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Manulife Financial Corp. (MFC)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Manulife Financial's Second Quarter 2019 Financial Results Conference Call for Thursday, August 8, 2019. Your host for today will be Ms. Adrienne O'Neill. Please go ahead.

Adrienne O'Neill

Global Head of Investor Relations, Manulife Financial Corp.

Thank you, and good morning. Welcome to Manulife's earnings conference call to discuss our second quarter 2019 results. Our earnings release, financial statements and related MD&A, statistical package and webcast slides for today's call are available on the Investor Relations section of our website at manulife.com. We will begin today's presentation with an overview of our second quarter highlights and an update on our strategic priorities by Roy Gori, our President and Chief Executive Officer. Following Roy's remarks, Phil Witherington, our Chief Financial Officer, will discuss the company's financial and operating results. We will end today's presentation with Steve Finch, our Chief Actuary, who will provide preliminary indications of the company's annual review of actuarial methods and assumptions, which will be completed in the third quarter of 2019.

After the prepared remarks, we will move to the question-and-answer portion of the call. We ask each participant to adhere to a limit of two questions. If you have additional questions, please re-queue and we will do our best to respond to all questions. Before we start, please refer to slide 2 for a caution on forward-looking statements and slide 32 for a note on the use of non-GAAP financial measures in this presentation.

Note that certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from what is stated. The slide also indicates where to find more information on these topics and the factors that could cause actual results to differ materially from those stated.

With that, I'd like to turn the call over to Roy Gori, our President and Chief Executive Officer. Roy.

Roy Gori

President & Chief Executive Officer, Manulife Financial Corp.

Thank you, Adrienne. Good morning, everyone, and thank you for joining us today. Turning to slide 5, yesterday we announced our financial results for the second quarter of 2019. We delivered solid net income and core earnings of CAD 1.5 billion with double-digit core earnings growth in Asia.

New business value generation increased 14% with particularly strong growth in the U.S., and our solid core earnings contributed to book value per share growth of 13%. With the LICAT ratio of 144% and leverage down to 26.4%, the company is in a strong capital position with substantial financial flexibility. These are solid results given the known headwinds that we faced this quarter, including the temporary suspension of COLI sales in Japan and suppressed AUMA growth year-over-year in our Global Wealth and Asset Management business as a result of challenging market conditions in late 2018.

Turning to slide 6. We're executing on our five priorities and are pleased with the progress that we made this quarter. Portfolio optimization continues to progress ahead of schedule. In the second quarter, we executed on the initiatives, which result in a capital benefit of approximately CAD 400 million, including two reinsurance transactions on legacy life insurance blocks in the U.S., and an expanded segregated fund transfer program in Canada.

The initiatives announced to-date have cumulatively released CAD 3.7 billion of capital and are expected to release a total of CAD 4.3 billion once fully executed, representing 86% of our 2022 goal. We believe there's further opportunity to reduce risk and free up capital for redeployment. We'll continue to evaluate all options both organic and inorganic to optimize the remainder of our legacy portfolio. We continue to aggressively manage costs to drive expense efficiency. Our expense discipline resulted in modest core expense growth of 3% year-over-year in the second quarter and just 1% year-to-date. As a result, our expense efficiency ratio for the first half of 2019 improved to 51.2% from 51.6% in the same period last year.

Expense efficiency initiatives continued to progress well and delivering savings ahead of schedule. Updated estimates now project incremental savings of CAD 400 million this year. When added to the CAD 300 million that we delivered in 2018, this brings our estimated 2019 cumulative pre-tax expense efficiencies to CAD 700 million. We're well-positioned to achieve CAD 1 billion of pre-tax expense efficiencies by 2022.

Our third priority is to accelerate growth in our highest potential businesses, and we aspire to have these businesses generate two-thirds of total company core earnings by 2022. During the quarter, we further expanded our footprint in Asia entering into a joint venture agreement with the asset management arm of Mahindra Finance, one of India's leading non-bank financial companies. Our highest potential businesses performed well and delivered core earnings growth of 10% in the first half of the year, outpacing our other businesses.

Overall, our highest potential businesses continued to account for over half of total company core earnings in the first half of 2019.

Our fourth priority is about our customers and how we're using technology to attract, engage and retain customers by delivering an outstanding experience. Our target is to increase our Net Promoter Score by 30 points by 2022. In Singapore, we launched an end-to-end online insurance platform in collaboration with DBS Bank which will enable customers to fulfill insurance needs on a self-serve basis.

In Vietnam, we are recognized as the Best Life Insurance Company for Digital Transformation by Global Banking and Finance Review magazine. And finally in Canada, we expanded our Par product shelf by offering enhanced payment flexibility, giving advisors more options in choosing the right permanent insurance product for their clients. Our continued success in the Par market contributed to individual insurance sales growth of 62% year-over-year.

Our final priority is high performing team, and our target is to achieve top quartile employee engagement compared to global financial services companies by 2022. In the second quarter, John Hancock was named to Forbes first ever ranking of America's best employers by state.

And in the Philippines where we employ over 6,000 people, Manulife, won the accolade or two accolades at the Best Employer Awards held in June. In the U.S. we're piloting the use of virtual reality to bring our strategy to life and improve the onboarding experience for employees. We're also piloting its use to create a dynamic and engaging training process for our sales force to ensure that they have the right skills to execute on our priorities.

Q2 was another constructive quarter for the company and I'm confident that we'll continue to build momentum and deliver on the various targets that we've laid out.

Phil Witherington will now review the highlights of our financial results. Phil.

Philip Witherington

Chief Financial Officer, Manulife Financial Corp.

Thank you, Roy, and good morning everyone. Turning to slide 8 and our financial performance for the second quarter 2019. We achieved solid core earnings and net income of CAD 1.5 billion in the quarter. We delivered strong growth in new business value of 14%, while expense growth was a modest 3%. Net flows were neutral in the quarter, which was largely in line with the prior year and a significant improvement from the prior quarter, and we maintained substantial financial flexibility with a LICAT ratio of 144% and a leverage ratio of 26.4%.

I will highlight the key drivers of our second quarter performance with reference to the next few slides.

Turning to slide 9. Core earnings in the quarter of CAD 1.5 billion were largely in line with the prior year on a constant exchange rate basis. This reflects in-force business growth in Asia and higher investment income in our surplus portfolio, offset by the non-recurrence of a tax-related benefit and notably positive group insurance policyholder experience in Canada, which totaled CAD 94 million, as well as the impact of portfolio optimization initiatives. If we exclude the items that favorably impacted results in the prior year quarter as well as the ongoing earnings impact of reinsurance and ALDA portfolio mix initiatives, core earnings increased by 9% year over year.

Net income attributed to shareholders was CAD 1.5 billion in the second quarter, up 14% from the prior year primarily driven by the non-recurrence of a CAD 200 million restructuring charge. Of note, we delivered investment-related experience gains of CAD 246 million in the quarter, driven by higher than expected returns on our ALDA portfolio and strong credit experience. This allowed us to report CAD 100 million of investment-related experience gains in core earnings and CAD 146 million outside of core earnings. Our strong investment-related experience since the beginning of the year has allowed us to report close to CAD 500 million of gains in excess of what has been included in core earnings year-to-date.

Slide 10 shows our source of earnings analysis. Expected profit on in-force increased 1% on a constant exchange rate basis as in-force business growth of 7% in Asia was largely offset by the impact of portfolio optimization activities on our legacy business in North America. We delivered solid new business gains in the quarter, driven by higher sales, improved margins and a more favorable product mix in the U.S. as well as a more favorable business mix in Asia and higher sales in Hong Kong and Asia Other, partially offset by the temporary suspension of corporate-owned life insurance sales in Japan.

