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PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good afternoon and welcome to the Manulife Financial second-quarter 2016 financial results conference call for Thursday, August 4, 2016.

Your host for today will be Mr. Robert Veloso. Please go ahead, sir.

Robert Veloso - *Manulife Financial Corporation - VP of IR*

Thank you and good afternoon. Welcome to Manulife's conference call to discuss our second-quarter 2016 financial and operating results.

Today's call will reference our earnings announcement, statistical package and webcast slides which are all available in the investor relations section of our website at Manulife.com. As in prior quarters our executives will be making some remarks and 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 webcast slides for this conference call as well 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 our performance in non-GAAP measures used in today's presentation.

When we reach the question-and-answer portion of our conference call, we would ask that each participant please adhere to a limit of one or two questions and if you have any additional questions please re-queue and 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 results for the second quarter of 2016.

The quarter, as you know, presented a very challenging operating environment. The volatility in equity markets remain highly elevated. In many markets interest rates hit all-time lows, most notably in long US bond yields which dropped roughly 30 basis points during the quarter and 90 basis points over the past year.

These and other factors contributed to disappointing core earnings and net income. Despite the challenging environment our underlying business remained resilient and our key drivers of growth continued to perform very well. We generated an 11% increase in insurance sales driven by record results in Asia.

We achieved a 34% increase in New Business Value which speaks to the quality of the sales and margin that we generated this quarter. We once again delivered positive net flows across our Wealth and Asset Management businesses globally, one of few firms that is able to make that claim. We reported a 25% decline in gross flows, but you will recall that last year's record flows included an $8 billion institutional mandate and exceptionally strong flows coming from mainland China. We also maintained very strong regulatory capital ratio of 236%, up 3 percentage points from the previous quarter.

Turning to slide 6, where we review our key highlights during the quarter. In Asia, we delivered record annualized premium equivalent or APE sales, up 34%, and growth in New Business Value of 47%. We've continued to experience strong momentum in the DBS partnership with Singapore, Hong Kong, Indonesia and mainland China all recording record growth versus last quarter.

We launched our single highest, second highest Wealth and Asset Management growth flows on record driven by the launch of the first US property real estate investment trust in Singapore and strong mutual fund sales in mainland China and we continue to enhance our customer facing technology. In mainland China we began to handle claims via WeChat and in Hong Kong we introduced the second generation of our electronic point-of-sale tool which features increased financial needs analysis capabilities.

In Canada we delivered strong gross flows in our Wealth and Asset Management businesses, up 7% compared to the prior year despite challenging market conditions. We delivered retail insurance sales which were in line with the prior year and we continue to make it easier for our customers to do business with us by extending life insurance eligibility to Canadians with HIV and simplifying our medical underwriting process for lower coverage amounts.

In the United States we delivered solid gross flows in our pension business, an increase of 23% versus the second quarter of 2015 with success originating from both the small and midmarket segments of that business. We completed the integration of the pension business we acquired from New York Life and exceeded our targets for sales and retention in the first 12 months post-acquisition.

We expanded the Vitality program by adding two term insurance options, one offering lower fees and the other offering a streamlined customer application process. However, overall we recorded lower insurance sales and modest mutual fund net outflows in the United States.

In terms of our global Wealth and Asset Management businesses, we delivered our 26th consecutive quarter of positive net flows. We reported core EBITDA of CAD288 million and continued to strategically invest in expanding distribution rates and operational infrastructure. And we achieved CAD503 billion in assets under management and administration, lifting our total Company figure to CAD934 billion.

So in summary, while core earnings were disappointing it would be overly simplistic to project full-year earnings by simply multiplying our year-to-date results by two. Our underlying businesses remained resilient, our key drivers of growth performed very well and we are taking a number of steps to improve earnings in the second half of the year.

We are very much focused on achieving or exceeding our CAD4 billion core earnings goal this year, but for the CAD400 million investment related component which as you know is largely in the hands of markets.

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

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

Thank you, Donald. Good afternoon, everyone. Let's start on slide 8 where we summarize our financial performance for the second quarter of 2016.

As Donald mentioned we were disappointed with our profitability metrics in the second quarter. Core earnings and net income were lower than we would have liked and additionally core ROE was impacted by higher equity.

We are focused on ensuring that the second quarter is not representative of the balance of the year. And our key growth drivers continue to perform very well. In the following slides I will discuss the key drivers of our financial and business performance.

Turning to slide 9, core earnings decreased CAD69 million or 8% compared to the second quarter in 2015. This reflects the absence of core investment gains versus CAD51 million included in the prior year, higher expected macro hedging costs and lower earnings on surplus assets partially offset by the favorable impact of foreign currency.

Turning to slide 10, net income in the second quarter was negatively impacted by the challenging environment including falling interest rates and volatile equity markets which led to a CAD170 million market-related charge. This more than offset investment related experience gains of CAD60 million which included very strong credit experience and modest gains on alternative long-duration assets.

On slide 11 is our source of earnings. Expected profit on in-force increased 3% from the prior year on a constant currency basis, primarily due to lower amortization of deferrable acquisition costs in our Variable Annuity businesses, partially offset by lower earnings from our Wealth and Asset Management businesses. The impact of new business improved versus the prior year, largely reflecting higher insurance sales volumes in Asia, partially offset by higher non-deferrable acquisition expenses in our Wealth and Asset Management businesses.

Experience losses this quarter reflect charges for direct market impacts and unfavorable policyholder experience, partially offset by favorable investment-related experience gains. This quarter we incurred a charge of CAD106 million pre-tax or CAD63 million post-tax for a policyholder experience as adverse experience in the US and Canada was only partially offset by continued favorable experience in Asia.

Management actions and changes in assumptions this quarter primarily reflects the expected cost of our macro hedging program and integration costs, partially offset by realized gains on available-for-sale bonds. And earnings on surplus decreased primarily due to lower available-for-sale equity gains and higher debt financing costs due to new issuances.

Turning to slide 12 and insurance sales. Insurance sales in the second quarter increased 11% from a year ago, reflecting record sales in Asia up 30% versus the prior year and driven by double-digit growth in most territories and strong momentum from the DBS partnership, partially offset by inherent variability in Group Benefit sales in Canada and lower US insurance sales amid heightened competition. Excluding Group Benefits, total Company insurance sales were up 19% from the prior year.

On slide 13 you can see that both net flows and gross flows remained resilient and all our divisions reported positive net inflows. As Donald mentioned, this was our 26th consecutive quarter of positive net flows in our WAM businesses. We are pleased with our net flows of CAD4.8 billion, especially given the challenging market conditions.

While net flows were down from the prior year, you will recall that last year's record flows included an CAD8 billion institutional mandate and very strong flows in mainland China as a sharp rise in local equity markets drove significant mutual fund inflows. Gross flows declined 25% from the prior year to CAD26.6 billion, reflecting lower institutional gross flows due to the non-recurrence of the substantial mandate I previously mentioned which more than offset strong gross flows in the US and Canada.

Moving to slide 14, Other Wealth sales were up 6% in the second quarter compared to the prior year, reflecting strong double-digit sales growth in Asia driven by the continued success of recent product launches in Japan and Singapore, partly offset by declining sales in Canada which were impacted by challenging market conditions and product changes.

On slide 15 is our New Business Value. We had a strong quarter with the New Business Value increasing 34% from a year ago. The growth was driven by Asia which increased 47%, partially offset by weaker results in North America which were impacted by the lower interest rate environment.

