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PRESENTATION

Operator

Please be advised that this conference is being recorded. Good afternoon and welcome to the Manulife Financial fourth-quarter 2014 financial results conference call for Thursday, February 12, 2015. Your host for today will be Mr. Robert Veloso. Please go ahead, sir.

Robert Veloso - *Manulife Financial Corporation - VP IR*

Thank you and good afternoon. Welcome to Manulife's conference call to discuss our fourth-quarter and full-year 2014 financial and operating results. Today's call will reference our earnings announcement, statistical package, and webcast slides which are available in the Investor Relations section of our website at Manulife.com.

As in prior quarters, our executives will be making some remarks. We will then follow with a question-and-answer session.



Today's speakers may make forward-looking statements within the meaning of securities legislation. Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied. For additional information about the material factors or assumptions applied and about the important factors that may cause actual results to differ, please consult the slide presentation for this conference call and webcast available on our website, as well as the sections in the securities filings referred to in the slide entitled "Caution regarding forward-looking statements." We have also included a "Note to users" slide that sets out the performance in non-GAAP measures used in today's presentation.

When we reach the question-and-answer portion of our conference call, we ask each participant to adhere to a limit of one or two questions. If you have additional questions, please re-queue, as we will do our best to respond to all questions.

With that I'd like to turn the call over to Donald Guloien, our President and Chief Executive Officer. Donald?

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Thank you, Robert. Good afternoon, everyone, and thank you for joining us today. This morning we announced our 2014 financial results. As you can see from the chart on the slide, we've enjoyed a very nice trend in net income over the past five years.

In 2010, we had a loss of CAD1.7 billion; 2011, a small gain. In 2012 earnings increased to CAD1.8 billion; in 2013, a further improvement to CAD3.1 billion. And in 2014, we ended the year with net income of CAD3.5 billion.

That is an increase of 12% over the prior year. And in fact if you adjust for a one-time-only, unusual, extraordinary event, that is the gain on sale of our Taiwan insurance operations that occurred in 2013, it is in fact a 26% increase.

Now before anyone is tempted to extrapolate that growth in net income through to next year and beyond, I have two notes of caution. Number one, our net income in 2014 included investment-related gains, favorable market impacts; and, number two, the current macroeconomic environment -- in particular, low interest rates and oil and gas prices -- present some specific headwinds for 2015. In our opinion, not insurmountable headwinds, but headwinds nonetheless.

From a core earnings perspective, we completed the year just CAD12 million shy of our goal, delivering CAD2.888 billion against a plan of CAD2.9 billion; and we viewed that goal as quite ambitious. But unlike prior quarters of the year, the fourth quarter was below our expectations in terms of core earnings due to a variety of experience factors, mostly claims-related. Steve will go into these in more detail.

One of the most notable achievements in the year is in fact something that did not happen. As you might be aware, through 2014 US government rates fell approximately 125 basis points, and Japanese rates dropped approximately 50 basis points during the year. We also experienced high equity market volatility.

It was a very difficult market environment, yet you would hardly notice it looking at our results. That is a great testimony to the quality of the hedging programs that we have in place.

You will recall, the most recent year that looked like that was back in 2011, the year the Company barely made a profit. This year we sailed by and barely noticed.

It is also somewhat a note of caution for those who think that we will benefit enormously from increased rates at some time in the future, a view that is perhaps emphasized too much. Yes, we will benefit from an uplift in rates, but perhaps not as much as some people would anticipate. You have to hedge the downside and the upside.

In terms of the top line, insurance sales -- excluding Group Benefits in Canada, which are highly seasonal -- increased 13% from the prior year, with record sales in Asia and momentum building through the year in our North American Life Insurance businesses. So with all three engines now in gear, this bodes very well for 2015 and beyond.



On the wealth management front, we ended 2014 with another sales record. This contributed to our reaching almost CAD700 billion in assets under management.

Last but certainly not least, in the third quarter of the year, the Company increased the dividend paid quarterly to shareholders by 19% to CAD0.155 per common share. It is my hope and that of our Board that this will be the first in a series of increases.

We've also developed the financial flexibility to finance not one but two transactions with very significant contribution from internal resources, while maintaining strong capital resources and improving leverage ratios.

Turning to slide 6 for a review of the year on a more granular basis, in terms of developing our Asian opportunity to the fullest, we achieved record insurance sales which benefited from successful new product launches and sales campaigns. Notably, insurance sales were up 60% in Japan, 28% in China, 15% in Hong Kong -- and I could go on with a much longer list.

We delivered another year of record wealth sales. We had particularly strong momentum in the second half of the year, with sales increasing nearly 70% compared with the prior year.

We also expanded our bancassurance footprint with nine new insurance distribution agreements, two of which are exclusive.

In terms of growing our wealth and asset management businesses around the world, we achieved our 25th consecutive quarter of record assets under management. We are one of the few companies in the world that can lay claim to that record.

We delivered record institutional sales of CAD8 billion at Manulife Asset Management across a broad variety of mandates. These included over CAD1 billion in mandates from our Private Markets business, which was its first full year in operation. We generated over CAD18 billion in positive net flows from our asset management and group retirement businesses around the globe.

In Canada, the core earnings were below expectations. But we continued to deliver solid mutual fund and group retirement sales. We experienced a decline in Group Benefits sales and Manulife Bank lending volumes, where we decided to maintain our pricing discipline despite strong competitive pressures.

Once again, at this Company, we emphasize margins over market share. That behavior is consistent with the philosophy.

Notably, we acquired the Canadian operations of Standard Life plc, which adds approximately 1.4 million new customers and over CAD27 billion in mutual fund and pension assets. This transaction accelerates our global wealth and asset management strategy through a range of capabilities including the defined contribution pension business and a real strength in liability-driven investing.

In the United States, we continued to drive sustainable earnings and opportunistic growth. We delivered record wealth sales, thanks to very strong mutual fund volumes at John Hancock Investments, which outweighed the negative impact of intensified competitive pressures on our small-case retirement sales.

On the insurance front, while sales were down for the year, we continued to build momentum through the year. In fact, sales increased sequentially every single quarter of the year, driven by product enhancements made in the first part of the year; and we expect that trend will continue.

In December, we announced our agreement to acquire New York Life's Retirement Plan Services businesses. This transaction, along with the Standard Life acquisition in Canada, will significantly increase our global retirement plan assets by about CAD80 billion.

In summary, we are pleased with the progress made in 2014. Our strategy is unfolding very well.

We are mindful of the major trends and disrupters that are impacting our industry. They are a source of opportunity for us, and we intend to take full advantage of it.

Working with our Board, we've developed a strategy for 2015 and beyond that prepares Manulife for the future and will accelerate our long-term growth trajectory. We will go into more detail in our annual report and at our Investor Day in May; but in brief, this strategy is comprised of three major themes.

