

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

MFC.TO - Q3 2020 Manulife Financial Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 12, 2020 / 1:00PM GMT

CORPORATE PARTICIPANTS

Adrienne O'Neill *Manulife Financial Corporation - Global Head of Investor Relations*

Anil Wadhvani *Manulife Financial Corporation - General Manager, Asia*

Michael Doughty *Manulife Financial Corporation - General Manager, Canada*

Naveed Irshad *Manulife Financial Corporation - Head of North American Legacy Business*

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

Philip Witherington *Manulife Financial Corporation - Chief Financial Officer*

Roy Gori *Manulife Financial Corporation - President & Chief Executive Officer*

Scott Hartz *Manulife Financial Corporation - Chief Investment Officer*

Steven Finch *Manulife Financial Corporation - Chief Actuary*

CONFERENCE CALL PARTICIPANTS

David Motemaden *Evercore ISI, Research Division - Research Analyst*

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

Gabriel Dechaine *National Bank Financial, Research Division - Analyst*

Humphrey Lee *Dowling & Partners Securities, LLC - Analyst*

John Aiken *Barclays Bank PLC, Research Division - Head of Research (Canada) & Senior Analyst*

Mario Mendonca *TD Securities - MD & Research Analyst*

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

Nigel D'Souza *Veritas Investment - Investment Analyst*

Paul Holden *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Scott Chan *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Tom MacKinnon *BMO Capital Markets - MD & Analyst*

PRESENTATION

Operator

Good morning, and welcome to the Manulife Financial Third Quarter 2020 Financial Results Conference Call. Your host for today will be Ms. Adrienne O'Neill. Please go ahead, Ms. O'Neill.

Adrienne O'Neill - *Manulife Financial Corporation - Global Head of Investor Relations*

Thank you, and good morning. Welcome to Manulife's earnings conference call to discuss our third quarter 2020 results. We are conducting this call virtually.

Our earnings release, financial statements and related MD&A, statistical information package and webcast slides for today's call are available on the Investor Relations section of our website at manulife.com. We'll begin today's presentation with an overview of our third quarter and an update on our strategic priorities by Roy Gori, our President and Chief Executive Officer. Following Roy's remarks, we'll end today's presentation with Phil Witherington, our Chief Financial Officer, who will discuss the company's financial and operating results.

Following the prepared remarks which were recorded earlier this week to ensure optimal sound quality we will move to the live question and answer portion of the call. We ask each participant to adhere to a limit of 2 questions. If you have additional questions, please re-que and we'll 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 34 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.

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

Roy Gori - *Manulife Financial Corporation - President & Chief Executive Officer*

Thanks, Adrienne. Good morning, everyone, and thank you for joining us today. Turning to Slide 5. I'm very pleased with the third quarter financial results that we announced yesterday. I want to start with a few opening remarks about how the diversity of our business has been a crucial factor in delivering strong financial performance since the onset of the global pandemic. Despite operating in a challenging environment for most of the year, we've delivered over \$4 billion of core earnings year-to-date, and our net income is comparable at \$4.1 billion. This is a testament to the diversity and resilience of our business model as well as to the importance of the investments that we've made in our digital transformation over the last few years. In Asia, we rank as a top three Pan-Asian player. We have insurance operations in 11 markets with over 115,000 agents. We have more than 100 bancassurance partnerships, of which eight are exclusive and provide us with access to over 14 million customers. In Asia Other, which includes emerging markets, agent count has grown 30% in the last 12 months. And NBV is up eight percent year-to-date. We are at scale in most markets where we have operations, and the breadth and depth of our franchise in Asia has played an important role in delivering the strong performance that I referenced.

In the U.S., we're a leader in innovative behavioral insurance products, and our John Hancock Vitality Plus offering has continued to be a key sales differentiator for us. In addition, the U.S. is a solid contributor to core earnings, led by stable contributions from our in-force U.S. business. In Canada, we're #1 in group benefits new business year-to-date, offering top-tier plans and support to more than three million Canadians and their families. Our Canadian business is a significant contributor to sales and NBV as well as to core earnings. And finally, in our Global WAM business, we're a leading provider of investment and administration solutions to retirement plans with nearly eight million participants globally. In Hong Kong, the Manulife Mandatory Provident Fund is the largest MPF scheme sponsor with a market share of nearly 25% in terms of AUM, and we've been ranked #1 in this market since the fourth quarter of 2016. In terms of sales, we also ranked #1 in Canada retirement and #2 and 3 in U.S. retirement, small case and mid case, respectively. We view the diversity of our Global WAM AUMA as a source of strength and a factor in reaching \$715 billion at the end of the third quarter.