New Business Value margins in Asia increased to 29.7%, up 2.3 percentage points from the prior year. This was most notable in our Asia Other segment where higher volumes, in part due to contributions from the DBS partnership, led to margin expansion of over 8 percentage points to 25.4%. We also benefited from improved product margins which more than offset the impacts of lower interest rates.

Turning to slide 16, our assets under management and administration, or AUMA, at the end of the second quarter was CAD934 billion, up CAD51 billion from the prior year. The increase was largely driven by net custom inflows, strong investment performance as well as foreign currency movements.

On slide 17, you can see our capital position and leverage. We continue to eye a path of diversifying our funding sources globally and successfully completed a $1 billion senior debt offering in Taiwan and a SGD500 million subordinated debt offering in Singapore. These transactions mark our first entry into the Asian debt markets, which has a large fixed income investor base and where we have a significant business presence that builds on our first-quarter US bond offering.

The offerings were the primary drivers of the strength in capital ratio and higher leverage ratio in the quarter.

Turning our focus to the operating highlights of our divisions, we begin with the Asian division on slide 19. Asia core earnings increased 12% on a constant currency basis driven by higher sales volumes, partly offset by lower interest rates. We achieved record annualized premium equivalent or APE sales of $627 million, up 34% from the prior year, reflecting double-digit growth in most markets and strong sales in Singapore, Hong Kong, Indonesia and Mainland China as we continue to experience strong momentum from the DBS partnership.

We delivered strong gross flows into our Wealth and Asset Management businesses of $3.5 billion in the quarter, albeit down from record results in the prior year which benefited from strong equity markets in Mainland China.

Turning to our Canadian Division's operating highlights on slide 20, core earnings increased 10% over the prior year driven by improved policyholder experience in Group Benefits and higher fee income from the Wealth and Asset Management businesses, partly offset by the non-recurrence of gains from reinsurance treaty recaptures. Insurance sales of CAD120 million declined 28% versus the prior year, reflecting inherent variability in large case Group Benefits sales. Wealth and Asset Management gross flows of CAD4.2 billion increased 7% compared to the prior year, largely due to strong mutual fund flows despite challenging market conditions.

Moving on to slide 21 and the highlights for the US Division. Core earnings were $280 million, down 11% from the prior year, reflecting more unfavorable policyholder experience in Long Term Care relative to the prior year, a number of smaller policy-related items from the second quarter of 2015 which did not recur, the impact of lower insurance sales and the timing of market spend and the impact of market volatility on fee income and shifts in business mix on our Wealth and Asset Management businesses.

Insurance sales in the quarter were $107 million, down 9% from the second quarter of 2015 due to lower life insurance sales as the expansion of the Vitality program and the momentum in recently repriced term insurance was more than offset by competitive pressures. Wealth and Asset Management gross flows of $11.7 billion increased 5% versus the prior year, reflecting robust mid-market pension sales which were partially offset by lower mutual fund flows due to challenging market conditions and weaker fund performance. However, it's important to note that despite these headwinds mutual fund gross flows continued to outperform the industry.

Turning to slide 22 and the overview of our Wealth and Asset Management businesses around the world. Core earnings of CAD152 million decreased 5% compared to the prior year due to the impact of market volatility on fee income, shifts in business mix and strategic investments to expand our distribution reach in Europe and Asia and to modernize our operational infrastructure.

Assets under management and administration of CAD503 billion were up more than CAD28 billion from the prior year, reflecting positive net flows and the benefits of the strong investment return. We are very pleased we achieved positive net flows of CAD4.8 billion in the quarter amid very challenging market conditions.

Despite these headwinds, positive net flows were delivered across all our divisions and within mutual funds, pensions and institutional asset management. We also successfully launched the first US property real estate investment trust in Singapore.

Moving to slide 23, as of June 30, 2016 the annual net pre-tax savings from our E&E initiative reached CAD450 million, exceeding our 2016 target of CAD400 million. While 2016 will officially mark the end of our E&E program, the program has resulted in a new way of life at Manulife. And we will continue to identify and execute on additional opportunities to make our operations more efficient and effective.

In the third quarter of 2016 we will complete our annual review of actuarial methods and assumptions. This year's review will cover over 100 assumptions including policyholder experience assumptions related to our Long Term Care and US Variable Annuity business and reinvestment assumptions used in the valuation of our policy liabilities.

While the review is not complete and the impact is difficult to estimate with precision, preliminary indications are that the impact could be a charge to net income attributed to shareholders of up to CAD500 million post-tax. This figure includes an allowance for a potential update to our ultimate reinvestment rate assumption for risk-free rates.

So in conclusion, while net income and core earnings this quarter were disappointing, we are pleased with how resilient our underlying business remained. Our key drivers of growth are continuing to perform well and we are focused on improving earnings in the second half of the year.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Aiken, Barclays.

John Aiken - *Barclays Capital - Analyst*

Good afternoon. Steve, with the efficiency and effectiveness initiative, the CAD450 million run rate is very difficult for those of us on the outside to ascertain. Can you let us know ballpark figures how much that amount to date has been reinvested in new projects and how much of that is being sopped up with just general business growth or factors like the growth of the Asia platform that you mentioned in your remarks?

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

Yes, thanks, John, thanks for the question. The way we look at it is that the run rate save of what is now CAD450 million to a very large extent, that has been offset, if you like, by strategic project spend and that project spend has a wide spectrum of types of projects. So on the one hand it would include a lot of activity around customer facing digital initiatives.

On the other hand, it would also include projects that relate to the improving infrastructure of the Company, projects such as the, which we've talked about before, the valuation systems transformation project dealing with how we go about valuing our liabilities each quarter, the infrastructure of the investment division, another very large project called the GO project. So until now a lot of that is not being seen net, if you, like in the bottom line. As we move forward, and we will try and get more guidance on this as we get through our planning process and probably in Q4, we would like to think that as we go forward we will start to see more of this coming through into the bottom line.

In reality, what's happened is we just continued on with a lot of project activity. And many of these projects you have to spend to save and that's still going on.

In terms of I will take the opportunity to talk about the growth in expenses in the year as well because I think you have to be a little careful when you look at the expense growth in the year. In, if you like, the baseline number, you have to be careful to adjust it for things like currency and also the timing of onboarding New York Life and DBS. So what I can say is that once you normalize the baseline the growth in expenses for the year is actually about 6% which is lower than the number you get on a headline basis.

And of that at least well over half of that is actually to do with sales-related expenses in Asia that don't rank for deferral. So overall we've got to keep very focused on expenses. We will certainly be doing that in the second half of this year and as we go forward, and we will try and give more clarity on E&E towards the end of the year.

John Aiken - *Barclays Capital - Analyst*

But Steve, not to nail you down to particular numbers, but looking for to 2017 and 2018 could we expect to see some more tangible results flowing through on the expense line? Not necessarily in absolute numbers but at least on relative growth against what we're seeing on premiums and sales?

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

Right. So we are going through updating our planning process right now and we will have to see how these projects roll forward and to what extent they will fall through to the bottom line. But as I say, we'd like to think as we continue on to succeed in the efficiency and effectiveness project that that starts to net-net turn into bottom line because I still believe to some extent there's only so much you can spend on projects each year.