Overall policyholder experience in the second quarter was unfavorable primarily due to adverse large claims experience in our U.S. life insurance business, partially offset by favorable experience in Asia. Of note, long-term care policyholder experience in the quarter was modestly favorable in aggregate. Core earnings on surplus increased compared to the prior year quarter driven by higher investment income from growth in our surplus portfolio, the extended duration of surplus assets and lower debt expense.

Turning to slide 11, we delivered double-digit core earnings growth in Asia despite temporarily suspending sales of COLI products in Japan. Core earnings in our Canadian business decreased due to the favorable impact on prior year results of the items I mentioned earlier, as well as the impact of recent portfolio optimization actions. In the U.S., core earnings declined due to the impact of recent portfolio optimization actions, as well as unfavorable policyholder experience in our life insurance business.

Core earnings in our global WAM business were largely in line with the second quarter of 2018, reflecting similar levels of average AUMA in both periods. We delivered core ROE of 12.7% in the second quarter and 13.4% on a year-to-date basis, in line with our 13% plus medium term target.

Turning to slide 12, we expect to achieve CAD 700 million of pre-tax expense efficiencies in 2019, up from our previous estimate of CAD 500 million, and we are well positioned to achieve CAD 1 billion of expense efficiencies by 2022. Our in-flight expense initiatives are progressing well. Our voluntary early retirement and voluntary exit programs as well as other restructuring initiatives have resulted in over 1,600 departures to-date, with a further 300 expected by the end of the year.

We have also renegotiated a number of contracts with third-party technology vendors, leveraging our global scale to achieve better rates and delivering expense efficiencies of almost 20%. And in Canada, individual new business – individual insurance new business volumes increased significantly due to Manulife Par, while underwriting expenses remained flat, primarily as a result of the development and adoption of artificial intelligence to adjudicate less complex applications.

Turning to slide 13, our continued cost discipline is delivering meaningful benefits. On a constant exchange rate basis, we contained growth in core expenses to a modest 3% in the second quarter and 1% for the year-to-date. This compares favorably to our historical growth rate of 9%. As a result, our expense efficiency ratio for the first half of 2019 has improved by 0.8 percentage points to 51.2%.

Slide 14 shows our new business value generation and APE sales. In the second quarter of 2019, we delivered new business value of CAD 479 million, up 14% from the prior year quarter. This was driven by growth in APE sales of 7% as well as improved margins in the U.S. and Asia. In Asia, new business value increased 7% from the prior year driven by on a more favorable business mix, partially offset by lower sales due to the temporary suspension of COLI new business in Japan. We re-launched COLI sales on the 18th of July, following the issuance of revised tax deductibility rates and corresponding adjustments to our customer solutions.

In Canada, new business value is in line with the prior year as higher insurance sales were offset by business mix changes in group insurance and the withdrawal of certain capital-intensive legacy annuity products. And in the U.S., new business value nearly quadrupled on a constant exchange rate basis to CAD 50 million primarily driven by recent actions to improve margins and a more favorable product mix.

Turning to Slide 15, our Global Wealth and Asset Management business continue to deliver – our Global Wealth and Asset Management business delivered mutual net flows in the second quarter, largely consistent with the prior year quarter and significantly improved from the fourth quarter of 2018. Compared with the second quarter of 2018, lower gross flows in our retail and institutional asset management businesses were offset by lower redemptions in our Asia retail and U.S. retirement businesses.

Our core EBITDA margin of 26.9% was largely in line with the prior year quarter. Our wealth and asset management businesses continue to be underpinned by strong macroeconomic fundamentals, especially in Asia and retirement, which positions us well for long-term growth.

Turning to Slide 16, we continue to make progress on portfolio optimization by executing on transactions that will result in a capital benefit of approximately CAD 400 million. In the U.S., we completed two new reinsurance transactions on universal life blocks, releasing CAD 265 million of capital. In Canada, we expanded our segregated fund transfer program which resulted in additional customers converting their contracts to a less capital-intensive option that offers them increased flexibility and higher potential returns. This initiative will release CAD 85 million of capital. We also released approximately CAD 50 million of capital through ALDA sales in the second quarter. We are pleased with our progress on portfolio optimization. And the initiatives announced to date, once fully executed, are expected to deliver CAD 4.3 billion of the overall CAD 5 billion target.

Turning to slide 17, the LICAT ratio of 144% for our primary operating company was strong at the end of the second quarter and represents CAD 25 billion of capital above the supervisory target. The ratio is unchanged from the prior quarter as the favorable impacts of lower risk-free rates and portfolio optimization actions were offset by lower corporate spreads. Our financial leverage decreased 60 basis points from the prior quarter, primarily due to higher equity. Net share buyback activity in the second quarter was CAD 234 million after taking into account dividend reinvestment, and we will continue to tactically buy back shares in 2019.

Slide 18 outlines our medium-term financial operating targets and our recent performance. Core EPS growth and core ROE for 2019 are both on target, reflecting not only solid core earnings growth, but also the impact of net share buybacks. Our capital position remains strong and we have made progress in reducing our leverage ratio towards the medium-term target of 25%. Expense efficiency and capital released from portfolio optimization actions are also tracking ahead of schedule.

I would now like to turn the call over to Steve Finch, who will discuss the preliminary indications from the ongoing annual actuarial review. Steve.

Steve Finch

Chief Actuary, Manulife Financial Corp.

Thanks, Phil, and good morning, everyone.

Turning to slide 20, we will complete our annual review of actuarial methods and assumptions in the third quarter of 2019. This year's review also includes a comprehensive long-term care experience study, which we conduct on a triennial basis. While the review is not yet complete, preliminary indications suggest that the impact to net income in the third quarter will be neutral in total and for LTC. This excludes the impact of new guidance issued by the Canadian Actuarial Standards Board in July, specifically the 15-basis-point reduction in the ultimate reinvestment rate.

As we indicated last quarter, we estimate that implementing the updated URR standard will reduce net income by approximately CAD 0.5 billion post-tax in the third quarter of 2019. This will be reported outside of core earnings within the direct impact of interest rates. For long-term care, there has been a significant increase in credible claims data since the last review due to the natural aging of the block. This additional data and the substantial progress we have made in our study so far is reinforcing our confidence in the adequacy of our LTC reserves in aggregate.

I'll now describe briefly some of the key drivers we're observing in our LTC study. In 2016, we embedded a conservative amount related to future premium increases and reserves. We've made good progress in securing premium rate increases and will update our assumptions to reflect this, as well as our expectations for further progress. Consistent with previous practice, we will maintain our approach of being conservative in the amount of premium increases reflected in reserves. Our experience shows that a portion of our customers choose to reduce their benefits rather than paying increased premiums on their LTC policies. We expect that reflecting this experience will allow us to reduce reserves.

Most LTC claims occur when customers are over age 80. Due to the natural aging of the block, we have significantly more claims data on older insureds in the current study, which increases our confidence level when setting our reserve assumptions for total claims costs. As a result, we expect to modestly reduce certain margins for adverse deviation embedded in the reserves.

Our LTC study is also showing lower termination rates during the elimination or qualifying period, which is the period between when a claim is filed and when benefit payments begin. The unfavorable impact of lower termination rates on reserves will be partially offset by lower incidence rates as we are seeing policyholders starting claims at a lower rate than expected. We are also seeing that once payments begin, the length of the payment period for claims has not changed materially since the last study.