Number one, we will transform from an organization traditionally focused on products and distribution to one that is more customer-centric. This will be manifested in a whole variety of ways, from the use of branding and social media, to offering simpler products, more needs-based solutions, and more accessible and user-friendly portals for support and service.

Second, we will continue to build and integrate our global wealth and asset management businesses, without restricting ourselves to geographies where we currently have insurance operations. This is a global business for Manulife, and you should expect that we will be opening both sales office and investment desks in areas around the globe where Manulife is currently not present with its insurance operations.

And third, we will work aggressively to leverage the skills and experiences of our people across our international operations to maximum strategic and expense advantage.

With that I turn it over to Steve Roder, who will highlight our financial results and then open the call to your questions. Thank you.

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Thank you, Donald, and good afternoon, everyone. Let's start on slide 8, where we summarize our financial performance for the fourth quarter of 2014 and the full year.

In the fourth quarter, we delivered strong growth in insurance sales and achieved our 25th consecutive quarter of record assets under management, but core earnings were below our expectations. For the full year, net income rose 12%, and core earnings were up 10%.

We continued to build insurance sales momentum throughout the year and achieved record wealth sales. And we further improved our financial flexibility by reducing our financial leverage and generating remittances of CAD2.4 billion while maintaining a strong capital ratio.

We continue to focus our efforts on improving our return on equity and have already taken steps to redeploy capital for the benefit of shareholders. For example, in 2014, the dividend was increased by 19% and we announced two acquisitions.

In the following slides, I will address our fourth-quarter and full-year results in greater detail. Turning to slide 9, in the fourth quarter of 2014, core earnings declined 6% to CAD713 million, reflecting unfavorable policyholder experience in North America and the timing of certain expenses; partly offset by the benefits of lower amortization of deferred acquisition costs and the benefit of higher life insurance sales on new business strain.

For the full year, we generated CAD2.9 billion of core earnings, up 10% over 2013, driven by growth in our fee income from higher wealth assets, lower net hedging costs, and the favorable impact of a higher US dollar; partly offset by unfavorable policyholder experience and the low interest rate environment. Our net income for the full year was CAD3.5 billion, a 12% increase from 2013.

Turning to slide 10, our reported net income in the fourth quarter was negatively impacted by unfavorable investment-related experience, as the sharp decline in commodity prices led to fair value adjustments in our oil and gas holdings. This was largely offset by a gain from market-related factors totaling CAD377 million, largely due to the impact of the flattening of the yield curve as well as widening corporate spreads and lower swap spreads.

On slide 11 is our source of earnings. Our expected profit on in-force rose 2% from the prior quarter, largely due to lower amortization of deferred acquisition costs. New business strain improved from the prior quarter, reflecting the impact of higher insurance sales volumes and a more favorable business mix.

Experience losses in the quarter reflect oil and gas related investment losses and unfavorable policyholder experience, partly offset by market-related factors. Management actions largely reflect the expected macro hedge costs and actuarial model refinements. And earnings on surplus increased due to higher realized gains on AFS equities.

Our low effective tax rate in the quarter is the result of income earned in low tax jurisdictions, losses or lower income earned in high tax jurisdictions, and tax exempt investment income.

Turning to slide 12 and insurance sales. Insurance sales in the fourth quarter increased 20% over the prior year, reflecting record sales in Asia, with most territories experiencing double-digit growth, and continued strong and improving momentum in North America life insurance sales as a result of product launches and enhancements undertaken earlier in the year.

Full-year insurance sales declined, largely due to our disciplined pricing approach in the competitive Group Benefits market. Excluding Group Benefits, insurance sales in 2014 were up 13% from the prior year, driven by very strong growth in Asia.

New business embedded value increased 12% in 2014, and 20% in the fourth quarter, thanks to fast-growing sales in Asia and our success at redesigning insurance products to be profitable in this challenging interest rate environment.

Turning to slide 13 and wealth sales. Wealth sales in the fourth quarter rose 6% over the prior year, reflecting new product launches, marketing campaigns, and improved market sentiment in Asia; continued strong mutual funds sales in North America; and strong group retirement sales in Canada; partly offset by lower bank volumes in Canada. Excluding bank volumes, wealth sales increased 9%.

For the full year, we achieved record wealth sales of nearly CAD53 billion, with strong mutual fund sales in all divisions. New business embedded value for our wealth business in 2014 was in line with the prior year.

Turning to slide 14, assets under management at the end of the fourth quarter were CAD691 billion, representing our 25th consecutive quarter of record AUM and a CAD92 billion increase from the previous year.

Slide 15 summarizes the capital position for The Manufacturers Life Insurance Company and our financial leverage. We ended the year with a robust regulatory capital ratio of 248%, in line with the prior year despite reducing our leverage by 3.2 percentage points to 27.8%.

Assuming the acquisition of the Canadian operations of Standard Life plc closed at year-end, our pro forma leverage ratio would have been 27.1%, lower than the 28% we had initially indicated. And our MCCSR ratio would have been in the 235% to 240% range we had initially indicated.

Turning to slide 17 and the operating highlights of our divisions, we begin with the Asia Division. In the fourth quarter, core earnings were \$229 million, down 9% from the previous quarter due to the impact of the weakening yen and the timing of certain expenses, partly offset by favorable policyholder experience. Adjusting for currency, additional dynamic hedging, and the sale of our Taiwan insurance business, core earnings increased 19% in the fourth quarter versus the prior year, and 16% for the full year.

Insurance sales reached record levels for the fourth quarter and the full year on a constant currency basis, reflecting continued robust sales growth in Japan, successful sales campaigns and product launches in Hong Kong, and double-digit growth in other Asia territories. In the fourth quarter, wealth sales rose 64% to \$2.5 billion reflecting double-digit growth in most territories, driven by new product launches, marketing campaigns, and improved investor sentiment. For the full year, wealth sales of \$8 billion set a new annual record on a constant currency basis.

Turning to slide 18 and the Canadian Division. In the fourth quarter, core earnings declined 8% as unfavorable policyholder experience in our insurance businesses was only partly offset by lower amortization of deferred acquisition costs.

Fourth-quarter insurance sales of CAD172 million increased 6% from the prior year, reflecting the continued success of our simplified UL solution and higher Group Benefits sales. Full-year insurance sales of CAD578 million declined 49%, largely due to our disciplined approach to pricing in

the large-case Group Benefits market. Excluding Group Benefits, insurance sales in 2014 were 3% higher than in the prior year, driven by strong market acceptance of our simplified UL solution.