I'll give you an example. The VST project, for example, that's the valuation project on the liability side of the balance sheet, the total project spend on that is not far short of CAD100 million. And it will ultimately give a run rate save of about CAD20 million a year but as of now it's still costing us.

So that would be a great example. And the GO projects on the asset side of the balance sheet, if you like, that's actually a bigger project. The cost of that is over CAD100 million and it will also produce run rate savings, but it's going to take some time to get there.

John Aiken - *Barclays Capital - Analyst*

Thanks, Steve, I appreciate it. I will re-queue.

Operator

Meny Grauman, Cormark Securities.

Meny Grauman - *Cormark Securities - Analyst*

Hi, good afternoon. Just a question on the CAD500 million indication for actuarial methods and assumptions. Did I catch it correctly; you said there was an allowance there for a potential URR decline? Is that correct?

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

Yes, that's correct. So our view is this, when we get to Q3 and we will have to take into account the facts and circumstances prevailing at the time, but there is a lot of talk around the revision of the URR and it may be that at Q3 we choose to take a charge in relation to changing our URR assumptions. So we haven't finalized that yet but included within that CAD500 million number that we've given you guidance on today there is a fairly significant amount in relation to potential URR charge.

Meny Grauman - *Cormark Securities - Analyst*

Would you be able to give some breakdown there in terms of what that is and then what the potential charge for the Long Term Care would be?

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

No, I can't get too specific. If I could be very specific I would be booking the charge right now. But we did give some guidance in our documentation that suggested that a 10 bps charge would cost us in the order of CAD300 million.

So maybe that gives you at least some help in getting to how the charge might breakdown. But I can't be specific.

Meny Grauman - *Cormark Securities - Analyst*

Okay, thanks for that. And then if it could just ask another question on the potential disposition of low ROE businesses, do you have any update on how that is progressing? Anything you can tell us on that?

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

Well, it's still early days in the project. These kinds of dispositions are not straightforward. We don't have to enter any transaction.

We won't do anything that's not in the shareholders' benefit. So I don't have anything more detail to report on that right now.

Meny Grauman - *Cormark Securities - Analyst*

Thank you.

Operator

Gabriel Dechaine, Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Hi, good afternoon. Just a follow-up on the reserve charge. So let's take that CAD500 million and if it is CAD300 million for URR, maybe it's less, I don't know, but that would mean CAD200 million of reserve charge for Long Term Care and VA.

That seems kind of low. It's good, but that seems kind of low. And I'm only saying that because over the past four quarters we have had well in excess of CAD200 million of negative policyholder experience in LTC specifically.

So I'm just wondering am I missing something there? Are you planning another repricing of LTC, did the 2013 process go better than expected? If you can help clarify please?

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

Yes, sure. So just as a headline, there is a huge number of assumptions being reviewed, Gabriel, and some are positive, some are likely positive, some are likely negative. We've obviously spent a lot of time focusing on Long Term Care which is a negative.

Maybe we don't speak so much about some of the positives and they are not so obvious. Let's ask Steve Finch to give you a bit more color.

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

Sure, Gabriel, it's Steve here. In this assumption review, as Steve mentioned, we're reviewing a lot of different assumptions and so on. And what we highlighted in the material was some of the material areas that we're reviewing on big blocks of business you noted Long Term Care, on Long Term Care it is a very comprehensive review.

It includes reflecting all the recent experience that you also noted as well as looking at our margins and we'll also include looking at our expectations on our success in getting future rate increases. So it will take all those factors into account and definitely reflect the more recent experience, as well.

On Variable Annuities, I think you assume that it will be a charge but we are actually finding some favorable aspects of policyholder experience that we're reviewing there. A few comments, as I said there are also other items that will be both positives and negatives. But as of right now the guidance on up to 500 is our best indication.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

That was a very helpful response. Then on the leverage ratio, you're at around 30% right now. Do you want to get back to 25% or in that ballpark?

I know there's about CAD1.1 billion of debt redemptions at the end of the year. I'm just wondering how eager you are to regain some of that financial flexibility because you've always liked that because of the uncertain macro and if anything we're even more of an uncertain macro.

And Donald, before I forget this one, you said don't take the first-half earnings and double them and get to an annualized figure because you're implying that there's stuff you can do to improve your profitability in the second half. What are you planning on there? I'd love to dive into that a bit, as well.

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

So Gabriel I will take the first part on the leverage and capital and then Donald can answer the second question. So yes, we've taken the leverage ratio up. We took a view that we had some fabulous capital raising opportunities in the first half of the year.

We were very, very pleased with what we were able to achieve. Particularly in Taiwan we were able to get 30-year money on very, very good terms. We think the pricing was very good. And so we took the view we should just take it because who knows what's going to happen in volatile markets, as you say.

So we've driven up the leverage ratio in the short term and you're absolutely correct, assuming we follow through on CAD1.1 billion of calls in the fourth quarter then the leverage ratio will come down by something in the order of 150 bps I would expect. So we'll probably be back down in 28, 28.5 range I would think at that time and that's fine. We're quite comfortable there.

Ultimately, one day we'd like to be back at 25 but I think even at 28 we've still got a fair bit of financial flexibility. So very comfortable there. And to be honest, if we can continue to raise money, 30-year money on very favorable terms we'd be inclined to always look favorably on that sort of opportunity.

And I do think the diversification has been a great thing because it's reduced the risk profile and it also served to bring in our spreads in general. So we count it as a success. Now maybe I will pass over to Donald and he can answer the question on the second half.

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

Yes, Gabriel, thank you for taking us there. We feel a lot of confidence about the second half being better than the first for a variety of factors, some in our control and others not. Some of the big ones are macro hedging costs.

We've taken a look at it and we think we maybe set the collars a little bit too tight. It's been great that we've been largely immune to equity market movements, are significantly immune but perhaps we kept the collars a bit too tight and that cost us in terms of core earnings.

There's a number, as Steve has discussed extensively we're getting these enormous savings from our E&E project that we're plowing into forward facing investments. One of the beauties of these forward facing investments, as necessary as they are to do to keep the health of an enterprise going forward, is that you've got a lot of discretion about how fast they are implemented and so on.

While I've said over and over again that I will not stop something that is truly strategic for Manulife just to make a quarterly earnings result, we do have the ability to change the pace of those and, in fact, we're running well under plan on expenses right now. That's our internal measure.

Everybody is doing the typical thing, expecting that they are going to catch up over the next half of the year and we won't necessarily let people do that. There's a pace to these things that we can manage. There's also other things where we have implemented E&E savings and some of our acquisitions where we will be harvesting greater gains going forward than we have to date.

Last but not least is all the new business we're adding. Some of it, most of it costs in one way or another. Steve talked about non-deferrable acquisition costs associated with various businesses that are growing rapidly like in the investment management business and in Asia.

That produces a stream of earnings going forward. Both of those businesses and all of them, in fact, produce a very positive stream to earnings going forward. It is really interesting, again, that we are going fastest in the businesses that have the highest margins and highest ROE and actually where we've got disappointments in terms of sales growth it is in areas that actually tend to have deficient ROE and lower than average margins across our enterprise.

So the business mix is shifting in a very favorable way. That's not entirely by accident. We are allocating resources, strategic capital, everything else towards the businesses that have the higher margins for our investors.

So there are other reasons but I don't want to speak too long and I guess you'd probably love me to speak for half an hour on this one. There's a number of things that Steve and I --

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Gabriel Dechaine - *Canaccord Genuity - Analyst*

I would.