And finally, our data continues to support the assumptions of both future morbidity and mortality improvement. However, for prudence, we expect to reduce the rate of assumed morbidity improvement which would increase reserves.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now take questions from the telephone lines. [Operator Instructions] There will be a brief pause for the participants to register. Thank you for your patience. The first question is from Gabriel Dechaine of National Bank Financial. Please go ahead.

Gabriel Dechaine
Analyst, National Bank Financial
Q

Good morning. I'll just fire away the questions here. You said reduce the morbidity improvement assumption, that was a CAD 1.6 billion reserve item. Can you tell me how much you reduced that by? Second, in Japan you resumed sales. When do you expect sales to rebound in new business gains like you were generating previously? And lastly, why were you compelled to flag the loss of new business gains that we should expect under IFRS 17, was there anything – just transparency – or something else that you wanted to notify us of?

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

Thanks, Gabriel, it's Steve. I'll start with your first question around the LTC morbidity improvement. I'll touch on the assumption itself, I can't tell you exactly how much we're reducing it at this stage as we're still in the study, but I'll just touch on the assumption and then the reserves in aggregate. I think the important thing is we continue to see evidence in our data that supports the inclusion of both morbidity and mortality improvement assumptions, and we strongly believe in that correlation that exists between the two assumptions. As I noted in my remarks, we do expect to reduce it and we'll give you details in our third quarter results.

But I always like to remind people to look at the overall aggregate of our reserves. We have over $10 billion of margin in our reserves, our PfADs and conservative assumptions on our premium increases. The margins represent an increase of more than 40% over our best estimate assumptions. And I think you need to put that in context with looking at U.S. reporters, they're under locked in assumptions, we've been updating our assumptions consistently over the years. They're locked in until they get to the point that they have zero margins. So you need to look at our reserves in aggregate, the over CAD 10 billion, 40% increase over best estimate margins. And I think, overall, the conservatism of our reserves is among the strongest in the industry.

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

Hi Gabriel, I'll take your second question on COLI. This is Anil. So as you know, we had to stop our COLI sales in quarter two on account of the introduction of the new tax rules. We did get a clarification on the new tax rules at the beginning of quarter three and pretty much within 10 days of clarification, we resumed our COLI sales.

The emphasis has been to train all our channels, our tied agents, our MGA partners, as well as our FI distributors. And I guess it's going to take us a quarter, if not two, to be able to understand and comprehend how the market and the customers react to our value propositions in light of the new tax changes. Needless to say, we're also working on some product ideas and solutions in light of the tax rules, but my reckoning would be that we'll be able to kind of only indicate that in about a couple of quarters based on the reactions that we receive from the market.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Great. And Gabriel, this is Phil. To answer the third components of your question, and firstly, thank you for that question. IFRS 17, you are referring to the comments that we make in our MD&A about the potential impacts of the adoption of IFRS 17. We did refer to this in our 2018 MD&A and there's nothing that required us or compelled us to provide this additional disclosure. But we do believe in transparency and therefore, given the stage of developments of IFRS 17, we felt it was appropriate to highlight two of the many changes that IFRS 17 will bring, but two that we felt could be meaningful in terms of the impact of the standard.

So the first we highlighted was the impact of the discount rate and the second that we highlighted was on an IFRS 17 basis, the fact that new business gains will no longer be recognized. However, there would be in-force earnings, whereby the new business gains that had previously been recognized would be recognized over the life of those contracts. So we just wanted to pull that out in the interest of transparency.

Gabriel Dechaine
Analyst, National Bank Financial

Q

Thank you. I'll leave it there. I asked three questions and broke the rule.

Operator: Thank you. The following question is from Meny Grauman of Cormark Securities. Please go ahead.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

Hi, good morning. A question on your indirect rate sensitivity yields falling to multi-year lows and I'm wondering if you could just review your indirect exposure as you see it and specifically talk about your ability to offset those pressures on earnings and then also what the current yield environment means for your portfolio optimization efforts if it has any implications for that?

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

A

Yeah. Thank you, Meny. Roy Gori here, I'll start and then I'll hand over to Naveed to talk a little bit about portfolio optimization efforts and activities. I think that the overarching comment that I'd make on interest rates is that low interest rates is not a new phenomenon for us and we've been in a low interest rate environment for some time now, and we've demonstrated over quite a long period of time, strong returns and profitability despite that environment. It's also important to note that we've significantly reduced our sensitivity to interest rates over the last 10 years.

In fact, interest rate sensitivity today is one-tenth of what it was in 2008. It's clear that the industry, our industry, benefits from higher rates. But we do have some ways to mitigate, and they include hedging, repricing, scale and growth, as well as cost management. So we feel that we are well equipped to deal with a lower interest rate environment and, again, that's going to be the continued focus that we've had over the past, and we'll continue to have.

Naveed, you may want to talk a little bit about the activities of portfolio optimization.

Naveed Irshad
Head of North American Legacy Business, Manulife Financial Corp.

A

Sure, Roy. Meny, on the portfolio optimization transactions, we have not really seen a change in market appetite. Interest rates are just one of the many variables to consider when evaluating transactions. It's really important to note that our legacy blocks are backed by seasoned assets and so we're going to continue to pursue both organic and inorganic initiatives that are in the best interest of our shareholders.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

And this is Phil. Just a supplement on the interest rate question to give some although your attention to our sensitivities. From an accounting perspective, you'll be able to see from our MD&A that the sensitivities are modest. There's also some information in our embedded value report which is very relevant. And what that shows is that the impact on embedded value of a 50 basis points parallel shift in the yield curve is in the order of CAD 850 million to CAD 900 million. And the impact of that really from an earnings perspective would flow through over a long period of time through lower PfADs.

One other area to draw to your attention is that our sensitivity disclosures are point in time disclosures based on the balance sheet. There will also be an impact on new business gains on a Canadian IFRS basis and new business value of lower rates. But as Roy said, one of the tools we have at our disposal is the ability to reprice. So whilst there can be an impact on new business gains, I see that as a short-term impact that during the period that we go through a repricing exercise.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

Thanks for that. And then just as a follow-up, just wondering if the low rate environment will impact your ability to hit your medium term targets in any way? Or is there any concern of that, especially the core EPS growth target?

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

A

So Meny, we remain committed to our core earnings per share target and quite frankly, all of the other targets that we established at Investor Day. So we were not walking away from any of those commitments and targets that we've established.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Absolutely, this is Phil again, and just to provide some granularity there, we have set out the 10% to 12% target. We expect approximately 6 percentage points of that to come from the emergence of in-force profitability. But then to supplement that we have the impact of our expense program which is contributing to the bottom-line. We expect a higher rate of growth from wealth and asset management and also the contribution from our new business we have growth businesses around the world 00:33:05 that we expect to contribute to earnings. So we feel good about the 10% to 12%.

Meny Grauman
Analyst, Cormark Securities, Inc.

Q

Thank you.

Operator: Thank you. The following question is from Humphrey Lee of Dowling & Partners. Please go ahead.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Good morning and thank you for taking my questions. A question about Japan core earnings. So I fully appreciate that the suspension of COLI sales would have an impact on new business gains and that's hurting the results in the quarter. But if I were to look at the quarter-over-quarter drop in core earnings for Japan, or even comparing to the new business gains in Asia for this quarter, the decline seems to be greater than the new business gain contributions by the COLI products that you laid out in the first quarter presentation. I was just wondering other than the suspension of COLI sales, were there any kind of sales impacts in Japan that could cause lower new business gains and lower core earnings in the quarter?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Thanks, Humphrey. This is Anil again. So you're right that we did see a decline on the new business gain line, primarily on account of the temporary cessation of our COLI sales in Japan. That impact on a post-tax basis from a year-on-year basis was about CAD 10 million. On a quarter-on-quarter basis, on a post-tax basis it was CAD 45 million.

