over 50% higher average length of stay assumption for lifetime benefits versus non-lifetime. We also assume a considerably higher claims incidence rates for lifetime benefits versus non-lifetime.

Lapses were originally up to 5% a year assumed. Now, our current ultimate lapse rate averages 0.5%. We do assume both mortality and morbidity improvements in our reserves, these are largely offsetting. So, mortality improvements would be unfavorable to reserves whereas morbidity improvements would be favorable. Combined, there's a less than CAD 100 million benefit to the combination.

Since 2007, we've strengthened gross reserves by US$ 10.9 billion and that does not include the quarterly interest rate changes. This has been partially offset by price increases. Cumulatively, we've achieved a 69% price increase on policies where we filed for rate increases. That translates to US$ 7.1 billion benefit which is approved and we're working towards the remaining unapproved amount of US$ 0.8 billion. You can think of this US$ 0.8 billion as an amount that's been padded for timing and amount of approval.

Some of the success in getting price increases comes in part from offering landing spots which I talked about earlier, which are well received by regulators. We've had a 50% take up of landing spots were offered. That said we have seen slower rate increase approval requests over time. We're seeing more capped approvals now where we get partial success and we're told to come back the following year for the remainder. This is not a denial, but just a capped approval. We believe that we're entitled to the full amount that we request and any outstanding amounts are rolled forward into future requests.

Now, on LTC, clearly there's significant uncertainty, but not all of it is downside. Advancements in the treatment or prevention of Alzheimer's will be highly beneficial such as with other advancements in healthcare and improvements in detecting and preventing fraud. The block does have significant morbidity risk, so 90% of our disclosed sensitivity to morbidity comes from the long-term care block and there are currently limited ability and options to reinsure or hedge this risk. You'll find a lot more granular info on our long-term care business in the appendix. So, we've shown the business with the various risk characteristics and across the multiple product generations. I think you'll find that very helpful.

Now, turning to variable annuities and doing a quick deep-dive on variable annuities. You can think of variable annuities as a mutual fund with some sort of guarantee. Post financial crisis we've really ramped up our hedging on variable annuities and now we dynamically hedge or reinsure 95% of the guaranteed value of the variable annuities within the Legacy block. The remaining 5% is either difficult to hedge efficiently or there is no material market risk within them.

Our hedging is sophisticated and effective, more importantly we hedge the economics which is encouraged by our accounting system which is quite close to economic. We have refined our hedging program over the years we use options and swaptions and we've introduced managed volatility funds in the U.S. where some of the hedging is essentially done within the fund itself.

Our hedging is effective. In the middle chart there you can see our variable annuity earnings variability to market movements and that's significantly declined over the years. There is another way to look at variable annuity risk, you can look at the variable annuity capital and reserves and compare that to the net amount at risk. The net amount at risk is the policy – the amount under water the contracts are policy by policy. You can see here the total of CAD 8.3 billion in liabilities and capital is higher than CAD 7.6 billion undiscounted net amount at risk. The net amount at risk would actually be payable over a significant period of time if at all. The majority of our variable annuity business is the guaranteed minimum withdrawal benefit. So, on that benefit, the account value needs to be exhausted first before the guarantees kick in.

On the variable annuity business, we collect a guarantee fee and an asset management fee. The guarantee fee is reflected in the balance sheet reserves, but the asset management fee is not. Based on current assumptions the present value of future asset management fees on this business is CAD 3.4 billion. So, that contributes to a low-teen ROE on this block in the current environment.

Now the challenge with the variable annuities is that the capital on variable annuity – the required capital is quite market sensitive, and that's why it's classified as Legacy. That's because there's no direct credit for hedging under LICAT. So, for example a 30% equity shock on the block would result in a 40% increase in required capital over time.

Rounding out the Legacy portfolio are our life and fixed annuity blocks. These represent over CAD 133 billion of reserves, and that's about roughly three quarters of the Legacy business reserves. Typically these are longer duration and lower return. These blocks will be the focus of transactions in the near-term. There's significant market interest in some of the blocks and strong counterparties available for transactions. We've done a detailed block-by-block analysis and established a roadmap. The roadmap encompasses both organic and inorganic opportunities and what we're really trying to do is reduce the ROE drag of these businesses on the overall company ROE. So, either we can do that by improving the ROE of the Legacy block, reducing its size or some combination of both.

Now, inorganic options would be the preferred choice if possible. So, either disposing of whole blocks or transferring certain risks through reinsurance. Now, even if we do transactions, we can still retain the ongoing administration, so, still focused on efficiency. So, inorganic and organic options are not necessarily mutually exclusive. We do target to free up CAD 5 billion of capital by 2022 through portfolio optimization and that represents almost 20% of the current Legacy capital base. So, that does include the ALDA portfolio asset mix exchanges and the Canadian Universal Life reinsurance transaction that took place in Q1. But the important thing is that roadmap and plan that we've mapped out includes all the organic opportunities and only some partial risk-transfer reinsurance. It does not contemplate larger transactions. That said, some large block type transactions are still something we're actively looking at. It's just that we're not banking on them or relaying them to meet this ambition. Any such transaction would essentially allow us to surpass our goals or achieve them sooner.

On the inorganic side, so we're evaluating inorganic options using a variety of metrics you can see with a key focus being adding value for shareholders. We are seeing a lot of interest in some of our Legacy blocks. You've seen a lot of transactions on fixed annuities, interest in mortality, risk, longevity risk, lapse risk, and even on the variable annuities side. The Legacy transaction on the Canadian Universal Life block is a great example of some of the success we can have through reinsurance. So, on that transaction, we transferred lapse and mortality risk to a highly rated reinsurer that generated CAD 240 million of capital including a CAD 70 million upfront gain. So, those are modest CAD 11 million annual core earnings tradeoff, so clearly an attractive tradeoff from a return on capital perspective. So, not all transactions will be this favorable, but we are engaged in a number of discussions right now, a number of processes and I'll update you regularly as we finalize these deals.

Now, turning to the organic initiatives on slide 14, you can see the detailed initiatives we have inflight for 2018 alone. So, we continue to utilize pass-through features such as the long-term care price increases. We have a number risk reduction initiatives, specifically focused on policy cash-outs, offering cash-out options that makes sense for both the customer and for Manulife; a number of claims management initiatives on long-term care. I'll discuss the long-term care portal shortly, but that and other claims initiatives like long-term care wellness have the ability to reduce claims over time. The other initiatives like the ALDA portfolio asset mix change, and streamlining investment options and some policies are already underway.

Encompassing all of this is the company-wide expense initiative to aggressively take cost out of the business that Phil outlined earlier. Now, these are just the inflight 2018 initiatives. We've got a strong team really going after this. We're trying a lot of things, learning quickly, re-prioritizing, adding, so we have a much longer list and we expect this list to grow.

I mentioned the Long-Term Care Portal. So, this is an online tool where customers can interact with us digitally. They can start a claims process and upload invoices. So, this is in the early stages, upcoming enhancements will further improve efficiency. We processed 45,000 invoices in the first year, and we expect a tenfold increase in invoice volumes over the medium-term as business shifts to the Portal. So, clearly digitization will reduce expenses.

But what we're really excited about is the opportunity on claims management. We're using geolocation and smartphone technology to ensure that customers get the services that they're entitled to and we pay for the services actually rendered. So, this is really important, especially for cognitive impairment. We're leveraging Vitality gym check-in technology to ensure that and verify that the provider has been at the customers' residence for the length of time that they're being billed for and family members can easily validate this. The digitization also allows for advanced analytics to prevent fraud. Our advanced analytics program on long-term care is in its early stages but it's already starting to bear fruit.

So, in conclusion, we have a dedicated strong team with clear priorities. We're focused on optimizing our Legacy business. The risks are well-managed. We're executing on inorganic and organic opportunities to enhance the risk return trade off. We have an ambitious CAD 5 billion target of capital release by 2022, and we're confident that we have the right team in place, looking at everything and doing the right things to drive value creation. Thanks.

Roberto Veloso

Head, Investor Relations, Manulife Financial Corp.

Thanks, Naveed. We're now going to open the panel up to questions. And joining Naveed, Roy and Phil on the panel, Steve Finch, our Chief Actuary, and we'll start with the front row.

QUESTION AND ANSWER SECTION

David Motemaden
Analyst, Evercore Group LLC

Q

Thanks. David Motemaden from Evercore ISI. I guess just one of the questions I had is just on morbidity improvement that you have embedded in your reserve assumptions. I understand that there is evidence of morbidity improvement in the general population, but there is limited credible data to support that in the insured population. I guess just wondering the sensitivity to your reserves, if you removed just the morbidity improvements?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Yes. I'll comment on that. And this is one of those topics in the industry that gets a lot of attention. We do believe, I believe that there is a correlation between mortality improvement and morbidity improvement over time. I look at our overall reserves when we talk about how frequently we've reviewed assumptions and strengthened reserves over time, satisfied with the overall level. In terms of your question around sensitivity, if we kept mortality improvements, but not morbidity improvements, which obviously I believe is where we're taking the right approach. That number is about USD $1.6 billion.

David Motemaden
Analyst, Evercore Group LLC

Q

Got it. Thanks. And then also just, Naveed, you had mentioned that the reserves don't peek out until 2030.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Yes.

David Motemaden
Analyst, Evercore Group LLC

Q

I guess just thinking about allocating capital behind the LTC book, I guess just one, how much capital do you have backing the book, specifically for LTC? And then two, I guess how should I think about that growing until peak reserves are hit and just tying that with the overall ROE target?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Copr.

A

All right, Steve will handle that.

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Yes. Dave, I'll take that. So, in terms of the capital allocated, we've disclosed the total capital for our Legacy block. We haven't gone into more granular detail. Part of that is under LICAT. It's very integrated and there's – you have to take diversification credit and figure out how we allocate that all out. But I guess what I would tell you is that the life and annuity blocks, they take over half of the capital in the Legacy. We have continued our disclosures in our supplement on how much capital we have back in our variable annuity business which is approximately CAD 5 billion. And then to kind of zero in on a ballpark, you can look at our embedded value disclosure and think of reserves are a good proxy for capital. The on-balance sheet asset intensive businesses, the reserves are a good proxy for capital as well as growth in capital over time. So, I think that gives you a rough idea.