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

Well, we feel a lot of confidence --

Gabriel Dechaine - *Canaccord Genuity - Analyst*

More numbers, though, too.

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

Barring extraordinary factors we've said it before we are very targeted as an organization in making CAD4 billion of core earnings, that includes the CAD400 million of investment-related component. Earlier in the year I said the CAD400 million given oil and gas prices looks like it's going to be unattainable.

But we have never backed off the other element of it which is the element that we can control. Our entire compensation system is targeted on achieving the result with the CAD400 million in there and so on. And we as a management team are very committed to producing that result.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Well, I appreciate the response. I'd love to dive into it more but I know others have some questions, as well.

So I don't want to hog. Have a good remainder of the summer.

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

Thank you.

Operator

Robert Sedran, CIBC.

Robert Sedran - *CIBC World Markets - Analyst*

Hi, good afternoon. This issue has come up from time to time on conference calls and I want to ask about interest rates and specifically what the interest rates mean to core earnings.

You probably can't quantify for me how much of a headwind they are to core earnings today. If you can it would be great, but part of what I'm getting at is the linearity of that exposure. In other words, is the decline from 3% to 2.5% the same impact roughly as the decline from say 1.5% to 1% if we were ever to go there?

Does it become more significant as rates go lower? I know that it does in some cases on the headline. I'm thinking more in terms of some of the core earnings that are being held back by lower interest rates.

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

Okay, hi Robert. It's Steve here. I will take a bit of a crack at that and then maybe pass it to Steve Finch.

No I don't think you can take that view that it's linear. I think the reality is interest rate declines may force management actions. And so, for example, in this quarter we've taken management actions in Japan to reprice product.

We even withdrew a particular Japanese yen product, albeit a product that we largely sell in foreign currency. So I think it's a bit more nuanced than that.

Having said that, and you're right it's very hard to quantify the overall impact on core earnings of declining interest rates. But let me pass it to Steve because I think he does have a bit of an overall view on what interest rates did to us this quarter.

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

Yes, and I think it's been explained in previous calls that when interest rates go down there is some knock on impact to our go-forward core earnings because our PADs become lower and there's less to release in the future. It's not a huge number and I think in general that's fairly linear. We've probably bumped into some minimum crediting rates which make it not quite linear but reasonably linear.

The other place you see it come through, what Steve was talking about, Steve Roder, is in our new business gains. And if you look at the trend from Q1 2016 to Q2 2016, some of that decline is from lower new business gains, which then the business can react to by modifying products and so on. So it is hard to put a figure on it but that's where you would see it coming through.

Robert Sedran - *CIBC World Markets - Analyst*

Thank you. And just I guess a point of clarification on something that Donald mentioned in his answers to Gabe. When you talked about the collars on some of the equity exposure, am I to understand that that equity exposure might be going up or just the nature of the equity exposure might be changing?

I look at the S&P and as much as we talk about market volatility, the S&P 500 is at reasonably healthy levels I guess. And I'm wondering what the view is on changing the way you look at those exposures at this point?

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

Yes, what we're talking about is for intraday movement a little bit greater. So we would be taking a little bit greater risk on intraday movement. And theoretically if markets went really, really bad there would be a little margin, there would be a little increase in equity risk.

But basically we think the price of hedging too narrowly exceeds the benefit to the shareholder by a pretty good margin.

Robert Sedran - *CIBC World Markets - Analyst*

So the philosophy is not changing, the implementation is changing a little bit?

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

I want to be straight. It will increase our equity exposure marginally, not something you would probably notice.

If equity markets were down 30% it's not going to be a meaningful difference. But what we're doing is hedging on an intraday basis and that's costing us, especially when you have markets going up and down like a seesaw based on election events or somebody's rhetoric or a terrorist event in some part of the world, that's costing us very dearly trying to keep it very tight. So we're going to open it up just a little bit.

Robert Sedran - *CIBC World Markets - Analyst*

Understood. Thank you.

Operator

Linda Sun-Mattison, Bernstein.

Linda Sun-Mattison - *Bernstein - Analyst*

Hello. Sorry you might hear noise in my background because I'm traveling. I have two questions to ask.

The first question is regarding the insurance sales in Hong Kong, in Asia. I can see that Hong Kong is growing very nicely. I'm just wondering how much this growth is coming from Mainland China, [Chongqing] and Hong Kong, therefore vulnerable to further capital control measures that China may take?

The second question is the URR, the ultimate reinvestment rate. This quarter it has dampened your earnings and just wondering why are you adjusting down the URR, this specific quarter are we going to see more -- what can trigger more downward revision and what kind of product, sorry, what kind of geography this URR actually impact you the most, so whether it's US, Canada or Asia? Thank you.

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

Thanks, Linda. We will ask Roy Gori to take the Asia question first.

Roy Gori - *Manulife Financial Corporation - President and CEO, Manulife Asia &*

Thank you, Linda. Linda, in terms of your first question on Mainland China business and its impact on Hong Kong, it's actually a relatively modest contributor to our overall Asia sales. Approximately 6% of our total sales come from Mainland China and in Hong Kong it represents less than 30%.

So whilst it does contribute to sales it is a relatively modest contribution and our Hong Kong business is primarily focused on the local domestic market. And there is where we have a very strong business. In addition to a strong agency, we've expanded our distribution and banker is now a much more significant contributor to our business in Hong Kong.

That's obviously off the back of the DBS partnership but also the furthering of our banker assets. So that's just probably a top-line snapshot summary to answer your question.

Linda Sun-Mattison - *Bernstein - Analyst*

Yes, thank you.

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

And then the URR question, Linda, I think this is a technicality around how reserving is required to be carried out. So Steve will just explain what is going on there.

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

Yes, hi, Linda. So the URR change that we're anticipating would come through in Q3 to be clear. And this is a rate that's prescribed by the Canadian Actuarial Standards Board in terms of what reinvestment assumptions are allowed in the valuation.

It was last set in 2014 and our expectation is that the Standards Board will reflect -- will update their guidance in 2017, taking into account the fact that rates have been lower over the last few years. It is a very, very long period that the Standards Board looks at. They go back all the way to 1935 in terms of calibrating this rate.

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

So Linda, just to add to that. So there is I'd say on balance of probabilities, the industry is expecting that guidance or requirement arising from the Canadian Actuarial Standards Board will change. And in that situation if we believe that the facts and circumstances suggest it prudent to do so, then we're giving some guidance that we would expect to take a charge in relation to that as part of our Q3 basis change.

Linda Sun-Mattison - *Bernstein - Analyst*

Okay, so just to clarify, so basically industry is expecting the guidance to change and you are taking basically giving us guidance what the impact would be for you if that is going to happen in fact?

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

Yes, we take the view that we'd rather be imprecisely right than precisely wrong. So take some charge now and then we will true it up when the actual guidance appears rather than wait necessarily for the guidance to arrive.

Linda Sun-Mattison - *Bernstein - Analyst*

And in this regard is it completely prescriptive, and forgive my ignorance, is it completely prescriptive or is there discretion left to specific Company management view and actuarial view?

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

It's prescriptive in Canada but then we have to apply consistently in our other operations. So there's some judgment there.

Linda Sun-Mattison - *Bernstein - Analyst*

Okay, great. Thank you.