In addition to that, we had overwhelmingly strong response to our VHIS product in Hong Kong. VHIS is a Voluntary Health Insurance Scheme, it's a tax advantage scheme that was recently introduced by the government of Hong Kong to motivate citizens of Hong Kong to save and get insured for health protection. And we introduced a couple of value propositions. They got some very strong responses. Overall, the margins on these products are pretty healthy. However, they do create a first year strain and that's pretty much what you're witnessing on the new business line. So, it's largely a combination of the lower COLI sales, as you alluded to, combined with the positive response that we got of VHIS.

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

A

Humphrey, it's Roy. Let me just add, we spent a lot of time talking about the strength in the diversity of our franchise, both globally and within Asia. And I think this quarter is a classic example of that diversity really coming to the fore. Asia was able to demonstrate and deliver 12% core earnings growth despite some very significant headwinds as mentioned previously. So, we feel really good about the strength of the franchise and the continuing focus on diversifying our business. And as Anil highlighted, whilst we have some challenges in Japan, which we've seen some more recent relief. And as Anil noted, we'll see that come through over the next coming quarters. We have the strength of our Hong Kong franchise and other franchises that are also lifting at the same time.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Fair enough. Shifting gear, looking at your kind of legacy business actions today, so in your Investor Day presentation, you kind of highlighted CAD 133 billion of legacy life and annuity reserves. I was just wondering how much of that have you been addressed through your legacy actions to date? And then also kind of in the seg funds in Canada, like, is there – how much more can you pursue those kind of transfer offering to further release capital?

Naveed Irshad
Head of North American Legacy Business, Manulife Financial Corp.

A

So Humphrey, it's Naveed here. We have – in terms of the amount, we talked about a CAD 23 billion of capital backing the legacy blocks of business at Investor Day. You can see where we're at in terms of the capital release so far over CAD 4 billion.

Now, in terms of the transfer program in Canada, we actually think this is actually just one of the first of I think many that will run across various product life in both Canada and the U.S. We really like buyout and transfer programs as they create an opportunity for win-win solutions for our customers and the company. And so in fact we're working on a full slate of these programs, which we;ll execute in coming quarters.

This includes a U.S. structure settlement exchange program pilot that we launched in June; U.S. universal life secondary guarantee pilot program that will launch later this year or early next year; U.S. variable annuity GMWB program around the same timeframe late this year or early next year. Similar to the Canadian program. We have an LTC return of premium cash out program that we have just recently launched for Florida. And other programs are being developed. So to be frank, I think we're sort of just scratching the surface on this.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Thank you for the color. Thank you.

Operator: Thank you. The following question is from John Aiken of Barclays. Please go ahead.

John Charles Robert Aiken
Analyst, Barclays Capital Canada, Inc.

Q

Good morning. And I'm going to ask a question about the growth in agents in Asia, and I apologize if you've addressed this before. We've seen some very strong growth in which you classify as Asia Other in terms of the numbers. Can you give us a little color as to what's actually driving these increases? And has Manulife actually shifted its philosophy because my understanding was that Manulife didn't want to just grow agents that only had one or two products but wanted to actually have true consultants in the business? Are we shifting away from that? Or are we actually attracting very strong agents in the region?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Thanks for the question, this is Anil, again. So we actually believe that one of our key strengths in Asia is the diversified nature of our distribution. So we have a strong agency, we have great banca partnerships, we have eight exclusive and overall 100 bank partnerships across Asia, and we're also kind of gaining strength in our broker channel. I guess the agency – growth of agency has been an ongoing focus for us and now it's kind of starting to translate into the growth that you are witnessing across all our Asia markets and Hong Kong in specific.

I do want kind of point the fact that it's not quantity or quality, it has to be both, quantity and quality. And I guess what that – there are couple of evidences of that. So one, we are now number three when it comes to MDRT rankings, we are number five a couple of years back and even if you look at our active agent ratio, rather active agent count, the active agent count is also increasing at a similar pace as compared to our agency growth. So agency, again, is an ongoing focus. Again, I wanted to emphasize the fact that it then kind of complements, it actually helps us gain more strength, given the diversified nature of our distribution in Asia.

John Charles Robert Aiken
Analyst, Barclays Capital Canada, Inc.

Q

And then that 20% or almost 20% year-over-year growth we're seeing Asia Other, is that across the region? Or are there any other geographies that are actually experiencing higher growth?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Yeah. So I guess the agency heavy markets are typically Vietnam, China where we started now, now witness double-digit growth. Philippines, again, we've kind of seen some strong growth. So there are typically the agency heavy markets where we've experienced some solid growth on agency.

John Charles Robert Aiken
Analyst, Barclays Capital Canada, Inc.

Q

Great, thank you. I'll re-queue.

Operator: Thank you. The following question is from Steve Theriault of Eight Capital. Please go ahead.

Steve Theriault
Analyst, Eight Capital

Q

Thanks very much. Maybe starting with a question on the WAM business. You had a nice recovery from the weak Q1 in terms of flows. Paul, your business is obviously market dependent, but how are you feeling going into the second half? Are you confident in getting back to positive flows in the absence of a big downdraft in markets? And how did flows trend I guess through the quarter in Q2 and maybe what are you seeing early Q3?

Paul Raymon Lorentz
Global Head of Wealth & Asset Management, Manulife Financial Corp.

A

Great. Thanks, Steve, it's Paul. Yeah. As we as we look at the quarter, I guess, and when you look at the results, you'll see we continue to have positive flows in Asia and Canada and while they were negative in the U.S., we're actually quite pleased with the progress we're making there. We continue to see improvement in our U.S. retail business in the U.S. overall from what we saw in Q4 to Q1 and in Q2 considering it was a relatively weak quarter for Q2 active flows in the U.S.

We also have seen our sales team pivot to a lot of the funds that are selling one of our funds, intermediate bond fund in the U.S. as the AUM is up 20% year-over-year, and we recently just launched some new products to fill some of the gaps that I mentioned on previous calls, in particular, short duration bond funds that should give us some traction in future quarters. So we feel pretty good from that perspective, and I would say overall, if you look in aggregate, there was also some large case impacts this year. We did have a large termination of our Canadian retirement business that was CAD 1.4 billion and that's going to happen from time to time and skew the flows, both positive and negative. It's less of an earnings impact, typically, on the large case, but it will kind of impact us in any given quarter.

If I just take a step back and look at the franchise, we have very strong market positions across our different businesses. Our investment performance is strong. And I guess, more importantly, because of the global footprint we have and the diversification of our business line, we feel we're well positioned to capitalize on a number of the very meaningful global trends whether it's the global retirement funding gap, the growth of the Asian middle class, we're seeing a shift from cash to more traditional investments in a lot of emerging markets, and frankly, the integration of ESG into core investing. So we feel we're well-positioned ahead of those trends in terms of our footprint and have lots of strategic choices for the business to continue to grow. And I guess the last point I'd make is, we also have an ability to leverage a global scale with our business coming together to help maintain margins and continue to offer competitive products.

Steve Theriault
Analyst, Eight Capital
Q

And in the past, in the U.S., you talked about outflows from fixed income and losing those, because you didn't have a short duration bond offering. Was that in place for the full quarter, like as there been more of that or has that stemmed?