Wealth sales in the fourth quarter continued to be solid, but declined to do to lower bank loan volumes. Excluding Manulife Bank, fourth-quarter wealth sales were up 2% versus the prior year, and full-year wealth sales were up 3% on strong group retirement sales.

Moving on to slide 19 and the highlights for the U.S. Division, fourth-quarter core earnings of \$297 million declined 5%, reflecting unfavorable policyholder experience, partly offset by improved new business strain. Full-year core earnings declined 15%, as higher fee income from our growing wealth businesses was more than offset by lower earnings from our variable annuities business despite lower DAC amortization and unfavorable policyholder experience.

Insurance sales for the fourth quarter were \$154 million, up 12%, driven by the continued momentum from product enhancements and targeted pricing changes. Full-year insurance sales of \$501 million were down 11% from 2013 due to a challenging first quarter and the impact of a sluggish estate planning market, but demonstrate sequential improvement in each quarter of the year.

Fourth-quarter wealth sales of \$7.1 billion were in line with the prior year, as continued strong mutual fund sales were partially offset by lower group retirement sales. Continued repricing initiatives are underway in our retirement business, and we continue to garner significant attention in the industry with our fee transparency initiative. On a four-year basis, we achieved record wealth sales of \$29.2 billion.

So in conclusion, in 2014 Manulife generated strong net income and core earnings, achieved record wealth sales, and continued to build strong insurance momentum throughout the year. We achieved record assets under management, increased the dividend, and announced two strategic acquisitions.

Before I open the line up to questions I wanted to briefly discuss our upcoming Investor Day on May 11, 2015. At Investor Day, we plan to discuss our strategy for 2015 and beyond, to which Donald referred earlier, as well as the key drivers of our earnings going forward. We'll also provide some more color around the integration of the Canadian operations of Standard Life, and we'll spend some time highlighting upcoming disclosures on our wealth and asset management business and on embedded value, including local embedded value for Asia.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Meny Grauman, Cormark Securities.

Meny Grauman - Cormark Securities - Analyst

Yes, hi. Questions on the oil and gas exposure.

First, I noticed that the book value of your oil and gas assets actually increased from CAD1.8 billion to CAD2.2 billion. I'm wondering; that seems a little counterintuitive to me. What's driving that?

Donald Guloien - Manulife Financial Corporation - President, CEO

We acquired some oil and gas properties in the fourth quarter, so it is an acquisition of net assets in the quarter. Obviously, in the course of the quarter, we would have a markdown on the portfolio; but the actual acquisition outweighed the markdown effect.



Meny Grauman - *Cormark Securities - Analyst*

Okay. Then just in terms of the fair value losses on investments, I'm wondering if you could just give us some more color on some of the key drivers there.

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

We'll pass them on to Scott Hartz, who's probably going to be the best to give you the color on that one.

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

The fair value drop in investments on the oil and gas, you mean?

Meny Grauman - *Cormark Securities - Analyst*

Yes.

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Yes, sure. In the fourth quarter we saw oil prices come down significantly; spot prices down 36%; gas prices down 25%. The forward prices were down a bit less than that.

Our oil and gas portfolio is about 10% of our total alternative asset portfolio, and it is a piece of the portfolio that has probably more volatility -- we certainly model it that way -- than the rest of the portfolio. And hence it can only grow to be so large.

But we enjoy a very diversified alternative asset portfolio. So although we had mark down in the fourth quarter, for the full year our alternative asset portfolio performed in line with our expectations, which really speaks to the power of the diversification.

But we will see in the oil and gas -- those values will be moved directly with the commodity prices. And we may see some lingering effects of that into 2015, to the extent prices don't rebound here.

Meny Grauman - *Cormark Securities - Analyst*

So do you need prices to go down further to recognize more losses here? Or is it also a function of credit and other variables that can deteriorate?

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Well really, we would -- in forward prices and everyone's expectations, where they're valuing properties, would assume prices would rebound fairly slowly over time. And if we don't see that rebound over time, you will see values continue to go down. So yes, we need prices to increase modestly over time to prevent further losses, I would say.

Meny Grauman - *Cormark Securities - Analyst*

Thank you.



Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

The other comment I would add is -- Scott gave you the data point on 9% of our alternative assets. But just to emphasize, that translates into less than 1% of our overall invested assets.

Meny Grauman - *Cormark Securities - Analyst*

Okay. Thank you.

Operator

Steve Theriault, Bank of America Merrill Lynch.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks very much. Just to be clear on the oil and gas exposure for a second, for Warren or Scott or Steve, it was my understanding --

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Sorry, Steve, would you mind speaking up a bit? We are struggling to pick you up.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Pardon me, sorry. Sorry, just a quick follow-up first on the oil and gas exposure. It was my understanding you do a more refined evaluation of that portfolio in Q1. So am I correct? It doesn't sound like you expect that to be immaterial factor come three months from now. Is that right?

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Yes. It's Scott again. We took our best shot at year-end. It is an estimate for year-end and it will be refined, as you point out. But we did take our best shot. We don't think there is a bias.

Warren Thomson - *Manulife Financial Corporation - Senior EVP, CIO*

One other point I would add, Steve, I think what you are referring to -- we normally get to our full engineering reappraisal done each year. And it doesn't come in till -- into our Q1 results; it is done as at December 31, but the engineering work isn't completed till after we release.

So that update work typically gives where we get proven reserves coming out from our drilling activity and other things that have occurred over the course of the year, as well you'd have a new look at the price curves when that work is done. So bottom line is, we would expect typically adds from drilling in that report as well as true-ups for whatever we produced, etc., and then we would have a refined look at the prices.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay. Thanks for that. Then for Don, please, I know you're -- well, we're still a couple of months away from Investor Day. It's clear these Q4 results are below plan, as you mentioned.

So I guess my question is, given the current market conditions, given rates, what they've done in Q1 -- bouncing back a little in the US, but not so much in Canada -- as you sit here today, does it feel like 2015 that there is a disproportionate risk that you get another couple, or that we are looking at below plan for 2015? Just like to (multiple speakers)

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Yes, my crystal ball isn't that much better than anybody on the call. But I would say right now looking at it, we have some headwinds; but as I say, not insurmountable ones for 2015.

I don't see anything that would cause me great concern about 2016. But again, that's just the way it looks at this point in time.

And again, there are things that we can do, hopefully, to overcome headwinds. We've done it before, and -- but the important thing I guess I would also emphasize is -- I've been asked many times about what keeps me awake at night. And what keeps you awake at night is not these oil prices, that's for sure. We see it as a terrific buying opportunity. And Warren's answer indicated that we are already in, doing that.