David Motemaden
Analyst, Evercore Group LLC

Q

Thanks.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Thanks. Tom MacKinnon, BMO Capital. Of the CAD 5 billion free up, so let's say CAD $2 billion excluding the ALDA or CAD $3 billion excluding the ALDA, how much of that just comes from a natural unwind of capital related as these books just run off by 2022? And how much comes from some of these other organic initiatives? And then how much would come from inorganic initiatives? So, can you break down that of the CAD 3 billion that you're getting from the Legacy?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Okay. So, Tom, it's Naveed, so we have not contemplated – this does not reflect any of the natural changes in capital, either increases or decreases. So, this is all incremental to that. So, you can think of the CAD 3 billion strictly as a result of specific initiatives that we take, either organic, inorganic. In terms of the breakdown between the two, there's a lot of moving parts here. I have a list of opportunities on both sides that are well in excess of that number. Some will hit, some will not hit. So, in terms of pinning it down specifically, it's a bit hard to do.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Well, maybe ask you different way, what would the capital be if you didn't do any of this thing? What would that, the capital you had allocated this Legacy, be in 2022 if you didn't do any of this stuff?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

I think it's naturally supposed to – it's going to grow for a few years...

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

There is natural growth as the reserves are still growing on the legacy overall and we mentioned LTC, those reserves peak roughly 12 years from now. So, we will see the capital continue to grow over time, I don't have the exact figure but the CAD 5 billion is off that projection. So, we're looking to free up CAD 5 billion off the projected capital growth.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

And you talked about these landing spots with respect to LTC. So if – does that mean 50% of the people then take an increase in premium and the other 50% take a reduction in the benefit. Is that what I should assume.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Coro.

A

Typically...

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

And then, how is that trended and what happens if you got that landing spot up to 75% taking reduction in premium, presumably you don't have to hold as much capital then.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Yes, that's correct. Yeah, so we've had good success on the inflation side. Now that's said, a lot of those have already taken place where people have sort of elected those landing spots already. So, you have to look for new landing spots. So, one area we're exploring and we're doing this as part of the current rate filing process is offering significantly enhanced cash out options as a landing spot. So, that could be also beneficial, we're going to try some things on that front. But I think that's the right way of looking at it. The higher the election of landing spots, the better it is from a reserve perspective.

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

And your point about funding capital that is a benefit that if we can reduce the rate of growth in the reserves, and the capital that's a benefit in terms of risk reduction over time.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Right, so, yeah just updates on those, I think it is important as we go along because I think that's internally ways if you are being able to manage the capital you have to allocate to that book.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Yes we have.

Rob Poole
Analyst, Picton Mahoney Asset Management

Q

Hi Naveed, over here it's Rob from Picton Mahoney. Just trying to square the two things that I guess when you highlight you know we can look at the PfAD obviously as you know your present value of future profitability in the block. But then, you kind of you contrast that to you guys – you feel that you're entitled to price increases. How does the state regulators look at that?

Steven Finch
Chief Actuary, Manulife Financial Corp

A

So when we file for premium increases it's related to deterioration in claims experience. So, we track and the way we file is through loss ratios, but effectively, it's looking at the claims experience that we've had and the projected future claims experience. So – and there's rules around how that's allowed. We, as you would expect do a lot of work around this, it requires filing with each individual state and they've got lots of questions around this experience.

What we found is that the filings that we've done may have been very solidly supported by actuarial experience and judgment. And over time, we have demonstrated very strong success at getting the price increases. Naveed had some figures on that in the presentation and we are still early days in our latest filing for price increases. It's as expected – it's taking time to get through it, but we believe we're entitled to those price increases and expect to achieve them over time. And I think that's another point to Dave's question earlier around the morbidity improvement. If it doesn't emerge, you know, that would become part of our – of our premium increase program, which we have demonstrated success on over time.

Sumit Malhotra
Analyst, Scotiabank

Q

Hi, it's Sumit from Scotia. Steve, I think these are going to be for you. I just want to make sure we're on the same page in terms of some of your terminology here. On the slide 4, when you talk about the allocated equity in the aggregate for the legacy blocks in aggregate, that you're using equity and capital interchangeably here right? That's the total capital you're saying is backing the entire legacy block for Manulife?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Yeah. Our approach is to allocate out to the businesses the equity capital of the company and that is the allocation that we've got to the legacy blocks.

Sumit Malhotra
Analyst, Scotiabank

Q

And I think this is a Canadian dollar number. I say that because I think one of your comments was where you can think about reserves and capital, and the business equivalently. So, when I look at the LTC piece, your total capital there is the CAD 30 billion including the PfAD, that's a U.S. number. Am I mixing up a few things up here?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Reserves. Reserves.

Sumit Malhotra
Analyst, Scotiabank

Q

You said so, but I think you're telling me was reserves and capital should be thought of interchangeably or did I get that wrong?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

No, I guess what I was saying was if you're thinking about how much capital is allocated, a way to kind of zero in on that is looking at, if you look at proportion – if you look at reserves block by block, capital roughly follows reserves.

Sumit Malhotra
Analyst, Scotiabank

Q

So there is...

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

Proportionately.

Sumit Malhotra
Analyst, Scotiabank
Q

It's kind of a two very different numbers there, you know, in terms of the total reserves you have for LTC and the aggregate capital that is backing all of legacy. So, at least, I think there's a currency difference and there's about CAD 10 billion, if I'm following you correctly.

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

Maybe we could take that offline.

Sumit Malhotra
Analyst, Scotiabank
Q

Okay. All right. We'll come back to that. And then, maybe to get right to the point of this, from what you're telling us your experience since the last review has been pretty neutral. We've heard that in the last year and a half, claims have been higher, you've got some expectation that perhaps pricing and morbidity move in your favor. So, how do we think about this every three-year process of reserve strengthening? Because it's been relatively neutral from an experience perspective, is that our best guide for what the financial impact to shareholders is going to be from reserving or are there other issues that have the potential to surprise?

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

Yeah. So, a few comments on that. I think the quarterly experience really over a period of time is a good indicator for how the business is performing. I say over a period of time, because we do see both gains and losses on a quarterly basis – that bounces around a fair bit. But since the last deep dive review, the experience has been about neutral.

The other thing I would point to that I think is important is tracking our progress on the premium increases. We've been very cautious, prudent about how much to reflect in our reserves. So, as Naveed pointed out, we currently as we said today have approximately USD $0.8 billion of benefit in the reserves that are not yet approved. However, our total ask is significantly higher than that. So, to the extent that we are successful in achieving the rate increases, you know, we've got additional potential margin.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC
Q

Humphrey Lee from Dowling & Partners. A question for Naveed, have you explore any options for kind of separating the different legacy business from the current legal entity. Because my understanding is a lot of U.S. businesses are commingled within the same entity.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.
A

Yeah.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Have you explored any potential options either through internal reinsurance or any type of potential actions that you could do in order to bifurcating the risk into separate entities?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Okay. So, right now there is no option. There's no enabling legislation in our home domicile state for that to occur, so that's not on the table currently in terms of the legal entity division. Now, in terms of internal reinsurance, ultimately, we still – we were looking at this on a Canadian consolidated basis, so whether we move it around, I don't think it has an impact on that overall consolidated picture.

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

I think the one thing I'd add to that is that while it would – we don't have the means to do that today, it's certainly something that we continue to explore and would look at doing over, you know, this is a long-term business that we've got and to the extent that we can achieve that in the future is something that we'll continue to look at and try to do.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

I know like certain states have talked about putting legislature in terms of allowing companies to break off or like break up certain books of business into different entities. Have you had a similar discussion with your regulators or have they at least looking to something similar to that?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

I think it's safe to say that we're exploring all options and the key question in terms of that type of approach is how much capital would have to go along with it. So, there's the ability to do it and then there's the – how much funding would be required, but it's safe to say that we're exploring all options.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

And there is a greater appetite for regulators to look at that which is encouraging.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

And, if I can sneak in one more?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Okay.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC
Q

So in terms of – you talked about the capital allocation for the legacy business kind of proportionally to your kind of reserve allocation, your reserve mix. How should we think about the earnings aspects for those four main blocks of businesses?

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

Well, I think one thing I'd point to I think the new disclosures that we started in Q1 give a better indication of the earnings on some of the legacy businesses. You know certainly in the U.S. we've combined the overall insurance with the retail insurance and LTC, and maybe I'll pass it to Phil in terms of any comments on future disclosures.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

So, I don't really have too much to add to that. I think it clearly is – as we become more focused and we are very focused on addressing our legacy portfolios, we'll consider what level of disclosure, granularity, in terms of how we analyze the earnings between legacy and other. But, we certainly not – we're not ready to do that externally at this point. So, I think watch this space.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Gabriel Dechaine, National Bank. I got a question – a couple actually, the gap in your reserves between the IFRS and statutory. If I want to make them somewhat more apples to apples like Granny Smith and McIntosh, I would add back the pricing adjustments you've taken over time and that's about a CAD 15 billion U.S. GAAP or we could use the CAD 8 billion that you've gotten in that slide whichever you prefer. How much of that difference would you attribute to say the discounting rate that's different maybe lower under IFRS to some of the insurance risks like lapse or the benefit utilization rate, stuff like that, is that possible?

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

I can do it at a high level. And maybe a way to get there is think of the premium rate increases that we filed for, that has all been related to claims costs as opposed to investment performance.

So, when we've looked at this, I don't have an exact number, but I would not attribute very much at all to a difference in assumed investment returns or the discount rate. The difference is really all driven by the padded claims costs under IFRS that have been strengthened over time versus what's in the NAIC which is the original assumptions.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Okay. So that CAD 8 billion or whatever it is...

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

That's the different. Yeah.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

That is primarily insurance risk...