Paul Raymon Lorentz
Global Head of Wealth & Asset Management, Manulife Financial Corp.
A

Yeah. So the short-duration bond fund was just launched and it will take us a little bit of time to get it on the shelves of our large distributors. So we wouldn't expect to see a meaningful impact this quarter. But we would expect to start seeing in Q4 and as we head into next year. The intermediate bond fund, we did have and we started shifting the sales team towards that. When we saw what's happening in the Q4 and we are seeing some traction there, but it was from a relatively low base. So the team is doing what they can, we're shifting to focus where the flows are and feel we're well-positioned as we move forward.

Steve Theriault
Analyst, Eight Capital
Q

Okay. Thanks. And second question on Asia. You mentioned in the notes a new online insurance platform you've undertaken with DBS in Singapore. Just wondering, like is that a digitization effort around what you had been doing with DBS in terms of the bancassurance activities? Or is this a new online offering sort of across Singapore that you just are undertaking with DBS?

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

So this is Anil, again. So yes, we are employing a lot of effort in terms of digitizing our processes, as well as coming up with direct-to-customer processes, whereby we make it very simple for our customers in Singapore to be able to access and buy insurance products online. I guess the reference that you are making is an effort in that direction. So this is three to four click process, straight through, and within seconds, the policy would be in your inbox. And this is pretty much early days, but we are starting to see some good response in the way the customers are reacting to direct-to-customer straight through processes that we've launched through DBS.

I also wanted to emphasize that one of the advantages that we have with our DBS partnership is that we pretty much get access to every single household in Singapore. And if you combine that and make things easier for customers to buy, I guess that combination could be a potentially strong combination in the way we would like to access Singapore market going forward.

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

A

Yeah, I'll just reinforce one point that Anil is alluding to, and that is that this is an interesting pivot for us in the bancassurance space. Traditionally, bancassurance sales are done through the relationship managers of the bank and it's typically done in the office of the bank. And with these new digital tools, it's giving us access to all the customers in the bank that don't come into the branch and frankly don't speak to a relationship officer. So they'll get a pop-up when they go online to do their online banking or quite frankly, even if they're just reviewing their statements. So it's really exciting for us, it's still very early days but we think we can gain some tremendous learnings from this with DBS and there's possible expansion and extension of that to our other bank partnerships as well.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

One of the other things that we've done with DBS is a recent addition to the customer dashboard. So for example, today if DBS customers were to kind of log in online and see their statements, they can now see their insurance relationship which is, obviously, driven by us. So I think that's invaluable addition. And if you combine that with making things easier for customers, I guess that could only augur well from a direct-to-customer and digital sales perspective in Singapore.

Steve Theriault
Analyst, Eight Capital

Q

Great. Thanks for the time.

Operator: Thank you. The following question is from Sumit Malhotra of Scotiabank. Please go ahead.

Sumit Malhotra
Analyst, Scotia Capital, Inc.

Q

Thank you, good morning. A couple of interest rate-related questions to start. First for Phil, on the URR assumption. So you reduced this in 2016 and now you'll do so again next quarter in 2019. There's a comment in the MD&A that based on your conversations, it sounds like this assumption will not be revisited until the industry transitions to IFRS 17. So irrespective of what happens with rates, we're three years away at the earliest from this being looked at again?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

So, Sumit, it's Steve. I think I'll take that question. So when the Actuarial Standards Board reviewed this and they look over a very long period of time, originally, they anticipated only adjusting every five years or so. They've done it a bit more than that. But when they published the guidance, they explicitly wrote that they did not anticipate further updates prior to the adoption of IFRS 17. So that's what we're basing our comments on. We don't expect further updates before IFRS 17.

Sumit Malhotra
Analyst, Scotia Capital, Inc.

Q

And that's 2022?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Yes.

A

At this point.

Sumit Malhotra
Analyst, Scotia Capital, Inc.

Q

And at this point, for whoever whispered that. The second rate-related question, I guess, I'll phrase it this way is in regards to your ALDA portfolio, if I go back many years, Manulife had talked about the long-duration assets, the alternative long-duration assets as being a differentiator for their investment portfolio.

At least early on, Roy, when you took the seat, the actions we had heard was to move to reduce some of this portfolio, although you said quite explicitly at the time that we aren't planning to take this materially lower. And that's been the case. In fact, the book has continued to climb. So, I don't know if this is for Roy or for Scott, but as we think about another leg down in rates here, does ALDA become a more important component of the Manulife investment strategy again or is the capital impact associated with this portfolio still something that you're looking to reduce?

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

A

Let me start, Sumit, and I'll hand over to Scott. So, from the outset I'd say that ALDA is an important asset class for us. It's an asset class that delivered great returns for us over a longer period of time and really matches our liability portfolio really very well from a tenure and duration perspective. We did rightsize the portfolio through actions that we took in 2017, late 2017 and subsequently, but we feel good about where we stand today. But let me hand over to Scott to provide some more commentary on that.

Scott Hartz
Chief Investment Officer, Manulife Financial Corp.

A

Yeah. Hi, Sumit. So, we've had this strategy for a long time. We've been in the ALDA markets for a long time and have built up great capabilities. So, we do sometimes get questions, is our strategy a reaction to the low rate environment. I think as Roy mentioned earlier, we've been in a low rate environment for quite a while. And that's really not the case. As he suggested, we think it's just the appropriate way to invest for long-tailed liability, sort of regardless of the interest rate environment. So, I don't really see any changes to our strategy based on rates being a bit lower now, and if they go further lower, I really don't see adjustment to that strategy.

Sumit Malhotra
Analyst, Scotia Capital, Inc.

Q

And then, last one for me is around capital deployment. So, this is likely for the Chief Executive Officer. Roy, it wasn't that long ago that buybacks ranked quite low on the Manulife pecking order when it came to capital deployment. And over the past three quarters, the company has repurchased close to 50 million shares.

So, we're hearing now about some potential opportunities from competitors in Asia maybe looking to shift their portfolio. With the balance sheet progress the company has made both with LICAT and leverage, how are you thinking about external capital deployment for Manulife at this stage? Or when you look at the – at least I'll speak from my seat, some of the frustrating macro volatility in the stock, does share repurchases, just given where your evaluation is, still rank at the high end of where you want to put the excess capital of Manulife?

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

A

Yeah. Thanks for that question, Sumit. I'd say, I guess from the outset that, we're really pleased with the capital position and the focus that we've had in this space, the LICAT ratio at 144% represents CAD 25 billion capital above the supervisory target, and despite that robust capital position, our core ROE remains really very strong at 12.7%. I'd also say, in parallel with all of that, we've been aggressively looking to reduce our leverage ratio. And our leverage ratio now is down to 26.4% which is significantly down to where we were – from where we were last year, which also provides us with tremendous financial flexibility.

In terms of how to redeploy that capital, we're going to be pretty consistent with our messaging here. First and foremost, we want to continue to improve our leverage ratio. We've got a medium-term target of 25% and we see a path to that goal in the not too distant future. We're going to continue to repurchase shares. We think that our stock is undervalued and repurchasing shares is in the best interest of shareholders. We're going to fund organic growth and opportunistically we'll also look at inorganic opportunities, and we'll do that very strategically though. And I think the good news on that last point, Sumit, is that to deliver our core earnings per share goals, we don't need inorganic opportunities, and I think that puts us in an enviable position.