Operator

Tom MacKinnon, BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Yes, thanks very much. A question on the interest rate charge that was taken in the quarter. Your sensitivity, again, shows really no impact on earnings from parallel changes in interest rates relative to the rates you assume in your valuation of policy liabilities.

So effectively the only thing that can hurt you would be the corporate spreads and swap spreads which were marginal and I didn't think they were going to impact it as much as what happened in the quarter. It seems as well that a lot of the interest rate headwind came from -- this is on the reported number -- came from the Asia operations. So was there something with respect to interest rates in Asia or perhaps in Japan that hurt you more specifically in the quarter than what your guidance generally explains?

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

So Scott is going to take that question, Scott Hartz will take that one, Tom.

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

Yes, hi Tom. And so, yes, our disclosure is that for a parallel shift does not affect us much, but that assumes a parallel shift the same amount in all countries, all geographies and, of course, rates don't shift in a parallel fashion. We do have some exposure to non-parallel, and it just gets very complicated to try to disclose all the nuances.

But I think you were right that the driver this quarter was really corporate spreads and we have an exposure to corporate spreads. They were tighter. What's most important to us are sort of long corporate A spreads and that's really the big driver.

There were a few tos and fros. I think you are right, swap spreads didn't have much of an impact, there have been other quarters where that's been a bigger deal. But that was not much this quarter.

So really it was corporate spreads. The big drop in Japan was not helpful, but not a big deal. Again, really it was the corporate spread move.

Tom MacKinnon - *BMO Capital Markets - Analyst*

And what was driving the decision not really to take much in terms of AFS gains in the quarter despite the drop in treasury yields?

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

We've kind of moved away from quarter by quarter taking gains or losses in AFS, unless we see a really big move that we think is going to be sustained and then we will typically do that. And so we did some of that in the first quarter. But this quarter wasn't that big a move and we didn't feel it was the right time to do so.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, and then a final question on Long Term Care. Assuming you get it right with your reserve review and your basis change for Long Term Care in the third quarter, what does that mean for -- presumably that means we shouldn't be having any sort of policyholder experience losses with respect to Long Term Care going forward, at least for some time until your experience deteriorates again. Help us walk through that then.

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

Okay, so correct. If we take -- if we were to take a charge in Q3 then that could be beneficial in terms of core earnings for the second half. So Steve can talk a bit about that.

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

Yes, hi Tom. I think your inclination, your view here is correct. We are definitely reflecting in our assumption review the impact of recent experience, which has been negative.

And we're definitely looking at the overall review with a bias to making sure we get the short term as well as the long term right. So I think we will be able to provide more information when we get to Q3. But directionally you're correct.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, thanks.

Operator

Sumit Malhotra, Scotia Capital.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks, good afternoon. I just wanted to come back to the URR one more time.

Steve, correct me if I'm wrong, in previous conversations around this issue you had indicated that this was more likely to be an event that the Company would have to deal with in 2017. If that's correct, the change today, is that a reflection of what you're being asked to show in the numbers from the regulators or is this just a view that maybe other items in the actuarial process aren't going to be that sizable, so it's better to be ahead of the process if you can?

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

Well, thanks. I'd say first thing nothing to do with the regulators at all. And facts and circumstances change and our understanding of those facts and circumstances change. So that would drive our accounting.

As I say my bias is always being imprecisely right rather than precisely wrong. So that drives up my thinking. But I will pass to Steve, he can give you a bit more color.

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

The only thing I would add is it's become also a lot more clear that the prescribed guidance is going to come in 2017 which I would say was uncertain earlier.

Sumit Malhotra - *Scotiabank - Analyst*

Sorry, meaning the official change or the mandated change will occur in 2017, but you're of the view that there's enough information that you can make the change now to, for lack of a better term, get ahead of it?

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

Correct.

Sumit Malhotra - *Scotiabank - Analyst*

All right. Then to go to the earnings for a second, if I think about the core EPS this quarter of CAD0.40 and just look back to three months ago, some of your line items don't look that different but the one that is always, at least from my seat, the biggest mystery to figure out is the experience gains. And you show us a large number there.

In your MD&A you talk about the CAD106 million in LTC pre-tax of unfavorable policyholder experience. Now if you can, if you leave the market impacts out of it, and looking purely at the insurance policyholder experience, are there other areas outside of US Long Term Care that are having a detrimental impact on this line?

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

Yes, hi, it's Steve Finch here. The number that you quoted, that's the total policyholder experience charge and Long Term Care was just under two-thirds of that.

In general I would say that's been a fairly consistent result over the last number of quarters. It has bounced around a bit. We're seeing consistent gains coming out of Asia claims results, and then we are seeing some lapsed losses coming out of different product lines in both the US and Canada makes up the rest of the experience.

Sumit Malhotra - *Scotiabank - Analyst*

But nothing that you would call unusually large this quarter? Because at least on the way I've looked at it that seems to be the area that was chiefly responsible for earnings coming in a little lighter this time around. Is that fair or am I not looking at that right?

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

There are a couple of isolated things and we're not sure that there are meaningful trends there because the experience did deteriorate a little bit from Q1 to Q2 of this year. The biggest driver was LTC and then it was a number of smaller items that don't generally look like trends.

THOMSON REUTERS

Sumit Malhotra - *Scotiabank - Analyst*

Okay, last one is for Donald. You're obviously sitting in a strong capital position. Steve touched on the fact you were able to bolster that with the issuances in a new geography and there was lots of demand and you are giving us as you usually do a pretty positive outlook for the Company and why things should be better in the second half.

So with all that said, the stock is trading 85% of book value per share. With the capital being where it is, it certainly seems like one of the best proceeds, use of proceeds for shareholders right now could be to buy some of that stock. Why have you, especially since the acquisitions have been quieter for Manulife of late, why doesn't it make sense with the stock where it is for the Company to be first in line to buy back shares back?

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

Yes, it's a fair question. I think we've said before that we're giving consideration and discussing that with our Board of Directors. We've always preferred to invest in the business, but when the stock price gets as low as it is stock buybacks could make sense and so there are active discussions, I can say that.

But the other thing is we're going to err on the conservative side with respect to the amount of capital that we hold for a number of reasons. None of us would have predicted rates would go as low as they are and it's having an impact on other asset classes. These are unusual times.

There's more volatility in the markets than there's ever been before for a whole variety of reasons. And the third thing is we're in the midst of a regulatory capital change here in Canada. And while we have no reason to believe that there's anything difficult come from there when we're adjusting capital ratios small changes equate to billions of dollars.

So we're inclined to be on the conservative side there. Again that's not foretelling any issues. We really don't know where that's going to end up, but it's better to have more that you have to think about different ways of deploying than have less and have to do a down round equity financing. I want to protect shareholders from that.

Sumit Malhotra - *Scotiabank - Analyst*

That's basically -- I will wrap it up here, this is basically the gist of my question. I've always thought it would make sense for you to at least file the paperwork on an NCIB so that if you have days or periods of time in which your stock is under pressure it gives you the option at least to be a buyer of the stock at those levels.

There's nothing like from an OSFI perspective that is preventing you from as I say filing the paperwork for NCIB. This is a Manulife decision, not something you've been asked to refrain from?