Steven Finch
Chief Actuary, Manulife Financial Corp.
A

That's right.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

That are not discount rate. Okay, great. Then, for future optimization efforts, we had one in Q1 that was a 5% return on capital business and then you're talking about the overall book that has a – about a 9% ROE, so pretty wide spread there. The next CAD 2 billion or CAD 3 billion of capital free-up are they going to look more like what we saw in Q1 or more aligned with the overall book, I know you said the – you answered my question on the Q1 calls, so the CAD 240 million capital that was low hanging fruit?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.
A

Yeah. So, I think that was a pretty favorable transaction for us. So, as I said we're looking at a number of different transactions. We've got a number of processes we we're running right now. There is a different sort of range of outcomes on these. But I think there is enough interest in some of the risks that we have to offer that we think we can do quite a few transactions that are incremental to our ROE. Maybe that sort of range was – we may not be there, but I think there's incremental opportunity there and I think you can expect some of these transactions over the next few quarters.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

So that we'll fall within that range, but not...

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.
A

Yeah. That was probably – that's probably the most positive end of the range. But we're looking at incremental ROE as a key driver of this.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

And just to be clear with the earnings give up that we're contemplating here that's embedded in your 10% to 12%, I imagine EPS growth target in the median term.

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.
A

Yeah.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Okay. Last one and I think this is maybe what Sumit was getting on earlier. The allocated equity, is there a very big difference between how you're allocating equity from a capital management standpoint to the carrying values that you have on an accounting basis. I'm just looking at possible haircuts on transactions?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

So, when we look at allocating our equity capital out, we're doing it largely along what the LICAT basis would generate. I think as we look at how to allocate out, we're also continuing to look at how all the credits and how all the diversification, et cetera, across businesses factor into that. As the capital regime is new, we want to kind of make sure we fully understand it and that's why I think we're more comfortable giving the total allocation to legacy as opposed to more granular.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

So, it's carrying value higher?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

.

I think we have to get back to you on that.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

Okay. Thanks.

Natalie A. Taylor
Analyst, CIBC Asset Management, Inc.

Q

Natalie Taylor of CIBC Asset Management. Just a question, given that this is a long-term business, reserves aren't expected to peak till 2030. This is obviously a difficult business for a lot of your competitors as well. Can you give us a sense of the discussions with the regulator in terms of finding a solution for the industry, the odds that you put on that and the kinds of discussions that are happening?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

I could touch on, I mean I think what I see and I've seen over time is that John Hancock was I think early in terms of managing the challenges on this business. I think part of that was related to the accounting standards that were under the scrutiny on the reserves and the diligence there. So, we were raising prices early. When we did that early, I think for a few years, this was viewed as a John Hancock problem. And then, what became apparent is, as other companies recognized challenges and more and more companies went to file for premium increases, it's now evolved to a recognition that there is an industry problem here and we've talked about some of the assumptions that changed over time since the original pricing. So, I think the regulators recognized that there is a challenge.

Some of the discussion and the additional questions that we get around the premium increases, I think part of it is that they're often what they are elected or appointed officials. So, the whole business construct of needing approval for rate increases puts them in a very challenging position. So, the discussion really focuses on, I think, the quality of the analysis that we do to demonstrate that the reserve – that the – sorry the price increases are truly needed. And with this business, it's important to do that early on, because otherwise the price increases for the customer get substantially higher and it's actually a bigger problem for the consumers to be able to absorb those price increases.

What's evolved as well as is the regulators are looking at this. They look at health insurance business, and it's typical that you might see a 10% or 15% increase in insurance costs there. So, there – that's part of why they're capping increases in any one year they want to mitigate the very substantial price increases that can occur if they get built up over time.

I would say that there is no industry solution at this stage to the problem. I think there's certainly a lot of time and intellectual capital being put into thinking about those types of things, but there is nothing that I would point to you today.

Roy Gori
President & Chief Executive, Manulife Financial Corp.

A

I'll just add that whilst clearly some of these conversations with regulators are challenging for the obvious reasons, at the same time there is a constructive dialog that's taking place and regulators are seeing both sides of the equation, they're realizing that it's important for them to have that industry that actually is constructively engaged in finding solutions for customers not just today, but for the long run. So, I think the conversation is constructive.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Thanks. Paul Holden, CIBC. So you highlighted – excuse me, on the U.S. VA business that you're not getting any capital relief or credit for your hedging positions, which seems like an archaic position to me. One of your peers last week at their Investor Day suggested that they might start getting capital relief on hedging for their Canadian seg fund business. So, wondering if you're having any ongoing dialog or what the prospect is of you actually getting capital relief on your hedging program? And if you did what kind of benefit might that equate to?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Its Steve here, so Naveed referred to no direct credit, there are some credits related to long and short equity positions that accrued at the total company. In terms of future benefit for hedging, when the LICAT came in this year, the seg fund rules did not change, they are anticipated to change with the adoption of IFRS 17 and it's possible that – and OFSI is in the room, Steve Manley is here, I'll point that out. It is a discussion that we have with the regulator around credit for hedging, I think it's too early to say exactly what that capital regime is going to be under the new LICAT when it changes. We are heavily engaged leading in the industry group that's working on this, so we will continue to have lots of input.

Gary Chapman
Managing Director, Guardian Capital LP

Q

Hi. Gary Chapman, Guardian Capital. In the long-term care, in the non-lifetime benefits, can you talk about how that's capped either by time or by amounts and how that might compare to the peers that you listed on page 6?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Yeah. Hi. The appendix on the slides has sort of the average, sort of benefit period, within the block by generation and the total for non-lifetime benefits, the average benefit period is 4.4 years, so that's the composition. Not sure, we have a great benchmark of that versus peers.

Gary Chapman
Managing Director, Guardian Capital LP

Q

Okay. Thank you.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

This is Alex Scott from Goldman Sachs. I had a question just in terms of earnings from long-term care on IFRS. I know you're not specifically disclosing the amount, but could you give us a feel for when we look at this appendix 1 here, are you making money across all of these blocks on IFRS basis, are there some where there's negative earnings and some where there's positive earnings, is there any way to think about the profitability of the various segments that you outlined here?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

So, when we true-up IFRS reserves from each assumption review what happens is, it is a reset and Naveed referred to this so the PfADs that we hold at CAD 10.5 billion, and the underlying best estimate reserves are trued up. So, then, the future earnings assuming that the claims experienced is in line with expectations, the earnings is effectively the release of the PfAD into income, so there would be future income generated from each of these blocks, assuming that the experience holds up.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. That's helpful. And maybe one on variable annuities, you mentioned the hedge credit and the LICAT sensitivity associated with that, so is that something that would motivate you to look for maybe, you know, inorganic transactional type solutions? Or is the anticipation of maybe the LICAT changing to better reflect hedge cost something that you'll wait to get clarity on before you'll make those types of decisions?

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Yeah, let me take that one. So, I mean, as you've seen variable annuity transactions in the marketplace, so clearly there's a market for the risk. Now those transactions have been legal entity sales. As we've talked about, our variable annuity business is a sort of housed in the same legal entities, all the other businesses including new business. So, those sorts of transactions are available and so we had discussions, but that would have to be through our reinsurance agreement. So, a reinsurance agreement would involve counterparty risk. So it's a question of sort of comparing for this contingent capital issue versus the counterparty risk and whether we can work it through. So, I would say, we're looking at those transaction opportunities, but it's a bit more complicate for us, because it is counterparty issue.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

The one other thing I'd add on variable annuities, really, I think in contrast to LTC where there's a lot of concern about what the future claims experience development will be. On variable annuities, the range of outcomes, remember this...[unavailable webcast portion]…

Naveed Irshad
Head, North America Legacy Business, Manulife Financial Corp.

A

Are their similar issues on our side? Is the profile of the business similar? What is it specifically that's happened there? Could it happen on our side? Now, let's say for the most part we've addressed a lot of those issues. I've talked about our block not necessarily having as risky characteristics as well. So, generally, we feel good. I mean, Phil, Steve, if you want to add.

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Yeah. You know, I think, what clearly the feedback that we've received since those big news items is that more information on long-term care was – there was a real thirst for that, which we believe we've satisfied today. What I really try to highlight is we've managed this business well given the challenges. We've been early in terms of price increases. We've strengthened our claims costs. I was getting questions obviously, GE strengthened reserves by USD $9 billion pre-tax or you can have the same issue. Well we've pointed out today that we strengthened our claims costs by close to $11 billion. We've been very successful at getting price increases. We are incredibly focused on managing the expenses and managing the claims costs and redoubling our efforts on reducing the growth in reserves and capital on this business through a lot of the initiatives that Naveed's team will lead.

And, while certainly we can't tell you what the future will hold, but we can tell you is that we will continue to focus our efforts on managing this business as well as we can, and we think we've been doing a good job.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Yeah. I'd just add, obviously there's been a lot of noise in the market certainly from the beginning of this year, and our response to that Darko is threefold. Firstly, we need to be more transparent because the assumption is that all businesses are equal and that's clearly not the case. So, we've put a lot more effort in today's disclosure to illustrate the differences; A, in reserving and B, in terms of the quality of the books. So, greater transparencies obviously one part of the solution to some of the noise and the impact from what we've seen and heard in the market. The second piece is a greater degree of clarity in terms of our game plan on how we're going to be tackling these businesses with a clear target on what our ambition is, and again, we went hopefully a long way towards dealing with that through today's meeting.

And then, finally, we need to demonstrate execution success. So, we've got some good wins today, but we don't think that journey ends through the execution of what we've achieved so far, but rather we continuously are able to demonstrate quarter-in, quarter-out that we're executing and we've got clear proof points that the journey that we're going on is one that we can actually execute against in the short medium-term as well as in the long-term. Again 12 months, 18 months from now when you've clearly seen that we've been executing against the game plan that we've articulated today hopefully there will be greater confidence in the story that we're telling.

Darko Mihelic
Analyst, RBC Dominion Securities, Inc.

Q

And just to be clear there has been no regulatory blowback towards you on long-term care, and then, specifically to my question on 2019 triennial review as a result of what we've seen, has it woken you up to something that you really have to pay a lot of attention to as you go into 2019?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

Thanks, Darko. I didn't mean – I forgot to answer the second part of your question there, too early to say. The increased focus from, you know, investors on LTC, and you know, our ramp up of scrutiny I wouldn't say that there is anything that we've seen and I wouldn't give any indication at this stage on 2019 nothing to note there.