But where we go at 2016 and beyond, we have the momentum that takes us through well beyond that time. And that's what we are to be talking to you about at Investor Day. It's frankly very exciting, and we are not going to sacrifice anything important in that initiative in order to make a 2015 or 2016 goal. I would rather disappoint you in the short term and delight people in the longer term.

When you ask me the question of what keeps you awake at night, I want this Company to be prospering and relevant and right on top of the game and one of the major disruptors at 2016 and beyond.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay. Thanks, Don.

Operator

Peter Routledge, National Bank Financial.

Peter Routledge - *National Bank Financial - Analyst*

Hi, thanks. May I ask you a question about Asia? I'm kind of curious about what's going on in the individual regions there. We saw some softness in core earnings really until the last two quarters; so two questions that are related.

What was causing -- in what regions were you seeing softness? Was it Japan and Indonesia?

And then in what regions in the last two quarters have you seen better results?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Well, let me start off and see -- Bob may want to add to that. Japan and Hong Kong remain fundamentally important to our Asia core earnings results; and Indonesia would be the third jurisdiction. So if you see a significant shift in Asian earnings, it normally reflects some performance in Japan and Hong Kong.

Now, Japan had very strong sales, and we do typically recognize some new business gains in relation to Japan. So Japan has been part of the story.



I think at the same time, we've been successful in some of our -- let's say not cost-containment initiatives, but making sure that our costs don't continue to escalate at the same pace as our sales have been. And that's starting to pay dividends as well.

But maybe I'll pass to Bob and see if he has anything to add.

Bob Cook - *Manulife Financial Corporation - Senior EVP & General Manager Asia*

I guess I would just add two things. Just a reminder, as we done each of the last four quarters, is ask you to adjust for currency hedging costs and the sale of Taiwan. And in fact if you do that, each of the four quarters during the year had double-digit growth over the same quarter in the prior year. So I guess I quibble a little bit with your question in terms of softness in the first half of the year.

But in terms of your more general comment about -- are there particular areas of softness, I guess the one I would highlight would be Indonesia. It had some struggles on the sales side during most of the year. As we've said in a number of cases, we really need strong insurance sales in order to drive the bottom-line results in Asia.

Peter Routledge - *National Bank Financial - Analyst*

I understand Indonesia is a growth market, so I'll leave that aside. It's Japan that interests me. It seems like it's going well; it seems like it's still a core part of Manulife's enterprise strategy.

But I find myself asking, why is it? It seems to be a country that's got some tail risk associated with it. It seems to me it's a country that's caused exceptional earnings volatility for Manulife overall in the past. Why is it core to Manulife's strategy, if indeed it is?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Well, let me start; and again, Bob may have some views, or even Donald. But no, we are very enthusiastic about Japan.

Personally I think Japan is underrated. It's a massive market. It still has a huge amount of money sitting on the sidelines doing not very much, sitting in people's bank accounts or underneath their tatami mats.

And there is a huge opportunity for people who can innovate and identify niches to play in. So we're not really competing with Nippon Life and Co. in the mainstream. We're much more, I would say, a nimble player taking advantage of market opportunities.

In fact, there are some interesting changes taking place in Japan. For example, the introduction of the NISA, the Nippon Investment Savings Account, in the last couple of years. You can start to see some quite interesting trends going on in Japan from which we can benefit, because we can produce solutions that can't necessarily be produced by some of the big domestic players.

So no, we see Japan as a real opportunity and we're very enthused about it.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Yes, the only other thing I would say, Peter, is in terms of the back book, you're quite right: the VA business gave us a lot of volatility. But two important things to note about that.

Number one, the majority of that has been hedged, and you don't see us knocking our financial statements around in any significant degree now. The other thing is, we don't get direct credit for hedging in the capital formula. So we're holding huge amounts of capital backing a risk that used to be there.

And that will eventually be liberated. Those are fairly short-dated obligations that come due as the market improves; and in fact they cash out in some portions of the business automatically.

So as that comes due that is a huge generator of profit and capital back to the Parent Company. So you've got two things happening: some very lively development in terms of, as Steve said, niche plays in the business going forward, and a very nice, attractive return of capital from the business that is in-force as it starts to go off, which is starting to happen now and will continue for a few years. So, we're actually --

Peter Routledge - *National Bank Financial - Analyst*

When does it hit the highest point of runoff, if I can call it that?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

The Japan VA book is pretty much runoff by 2019.

Peter Routledge - *National Bank Financial - Analyst*

Okay.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Yes, the peak might be 2017/2018. Is that about right? I'm getting nods here.

Peter Routledge - *National Bank Financial - Analyst*

Okay, that's interesting. Thank you.

Operator

Gabriel Dechaine, Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Good afternoon. Just on the policyholder experience, if I back out all the investment-related stuff and the macro-related stuff I get to a number of over CAD100 million on policyholder experience. I'm just wondering, A, if that number is right; B, can you break it down for me?

Where were the major issues? I can tell by geography, but I guess more of a -- what was causing this, and how much of it was more one-time-ish or a blip?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Okay; thanks, Gabriel. I would say round numbers we're talking about CAD50 million post-tax, North America. Two-thirds of that in Canada, one-third United States.



In Canada, that would've been in relation to group business, the high cost of specialty drugs. Most of it's repriceable. In the United States, there was some adverse experience in long-term care claims; but I emphasize that for the year as a whole, we are almost even on long-term care claims in the US. We had two quarters of positive experience, two of negative.

So based on all our investigations to date, there are no alarm bells ringing here. We are taking the CAD50 million as normal volatility, if you like, in policyholder experience.

Then on the other side of the coin, Asia was actually positive. But the CAD50 million is the biggest component of the miss, if you like, against the Street estimate on core earnings.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. I'm probably going to have to go over some of those numbers off-line, because I'm wrong in my math somewhere. Then just on the investment that you are making in oil and gas. I'm just thinking of the mechanics.

If you had a CAD400 million loss, most of that coming in the oil patch, that's the net number; there would have been some yield enhancement, I'm assuming, if you are making investments in the oil patch currently. Why wasn't that -- or did you not have big yield enhancement gains in the -- from those actions?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, CIO*

You actually have to break the loss down into two components. Our oil and gas portfolio consists of our direct holdings in our NAL oil and gas operations in Western Canada, which is predominantly in Alberta and Saskatchewan. Then in the United States we have a number of interests in Limited Partnerships and through fund holdings, etc.

So the mark in the portfolio is a combination of those two items. The mark that's going against the NAL oil and gas portfolio I think was in the order of CAD200 million. And there was a CAD380 million acquisition in the portfolio, hence the growth in that NAL oil and gas portfolio.

Scott, I don't know if you want to add anything to that.

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

No. Was there something more specific, Gabriel?