Now, we'll still look at them and I think the strength of our capital position means that where we see an opportunity that fits strategically with what we're trying to do and if we can leverage and generate good value, we will certainly be interested. But we don't need it to generate our goals and our targets, and we want to make sure that we're not just making acquisitions for the sake of doing a transaction.

Sumit Malhotra
Analyst, Scotia Capital, Inc.

Q

Thanks for your time.

Operator: Thank you. The following question is from Doug Young of Desjardins Capital. Please go ahead.

Doug Young
Analyst, Desjardins Securities, Inc.

Q

Good morning. So, Steve, just wanted to go back to the long-term care insurance, and I think in your comments, you mentioned increased claims data that has given you comfort in a few areas. So, I just wanted to go back and see, because I know I think in the past, you've kind of given some numbers around there's about 1 million policies outstanding, about 30,000 are on claim. Just wondering if there is an updated data that you could give around that? And then, 30% to 40% of claims are really related to Alzheimer's and dementia. Have you seen kind of a pivot in that? And then, just the average age of the book, if you can update us a little bit around that? Just trying to get a sense of that increased claims data and what that's telling you?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Sure, Doug. If you look at the increase in data, as I mentioned in the prepared remarks, it's in those older ages that really drives the ultimate claims costs, and that's where – when the block was younger, we just didn't have the data, the industry didn't have the data on which to set assumptions. So, on that older age block, over age 80 or 85, we're seeing in this study almost double the amount of data that we've had to study in the past. So, that does increase the confidence level in the reserves and that's really what the comment is about.

Doug Young
Analyst, Desjardins Securities, Inc.

Q

And how much of your book would be now over 80, 85?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

I don't have the stats. We provided the stats at Investor Day in that presentation. We can refer back to that. We can update you with the disclosures at Q3. But it's progressing gradually from that position that we disclosed at the last Investor Day.

Doug Young
Analyst, Desjardins Securities, Inc.

Q

Okay. Yeah. Maybe I can follow-up. And then second just – and maybe this is for Roy or Anil you entered the India asset management market through a JV. We've had discussions in the past about your potential interest in India. Just wondering what your strategy is there. And then, the natural thought would be what is your strategy or do you have any interest in entering the India insurance market? I know there has been a lot of challenges in the India insurance market in the past, it seems like its pivoted and taking a positive turn. But just wanted to see about your inorganic interest in entering that marketplace? Thank you.

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

A

Yeah. So thanks, Doug. We're obviously very excited about that new joint venture partnership that we've announced. We think there's a lot of opportunity. Let me ask Paul, who runs Global WAM, to share a little bit more about that, and then Anil can provide some commentary as it relates to the insurance market in India.

Paul Raymon Lorentz
Global Head of Wealth & Asset Management, Manulife Financial Corp.

A

Great. Thanks, Roy. Yeah. We're very excited about our entry into India. It's a very attractive market with very strong growth prospects, particularly in the Wealth and Asset Management space. And I guess just to give a little context of Mahindra, our partner, they're a recognized and trusted brand with a strong customer base across India. They're a very high-integrity player and frankly have a history of successful partnerships with large foreign companies. And they have a very similar culture to us and shared values around improving the lives of customers. So, the fit from a culture in just commercial enterprise perspective is very strong.

We really complement that partnership with investment management expertise, which is something we can bring to the relationship, as well as our ability to build Wealth and Asset Management business in a lot of emerging markets. So, they've seen what we've done in other countries, look at the capabilities we have and feel like it's a great partnership as we do with them. So, we're quite excited about that, and again, just position ourselves in front of some of the larger trends we see in the Wealth and Asset Management space.

I'll pass it over to Anil maybe just to comment about the life side.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Yeah. I think India is always going to be an interesting market just kind of with the scale, the demographics and the potential that we have in the market is quite interesting. I guess the challenge has been some of the shareholding rules in India. Having said which we believe, given the newly-elected government, we are hoping that that might result into further liberalization, which would make the entry into India an interesting proposition for us. I think what's our area of focus right now is the joint venture partnership. I think Mahindra is a fantastic brand. If you then combine that with the global investment capabilities that we have, it's a solid partnership. And in many ways, it will allow us to test what is in a market like India, and if the rules were to change, then we may want to kind of explore the opportunity on the insurance side in the future.

Doug Young
Analyst, Desjardins Securities, Inc.

Q

So, essentially you have to be able to have over a 50% ownership stake in the JV partnership on the insurance side to really be interested in the market. Is that a fair characterization?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Yeah. I mean that would be the preferred option. There are couple of other objectives as well, the right partner, the right business model, there are a lot of existing insurance players in India. So, we have to – there are few considerations to evaluate before we kind of decide the possibility to explore the opportunity on insurance in India.

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

A

Yeah. I would just summarize by saying that our priority and focus right now is to get our JV in the wealth space to work. We think that's an exciting opportunity, but that could provide a springboard for other opportunities and we'll see how that pans out.

Doug Young
Analyst, Desjardins Securities, Inc.

Q

Okay. Thank you.

Operator: Thank you. The following question is from Mario Mendonca of TD Securities. Please go ahead.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

Hi. Just have a couple of things I want to clarify. Anil, first, the new business margin in Asia, and I'm not referring to embedded value, I'm referring to just taking new business and comparing it to the annual premium equivalents. That ratio is down a fair bit relative to the last couple of years. I suspect this is really related to the Voluntary Health product in Hong Kong. Is that fair?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

That's correct. So, that did create an extra level of strain in quarter two.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

And you expect that to continue for – well, I guess, for as long as this product remains fairly popular and active?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Yeah. As I mentioned, the new business margins on VHIS are pretty healthy and we just got off into the first three months of offering there. So, we believe that based on the response that we've kind of got in quarter two, that is likely to kind of continue in the foreseeable future.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

Okay. And then, perhaps for Steve then, what created the strain in this product? Is it the distribution cost or is it because this is a long-term product with a lot of guarantees associated with it?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Thanks, Mario. It's a yearly renewable. So, under the standards, we have to hold the unearned premium reserve. So, we're not deferring acquisition costs. As Anil said, we expect the margins on this product to be quite good. So, while we do incur the upfront strain, it will contribute in the future quarters and we're quite happy with the product.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Mario, I also wanted to emphasize one more thing. I mean, if you look at the Hong Kong growth, the VHIS is only about 50% of the growth. There are a lot of other value propositions that we have in Hong Kong. We have a very diversified set of offerings and that continues to grow as well. And as you can tell from the growth that we have seen in our agency, the strength that we have in account of our DBS partnership, plus the strides we are making on the brokerage side, there are other opportunities in Hong Kong other than VHIS. I just wanted to emphasize that.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

Sure. How do you get – just going back to Steve for one, how do you get comfortable with a new product like this with guarantees? And I appreciate your yearly renewable, so you can reprice it. But how do you get comfortable with a new product like this?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Well, I think we look at the underlying need, the strength of our distribution and we're not taking material long-term market risk. So, we like this business. We are happy to write lots of this business.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

Okay.

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

And also, Mario, what this does is it allows us to kind of build relationship and deepen relationship with both our existing and new customers. So, if you were to acquire a customer through VHIS, which is an attractive proposition, it also opens up avenues to be able to up-sell and cross-sell different value propositions to the clients going forward.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

Okay. And then, real quickly on the assumption review, Steve, you indicated that you released some PfADs or you expect to release some PfADs associated with the long-term care business as part of the assumption review. Would I be correct in saying that that number is not very large and because it's a very long-term business, the annual impact on your expected profit shouldn't be something to think about that much?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

That's a good way to look at it, Mario. While it's a driver of some of the movement that we're seeing in the LTC review, the change is quite modest relative to the size of the LTC business, when you look at either our PfADs of over $10 billion. We expect that the PfADs will still be over $10 billion after this change. So, yes, the run rate earnings impact would not be notable.