Darko Mihelic
Analyst, RBC Dominion Securities, Inc.

Q

Okay. Thank you.

Robert Veloso
Head, Investor Relations, Manulife Financial Corp.

A

We'll take one last question.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

Hi. It's Meny Grauman from Cormark. Just referring to slide 8 here, you show a reserve strengthening over the past 10 years. The question is – is it reasonable to assume that if we look out over the next 10 years that that number would be a lot smaller. Can you make that kind of statement and then related you show that the offset from price increases and it's about 65% of the reserve strengthening over the past 10 years, can you just comment on that proportion of going forward, do you expect that to be more or less the same what's reasonable to assume there?

Steven Finch
Chief Actuary, Manulife Financial Corp.

A

So what I can tell you on what's behind the reserve strengthening is this is a very long-term business. People buy the product in their 50s late – mid to late 50s. Claims really only develop once people get to over age 80, really around 80 years to 85 years and then even older than 85 years. So, what we've seen in the last couple of reviews is significantly more credible experience on which we can base our assumption, so that's been all the credible experience that we have has been factored in. What I can't do is predict what the future will hold. We will continue to carefully monitor and evaluate all the available experience and if experience were to deteriorate and we anticipate that it will that would continue, we would be filing for more rate increases. We would just re-emphasize that we believe that the rate increases that we have filed for are fully supportable, fully justified and we do expect to achieve them over time. We recognize that it will take time.

A

Robert Veloso
Head, Investor Relations, Manulife Financial Corp.

Right, thanks for the questions. Thank you.

[Break] (02:39:38)

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.

If I could ask everyone to please take a seat. We'll get started shortly.

Welcome back everyone. Our next speaker this after or rather this morning is Mike Doughty, General Manager of Canada; and he will deliver a presentation on how we are winning in our home market.

Following Mike's presentation, we'll go straight to a presentation from Marianne Harrison, General Manager of the U.S. who will outline how we're building the next generation of protection of wealth products in the U.S. At that point, we'll have Q&A on both sessions.

With that I'll hand it over to Mike.

Michael Doughty
General Manager, Canada, Manulife Financial Corp.

Thank you, Robert. And good evening or good morning everyone. It's a pleasure to be here to talk to you about the opportunities that we have in our Canadian marketplace. And it's important for us to be competing in our home market. I'm going to talk about a number of topics today, but I'm going to focus on a couple of key messages that I'd like to leave you with. The first is that we have a good business here in Canada that is actually performing very well relative to our peers. Having said that, there's work that we know that we have to do to get better. Naveed and Phil already talked about the importance of managing and optimizing our legacy business and certainly focusing on our expenses, we view that as critical in Canada. But we also know that there are specific things that we can work on to enhance our market franchise in this country.

We want to revitalize our insurance business. I'm going to speak about that. We want to continue to expand our Wealth and Asset Management businesses, which are performing very well. We want to really transform our customer experience and many of you will have seen the announcement we made last week, which is the start of that. So, I'm going to – I'm going to cover that in detail. And then, lastly, we need to transform the team that we have and the skills that we have to enable us to carry out this transformation.

Canada is – I'm going to talk about the market for a second just to provide a bit of context. Canada is a stable market. It's delivering moderate growth, but it's also a market that presents great unmet potential. On the wealth side, you can see here, mutual funds have been performing very well, and all of the projections suggest that that's going to continue into the future. ETFs are also growing steadily off of a relatively small base, but there is an unmet need in the market that doesn't show up in these numbers.

The first is a very large wealth transfer that's going to take place over the next 10 years, estimated at about CAD $750 billion. That's going to transfer to the next generation. The other element and Roy mentioned this earlier, is the retirement gap. The retirement gap stands at around CAD $3 trillion in Canada alone, and that's expected to grow over the next by 2050 to about CAD $13 trillion as people live longer and because of the low saving rates.

Only about 50% of Canadians believe that they're going to be able to maintain their desired standard of living in retirement. And we believe that with the products and services that we're bringing to the market, we can go a long way into tapping into that opportunity.

On the insurance side on the right-hand slide, you'll see actually a quite similar story. The growth rate has been a little bit lower, but it – and quite modest over time, but again there's a big unmet need in Canada. About 12 million Canadian households don't own any life insurance and even for those that do, about 45% of Canadians with active coverage don't have enough of it.

So that creates about a CAD $1 trillion protection gap in this country, and again, we think that, I am going to talk about, we think the industry can do a much better job of closing that protection gap by offering a life insurance product that is more engaging to own and creating a purchase process that makes it much easier for customers to get that product into their hands when they recognize that they need it.

So, talking about Manulife, we are a significant player in this favorable market. We already serve about one in three Canadian adults. We have strong core earnings CAD 1.5 billion in 2017 representing about a third of the company's total core earnings. We've seen solid growth in our assets under management, that's been fueled both by the Standard Life acquisitions, but also solid WAM growth flows across all of our businesses and overall our insurance sales remain very strong, driven primarily by the success that we've had in group benefits. Compared to our peers, you can see here that our earnings are larger than our peer companies here in Canada. They've also been growing faster than our peer companies in Canada.

Now, these numbers got a significant boost with the acquisition of Standard Life, but even if you back that out, our 12% growth over this time period is exceeding our competition. We have a number of kind of overarching strengths that we can draw on, not least of which is the fact that we serve 8 million existing customers and we have probably the broadest suite of products and solutions of any financial institution. Because we cover the full range of protection across health and wealth right into savings and lending. Versus our life insurance competitors, we think that our strong wealth manufacturing capability and our ability to offer banking solutions really sets us apart. We also think that our strong digital and direct offerings like Vitality and CoverMe serve as a competitive advantage.

When you look at the wealth and asset managers, our holistic wellness and insurance value proposition compares very favorably to what they can provide to consumers. And our market leading presence in the group benefits and group retirement's space provides us with access to millions of Canadian households where we believe we can increase our share of wallet. So, there's lots going right in this business, but there are some places that we know we absolutely need to focus on.

And the first two we've talked at length about today. Our legacy book, well, it contributes a lot of earnings, its capital intensive and is dragging down our ROE and we're very committed to focusing on that. Our expenses have been growing at a rate that is outstripping our revenue growth. Our expenses got a big jump up when we acquired Standard Life and we started investing in our transformation. Since that time, they've actually stabilized, but we know that there's lots more we have to do there.

From a new business perspective, we've done a very good job of accelerating the growth of some of our highest potential businesses, our high margin capital light WAM businesses have been growing very well as I said, both inorganically and organically with solid track record of positive net flows across all those businesses. In our group business, driven by particularly success in the large end of the market, we've had solid growth. But if you look on the right hand side of the slide, our individual insurance sales have remained flat over this time period, and have actually been – as Naveed has already focused on portfolio optimization and Phil has talked about expense efficiency. I guess all I'll say about those ones is that those are absolutely critical to the Canadian strategy going forward and we are absolutely committed to moving the needle significantly against both of those and you've seen we've already started to do that.

For the balance of my presentation, I'm going to cover the other three, and I'm going to talk specifically about revitalizing our insurance franchise, expanding our market leading WAM business, leveraging our group platform and Manulife Bank to deepen existing client relationships. We want to enhance our client experience through a real transformation where we go to a digital platform and we reorient around these life moments that I talked about. And then, finally, I'm going to just talk about making sure that we have the teams with the skills that we need to be able to succeed in the future.

So let's start with insurance. Earlier this week actually, we reintroduced a participating whole life product into the Canadian marketplace. PAR represents nearly 50% of all the life insurance sold in this country. And we were missing out on a big part of the market. PAR, Tom to answer your question, does actually have an attractive ROE on its own because of the pass through nature of it and the relatively favorable LICAT treatment. But it does a couple of other very important things to us. The first is two-thirds of advisors in Canada, although their licensed is with pretty much every carrier provide – advised all advisors provide two-thirds of their business to their lead carrier. They get to know them, their products, their technology, their processes and that's where the bulk of their business goes. Without having that sort of core anchor permanent product, we ran the risk that we're going to lose some of those peripheral sales.

The second thing is that by growing our PAR business, we are going to get significant fixed expense coverage that is going to lift the profitability of our entire new business portfolio. So, this is a very important move for us and we're quite hopeful that it's going to drive solid returns for our franchise.

The other part of insurance that we're focused on is really maximizing the Vitality opportunity, which is unique to Manulife in Canada were the exclusive partner with Vitality. This is an enormous opportunity for us to reinvent what it means to own life insurance and we've had a solid take up rate, about 40% of our customers who are buying Vitality eligible products are choosing to have that feature on their products. Vitality provides dynamic pricing, but it also offers incentives and rewards to get people to live and engage in a healthy lifestyle.

And what's important is that in addition to attracting new customers, it significantly improves the interactions that we have with them. And we go from having one or two interactions a year where we send them a statement or a bill to up to now 27 times a month that those customers are engaging with our program. What that's going to translate to over time is far more loyalty and the opportunity to increase share of wallet. And we've already seen that our Vitaliy members, 48% of them hold more than one of our products compared to just 28% for our other life insurance customers. We expect this to continue. So, we're focused hard on aggressively marketing this program and expanding it, and over the past six months, we added the Vitality active rewards with Apple Watch where you can actually earn an Apple Watch just by owning our product, engaging in the program. We've had significant increase as we associate Manulife and our products with that iconic brand.

We're also continuing to expand the products that – the products that Vitality is available on. Earlier this year we expanded it to entire term portfolio. And you can look to us to continue to integrate it into our portfolio going forward.

The final thing that we need to do from an insurance perspective is we need to simplify the purchase process. And this is going to go a long way to helping and close that protection gap. So, we're focused on digitizing the buying experience, using AI and data analytics to streamline requirements and speed up the underwriting process. We recently launched the first AI decision algorithm in Canada, and that's speeding up decisions, our quick issue term which we instituted in 2016 has eliminated the need for fluids on 80% of our business and has really sped up underwriting. So, we're going to continue to invest in this going forward to make it easier for customers that want insurance to be able to get it in their hands.