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

Well, I can't talk about the regulator, but I'm frankly not aware of any barrier whatsoever to us doing that if we choose to do it. It's a matter of the board deciding. And our bias has been quite clearly to use capital in other ways that are more productive. But again, we never anticipated that our stock price would be down at [CAD17] and change, and may be that changes our thinking. Some words that you have used in describing it is very similar to words I've heard elsewhere, shall we say. So it's clearly under consideration.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks for your time.

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

Sumit, just one add-on to your question about Q1 to Q2, where you are trying to get under the reason for the decline in core earnings. One thing that should not be overlooked is the impact of foreign currency. So the decline in or the weakness in the US dollar between Q1 and Q2 probably cost us quite close to [CAD40 million]. So quite a big piece of that decline in core earnings is pure foreign currency related.

Operator

Mario Mendonca, TD Securities.

Mario Mendonca - *TD Securities - Analyst*

Good afternoon. Steve and Donald, because of the improved disclosure around pre-tax experience items and items of note, it has become easier to drill down on those items. And one area in particular that I'm focusing on is trying to back into the unallocated expenses. And I think I've come fairly close to understanding what that's all about.

Could you help me understand, did the unallocated expenses, have they increased say quarter to quarter or over the last year or so?

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

Hi, Mario, it's Steve. No; the answer is no, they haven't. I think most organizations have a level of allocated expenses, and our business as usual trend in allocated expenses I'm pretty happy with. There has been some strategic spend in the center that is not allocated as well. Most of it is associated with the buildout of the investment division infrastructure.

So earlier on when I talked about the true normalized growth, if you like, in expenses, it's around 6%. And I mentioned that over half of that was associated with sales in Asia. Well, around a quarter of it is related to the buildout of the investment division's infrastructure and that relates to the buildout of the European initiative to further our ability to distribute product across European institutions. It includes some private market buildout and it includes expenditure in relation to the Go project.

So those would be in there. And that takes care of most of the increase in expenses. It doesn't relate to that Asian sales-related expense growth.

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

Mario, if I can jump in remember, we're building that business the hard way, that is organically, by constant investment. But as you would really appreciate, it is much cheaper doing it that way, it's now a CAD500 billion business. If you went out and bought a CAD500 billion asset management company I think you'd know what that would cost.

And it's a lot less. It's multiples, multiples higher, easier to do to buy somebody else's finished business than to grow it organically piece by piece and we're going to continue. That's where you talk about where people talk about where the savings of E&E are going, that's one of the places it's going, the other place is obviously Asia that we're continuing to invest in. And that is all being reflected through run rate expenses.

Mario Mendonca - *TD Securities - Analyst*

Sure, I get it. Building doesn't create goodwill, so materially change, I follow that.

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

You've got it. I'd like to ask you to repeat that, but that would be unfair.

Mario Mendonca - *TD Securities - Analyst*

I get it. The other thing I wanted to quickly touch on is if we were to, sort of a related topic, if we were looking a year out from now would the corporate segment, and I've observed that the corporate segment generates a loss equal to roughly equal to the WAM business, that's a material segment, would you think a year from now that corporate loss would be materially lower than where it is today?

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

Mario, I think the answer to that will depend on where we go on strategic spend. Because there is strategic spend in there. These expenses are basically entity-sustaining expenses, so there are expenses that quite rightly belong in unallocated.

It depends where we go in our planning process and the sequencing and pacing and phasing of our projects next year. So I can't really give you a crisp answer from that, but I will tell you that in the first half of the year that investment division buildout is probably worth something in the order of CAD60 million.

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

The other thing Mario, Donald again, is we don't want to underestimate this or not speak to it and not embarrassed to talk about it is we've had phenomenal growth in risk -expenses around risk and compliance. Now every FI has. But if you look at the rate of growth in those areas, it's simply spellbinding and it's stuff we have to do.

All the regulatory stuff, but that's not unique to us but it's phenomenal. Now it's not growing at the same rate forward but that has been a big increase and that would fall into that line, as well.

Mario Mendonca - *TD Securities - Analyst*

And then a question for Steve Finch then. You referred to the decline in interest rates and the impact that can have on core earnings. You specifically referred to the release of PfADs and how that causes expected profit to go down going forward.

The question I have is, did that phenomenon play out this quarter, specifically the release of interest rate related PfADs?

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

Yes, it was not a huge number, roughly CAD10 million pre-tax.

Mario Mendonca - *TD Securities - Analyst*

Okay, so the impact on expected profit going forward is inconsequential then?

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

It's really the new business strain. So Mario, you understand it, but for the benefit of everybody we have hedging programs in place that once we've written a piece of business we by and large forward hedge it. And we should be relatively protected from movements in interest rates within a reasonable amount.

But the new business that we've priced, we priced it the prior quarter, interest rates dropped by 60 basis points, that's going to be underwater until it has been repriced. The vast majority of that impact shows up in the quarter what's written as reduced new business gain or theoretically a new business loss. And then it will tend to go closer to long-term expected, as Steve said, very minor adjustment after that.

But it's basically all present valued and you are putting it on at a lower rate than you priced in the product you take a hit at the time. So that is what we experienced. With the big decreases you don't notice it so much in North America, although it's significant but in Asia, particularly Japan the decreases were very, very significant and that impact was felt.

The other impact that's felt under the Canadian MCCSR basis is the required capital goes up. So a lot of you would look and say you raised some capital and we would expect your MCCSR to be higher. But the impact of interest rates on required capital is actually very profound and the Canadian system is a little bit procyclical.

I think the regulators take a good look at whether or not this makes sense that if rates go down actually the margin for error goes up that more required capital is held and if interest rates go up it gets skinnier. It's sort of counterintuitive, frankly, as rates go down you'd think there'd be less margin required and rates go up more margin required.

But the system is the way it is and as the balance sheet expands we have to have more required capital. So it has that impact on us, as well, which is another reason we are holding more capital.

Mario Mendonca - *TD Securities - Analyst*

Let me be sensitive about time here and I will be quick, but Steve Roder now, you do spend a good amount of time emphasizing the improvement in embedded value margins in the Asian business. And I feel like when you do that I should pay a lot of attention and I should care about that.

But help me understand why that matters from a near-term perspective or medium-term perspective on earnings and the emergence of earnings for this Company? Or is the answer it doesn't't?

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

It depends what you mean by near term. The earnings will emerge over a period of time and the emergence curve depends on the product and the shape of the emergence curve, etc. So what we have seen as a result of the growth in New Business Value is that we have had consistent quarters of growth in Asian core earnings.

Not this quarter it was 12%. That's on the low side compared with the last several quarters, but because policyholder experience was still positive in Asia but not as positive as it has been in the previous quarter. So that New Business Value growth is driving Asian core earnings growth.

So I think that's why I think it is important from that perspective and will continue to be. And the other interesting feature is that if you look at our embedded value I think compared with some of our peers the earnings emerged faster than some of our major peers in the region. So that's also a positive.

But is it going to affect - does it have a major impact on the next quarter? No, not necessarily. So it depends on how you value that future income stream and how much you ascribe to that future growth profile.

Mario Mendonca - *TD Securities - Analyst*

So your outlook is five years but mine is five minutes. That's the difference?

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

Well, to some extent, I mean it is a stark comparison if you talk to investors in different parts of the world they take an entirely different view. And I can tell you I get a lot more questions about the New Business Value, embedded value in those parts of the world which tend to take a longer-term view, that's for sure.

Mario Mendonca - *TD Securities - Analyst*

I'm just surprised why they are not buying the stock on a day like today then.