Mario Mendonca
Analyst, TD Securities, Inc.

Q

That covers it. Thank you.

Operator: Thank you. The following question is from David Motemaden of Evercore ISI. Please go ahead.

David Motemaden
Analyst, Evercore Group LLC

Q

Good morning. Just a question for Steve on the long-term care review, just wanted to get a sense for the commentary around incidence being better than expected, I was wondering specifically on the older age cohort that you have I guess more experience now, what exactly are you seeing on incidents there specifically?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Yeah. So, the comments that I made in the prepared remarks were around what we're seeing on incidence is some lower level of customers going on claim that are in our valuation assumptions. I think it crosses most of the ages. I think the key thing at the older ages – and one thing that we really watch out for on trends is the length of stay, right. So, once people qualify for their benefit, start receiving them, how long do they stay on claim, and that is not driving our results. We're seeing quite stable experience there.

And I think one of the things I get asked about a bit is what's driving that and Doug actually asked earlier about the Alzheimer's experience that we're seeing. Alzheimer's is getting detected and diagnosed earlier, but it does not necessarily mean that people are needing long-term care services earlier. And so, that's I think a key driver in terms of why we're not seeing an increased length of stay. And we'll provide more color in Q3 when we disclose the final results of the review.

David Motemaden
Analyst, Evercore Group LLC
Q

Okay, great. That's helpful. And then, I guess just thinking about – I know this is on a Canadian IFRS basis, but just thinking about on just the legal entity basis and the U.S. statutory cash flow testing. I mean it looks like you guys only have I think around – or about $23 billion of stat reserves in the U.S. If there is – do you foresee any need to add to those from cash flow testing reserves? And if so, is that just a mere transferring assets out of Canada into the U.S. or could you I guess just talk about your expectations around that?

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

Sure. And we do do asset adequacy testing every year as required on our total business and on the LTC block standalone. And while the margins are not as large as the margins on the IFRS basis, we do still have margin – material margin on the NAIC basis. So, we don't see any erosion to RBC levels or any need to fund anything related to LTC in the U.S.

David Motemaden
Analyst, Evercore Group LLC
Q

Okay, great. Thanks. And just a question just on Asian, if I look at core earnings before tax on a constant exchange rate basis, they were up just about 2% year-over-year. Is this the kind of growth that you'd expect to continue until COLI sales came back – or come back in Japan?

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

Yeah. Hi, David, this is Anil. So, let me just clarify that, right. So, the core earnings before tax on an ex-Japan basis grew approximately 10%. If you were then to adjust this for minority interest impacts related to tax that are included in this figure, the growth is actually on an ex-Japan basis in the region of about 15%. So, I think there are some noises that are in there and I guess if you look at on an ex-Japan and an ex-MI basis, the growth is actually 15%.

David Motemaden
Analyst, Evercore Group LLC
Q

Okay. And just a follow-up there, I saw the annuity sales were down in Japan around 16% year-over-year, ex-FX. Is this something – and just a broader question around FX products in Japan, because I think that's around the other half of your sales, with the other half being COLI. What's your outlook here on the FX products, because some of your competitors have said that these are, I guess, a bit less attractive to consumers, just given the current foreign exchange and interest rate markets?

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

Yeah, David. So, annuity sales, you're right that the annuity sales were down 16%. Having said that, the annuity sales phenomenon is not only restricted to Japan, I guess it's more in response to the volatility that we have seen in markets, pretty much kind of panning from the back end of last year. Within that, if you look at FX annuity sales, they're only down by about 8%. And if you then look at FX sales purely, which is a large component of our non-COLI business, that actually is up on a quarter-on-quarter basis by about 1%.

We again believe that FX products are going to be a pretty integral part of our value proposition mix in Japan, something that we've kind of seen an ongoing demand from customers. More importantly the regulators have supported that just given the yields on foreign-denominated product versus the local-denominated products. So, even notwithstanding some of the macro level changes, we believe that there is an ongoing place for FX products in the product mix that we are going to be offering to our Japanese clients.

David Motemaden
Analyst, Evercore Group LLC
Q

Great. Thanks for the answers.

Operator: Thank you. The following question is from Tom MacKinnon of BMO Capital. Please go ahead.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)
Q

Yeah. Thanks. Good morning. Just want to continue on the capital deployment theme. I get that you don't have to do an acquisition to get your 10% to 12% medium term core earnings growth target. But if you look year-over-year, you're losing about CAD 40 million post-tax per quarter as a result of your portfolio optimization strategy here and that's probably in the area of 2.5%, maybe 3% of your earnings. How are we – how do you look at replacing that in terms of trying to get back to the – or get to the 10% to 12% earnings growth target? You upped your NCIB to 5%, would you be comfortable kind of moving your share repurchases up to compensate for this loss of earnings as a result of this portfolio optimization?

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

Yes. I'm Roy here. So, again, I'd say that this focus from a capital redeployment perspective will continue to be the prioritization of the items I mentioned earlier: leverage, repurchasing shares and organic growth. And I just again, just reiterate that we've been able to demonstrate core earnings per share growth. In fact year-to-date this year, we're at 11% growth versus last year. Some of the driving forces behind that are the growth of our sales, in fact year-to-date, our new business value growth has been 23%. So, the organic power of the franchise has been very strong and that's contributing to that uptick. We're obviously benefiting from the repurchase of shares and we remain committed to repurchasing shares, and that's obviously also helping our earnings per share growth, our core earnings per share growth. So, we feel confident that we can deliver against our core earnings per share growth targets through the deployment activities and the assets that we're placing.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

And, Tom, this is Phil. Just to add a bit of granularity on some of the short-term capital deployment options that – our options at our disposal, Roy talked there about lowering leverage to get to a 25% medium-term target. We actually have CAD 1 billion of debt that becomes available for redemption in the fourth quarter. We haven't made any decisions with respect to that maturity at this point, but it's certainly an option to deploy CAD 1 billion of capital. And then further to that in the first quarter of 2020, there's another CAD 500 million issuance that would be available for potential redemption. So, I think in the short-term, we have various options to deploy capital by strengthening the balance sheet or continuing the NCIB.

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

A

Yeah. I'll just add, the portfolio optimization activity that you referenced, Tom, also have been a real good trade off for us and, quite frankly, for the shareholder. It's been about CAD 160 million of earnings on an annualized basis; CAD 4 billion, CAD 4.3 billion worth of capital which we freed up. So, that's a pretty good trade off in terms of return and the ability to actually repurpose that for the benefit of shareholders, we feel is quite strong.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thanks for that. And the second question has to do with any inorganic portfolio optimization plans for long-term care. Can you talk about any progress or what you're seeing in the marketplace? We did have one transaction a while ago. What's happening in the market place there? What are you seeing and are you doing anything to try to transact on the long-term care inorganically?

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

A

Yeah. So, let me ask Naveed to talk to that.

Naveed Irshad
Head of North American Legacy Business, Manulife Financial Corp.

A

Hi, Tom. Thanks for the question. So, yeah, you're right, we did see the other transaction last year. From our end, we're focused on both organic and inorganic options on long-term care, whatever is in the best interest of our shareholders. So we'll pursue either. We made great progress on the organic side. On the inorganic side, again, we continue to see that there are parties out there that are interested in transacting. So, it's something that, obviously, we need to look at. I just can't comment further on anything specific.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Is a lower rate environment, has that been a deterrent to their interest?