From a wealth management perspective, we have tremendous traction. In early 2018, we reopened our popular monthly high income fund. We're really focused on leveraging the capabilities, the core capabilities that we have as a life insurer to set us apart in the wealth management space. And a great example of this is the goals-based investing tool that we're working on, it's going to launch towards the end of this year, which for the first time is going to bring LDI type expertise to the retail market. We're also making sure that we're paying attention to the trends towards passive. We continue to expand our ETF offering. We just added two new smart beta ETFs in November. So, we now have a total of six. And those assets are growing rapidly to about CAD 300 million year to-date.

Finally, on Wealth Management on the retail side, we want to continue to strengthen our distribution footprint and franchise. We want to continue to build a solid foundation and deeper product penetration with the big six banks, with the MGAs, we're focused on increasing adoption of our online tools and really educating them about the value proposition that we bring uniquely to the market, and we're continuing to invest in our portal technology, so we can extend our reach electronically.

On the group side, we're going to continue to capture sales in the mid-to-large case market where we've been very successful recently. We're very focused on the rollover opportunity. In 2018, we're off to a very solid start with CAD $524 million in assets rolling over in the first quarter. And of course in that business, you've got to focus on sponsor retention. We believe we can continue to improve that off of our very solid 97.5% persistency rate. So that's going to be our focus there. I mentioned the need to have a deeper relationship with our existing clients and the opportunity we think that presents to us. And we're really going after this in three different ways.

The first is tapping into the full potential of our 4 million group members, and we're doing this with a strategy that internally we're calling in up and over. And In, is basically making sure that we have a personalized intuitive onboarding system that gets people into the Manulife Plan and makes them aware of all the benefits that it has to offer. Up is about delivering a first-class experiencing and using data and analytics to provide personalized nudges along the way, so that they can take advantage of the features of their plan. And Over is about retaining those customers as they leave their group plans. A great example is that rollover business, where we've now in 2017 we've rolled over CAD $2.1 billion in assets from people that were either exiting or retiring their group retirement plans. We think there's a similar opportunity in group benefits, where people leaving their employer or retiring can continue to take advantage of similar products and services by purchasing them directly from Manulife.

The other area we're looking at is Manulife Bank. Manulife Bank is performing very well on its own, but we believe it's a key differentiator for us and we know that by having this more holistic financial offering, we drive greater customer loyalty. 45% of our Manulife bank customers own more than one of our products and we'd like to see that those products and services, which are unique in the banking space, deployed far more widely across our entire customer base.

So, we're working hard at accelerating that. The other thing that the bank does for us, it's a terrific way for us to attract clients to Manulife that we may not necessarily get. Manulife bank has added 20,000 new customers this year. About 20% of them have been acquired direct, but most interestingly, about 30% of our new customers are under the age of 35, which historically has been a market segment that's growing in importance that we – we, as an industry, frankly, have had a hard time attracting. And then, the final area that we're interested in is really making sure that we have an advice solution for our existing clients. And we want that to be an omni-channel advice system that can meet the needs of all the market segments, and I'll give you an example.

If you're now a member of the group retirement plan, just starting out, figuring out what you want to save, we've built a tool called Retirement Redefined, which is entirely digital, you can do it on your mobile phone, your laptop, and it helps you imagine your retirement and start taking the steps today to achieve that. As your needs evolve, we have a team of face-to-face plan right advisors that you can call on and we now have 26 of them serving – working with 400 of our sponsors, serving 9,000 of our customers, and they're providing a full range, they're fully licensed, providing a full range of financial advice across the entire spectrum. Then, for the higher end people, the owners of the businesses, et cetera, we have Manulife Private Wealth, which is bringing together investment counselors, private bankers, tax and estate planners to really helped affluent customers meet their goals. So, we want to continue to build that out as we deepen our existing client relationships.

Last week, we announced a major step forward in our transformation of our customer experience. And we believe this is not only going to have a significant impact on our Net Promoter Scores and a more engaging customer experience, but also drive significant expense efficiency for our business.

We are going to be focusing on the 20% of the – the 20% of the interactions that we have with customers that are related to what we call life moments. And think of these as the moments that really matter and where you really want your financial institution to be there and make it simple for you.

Birth of a child, retirement, first home purchase, the death of a loved one, at those instances, we want to provide great white glove treatment, concierge service. But think of the other 80%, just the routine transactions. For those we want them to be simple and we want to digitize them, we want to take the effort out of the system for the customer. So, that it's inexpensive, fast and instant.

A great example of this is in our group benefits business, where over the past 18 months, we have reduced paper claims by 42%. And we believe that these announcements that we made last week are going to go a long way in getting us to that goal.

Finally, I just want to talk about the fact that we're not going to achieve this transformation if we don't have the people with the skills to be able to deliver what we need going forward. And we're really focused in two ways. The first is with our existing team, we're focused on rescaling and retraining them, to have the skills necessary to work in this new environment. We're revitalizing our workspace to be more open and collaborative. By the end of this year, we'll have put about 2,000 of our employees through agile and innovation and design thinking training to make them more competitive for the future.

But with all the reskilling that we're doing, we also know that we're going to need new skills and we're aggressively hiring, and some of the areas are going to help drive this transformation to digital. We're looking for people across the full software development stack, user interface, user experience design, customer journey mapping, digital marketing.

So far, this year, we've hired about 100 people in this space and we expect to probably double that by the end of the year. We want to become a destination for some of this tech – top tech talent, because we know that we need that workforce for us to be able to compete going forward.

So, I'm going to wrap up. In summary, we've got a good business. It's been performing well relative to our peers, but there are certainly areas that we need to improve, not least of which is our focus on optimizing that in-force legacy book, which Naveed is driving on our behalf, and making sure that we're managing aggressively our expenses to be competitive. But we also have a solid plan to revitalize our insurance business; to continue to grow our Wealth and Asset Management business; to transform the customer experience, so we have a deeper relationship with our clients; and to make sure that we have the workforce we need with the skills and talent to make us competitive in the future. Thank you.

And with that, I'm going to turn it over to Marianne, the GM of our U.S. business to talk about it.

Marianne Harrison

General Manager U.S., Manulife Financial Corp.

Thanks, Mike. You're actually going to see a lot of similarities when I'm doing my presentation of the U.S. and Canada, and I guess that's one advantage of being a part of this global organization, and similar to what Roy was talking about around the culture and making sure that we leverage one another in order to come up with the best products and services that we can.

In terms of some of the key messages that I want to talk about today, we operate in a number of niche product offerings in the United States going after fairly specific target markets that we want to operate within. Certainly, since the 2008 crisis, as you've seen, there has been a lot of focus on de-risking our businesses. We've gotten out of the long-term care business, we're out of the variable and fixed annuity business, and we're out of the life long- term guarantee business as well. So, we spent a lot of time and focus in terms of that de-risking. And as you heard today, there's a lot more yet to be done.

But at the same time, we've really been leveraging our growth businesses and our Wealth and Asset Management side and continuing to grow those businesses quite strongly through that time period. And we're continuing to look for the – to the future to really drive a much better engagement with our customers, whether that's offering sort of digital advice at the front end or whether it's digitizing some of our back end processes to make it easier for consumers to do business with us.

Similar to Mike, here's – gives you a little bit of an idea in terms of what the landscape looks like in the United States. So, on the left-hand side you can see, in terms of asset management, the U.S. is number one from a world perspective in terms of the marketplace. And there really is a lot of opportunity here. You heard Roy talk about the retirement gap, and in the United States it's $28 trillion right now. We are expecting to see the market grow at about $9 trillion dollars between now and 2021. So, there's a lot of growth that's still happening in the United States and the intergenerational wealth transfer is going to put a lot of this money into movement as well. So, it really creates a number of opportunities for us in the U.S. If you'd look at the right-hand side and you look at the insurance side of the market, Asia is larger on an absolute basis, but when you look at it market by market, there is no market in the world that is as large as the U.S. marketplace.

And Roy had talked about it earlier as well, when you start to look at how many people don't have any insurance in the U.S., it's about 40% of the population that has no insurance and 20% of those that do have insurance are actually underinsured. So, really, on the insurance side, the opportunity is not even what's on this screen. It really is that the protection gap that exists out there which is about $20 trillion right now. So, for us in the U.S., there is a huge opportunity. Yes, there's a lot of competition in the U.S. marketplace, but the market is so significant that there really are a lot of different places that we can play in.

Despite a lot of the de-risking that's been going on, our earnings results have actually been pretty solid. You'll see that we have a CAGR of 7% between 2014 and 2017, and our AUM has seen a lot of strength with a CAGR of 12%, and our gross flows at 15%. Our net flows have actually been ahead of where the industry has been as well. So, we've been very pleased with what we've been doing on the Wealth and Asset Management side.

We also have launched an ETF block of business as well, and it has surpassed the $1 billion mark as well in terms of assets in the ETF portfolio. So, we really are focusing on a breadth of product offerings that we have on the wealth management side. When you look at the insurance side, you know it has remained relatively flat with a 2% CAGR, but if you refer back to the previous page, where we talked about the industry, between 2012 and 2016, the growth rate in the industry was actually 1%. So, we're actually slightly ahead of where we are. But, in addition to that, if you look at the mix of the business that we're selling, it is very, very different than what we used to sell. 50% of our new business historically has been from long-term care or life products with very heavy guarantees. If you start to look at what we're selling today, 99% of the business that we're selling is either adjustable or it's term. So, the profile has really changed over the years.

As I commented earlier, we're actually in a number of niche – have a number of niche positions in the marketplace. If you look at us on the insurance side, you know we're number three in the Universal Life. If you look at insurance more broadly, we're actually in Tier 2 from a market share perspective, but that's because we're choosing not to play in certain areas. We're not in Par, we're not in the long-term guaranteed life insurance business, so those are areas that we've consciously decided not to play in where the risks are a lot higher than what our risk appetite would be or else the return is a lot lower than what we would like to focus on.

If you move over to the Retirement business, we have about $165 billion of AUMA in the Retirement business and we have number one positioning in the small plan marketplace. We've held that position for quite some time and we have a lot of strength there. But we also did the acquisition of New York Life back in 2015, which has gotten us into the mid- and the larger-tier market as well and so we're now competing more broadly across the marketplace.