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

Well, actually they are buying the stock. If you look at the underlying investor base, we have seen quite a significant extension in the number of shares held outside of Canada.

Mario Mendonca - *TD Securities - Analyst*

Thank you for indulging me. Thanks. I appreciate it.

Operator

Humphrey Lee, Dowling & Partners.

Humphrey Lee - *Dowling & Partners - Analyst*

Good afternoon. Thank you for taking my questions. I just wanted to follow up on the assumption review, especially you mentioned some of the positive side.

It sounds like VA is still getting a little bit of positive experience. Was it more the utilization being more favorable? Any color that you can share would be helpful.

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

Yes, I think at this stage in our review we probably don't want to get into that level of detail. We will be happy to share all the details when we report our Q3 results. I think we will leave it at that for the Variable Annuity right now.

Humphrey Lee - *Dowling & Partners - Analyst*

But what about in recent years in terms of the surrender or lapsed experience, how are they compared to your current assumptions?

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

Well, if you'll recall we did take some material charges roughly four years ago related to policyholder experience. And the trends since that time have been quite acceptable.

Humphrey Lee - *Dowling & Partners - Analyst*

Okay, got it. And then maybe moving on to in the US, especially for John Hancock Investments, you talked about the gross flows were positive but the net flows were outflows and then you were citing market conditions and some fund performance. Specifically, I guess maybe I'm just a little bit curious, especially given your fund lineup in the US there seems to be more target date funds or asset allocation.

Those seem to be more of the bread and butter for John Hancock Investments. So that's why I was a little bit surprised in market conditions having a big impact on your flows in the US. So maybe you can elaborate at little bit on what you're seeing there.

Craig Bromley - *Manulife Financial Corporation - President, John Hancock Financial Services &*

Sure, Humphrey, it's Craig Bromley. I will just talk a little bit about that and maybe Kai will want to add something or maybe not.

So I guess first of all, we still have a pretty good experience in terms of our gross and net flows versus the industry. We continue to take market share. So it's not a dire story by any means.

In terms of the product mix that we're selling, a big portion of our assets under management are target date funds, particularly in support of our 401(k) RPS business where that product is quite a popular option. However, most of our sales in John Hancock Investments are not target date funds, they are actually a mix of various types of products, both fixed income and equity and absolute return.

So it isn't one of the bigger sellers, actually, target date is one of the biggest assets under management. And it's great to have a dispersion of different types of funds to weather different market conditions and that's been a real benefit for us. But we are experiencing some performance challenges in a couple of those funds, not target date funds but actually a couple of other high selling funds for the last few years.

We expect that to turn around and we are getting still great sales out of those products. But we have seen some significant redemptions. And redemptions are actually quite lumpy in this business, surprisingly.

You think of retail mutual funds as not being particularly lumpy. But there is a fairly big semi-institutional component of the sales which are really platform and model sales and those do redeem and sell in big chunks. So second quarter was disappointing in terms of redemptions but we have no reason to believe that that is a continuing trend.

So we have pretty good expectations for the John Hancock Investments platform. It's been a great story for a number of years, 18 consecutive quarters of net inflows.

We sincerely expect to be back in that situation going forward. Is that helpful?

Humphrey Lee - *Dowling & Partners - Analyst*

Yes, that's helpful.

Kai Sotorp - *Manulife Financial Corporation - President and CEO, Manulife Asset Management & EVP, Global Head of Wealth and Asset Management*

So this is Kai Sotorp. Just to add to that, one of the big dimensions in the US that played out was related to the volatility of markets and the Department of Labor rulings. There was a big shift in flows out of active and into passive.

So most of the wirehouses, which make up a big chunk of every mutual fund companies' sales, actually the redemptions we saw were not out of us versus another active manager, they were out of active into passive. And of the top 10 franchises, there were only two active manager franchises that had net positive flows last quarter.

Humphrey Lee - *Dowling & Partners - Analyst*

Got it. Thank you for the color.

Operator

Peter Routledge, National Bank Financial.

Peter Routledge - *National Bank Financial - Analyst*

Hi, thanks. A question related to your Wealth and Asset Management businesses. And on page 12 of the set pack, you've laid out source of earnings overall and excluding Wealth and Asset Management, which means you can back into source of earnings for Wealth and Asset Management.

And what strikes me there first of all, and I'd like to get your comment on it, is there's a very high level of strain on new business relative to expected profit and that it is rising as a percent. What is driving that strain?

Kai Sotorp - *Manulife Financial Corporation - President and CEO, Manulife Asset Management & EVP, Global Head of Wealth and Asset Management*

So this is Kai Sotorp. So the strain that we have is a fair chunk of that is on the retirement and retail side.

Peter Routledge - *National Bank Financial - Analyst*

Okay, why is it so hot?

Kai Sotorp - *Manulife Financial Corporation - President and CEO, Manulife Asset Management & EVP, Global Head of Wealth and Asset Management*

We have deferred acquisition cost is pretty high related to intermediary sales. There is none of that really in the institutional business. So I think as our mix shifts more towards institutional and out of the intermediary channel driven retail we should have less strain.

But the two biggest impacts actually in terms of margin have been the following. About 56% of the decline was due to compression effects in the retirement business. So change of business mix as we shifted from the small to midsize market and fee compression from shift from equity to fixed income.

The remainder is really due to strategic initiative spending. So that's the increase in agency force, the infrastructure spend behind the investment division and the distribution expansion inclusive of Europe. So the strain is not as obvious or as great as you would see because it's actually there's a variety of factors driving the decline of margin and the decline of earnings.

Peter Routledge - *National Bank Financial - Analyst*

And part of the strain is you are getting pretty healthy sales in this business. So that's probably driving it, as well.

Kai Sotorp - *Manulife Financial Corporation - President and CEO, Manulife Asset Management & EVP, Global Head of Wealth and Asset Management*

Yes, yes if you actually if you look at WAM flows, gross flows last quarter versus the prior-year same quarter and you exclude the large mandate win we're virtually on the money in terms of the gross flows but in a dramatically different environment, which is I think a heroic effort by the teams around the world in terms of getting the retail institutional and retirement business moving.

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

Donald here. That's one of the reasons why we talk about EBITDA of that business is that's the way a mutual fund company looks at it. Because they don't have a concept to strain, and you are quite right when you look at it as a source of earnings that's a life insurance approach applied to a business that doesn't have that.

But if you look at Fidelity, T. Rowe Price, CI, whatever they don't talk about strain. They know they have a cost of originating business. It tends to be upfront or a big portion of it is upfront.

And that's why they look at EBITDA is what they can really expect the emergence to be and that's why we measure it on that basis. But being a life insurance Company we're forced to actually reflect it also in the source of earnings which gives to a notion of strain.

Peter Routledge - *National Bank Financial - Analyst*

Yes, and I will ask one more question just on expected profit, and I admit it's a life insurance-centric question, but the expected profit in this line has flat lined for the last several quarters. So it's related to an earlier question, when do we start to see expected profit grow in line with your sales success?

Like that's what I'm surprised about. I get strain is higher. What I don't get why don't we get more profit, expected profit out of this pretty strong asset growth?

Kai Sotorp - *Manulife Financial Corporation - President and CEO, Manulife Asset Management & EVP, Global Head of Wealth and Asset Management*

Yes, so there's a number of factors. One is the integration of two fairly significant platforms in retirement last year which was New York Life and Standard Life. That's translating through into Q1 and Q2.