Naveed Irshad
Head of North American Legacy Business, Manulife Financial Corp.

A

We haven't seen that. Again, as I said earlier, the interest rates are only one variable to consider in evaluating the transaction. And our legacy block, including our long-term care block is backed by seasoned assets.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thank you.

Operator: Thank you. The following question is from Darko Mihelic of RBC Capital Markets. Please go ahead.

Darko Mihelic
Analyst, RBC Capital Markets

Q

Hi. Thank you for taking my question so late in the call. Just, I'll try to be quick. First, in your MD&A, you mentioned in the U.S. business that you continued momentum to improve the new business profitability in brokerage and international channels. So, the question is when I look at the U.S. business and I see the increase in the impact of new business, like $34 million versus $3 million last year, is the vast majority of that coming from the international piece? And when you say building momentum, do you think $34 million of new business gains can be improved upon and how significantly from here?

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

A

Thanks, Darko, for the question. It's Marianne. In terms of the new business value, it is a combination of the brokerage and the international, but there is a big piece of it that is the brokerage piece. We've been focused, over the last couple of years, just trying to turnaround the profitability in the brokerage, taking a number of different actions to reduce – getting rid of businesses like COLI/BOLI, getting rid of products that have been unprofitable, looking at our distribution and making sure they're being effective in terms of reorganizing the distribution, and then driving expenses out. So, all of those things combined, in addition we've had an increase in sales, has been driving the new business value for us and we're really pleased with the actions that we've taken and the results it's had.

We still think that there is some upside and we're continuing to focus on that on the NBV side. You commented that the NBV has year-over-year – if you look at this quarter, it's pretty much everything we did in 2017 for the full year. So, we're really happy with the progress we've seen.

Darko Mihelic
Analyst, RBC Capital Markets

Q

Okay. And a question on the balance sheet, there is a significant increase in derivatives quarter-over-quarter, year-over-year. Can you just provide some color on that and what impact that might have going forward?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

So, Darko, this is Phil. So, the increase in derivatives that you see on the balance sheet really is reflecting the impact of evolving market conditions over the course of the last year. There's no material change in the hedging strategy that we have pursued.

Darko Mihelic
Analyst, RBC Capital Markets

Q

Okay. And then, last...

Rahim Hirji
Chief Risk Officer, Manulife Financial Corp.

A

Darko, it's Rahim. We do see increases in notional amounts over time. As part of our hedging activities we do layer on derivatives rather than completely offset them. And every so often, we actually go through a compression exercise where we actually go through our book and reduce the overall size of the notional. So, the pattern that you will see, in general, and that's described in the notes to the balance sheet. We'll see general increases in notional amounts, but that, on a net basis, our strategies are performing just as intended.

Darko Mihelic
Analyst, RBC Capital Markets
Q

Okay. Thank you. And then lastly, with the action you've done to – you've taken to reduce ALDA, I'm surprised that the sensitivity to a change in ALDA assumptions is going up. Can you describe why that is and why we shouldn't expect that sensitivity to actually decline?

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

It's Steve, I can take that question. So, the marginal impact of reducing our ALDA portfolio did reduce that sensitivity, but the business continues to grow, the balance sheet continues to grow, both on the in-force, but more importantly on the new business. And where we deploy ALDA on our new business is really now primarily in products where we pass through the experience of the returns to our customer, both favorable and unfavorable. So, yes, we would have – we saw at the margin, we did see a meaningful reduction in that sensitivity, but it's masked by the continued development of the balance sheet.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Yeah. This is Phil. One supplement to that, prior to the commencement of the ALDA portfolio strategy change, we were in a different U.S. tax regime. So, U.S. tax rates have come down notably and our disclosure sensitivities are post-tax. So, that's in effect, been a headwind on a sensitivity basis.

Darko Mihelic
Analyst, RBC Capital Markets
Q

Okay. Thank you.

Operator: Thank you. The following question is from Paul Holden of CIBC. Please go ahead.

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Thanks. I'll just keep it to one question for interest of time. Regarding the WAM business, EBITDA trend in the U.S. looks different than Canada and Asia. So, I'm just trying to get a sense of whether that's due to the industry pressures we're all well aware of or if there's some kind of incremental costs going through that geography related to the rollout of new product that you've talked about? And then tying that together, when should we expect the EBITDA margin trends to improve, if at all?

Paul Raymon Lorentz
Global Head of Wealth & Asset Management, Manulife Financial Corp.
A

Yeah. Thanks, Paul. It's Paul here. The primary driver of that in the U.S. is the business mix shift. Really, what the market has moved to is that shorter duration, fixed income relative to some of the risks that the model changes – change where we had some redemptions in Q4. So, it's a little bit of a business mix in the U.S.

In terms of looking forward on when you'd expect the return, I think it's really a question of when the markets would – the investor appetite, just with some of the volatility. Our view is just to position the portfolio and make sure we have the right investment solutions for retail investors, independent of what market cycle we're in. And again, we'll continue to drive global leverage to try and maintain margin there as we look forward.

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Okay. So, you don't think – you don't believe this is ongoing secular change in your ability to maintain margins. You think this is more temporary in nature?

Paul Raymon Lorentz
Global Head of Wealth & Asset Management, Manulife Financial Corp.
A

No. We feel quite good about our ability to manage expenses and drive global leverage. And frankly, just with the product suite we have, our view is it's somewhat temporary just because of the market we're in and the investor choices of types of fund. But we feel quite optimistic about our ability to maintain margin and continue to grow the business.

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Great. Thank you.

Operator: Thank you. The last question is from David Motemaden of Evercore ISI. Please go ahead.

David Motemaden
Analyst, Evercore Group LLC
Q

Hi. Thanks. Thanks for taking my follow-up. Just wondering, the ALDA return assumption is – I think it's 9.5%. Given the low rate environment, I guess are you guys thinking about reevaluating that return assumption, just given where we are on risk-free rates and potentially lower go-forward returns?

Scott Hartz
Chief Investment Officer, Manulife Financial Corp.
A

Hi. It's Scott. As you know, we did reduce those assumptions – was it last year, Steve, I think that we reduced them?

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

A year before...

Scott Hartz
Chief Investment Officer, Manulife Financial Corp.
A

A year before. And looking at where we're seeing transactions in the marketplace, I'm comfortable with where those assumptions are now. But those are things we look at every year and they are very long-term assumptions. We don't have to react to short-term changes in the market. So, bottom line, we'll continue to reevaluate them. At this point, I think we're comfortable with where they are.

David Motemaden
Analyst, Evercore Group LLC
Q

Okay. And just a quick follow-up, what portion of the ALDA book is backing the long-term care book in the U.S.?

Scott Hartz
Chief Investment Officer, Manulife Financial Corp.

A

The way we look at it is the ALDA backing our legacy or long-term businesses, we tend to look at those investment strategies in aggregate. So, we don't have an investment strategy for LTC in particular. It's more we group these long-term type businesses together. So, that U.S. block and Canadian block, they've got consistent levels of ALDA in the portfolios.

David Motemaden
Analyst, Evercore Group LLC

Q

Okay. Thanks.

Operator: Thank you. This concludes the question-and-answer period for today. I will now turn the meeting back over to Ms. O'Neill.

Adrienne O'Neill
Global Head of Investor Relations, Manulife Financial Corp.

Thank you, operator. We'll be available after the call if there are any follow-up questions. Thank you for joining us and have a nice morning.

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