And then, when you start to look at where we are from a mutual funds perspective, our managed architecture platform really uses the best in – best of the best in terms of asset managers to drive superior performance across our product offerings.

This slide is more directionally than anything else, I think people will find this somewhat interesting. And really, the point I'm trying to say in this slide is, if you look at our block of business today, and again this is directionally, and you look at how the earnings are going to run-off in terms of some of our in-force business that we have there, there is a steady stream of earnings that's coming off this block of business, and will be coming off this block for the foreseeable future. There's good things and bad things about that.

On the negative side, as Naveed had talked about, this does have a drag on our ROE, because as he mentioned, the ROE on some of our legacy block is 9%. So, it does drag down the ROE. But if you look at it on the positive side, as I said, it does have a steady stream of earnings and we can reinvest those earnings in other places within the organization of Manulife that – actually grow our businesses, as well, it actually really increases our remittance capability as we look forward to the future. And as I've said, this is more directionally, more than anything else, to really drive across the point that there really is a long stream of earnings that's coming off the blocks of businesses that we sell today. Of course, this takes – doesn't take into account any new business that we would be writing over those years as well.

In terms of competitive strengths, we've got a number of spots that we are very competitive in the United States. One in particular is our distribution. We have a number of seasoned wholesalers in the U.S. who are consistently getting high marks from advisors in terms of the quality of the distribution that we have. We also are getting a lot of marks for our innovative product offerings that we have, and Vitality being the number one. Really changing up how people think about insurance and encouraging people to live long and healthy lives, as they're thinking about purchasing their insurance program. So, really being innovative in terms of the product side.

We have a highly lucrative business in our high net worth insurance business, it's really ultrahigh net worth, which has been a good business and a strong differentiator for us in the previous years. And our sub-advisory model really allows us to have the best of the best and a number of exclusive relationships with institutional managers like Wellington and Boston Partners just to name a couple of them. As well, we have Manulife Asset Management, where we can leverage some of their capabilities around fixed income and alternative strategy solutions as well.

Our legacy business, certainly in the U.S., does get distorted – does distort our earnings for sure and compared to our go-forward businesses. And the chart on the left gives you a demonstration of that, where legacy really is about 70% of our earnings on our block of business and the go-forward businesses that we're actively selling represents about 30%. We do expect this trend to flip and start towards flipping as we continue to move out. Over the next five years, we hope to get that more balanced in terms of the split between the legacy business versus the new business. And that's even despite some of the things that Naveed is talking about and trying to do.

On the right-hand side of the page, you can see where we've had some challenges with respect to expenses. The gray part on the 2017 is the inclusion of Manulife Asset Management expenses, which we did not restate. And so, that does distort the expense picture a little bit, but even without that, our CAGR is a 6% compound annual growth rate that we're seeing on the expenses and our earnings were growing, as you saw earlier, at a rate of 7%. So, we're still not happy in terms of some of the things that we we're seeing on that side.

Some of the areas that we're focusing on is on the insurance and really trying to rightsize that business from an expense perspective. We're also very focused on our pension business. With the acquisition of New York Life, we've really been focusing on trying to get the technology where it needs to be, but we do need to make sure that we continue to focus on implementing lean practices and more end-to-end processing as we move through. And the global pensions that Paul is heading up is actually going to help us as an organization as we continue to see more scale coming out of the global initiatives that will happen as we move forward.

As we continue to execute on our plans, our – we continue to accelerate the growth that we're seeing on our Wealth and Asset Management businesses. As you can see, those businesses have a 23% compound annual growth rate in terms of AUMA and that's both organic and inorganic because we have done the acquisition of New York Life as well.

When you look on the right-hand side, all the de-risking that we have been doing on the insurance block of the business has had an impact on the new business value. And so, new business value has gone down as those riskier product offerings are no longer there and therefore the profitability hasn't been quite as strong. We're not saying that that's acceptable we think that there's opportunities for us to improve that. Part of that are the expense initiatives that we're focused on will really help in terms of getting the profitability where it needs to be, plus there's other things that I'm going to talk about a little bit later as well that will help along that side.

In terms of our customers, similar to Canada, it's no secret in our insurance industry that we have not exactly been delivering memorable customer experiences. I think that's something that's been around for many, many years. And in the U.S., it's no different than it is in Canada where we are trying to deal with some of those challenges. In the U.S. marketplace, you can see that it's about 1% NPS and we're significantly lagging behind the P&C industry as well as the banking industry.

In terms of us – specifically in the U.S. in terms of the insurance business, in 2016 when we look at our LIMRA NPS work that gets done, we're actually at negative 1% in 2016 which we've managed to move up to 33% currently. So we are moving in the right direction, but we still have a long way to go. And a lot of the things that we're going to do around focusing on the end customer and getting more digitization and having more end-to-end processing which will make a very big difference in the customer experience will really continue to help that. And I think Mike addressed it quite nicely that those people that are promoters are much more profitable than the detractors. And so, we will continue to focus on that as we move forward.

When I look forward in terms of the future trends, the financial services industry is evolving pretty quickly and we're starting to see a lot of trends that are coming out. And on the page here, you'll see in the middle of the page about six trends that we're quite focused on. One and you've heard it more than from just me, the customers are demanding more simplicity. They want things to be easier to understand, and they are very focused on the price points as well, so they are looking for good value that they're getting at the same time.

The role of the advisor is something that we spend a lot of time looking at. We don't believe the role of the advisor is going away. Consumers like dealing with advisors, but we do believe that it's going to evolve over time, and there is – technology is going to play definitely a bigger role when you start to look at the role that the advisor plays as we move forward.

Technology, from an industry perspective, is really starting to move. We're starting to see a lot more happen in terms of both distribution as well as some of the platforms that we operate on. And that has continued to – going to continue to move at a fairly rapid pace as we move forward.

In terms of the active management model, we think that that's a very strong model, and we believe that it's going to continue to be there, but we also think that there's going to be some hollowing out of the middle of that, and that it's all going to be around performance as well as costs, are going to be the two big drivers in terms of the active side.

Fee compressions, it's here to stay. We've seen it over the last many years, we continue to see it, and we don't expect that that's going away. There's going to constantly be a lot of pressure on us in terms of the fee side.

And we also believe that whoever owns those customer relationships is going to win. And you don't necessarily – when we say own it, it doesn't mean that you can't work through an independent third-party advisor. But it really is trying to increase your touch points with the customers.

And so, all six of those trends have really informed our strategy as you can see here. Really, it's going to be about customer relationships, it's going to be about simplicity and digitization, it's omni-channel approach so that people can deal with us how they want to deal with us and a lot of that is on the digital side as well, and it's about providing holistic services and solutions to consumers.

Our bold ambition is really – here, to keep it in it's very simplest form on this one-pager. On the insurance side of the business, we are going hard at the behavioral insurance, which you've heard a lot being discussed today. At the same time, we're really trying to transform our brokerage business which really is our business that we're doing through our independent third parties, which 95% of our business is done through independent third parties. So, we want to continue to focus on turning that brokerage business to where we want it to be from a profitability perspective.

On the investments side, we're going to continue to drive there our mutual fund businesses and expand our channel access and develop innovative new products on the mutual fund portfolio. And then in the pensions business, it's going to be about maintaining our leadership in the small market, but also growing our leadership in the mid to large market and really monetizing our participants and making sure that we're deriving more lifetime value from those participant relationships. And then in the center, we sort of bring it all together in our digital advice offering, it really is an opportunity for us to bring our product offerings altogether and offer a digital solution to consumers.

Similar to Mike, our priorities are very much focused around the company's five global priorities that we see. I'm not going to cover the two on the left on the portfolio optimization and expense efficiency because Naveed and Phil have actually covered those in quite a bit of detail. I'm going to focus, for the remaining of my presentation, on the right-hand side and it's really going to be on our strategic priorities that we're focused on.

And I'll start with insurance, very similar story to Mike, to be quite honest, in terms of some of the things that we're trying to do. We're trying to optimize our product portfolio. We are very focused on expenses and continuing to drive the expenses so that we are as efficient as we possibly can be. We are really focused on getting down to the producer level. A lot of times when we're introducing product offerings, we do it generally at the general agent at the top of the house and they're actually delivering our messages through. We're now going – being much more focused in how we attack people from a wholesaler perspective and we're going right into the producers and explaining the story. And that's particularly important when you're dealing with something like Vitality and the behavioural insurance offering that we have because it is different, it is unique in the marketplace. And so, that's an opportunity for us to get in and really talk to the producers and make sure that they understand the offering that we have.

And part of what we're trying to do as well is making it easier for people to do business with us. Very similar to Mike, the touchless, seamless service that we want to be able to offer to consumers is going to make it a lot easier for them to do business with us whether that's underwriting or just the ongoing end-to-end processing of our product offerings that we have. Vitality, we've talked about, will increase the touch points and has increased the touch points that we have with consumers and it is really an opportunity for us to develop those relationships even more so than what we have seen in the past. And consumers really like the product. As Roy was talking about earlier, 8.5 times out of 10, when you put up our Vitality product to a regular traditional insurance product, they want our product.

And now that we've launched the Apple Watch, which we did at the end of last year, we're seeing that even more so really attracting consumers and they really are interested in the product offering and what we have to offer there. We just recently launched a direct-to-consumer offering that we did two weeks ago. So, we're going to continue to focus on that business and try and drive up more scale on there. There really is a significant opportunity, about 7% of our sales today are really on the direct side, and we're trying to get more focused on that because there's an opportunity to really grow that, not just ourselves, but many of our competitors are very focused on the opportunity on the DTC side.

And then, establishing strategic partnerships, I talked about the one that we established with Apple. We've also established a partnership with the American Diabetes Association in the United States and part of doing that partnership was so that people could understand, when it comes to Vitality, it's not just about those people that are super fit, that it really is for people that are not quite as healthy as well and that there is a lot of advantages to people being more physically active and living a longer life. And so, that actual partnership has actually helped us in terms of making people get a better understanding of Vitality's app. We're actually seeing a lot of take up, by the way, on the Vitality, especially since the Apple launch. Our applications have doubled versus where they were a year ago, so we're continuing to see more traction happening on the Vitality offering.