Secondly, the business mix that came on board with New York Life, and Craig probably can speak some more about this, that book has a higher proportion of large case to medium case which while it has a bigger quantum the actual fees charged are smaller on a basis point basis. So it looks as if you are having an opposite effect on that side.

But when you strip out the integration costs, when you strip out the strategic initiatives and the compression effect from the mix of segments we've actually had an increase of about 50 bps in terms of margin expansion in the other businesses, retail and institutional. So I think we're already starting to see some of the margin expansion benefits coming through.

Peter Routledge - *National Bank Financial - Analyst*

And does that factor into your optimism for second half of this year overall for Manulife?

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

I think the factors that Donald detailed earlier on are probably the bigger drivers for how the second half may look different --

Peter Routledge - *National Bank Financial - Analyst*

So I should think about more --

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

-- versus the areas we're concentrating on. I mean some of the strategic spend that Kai is dealing with, that's going to continue on in the second half, for example. That's not a flash in the pan, that's heavy lifting.

Peter Routledge - *National Bank Financial - Analyst*

So this is more of a 2017 lift? Thanks for indulging.

Operator

Doug Young, Desjardins.

Doug Young - *Desjardins Securities - Analyst*

Good afternoon. I will keep this relatively quick and I guess probably a question for Roy.

Back to the margins in Asia and the improvement in margins it sounds like a lot of that is being driven from Other Asia and it sounds like a lot of that could be coming from DBS. And I'm just trying to get a sense if that is correct?

And then just thinking about it, does that mean the DBS margins are better than the existing business or this just a volume gain where you were under scale in certain regions and scale is giving you a pickup in the margin? Thank you.

Roy Gori - *Manulife Financial Corporation - President and CEO, Manulife Asia &*

Thanks, Doug. I think you are right in broad terms. The improvement in margin across Asia, well, actually the MBV total improvement year on year is about 47%.

Year to date we're about 57% up and our margin lift has been about 2.3 percentage points. Geographically Other Asia is contributing much more significantly. Our APE growth in Other Asia is about 92% and we've got NBV growth in Other Asia of about 201%.

DBS is obviously a significant contributor to that and I guess the first comment I would make is that we're delighted with our progress with DBS. We kicked off our partnership in Q1 of this year and again that was something that was nine months in progress with significant work on technology integration as well as new product launches.

Q2 for us with DBS saw not only a continuation of that momentum but actually an improvement. Our growth in sales was 14% up on Q1, so we're really delighted with that partnership. We've got a strong alignment of interest through the commercial construct that we've created with DBS, but also just culturally there is a real strong alignment.

In addition to DBS, though, we've really had strong growth across the other geographies in Other Asia. Vietnam, Malaysia, Cambodia, China have all contributed significantly to Other Asia growth. So it's not just a DBS story, and Other Asia is now becoming a much more significant contributor to our total growth.

And then again from a distribution perspective we've talked about the fact that not only are we focused on bancassurance and our banker sales have grown by 200% year on year, DBS is a factor there but again we've got seven exclusive bank partnerships across Asia and they are all growing very significantly. Agency growth has also been very strong and while we grew our total agency count by about 8% our agency sales grew almost 20%. So we've been really focused on getting much greater productivity out of our agency and the focus around quality as opposed to absolute quantity of agency has been a huge area of attention.

So yes, in summary, Other Asia is now a much more significant contributor. DBS and Singapore is a significant component of that but there are other geographies within Other Asia that are now really starting to come into their own and contributing more significantly.

But the focus more generally around channel diversification through banker as well as getting greater productivity of agencies is also coming through. They are all contributing factors, as well.

Doug Young - *Desjardins Securities - Analyst*

So my view that the DBS margins are higher is maybe not the case, there's other drivers. Is that the way to think of it?

Roy Gori - *Manulife Financial Corporation - President and CEO, Manulife Asia &*

Well, we don't disclose margins on any of our partnerships. And DBS is clearly one that we're not going to get into that detail. But I would say that all of the key factors that we're measuring success against for DBS have been not only achieved but we've exceeded our targets.

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

Doug, it's Steve here. If I could add to that, I think if you look at it on a first-order basis typically you'd probably say that you would achieve higher margins through the agency channel in Asia than you would through the bank channel. And I'm making a general comment there, not specific to DBS.

On the other hand, you can achieve much higher volume through the bank channel much faster and you can, I think, argue that the bank channel sales are more efficient. So that's very, very important.

And if you go back to Investor Day 2015 at the time Other Asia margin was something we highlighted as I think the word I'm going to use is opportunity there because the margin at the time was something like 14% and it's now in a mid-20s. So scale is clearly a big piece of that. And as Roy has explained that's quite widely based across the Other Asian region.

Doug Young - *Desjardins Securities - Analyst*

Great, thank you very much.

Operator

Darko Mihelic, RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets - Analyst*

Hi, thank you. Good afternoon. I realize the call is getting long, so I will try to be very brief.

My question's also on Asia. And it's actually twofold, and I just want to make sure that we're not - there is no potential for a negative surprise here. And so what I'm looking at is page 13 of your supplement.

My question is twofold. When I look at this page I see the direct impact of equity markets and interest rates and variable annuity guarantees as quite negative. It's been that way actually, hasn't been very good, haven't had a very good experience in the last five quarters, frankly.

So your reported earnings are not looking that great here in Asia. So the question is twofold.

The first is does this set us up for a potential revision to assumptions in Asia in the future in 2017, let's say? And then secondly, I think Donald at Investor Day you suggested that the variable annuities in Japan are largely start to wind down or really run off in 2017 and beyond. Does this potentially, given where the TOPIX is, given what's happened in Japan, does this potentially change that narrative?

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

I could answer that one easily. So I will deal with the latter part first and the other guys will deal the other.

But no, they are running off now actually and that is actually contributing to some of the net income disappearing in Japan as some of those blocks of business go away. As markets hit certain levels those things or reach a time limit those products expire. So those are coming off the books now, releasing capital and earnings but of course don't contribute going forward.

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

And second part, Steve may want to just talk about those assumptions.

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

Yes, I think the majority of the impact that we're seeing here is from interest rates which have dropped so dramatically. And those are then reflected in our reserves going forward.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay. And with respect -- so if I were to look at, not to belabor the point, but if I look at page 30 of your supplemental pack and I look at the significant amount of liabilities held for your variable annuities, the fact that they've been rising as they've had been in connection with the drop in some of these markets, there's about 11.3 billion of these, of policy liabilities held for variable annuity guarantees. Is it fair to assume that a big chunk of this is in Japan?

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

We're seeing a big rise actually in the US as well as swap rates have come down. We're seeing our liabilities increase but we're also seeing that the hedging programs are operating very effectively and we're seeing an offset in the hedge assets that we're holding. But it's primarily the swap rates that are driving up the reserves. And I think, as well, there's been some FX impact as this is reported in Canadian dollars.

And again to be clear, the assets are - they are all, in the US it's US liabilities and assets. So it's not hitting our earnings but that's what's driving some of the reported increase in liabilities.

Operator

This concludes today's question-and-answer session. I would like to turn the call back to Mr. Veloso.

Robert Veloso - *Manulife Financial Corporation - VP of IR*

Thank you, operator. We will be available after the call if there is any follow-up questions. Thanks everyone and have a good afternoon.

Operator

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