Gabriel Dechaine - *Canaccord Genuity - Analyst*

No, that'll work. Then just to sneak in on the expense guidance, based on the language you're using it sounds like you're making faster investments or realizing them sooner and finding more expense savings throughout the Company. I'm just wondering why you weren't able to take the CAD400 million higher. Or is that something you anticipate over the long haul?

Paul Rooney - *Manulife Financial Corporation - EVP, COO*

It's Paul Rooney here, Gabriel. You are correct; we are seeing a faster trajectory on our savings. But it's a combination of realizing some savings sooner; as well as some of the cost that we estimated in building new systems and building out some of the technologies and things that we needed to do, it turned out to be too conservative. So our cost side on these E&E initiatives was down.



But just because we are realizing them sooner, our trajectory will get to the -- we are still targeting the CAD400 million by 2016. So we are getting them sooner, but we are still at the same endpoint target.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

How much of that -- okay, go ahead.

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

One thing I was going to add is, I think we said previously that we wanted this -- the E&E project, if you like, to be a way of life. So it doesn't come to a grinding halt at the end of 2016, just for clarity.

So it will continue on, and we continue to identify further projects that we are investing into, which will produce even more benefit beyond 2016. Maybe I'll give some more clarity on that at Investor Day.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Was any of the CAD200 million that you achieved this year -- did it go to the bottom line or was it all reinvested?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Well, I would say it went to the bottom line. But on the other hand, Donald started to talk about some of the growth initiatives that we've identified. So what we were able to do was come in virtually bang on plan, because we were able to get the CAD200 million out and effectively invest into future growth strategies.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Thanks.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

You'll see some of the benefits -- some of the specific projects and achievements and developments for the future at that Investor Day. I think you'll be impressed.

Operator

Sumit Malhotra, Scotia Capital.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks. Good afternoon. Just to stay on the expense topic for a minute, your disclosure is interesting: that you exceeded the CAD300 million, but the net was CAD200 million.

Don, when you start your comments talking about not only the potential emerging threats but the opportunities to the Company from, let's call it, the shifting landscape -- and I think you are talking about technology and new competitors, to some extent -- when we think about that CAD400 million number in 2016, is it reasonable to think that a similar portion is going to get invested back into these new initiatives?

So it shouldn't necessarily be seen that we are going to get more of it on the bottom line than we did this year. Is that a fair way to think about it?

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Well, there's really two things happening. Number one, we're being quite honest with everybody and transparent about we're getting more gains faster than we expected. Rational behavior is, when you have that kind of outcome, you want to invest more, not less. Right? Because we can see the efficiencies emerging faster and more significantly than before.

So to some degree that's happening. The other thing that's happening is investment into forward initiatives.

But you're hearing nobody here suggest that 2016 is in peril because we aren't getting the expense saves we projected or because we plan to spend it all on new initiatives. What we're going to do is maintain a very fine balancing act that ensures that we are investing for the future in some things that we think are going to be very exciting, and -- but still meeting our goals.

Again, that's not a promise we'll get to the exact number in 2016. I am probably boringly repetitive on that thing. I'll be damned if I'm going to stop a project in the middle of November because I think it's going to cause us to be off by CAD35 million. I should be fired by the Board if I indulge in that kind of behavior -- and I would hope they would do that.

But we don't see a big problem here. We are getting gains faster than we expected; and, yes, we are reinvesting significant portions because we are delighted with these gains. Plus we're investing in the future at a rate that has never been experienced by this Company before.

Sumit Malhotra - *Scotiabank - Analyst*

All right, thank you for that. Then back to Steve Roder, just on the experience and the stickiness that this may have. It sounds like the Group Benefits, especially drugs issue in Canada, you think pricing can solve that problem in the near term; correct me if I'm wrong on that.

You mentioned the LTC. You've had some wins, some losses this year. So I don't think that sounds overly concerning.

There was one more you mentioned in the US. Was that lapse?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Yes. Cindy is going to take that one.

Cindy Forbes - *Manulife Financial Corporation - EVP, Chief Actuary*

Hi, it's Cindy. Yes, it was lapses on US life, and that is one area that we will be looking at in our 2015 experience review.

Sumit Malhotra - *Scotiabank - Analyst*

All right. So that of the three items, is it fair to say that that's the one that may have a little longer tail that we see in the future?



Cindy Forbes - *Manulife Financial Corporation - EVP, Chief Actuary*

It may have, although experience on that varies quarter to quarter as well. But it will be something we look at and assess when we look at our assumptions this year.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks for your time.

Operator

Darko Mihelic, RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets - Analyst*

Hi, thank you. A question for Steve. I was wondering if you can give me a hand with the model in two spots. In particular I'm hoping to get something from you on the expected impact of Standard Life on expected profit and strain. Can you give us an early eyeball on what that could look like?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Darko, I'd like to help you, but we're not really in a position to update the previous guidance we gave on Standard Life. We completed the acquisition, as you know, at the end of January; and we are full on into the integration aspects of that and getting under the information that we now have access to, that we didn't have before.

So I'm afraid I don't have any particular update for you on that. But we will be in a position to give a lot more color on that at the end of Q1 and particularly at Investor Day.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay. Then maybe just another question. Something that's topical is exposure to Alberta, and what I'm curious about is your mortgage book. Can you give us an idea what that would look like in terms of exposure to Alberta, loan-to-values and so on?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Well, I will start off and I think Scott will chime in. To this point, we've seen no signs that we have any issues in the mortgage book in relation to Alberta. And the loan-to-value ratios there are pretty much in line with the rest of the portfolio. In fact I think the last data point I saw, they were marginally better than the average for the Canadian market.

So obviously it's something we're watching very closely, but so far we don't have any alarms ringing in relation to Alberta. I'll just see if Scott wants to add to that.

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

I think that pretty much summarized it. I guess just with this stress we've seen in the oil and gas, we certainly have combed through the entire portfolio. And for sure that's one area we looked at very closely, Alberta and then down in Houston in the US.

To Steve's point, we underwrite very conservatively. We don't -- could we have some deterioration in property values there a bit? For sure we could; but we think at the levels we've underwritten these two we don't expect any significant problems.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

And, Marianne, why don't you cover the bank?

Marianne Harrison - *Manulife Financial Corporation - Senior EVP, General Manager Canada*

Yes. From the bank perspective, we have not seen any increases in delinquencies. Needless to say, we are monitoring it very closely, but we haven't seen any issues at this point in time.

Darko Mihelic - *RBC Capital Markets - Analyst*

Yes, Marianne, I wouldn't expect any issues yet. But could you just tell us what the exposure is to Alberta?

Marianne Harrison - *Manulife Financial Corporation - Senior EVP, General Manager Canada*

I don't have that.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

About 18% of that portfolio which I think is pretty -- don't hold me to that number, but that's what I heard earlier this week.