When I look at the mutual funds side of the business, we've seen strong growth and we're continuing to build on our product offerings and leveraging our unique capabilities that we have in the general account as well. Now, we're offering investors comprehensive solutions whether it's across active, passive, alternative-based strategies both domestically and internationally. We've increased our AUM about 40%, since 2014 and we've surpassed our $100 billion mark in AUM in the fourth quarter of 2017. We're going to continue to expand our channels that we're selling through. We have new product offerings like privates and retirement platforms, as well as separately managed accounts. And we're expanding distribution in wirehouses and we're really trying to use data analytics to help our wholesalers focus on who they should be going – who should they should be targeting and what product offerings they should target with them.

In looking at our Retirement business, as Roy talked about and I did as well, there is a significant retirement gap here. There is an opportunity for us. We have access to 3 million customers in our pensions business in the United States. And part of what we're trying to do is optimize our platform and continue to gain efficiencies as we move forward, and delivering our model to make it a better experience, whether it's onboarding the customer and trying to make sure that it's easy for them to onboard. And just trying to see how we can offer them other offerings around in-plan advice to help them with those very difficult decisions that they're trying to make, and driving revenues even outside of the plan through consolidation of assets and cross-sell opportunities with our Vitality product. We're also building out the digital advice experience in our Retirement plan and we've been working with NextCapital since 2017 to actually build out that that strategic advice, in-plan advice for our members.

The other area that we're very focused on is holistic financial solutions, making sure that we're meeting the holistic needs of consumers and trying to bring it all together into a digital environment for them. We've been trying to do that as a more cost-effective tool for consumers and just to be able to meet their holistic financial needs. In the U.S. there's a $10 trillion digital advice opportunity amongst the mass affluent, the mass market and the millennials. So, we think it is a significant place that we can play as well and we started to build out some of those product offerings. We have our DTC on the Vitality side. We've introduced Twine, which is an opportunity for couples to save for the future and have specific goals that they're targeting. That one was just launched actually in November of last year and it's been on App of the Day, new apps that we love "New Apps That We Love", and it's got a rating of 4.2 out of 5 in the App Store. So, it's actually been quite successful so far and we're going to continue to build that ecosystem and make sure that we can deliver those holistic experiences digitally as well.

And finally, and probably the most important, is our employees. You heard all of us talking about the importance of them. They are our biggest asset that we have and it is absolutely critical that we are engaging them and that we have a high performing team. Similar to what Mike was talking about, we're very focused in the U.S. in terms of making sure that we have the skill sets that we need as well for the future and re-training our people to make sure that they are able to deliver on the strategy that we have. We're focusing on sort of five key areas, that you can see there on the slide, that are going to be critical for us for engaging our employees as we continue to move forward.

The other thing that we're doing is really focused on building out our diversity and inclusion and this is an area that's very important to me personally and to me, it's much more than just gender. It's going beyond the gender and looking at race, religion, sexual orientation, disabilities, and really focusing on being a much more diverse organization. We hired a Head of Diversity and Inclusion at the beginning of this year and she's very focused on making sure that we are operating at the level that we feel we should be operating when it comes to diversity and inclusion and I think there is more work for us to do there. I have been very focused on my own personal management team. At this point, I've got about 40% diversity in my management team around gender, race and disability. So, it's something that we are all focusing on within the U.S. division around diversity and inclusion.

And finally, the way we work is going to be very important to us. It's part of the reasons why we're actually bringing our two business together – two businesses together in the United States and consolidating into the Back Bay, because we want to bring people together and create that culture where people are collaborating a lot more, where they can work in more of that agile work environment across the different functions and businesses and break down a lot of the silos that we have. So, we're actually really looking forward to the opportunity of combining our space.

So, in summary, I believe that we're well-positioned in the U.S., there's a lot that we have to do on the legacy businesses and Naveed has been doing a great job in terms of identifying the challenges that we face and we're really focusing on that. But if I even look beyond the legacy business, we have a very strong plan in terms of where we're going. I think a lot of the things that we are doing as we move forward in terms of transitioning our U.S. insurance businesses and really growing our wealth management businesses is going to help us to achieve the success that we're looking for in the future. So, thank you very much.

Roberto Veloso

Head, Investor Relations, Manulife Financial Corp.

Thanks, Marianne. Panel will now open up to questions.

Joining Marianne, Mike, Roy, and the Phil on the panel are Steve Finch, Linda Mantia, our Chief Operating Officer, and Paul Lorentz, our Global Wealth and Asset Management Head. And once again, I'll just remind everyone to please limit yourself to one or two questions and please let us know who you are and where you're from.

QUESTION AND ANSWER SECTION

Dean Highmoor
Director, Investment Research, Mackenzie Investments

Q

Hi there. It's Dean Highmoor from Mackenzie Financial. I have a couple of questions. One, you'd mentioned that there's value in who owns the client. And so, I guess I would ask who do you believe in your organization owns the client, is it Manulife or do you think your agents own these client relationships? And then, just secondly, I heard – we heard a lot today about the opportunity of the upcoming wealth transfer coming in North American society. But based on Mike's comments, you said that you have a kind of a poor penetration or a track record of attracting those under 35 to your products. When their parents pass away, my understanding is that the kids, if we can use that term, generally do not retain their parents' advisor. So, what do you need to do to ensure you keep or attract assets under this transformation versus actually lose them?

Marianne Harrison
General Manager, U.S., Manulife Financial Corp.

A

Why don't I start on the who owns the client and I think it's a really good question. Obviously, when we're moving to more of a direct-to-consumer, we would own the client in that perspective. But I would say it's – certainly, in the advisory world, which today we sell probably 90% of our business through third-party advisors, the advisors actually have a very strong relationship with the client. I don't want to suggest that we would take over that relationship that advisors already have. But it really is our interaction with customers. If you look at, take insurance as an example, if you look historically at us selling an insurance policy, we would sell it today and then we would may be interact with our customers once a year as we talk to them about premiums and then we would never talk to them again, we would talk to their beneficiaries. Vitality changes that entire game for us. We're touching the customers probably 22 times a month on average, so that we are even though owning the client is critical, it's developing that relationship with the client that's even more important and that's what something like Vitality gives us the opportunity to do. So, I would say it's a combination and it really is about driving the relationship.

Paul Lorentz
Head, Global Wealth and Asset Management, Manulife Financial Corp.

A

Maybe I'll just add a comment as it relates to the Retirement plans both in Canada and the U.S. is the participants – and Marianne and Mike spoke to how when they leave a plan or they retire, we try and maintain that relationship and I think once they move to that individual relationship with us either through an in-plan advice or retirement counselor, they become a client of ours essentially and to the extent that relationship is strong, we can bring other solutions to the table which gets out a little bit around the issue around wealth transfer and trying to get to that younger demographic.

I think the other thing and it's kind of weaved in the different components of the strategy is the whole digital platform and part of the reason I think the kids don't want to stay with their parents' advisors is a little bit of an age gap there. But it's also not how they want to interact go-forward and the experience they want, frankly. And so, to the extent we can leverage the digital tools, the interface the platforms, to create an experience for that younger client, but still bring the knowledge and the advice to the table, I think it's where we will be able to capture some of that which we haven't been able to historically.

Josh Shanker
Analyst, Deutsche Bank Securities, Inc. Q

Josh Shanker, Deutsche Bank. You know, Naveed first mentioned and then you have the slide on number 6, where you talked about the 2024 peak in earnings from the legacy block. It's a non-linear path in 2023 to 2024. Could you first talk about the huge surge in earnings and what's behind that? And two, how would this chart look different if we compared core earnings to cash earnings?

Steven Finch
Chief Actuary, Manulife Financial Corp. A

So, I can handle the question regarding earnings, and I'd go back to the point that Marianne made. I think the key takeaways from that chart are that, the earnings on those blocks of business are material. They do grow over time, but then they will persist for a very long time. So, there's a long-term core earnings here. In terms of technically what's happening there, I won't go into too much detail, but it's related to what's coming out of the model. It's related to when asset sales are occurring. So, I wouldn't get too focused on the year by year there. I would think of just being representative of the earnings growth over time and it is meant to be core earnings, so that we would not have investment gains or losses embedded in those earnings.

Josh Shanker
Analyst, Deutsche Bank Securities, Inc. Q

And how do the cash earnings look by comparison?

Steven Finch
Chief Actuary, Manulife Financial Corp. A

So, when you say cash, you mean like pure cash flows in and out, we're still in those businesses, we're still in a position where the premiums coming in, we're setting aside a good portion of that to fund the reserve growth over time.

Josh Shanker
Analyst, Deutsche Bank Securities, Inc. Q

Any idea when the peak cash generation period is for those?

Steven Finch
Chief Actuary, Manulife Financial Corp. A

I probably know little bit more block by block. I mean, in LTC the claims -payments peak a little further out than the reserves peak, don't know offhand for the life and annuities.

Josh Shanker
Analyst, Deutsche Bank Securities, Inc. Q

Thank you.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC Q

Humphrey Lee from Dowling & Partners. A question for Mike or Paul. One of your mutual funds competitor has made a big announcement recently about providing low-cost ETFs. I was just wondering can you comment on the potential risk of Vanguard coming into Canada being more aggressive in how you position yourself against the age-old active to passive trend discussion?

Paul Lorentz
Head, Global Wealth and Asset Management, Manulife Financial Corp.

A

I'll take it. Thanks, Humphrey. I think at the core, what we focus on is, are we delivering value over and above the incremental cost of active management? And that's how we benchmark the capabilities that we plug into all our solutions. And if we're not adding value over that incremental cost, then we likely won't be providing those solutions longer-term. So, that's our overall benchmark.

In terms of our own capabilities, how we achieve that, we look to our private markets business which are highly differentiated, high margin, can't get enough of in terms of the demand from clients. We start moving down to where we have our own capabilities: global fixed income, specialty, equity. And then, we also bring this multi-manager model because we know we're not going to be all things to all people as it comes to asset and active management and we can plug in with the partners whether it's the U.S. or Canada. Other firms that don't have distribution want to build it to come through our platform so we can bring a broader solution set there.