Darko Mihelic - *RBC Capital Markets - Analyst*

That would sound representative. Okay, thank you.

Operator

Robert Sedran, CIBC.

Robert Sedran - *CIBC World Markets - Analyst*

Hi, good afternoon. Just want to come back to Asia, actually from the sales perspective. They do seem to be lifting a little bit, especially in the second half of the year. Wondering if you can give a little bit more color on what is working.

And then just thematically from a competitive perspective, is this an area where you need to be more aggressive on price or product features to get those kind of sales results? Or is it more about locking in on the right product with the right distribution?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Okay. Let me start off and then Bob will probably want to -- have something more to add. I think you have to look at the individual markets differently.

Japan is continuing to benefit from the new corporate products that we launched last year. There's been strong momentum from those launches that's continued on through 2014. So that's been very healthy.

In Hong Kong, we launched some new products and that gave us momentum into the second half, and we had a very successful campaign.

When you come to the issue of product competitiveness and pricing, etc., those situations can arise, but by and large, because margins in Asia tend to continue to be pretty healthy, there is usually some latitude for us to take necessary pricing actions whilst maintaining our target returns. So those have been my comments, but I'll pass to Bob and see if he wants to add.

Bob Cook - *Manulife Financial Corporation - Senior EVP & General Manager Asia*

Yes, I think as you implied in your question it's a combination of both product and distribution initiatives. We had a number of successful new product launches in Japan, but at the same time we expanded our independent channel into the retail markets; we rejuvenated our sales through the banks there. So it was a combination of both things.

In Hong Kong, I think I told a number of people on the call that the big run-up in recruiting we had at the end of 2013 would lead to a run-up in sales at the end of 2014. And that's exactly what we saw.

I guess my only additional comment on the margin aspect of your question is that -- no, we have not trimmed margins to achieve those results. But at the same time, I would highlight that there are certain headwinds on our margins from declines in interest rates that we saw during the year in a variety of countries, that we will have to keep an eye on in the future.

Robert Sedran - *CIBC World Markets - Analyst*

So the part of the answer that was around product launches is kind of where I was coming from. Because it seems like maybe the staying power of a new product launch doesn't -- they tend to -- once they start lapping some tougher quarters the sales start to trail off.

So like, how important is that on the ongoing refresh of the product shelf to getting these kinds of sales going? Or do you feel like you have products that these kind of sales can continue for a while?

Bob Cook - *Manulife Financial Corporation - Senior EVP & General Manager Asia*

Yes, I guess again, the answer varies country by country. Where in a place like Japan, where we only -- we get less than a quarter of our sales from our controlled captive distribution system, having a regular stream of new product introduction is an important part of keeping sales momentum going.

In contrast to that, in a place like Hong Kong, where essentially 90% of our business comes from a controlled distribution system, it's less important there.

Robert Sedran - *CIBC World Markets - Analyst*

Thank you.

Operator

Mario Mendonca, TD Securities.



Mario Mendonca - *TD Securities - Analyst*

Good afternoon. A question perhaps for Donald and Steve. There have been plenty of quarters in the past where the core number has taken a step back, and you've reminded us that we shouldn't expect it to be up on a straight line. So when you look at this quarter, quarter-over-quarter took a step back, do you think of this as a reset to a lower level that we build from, or just another anomalous quarter on a long stretch of improving core earnings over time?

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Mario, it's really the latter. We didn't jump to that. Steve's done some analysis; and he might want to refine my remarks.

But experience gains or losses can be one of two types: one that gives you pause and concern that it's a lingering thing that's likely to be repeated; or one that's more or less a random walk. Most of this looks pretty much like a random walk, so it gives us no pause.

If you ask me what the forecast is for next quarter, I would say breakeven on experience gains and the very same things that caused us a bit of a challenge in this quarter; or it could go the other direction. Some of these have had a habit of almost reversing the signs every quarter, and so you draw no inference from it.

So no, your supposition that this is just a bit of noise, we would tell you if we thought it was different.

The interest rate one is different. Interest rates have dropped a lot; and yes, they've come back a little bit. But they are still down, and that has an impact for the next year.

Who knows what's going to happen in the following year? But at some stage they start to go up again. But we've given up betting when that's going to occur, and we've hedged to minimize the risk, but it still has some impact.

Mario Mendonca - *TD Securities - Analyst*

Okay. Let me just flip over to a different type of question, maybe for Warren and again for you, Donald. The oil and gas exposure -- I understand why it's in your -- why it's there, why Manulife owns this stuff. I get it from a diversification perspective.

But does it make sense in an insurance company, where investors are really looking for stability? I get it that this quarter there were some offsets on the interest rate side. But there could easily be quarters where this goes the other way and there's nothing there to offset it. So does this make sense in Manulife or any insurance company?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, CIO*

Yes, we do. It's -- again, I think Scott made the point earlier, and this is I think a really important one. We've got a diversified mix of alternative long-duration assets. They comprise around 9% of our total on-balance sheet portfolio, and they are very diversified. And this asset class is less than 1%.

So yes, it is the most volatile asset class. But it also has been our strongest long-term. We've been in the business for 25 years, so this isn't a flavor of the month thing. We've been doing this for close to a quarter century.

And over that time frame it's been our strongest returning alternative asset class. We tend to look at this type of time in the cycle as an opportunity to pick up some incremental reserves. And we just think it's a very good diversifier in the context of our total book.



Donald Guloien - *Manulife Financial Corporation - President, CEO*

Mario, it's Donald here. I think what we've got to do is -- you're asking a very fair, reasonable question. What I'd suggest, we bring out at Investor Day, Steve and Rahim, the lists -- the Efficient Frontier thing.

For other people on the call -- I think, Mario, you're quite familiar with this. We basically use a bastardized Markowitz Frontier to look at different asset classes. And one of the reasons that Manulife had so little damage in the financial crisis having to do with fixed income, when everybody else was writing down bond portfolios by billions and in some cases tens of billions of dollars, we didn't have any of that.

Why? Because we had a highly diversified portfolio that'd allow us to get a target return without experiencing the tail end of the spectrum, the risky end of the spectrum, on fixed income. Which is a safer overall strategy, right? It actually has higher return and lower risk than sticking with fixed income alone.

So occasionally you get some bumps, but this is not an unrecoverable bump. I want to be really open with people: we are trying to back up the truck to buy more oil and gas.

We've been trying to buy it; the price was way too expensive when it was \$120 spot price. This might provide the opportunity, and we're already executing on that plan.

You know, there's a real paucity -- just let me remind everybody. Go and get up your Bloomberg screens and look for 30-year bonds; and then look at 30-year bonds that you'd want to invest in, that you're actually sure that business is going to be there in 30 years. You are down to a very restricted universe, excepting that -- unless you want to play structured and securitized products, and I won't go there.

So it's a very, very small universe. What you're asking for is a high degree of concentration.

So what intelligent people do -- and what we do is not that much different than what David Swenson does at Yale University or what the guys at the CATS or CPPIB or any other -- Temasek, like any other great institution that you admire, is if you got long liabilities, you invest long. And if you can't buy long bonds and get adequate diversification, you go to other things.

This is not a passing fad for us or something that we discovered in the fourth quarter of last year. This is a thing that we've been doing year in, year out, with a great deal of success.

Mario Mendonca - *TD Securities - Analyst*

Thank you.

Operator

Doug Young, Desjardins Capital Markets.

Doug Young - *Desjardins Securities - Analyst*

Good afternoon. Just -- I guess this might be a question for Scott. There was a comment made in the prepared remarks about how the flattening yield curve was a benefit, but I think it's that the tail end of the curve kind of pushed down. Which goes counter to the way I think about the sensitivity for Manulife or any insurance company with rates.



So I think there might be something -- and hopefully it's easy to explain or we can take it off-line -- but I just wanted to get a better sense of how Manulife benefited from the flattening of the yield curve.

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Sure, Doug; it is Scott. Yes, I think you can see our disclosures on our interest rate risk; and you can see for risk-free rates it's fairly low. I think like CAD100 million for a 50 basis point drop.

But that's assuming all rates globally move in a parallel fashion. We are dealing with rates in Canada, the US, and various markets in Asia, and they are all moving differently. And the shape of those curves is also moving.

Our primary goal is to hedge against the overall level of rates. We don't fine-tune it in great detail to the shape of the curve.

A lot of our hedges, particularly in North America, are stacked up at the long end of the curve, which gives us a little bit of accounting exposure, I would say, to the shape of the curve, where we are going to benefit from a flattening and we're going to lose a little bit in a steepening.

Doug Young - *Desjardins Securities - Analyst*

So it's more on the hedging side where the benefits have come through, because of where they basically stand on the curve?

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Yes.

Doug Young - *Desjardins Securities - Analyst*

Okay, I think that's -- then maybe just big picture, Donald, there's been, obviously can't go through a call without a question on acquisitions. There has been discussions in Asia; there's a lot of bancassurance deals that have been floating out there. They are not cheap.

Just want to get a sense -- you've done Standard Life. On the acquisition front, your appetite, would it be more on the distribution side? Would you be willing to take a big step into bancassurance in Asia? Maybe just a little color. Thanks.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Doug, you've got to send me the names; it sounds like there's some bancassurance deals in Asia I should know about. Only kidding.

It doesn't fall into -- I guess it's a pretty similar answer to what we usually give. We look where the greatest opportunity is around the world.

It doesn't have a geographic focus. We don't have any big holes in the portfolio that we think we have to make up.

So we look at each deal on an opportunistic basis; say: what does it do for our shareholders at the margin? So we are looking at any point in time acquisitions of blocks of business, acquisitions that position us with better strategic advantage in a given market, acquisitions that give us distribution with quality partners that we respect and think can add value to.

The other thing is sometimes we lose them, sometimes we get them. We don't aim for a track record of 90% success. Quite candidly, it's less than 50% success, and I'm quite happy with that. Because if you're getting 90% success, you're overpaying systematically.

So there is -- it's all within the rubric of what we want to do strategically. You're not going to find that we're -- waking up buying a bank in Patagonia. It's all what fits in the rubric, and that's why I wanted to talk to a little bit about our three themes of our strategy: that you shouldn't be surprised if you hear that we are buying an investment management operation somewhere in the world where we don't have an insurance operation. Because we look at that as a global business.

So we have a very strong strategic rubric of what we want to build. If it fits within that rubric and it comes at the right price, or we think we can pay a higher price and enhance it significantly, which would give you a great return over the long term for our shareholders, we aggressively go after it. And we get less than 50% of the ones we go after. Does that help?

Doug Young - *Desjardins Securities - Analyst*

Yes, that helps. That's fine. Thank you very much.

Operator

Tom MacKinnon, BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Yes, thanks. Good afternoon. Just going back to the investment gains, as I look at them, there must have been CAD353 million of losses. Then you threw CAD50 million of that into core, and you called -- or CAD50 million positive into core; so therefore you had CAD403 million in terms of non-core investment losses.

So of that CAD353 million, you've told us that CAD200 million was from a markdown on NAL Resources. What was the other CAD153 million comprised of?

Scott Hartz - *Manulife Financial Corporation - EVP General Account Investments*

Yes. Tom, it's Scott. You have the numbers right. It was CAD350 million of losses, and a little less than CAD300 million was our total oil and gas mark-to-market. And then there was another CAD100 million of secondary modeling effects due to that drop in market value.

So really the oil and gas really explains all of it, or even a little more than all of it. And then there were some other pluses and minuses. It was a good credit quarter yet again; we had some trading gains; there were some other modeling impacts.

But all of those are minor. Really the story for the quarter was the market value change in the oil and gas.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay.

Warren Thomson - *Manulife Financial Corporation - Senior EVP, CIO*

Tom, it's Warren. Just to clarify that, too, the oil and gas loss was two components. The NAL was one piece, and the second piece that Scott spoke to was more related to the direct holdings in our limited partnerships in the US, etc.



Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, thanks. Then, Steve, I was wondering. You took us through some of those policyholder experience losses. I was wondering.

There is another item that was mentioned, timing of certain expenses that hurt the core earnings in the quarter. Can you elaborate on a little bit as to what those were?

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

Yes, for sure, Tom. I gave you the CAD50 million number post-tax on policyholder experience. I would probably give you a CAD25 million number in terms of expense.

And there is a bit of timing -- sorry, a bit of seasonality I think on our expense, particularly in Asia where in the fourth -- the fourth quarter of the year tends to be the strongest quarter. This would be particularly the case in Hong Kong.

And we tend to ramp up our branding spend in Q4. So there's definitely a pickup in costs in Q4. So if you compare this Q4 against the Q4 of the previous year, the expenses are pretty flat actually.

The other thing would be that all these various projects that we've been talking about -- and overall we are ahead of plan on realization of benefits in the E&E program, but we did have a fairly chunky spend in Q4 on certain projects that are not going to be producing benefits until later in the program. So I'd say there is about CAD25 million that you would probably say is not what you'd expect to recur in Q1.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, thanks. Then just a final question for Donald. I think in your -- in the press release, you did talk about headwinds from interest rates. Yet you made CAD533 million in fourth quarter, and interest rates were down 30 basis points. And then if I look in the strain it didn't seem to have any material impact with respect to your strain.