At the end of the day, though, there's still going to be price difference between potentially low-cost ETF and the value. I think we have to be cognizant of how big that is and to make sure that we're not too far off to make sure that regardless of the value we add that that consumer is still willing to pay that price, and that's for Global WAM and the leverage of driving efficiencies to make sure we can continue to offer those at a proper price point that makes sense.

The only other comment I would make is, typically, when we look at or you hear funds getting launched out there, whether it's 40, or 50 basis points, they don't include the cost of advice which, typically, in an Advisor Series mutual fund would when you hear fees of 2%. So, the gap between a pure passive ETF or even a smart beta ETF and an active might only be 40 to 50 basis points; it's not 150, which is what a lot of people think it is.

The last comment I would make is that within our lineup, because we do believe in active management, we have struck a strategic partnership with Dimensional Fund Advisors both in Canada and the U.S. and to offer their strategic beta solutions within an ETF offering under Manulife Investments and the John Hancock brand, and that allows us to bring, again, another price point to our distribution channels something that is differentiated from pure passive, and something they can use that fits nicely with the story of offering solutions that are value add.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

Let me just add to that. I think Paul answered that question incredibly well, but what I'd also say is that we don't see passive as the enemy of the active. We see that both have an important role to play in helping to manage consumers' portfolios to deliver the best returns possible. So, we see, clearly, the two need to work side by side, if anything, passive has created greater scrutiny on value and we welcome that. We think that active managers need to demonstrate the value of the fees that they're charging. So, that's not something that we want to resist or fight. We see there's an active place for both and that we're going to welcome that and in the cases where we will not manufacture, we'll partner with others to deliver the passive solution.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

And then, maybe a question for either Roy or Phil. So, when you think about the CAD 5 billion being released by 2020, the capital relief, how should we think about the – like what are going to do with that CAD 5 billion? Is it going to be redeployed for organic business growth or inorganic business growth or shareholders' return? How should we think about the potential deployment priorities?

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

So, let me kick that off and then Phil might want to supplement. So, in broad strokes what I'd say is that the key priorities for us around reducing our leverage ratio – Phil sort of talked about it in his presentation earlier, that's clearly a priority for us. Not that we believe that our current leverage position is one that's limiting, but wewould like to see it get close to the target that we've set for the medium term of about 25%.

The other key opportunities for us is to again continue to deploy our capital to the areas where we see maximum growth and potential. They clearly include Asia and WAM. Organically, those businesses are actually generating capital, so they're not diluted from a capital perspective which is a tremendous position for us to actually be in, but if we see opportunities to accelerate our growth there, we'll definitely want to deploy capital in those spaces and if there are inorganic opportunities, again, we would look at those as compliments to the strategy that we already have.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

And maybe I'd just supplement with a comment that I think we are in somewhat of a distinctive position that we have lots of different options in terms of how to deploy the capital that we have. We're not in a situation where we're in – only in one mature market with sort of scratching our heads what to do with capital that we generate.

So, Roy talked about our ability to organically reduce our leverage ratio. We can do that through the organic capital we generate each year. We could accelerate that through the capital release from portfolio optimization activities and, again, we're in the fortunate position that the growth in Wealth and Asset Management and Asia is funded organically. So, I think the – there's lots of options, but the thing I would emphasize is that when you look at our strategy to return capital to shareholders, we very much focused on a stable, regular dividend that will increase progressively.

Robert Poole
Analyst, Picton Mahoney Asset Management

Q

Rob Poole, Picton Mahoney. Just a question for Marianne on, I guess, your comment around like slide 8 where you talked about the 70%/30% mix and then inversing that in the next five years. How do you do that when I look at the profile on page 6 and almost a near doubling of core earnings from legacy businesses? And then, the second one I have there is should I look at that slide 6 and assume a similar trajectory for capital backing those businesses or not?

Marianne Harrison
General Manager, U.S., Manulife Financial Corp.

A

So, I guess the comment I would make in terms of the earnings, in the next five years, we're hoping to get that closer to 50/50 versus reversing, and a lot of that is in terms of the new business that we're building and that's also on the Wealth and Asset Management business, too, that will be included that we're looking at that. So wedo think that the new business opportunities for us are pretty significant and we'll be able to – as you start to see some of the legacy stuff running off as well, that we will get there in our strategic plan.

Your other question on slide 6, I think Steve is going to take that.

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

I think I'll address that question on the capital. The question was whether the capital growth would kind of mirror how this – and it would be more muted. It – while it is growing it's certainly much more muted than what's – than the earnings profile shown on the graph here.

David Motemaden
Analyst, Evercore Group LLC
Q

Hi. David Motemaden, Evercore ISI. I guess, just a follow-up. I think the question was asked earlier. Just, I guess, I'm just wondering what remittances have been out of the U.S. over the past several years? And I guess, do you expect that changing going forward given the optimization program announced?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Shall I pick that one up? So, we don't separately talk about remittances for any particular division but we – have started to disclose a few years ago now is what the aggregate remittances are from all of our divisions so that's in the public domain. The – all of our divisions, all of our geographies are important remitters to support our group cash flow needs to pay interest on debt and dividends to shareholders as well as covering the cost of running the head office of the company.

The U.S. has been an important component of that along with the other division – divisions plus WAM. As we look to the medium-term, the U.S. will remain an important remitter of cash to support group dividends and interest payments. And really, when we're talking about some of the optimization activities, we'll be looking at are other opportunities for us to accelerate the capital release from the U.S. and therefore further support remittances, as we don't anticipate a drying up, if you like, of the value that the group gets from the U.S. in terms of remittance and dividend support.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)
Q

Tom MacKinnon, BMO Capital. You know, historically, this company was organized divisionally and now we've got WAM separates and we have, well, legacy kind of dotted line separate, I guess, to some extent. Then you have the goals within each one of these, but – and then we have – should we still be looking at this company on divisions, because when we just had some divisional presentations, we had legacy stuff within that and WAM stuff within that. So, I'm just wondering how we should be looking at the structure of the organization and how that is consistent with the goals that you're trying to deliver here in terms of expenses.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.
A

Yeah.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)
Q

So, I know it's a little open-ended question, but I'll leave it to you.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

A

No. It's a good question, Tom. So, the first thing I'd say is that what we've created is a clear matrix organization. We're not the first company to create a global matrix, multinational companies that operate across multiple geographies clearly do have dual accountability for certain parts of the franchise. The announcement that we made in September of last year through the creation of a Global Wealth business and a structure around legacy was in large part a focus or driving a much stronger focus around two of the key big priorities that we see as critical to the next chapter of our history. And we see a huge opportunity in Global WAM and quite honestly, we've run that business to date as a collection of different geographies.

We have not looked to find the synergies that these businesses can actually deliver against across our entire global footprint. So, with Paul Lorentz now running our Global WAM business and with having direct accountability for all of different geographies that roll up into Global WAM, we now have a more unified strategy to execute against that WAM ambition. And there is clear synergies across the different geographies. We talked about retirement and the growing and aging population and the need for retirement solutions, but we also see huge synergies across asset management in different parts of the world. So, through his new organization and through the leadership that he's creating to underpin a strategy for Global WAM, we're looking to identify how do we execute against some of the global opportunities and how do we synergize against the scale benefits that we get, but at the same time, we don't want to lose focus on the ability to execute in each market. And that's clearly what we've done. And there is direct accountability for our WAM businesses in each of the geographies. Not only to Paul, but there's an accountability into the geography Head, in this case, in the U.S., its Marianne; or Mike in Canada; Anil in Asia.

And again, in a similar way, with legacy we've got now a clear leadership and accountability for our legacy businesses with a pure focus around measures of success that we're going to be driving a strong accountability against. And Naveed, again, has dual accountability into both Marianne and Mike. But it's part of our executive leadership team that, obviously, is running and driving the franchise and the business.

So, we see that having two views in on some of these businesses is really critical. I mean, it ultimately is the classical matrix where you're having a dual lens of the opportunity, but also ensuring that you get the benefit of the scale that you have. But at the same time, making sure that you execute locally against the specific needs that we have in the marketplace. And again, that's something that we're not the first company to execute against, but we've provided a lot greater clarity through the org announcements that we've made and so far the execution is going really well.

Roberto Veloso
Head, Investor Relations, Manulife Financial Corp.

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There are any more questions? Okay. Well, that concludes the final Q&A session, but before we end the day, I'll ask Roy to come up and say some final remarks.

Roy Gori
President & Chief Executive Officer, Manulife Financial Corp.

Okay. So, well, firstly, thank you, Rob. And thanks to everyone in the room. I guess, I'll end the day with where I started and these are the key messages that I really wanted to leave you with when we kicked off the day. And I guess, I'd just like to remind you about the key thrust that we're really embracing as we embark on the next chapter of the company's history.

The first is a reminder and that is that we have an incredibly strong foundation that we're building from. This is not a burning platform that we need to reverse in a significant way, but we do have an incredible platform across all the various geographies that we operate in and we are a leading global financial services company. We are in the very enviable position of having an opportunity both in Asia and in WAM that is a function of having operated in those areas, in those markets for a very long period of time and they represent very significant opportunities and incredible growth potential.

We've been delivering strong operating results over the last five years, but we're now embarking on the next chapter of our journey. And that chapter begins with a bold ambition and we've shared with you today the way we're going to measure the ambition that we're setting for the company. The focus on delivering against that ambition is really narrowed in against the five key strategic priorities that are underpinning the execution but also the way that we are prioritizing the efforts that we're making across every decision in the company.

And to-date, we're delighted with the execution that we've been able to demonstrate but the execution doesn't end today. In fact, in many ways, begins today and where – well, we hope to be able to demonstrate to you that we're continuing to execute against the agenda and that we'll provide updates on a regular basis on the progress that we're making against the five strategic priorities that we've laid out, hopefully very clearly.

So, I – in conclusion, I hope you found the discussion and the disclosures useful today. I want to thank you for your time and I hope you join us for a lunch in the convening room . Thank you very much.