So what are these headwinds that you talk about? Where are we going to see them? And where would we see them?

We certainly didn't -- were they evident in the quarter? Because we did certainly have rates go down in the quarter.

Donald Guloien - *Manulife Financial Corporation - President, CEO*

Well, yes, I guess I'll give a very simple man's answer -- because I'm a simple man, not because the question isn't. The gain in the quarter occurs because of the shape of the yield curve changes, basically. And while it's down in general direction, it's not down at all points and so on; and a whole bunch of other factors factor into that.

In terms of the headwinds, it also changes the pads and the timing of the release of gains, which was something that would be affected in the next year and in some cases could cause strain at issue. So a product that we priced in a slightly higher interest rate environment or a higher interest rate environment being sold in a lower interest rate environment, as you well know, can throw up some strain.

So the sum total of that is the kind of thing we're talking about. Again, it's not a gigantic factor relative to things that we've seen hit or impact our financial statements.

And as you say, when you compare it against the type of investment gains that we regularly generate, again, something that could easily be overcome. But we just want to be very disclosive and tell people at any time when we see a headwind.



Maybe it will disappear; maybe it will be overcome by other things. But it is a headwind, and you want us to be honest with you, so we're going to talk about headwind.

Tom MacKinnon - BMO Capital Markets - Analyst

(multiple speakers) impact, I'm trying to quantify what -- because we did have rates down in the quarter, I'm trying to quantify how much it would have impacted the quarter's core number.

Donald Guloien - Manulife Financial Corporation - President, CEO

Yes, last quarter?

Tom MacKinnon - BMO Capital Markets - Analyst

Yes, fourth quarter. I mean, I think we started with a 240; we were down over 30 basis points in the fourth quarter, at least on a US 10-year.

Steve Roder - Manulife Financial Corporation - Senior EVP, CFO

Yes, okay. Round number 15, Tom.

Tom MacKinnon - BMO Capital Markets - Analyst

Where would that have showed up in? The strain, or the PfADs, or lower earnings in surplus? Where were things?

Steve Roder - Manulife Financial Corporation - Senior EVP, CFO

It would be PfADs and it would be in earnings on surplus, and a bit in strain. Those would be the three components.

Tom MacKinnon - BMO Capital Markets - Analyst

Is that fair enough? That's not even CAD0.01. Do we go and extrapolate that out using -- if it were down twice that, we go and double that thing and then run it on a quarterly basis? Is that fair enough a rule of thumb that we should try to work with here?

Steve Roder - Manulife Financial Corporation - Senior EVP, CFO

We can't predict what's going to happen for interest rates for the next 12 months. This was a particularly difficult quarter from a macro perspective, so I don't think I would want to go there.

One other thing I would point out, by the way, is the interest rate movements are not unrelated to currency. And the headwind is interest rates, but there is a bit of a tailwind on currency in terms of where the US dollar has gone since we put the plan together.

So as we sit here today and look at our plan, the headwind of interest rates is counterbalanced somewhat by the currency tailwind. But there's another (multiple speakers)



Tom MacKinnon - BMO Capital Markets - Analyst

If we had the rates go the other way and forget about the currency, would we expect a positive 2015, if the rates had gone the other way in the quarter?

Steve Roder - Manulife Financial Corporation - Senior EVP, CFO

By and large, yes, that would be the case. Yes.

Tom MacKinnon - BMO Capital Markets - Analyst

Okay. Thanks for that.

Operator

Dan Bergman, UBS.

Dan Bergman - UBS - Analyst

Hi, good afternoon. I was just hoping you could provide a little more color on what drove the weakness in the long-term care business this quarter? Maybe just in general, also any updated thoughts you had around how we should think about the overall health of that block, given the decline we've seen in US interest rates in the past few quarters?

Steve Roder - Manulife Financial Corporation - Senior EVP, CFO

Yes. This quarter, if you look at the data compared with expectations, we had pretty high frequency of claims in the quarter. Marginally higher utilization.

But as I say, if you look at the quarters in the year sequentially, we've had volatility from one quarter to the next. We've had two positive quarters and two negative quarters.

So we've obviously looked at it closely and, as I said earlier, no alarm bells ringing at the moment. But we obviously continue to look at it closely, and we'll see how Q1 plays out.

Dan Bergman - UBS - Analyst

Got you. Maybe just in terms of interest rates, is there any near-term pressure you're seeing due to that in the business? Or is that something that you are just going to monitor longer-term?

Donald Guloien - Manulife Financial Corporation - President, CEO

In respect to the long-term care?

Dan Bergman - UBS - Analyst

Yes.



Cindy Forbes - *Manulife Financial Corporation - EVP, Chief Actuary*

It's Cindy. There is no particular pressure because of interest rates on long-term care. On a Canadian IFRS basis, our reserves take into account the current interest rate environment every quarter; and so they take into account the change in rates. So I wouldn't see any particular impact from interest rates on LTC versus any of our other blocks of business.

Dan Bergman - *UBS - Analyst*

Great, thanks. Maybe staying on the topic, in terms of your methodology for setting those long-term care assumptions and reserves margins, can you just remind me whether you include future rate increases that I guess either haven't been filed yet or haven't been approved by regulators when you do that analysis? I guess just any color on your methodology or thinking in that regard would be helpful. Thanks.

Cindy Forbes - *Manulife Financial Corporation - EVP, Chief Actuary*

Sure. As we disclosed in 2013 financial statements when we discussed our basis changes, we do include future rate increases that we plan to file for. And we last updated that in 2013 when we did our last review of assumptions.

What we disclosed at the time is that the impact of including future premium increases in our reserves had a benefit of about CAD1 billion impact on earnings. So CAD1 billion post-tax.

We do -- because on Canadian IFRS we have to put provisions on every single assumption we make. So we have provisions for how much of the rate increase will be approved. So we do have them in our reserves but on a conservative basis.

We also take into account our expected timing of getting those increases, and we're conservative on that front, too, in line with Canadian standards which require you to take -- to have margins on all of your assumptions.

Steve Roder - *Manulife Financial Corporation - Senior EVP, CFO*

It's probably worth saying the first time around when we did the price increase we would have padded the assumptions varies substantially. And in the event, the pads proved to be much more than was required.

So we have that experience when we're setting these assumptions.

Dan Bergman - *UBS - Analyst*

Great. That's very helpful. Thank you.

Operator

Sumit Malhotra, Scotia Capital.

Sumit Malhotra - *Scotiabank - Analyst*

Asked and answered, guys. Thanks for your time.

Operator

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

Robert Veloso - *Manulife Financial Corporation - VP IR*

Thank you, operator. We will be available after the call if there's any additional questions. Have a good afternoon, everyone.

Operator

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

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