Turning to Slide 6 and our financial highlights for the third quarter of 2020. We delivered core earnings of \$1.5 billion and net income attributed to shareholders of \$2.1 billion, which included a gain on a reinsurance transaction that improved the capital efficiency of our legacy business, and a charge related to the annual actuarial review. Our APE sales were \$1.4 billion, down a modest two percent from the prior year, which reflects the strength of our product shelf, the maturity of our digital capabilities and the tenacity and resourcefulness of our distribution channels.

Our capital position remains strong with a LICAT ratio of 155%. Book value per share rose to \$25.49, up 8% from the prior year.

Turning to Slide 7. As I've said on various occasions in recent months, the focus on our five strategic priorities has not changed, nor have the three macro demographic trends that underpin them, namely: one, the emergence and growth of the middle class in Asia; two, the impact of aging global demographics on the retirement gap and wealth transfer; and three, increasing trends towards digitization of the customer experience. While we've already achieved our portfolio optimization target, I'm very pleased to report that we released \$485 million of incremental capital from our legacy businesses in the third quarter. This was largely as a result of executing a reinsurance agreement related to our U.S. bank-owned life insurance block. We have a mature expense efficiency program with processes in place that enable us to be responsive to headwinds such as those encountered throughout the pandemic. Core expenses declined by five percent in the third quarter of 2020 versus the prior year quarter, and we achieved an expense efficiency ratio of 51.2%, a modest decrease of 0.2 percentage points from the prior year quarter. And we continue to expect to achieve our target of \$1 billion of expense efficiencies by the end of 2020, two years ahead of schedule. 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. Our highest potential businesses accounted for 65% of total company core earnings year-to-date. However, it's worth noting that this figure benefits from the absence of core investment gains in the denominator. Normalizing for this item, our highest potential businesses would have contributed 61% of total company core earnings, which is a five-percentage-point increase since 2019.

In Asia, we sold our first policy in Myanmar, a digitally savvy market with one of the lowest insurance penetration rates in Asia. And we entered into a new partnership with Cong Dong Bau, a community with more than five million members across Vietnam that improves access to financial advice and solutions for expectant and new mothers. In Global WAM, Manulife Investment Management was included in the principle for responsible investing leaders Group 2020, and as one of only 36 organizations globally recognized for being at the cutting-edge of responsible investment and demonstrating a strategic commitment to climate-change reporting. This highlights our commitment to being a leader in sustainable and responsible investing.

Our fourth priority is about our customers, and how we're using technology to attract, engage and retain customers by delivering an outstanding experience. We remain focused on our digital transformation, and we've invested over \$600 million in digital capabilities since 2018. In Asia, our relationship NPS score increased by 11 points this quarter compared with the third quarter of 2019. This reflects the quality of the digital solutions that we've rolled out and our commitment to continue to provide outstanding service to customers during the pandemic. Our final priority is building a high-performing team. Our target is to achieve top quartile employee engagement compared to global financial services and insurance peers by 2022. We recently completed our 2020 employee engagement survey and ranked in the 80th percentile amongst global financial services and insurance peers, a top quartile position and a significant improvement compared to 2019. In addition, Manulife was recognized by Forbes on its 2020 World's Best Employers list, putting Manulife in the top 100 best employers globally and making us one of only three financial services companies globally to make the top 100.

Turning to Slide 8. We embarked on a digital transformation journey several years ago and have invested over \$600 million in digital capabilities since 2018. These metrics reflect the impact of those investments. The vast majority of our products are available to prospective customers through virtual face-to-face solutions. And given our success in this area, we expect these figures to remain fairly stable over time.

Turning to Slide 9. We remain committed to proactive and continuous investment in digital capabilities to re-orient the customer experience over the long term. This quarter, Canadian Group benefits launched health by design, a proactive approach using the latest science, technology and predictive analytics to help each member with their unique health journey. In the U.S., we added the Amazon Halo wellness band to devices supported by John Hancock's Vitality program. In Mainland China, we introduced facial and video recognition and intelligent guide script into the sales process. And in our Global WAM business, we launched several online tools and automations supporting our adviser community. Overall, the acceleration and expansion of our digital tools have greatly enabled us to engage more effectively with our customers.

Moving to Slide 10. To conclude, I'm pleased with our third-quarter and year-to-date performance, and I'm confident that Manulife is well positioned for the future. We entered 2020 in a position of strength, thanks to actions taken over the past decade to de-risk our business and reduce our company's sensitivity to market movements. Our financial performance has been solid, and we've continued to execute against our strategy. And we have the financial flexibility to navigate the downturn and to capitalize on opportunities as they emerge, both organic and inorganic. We will continue to take a disciplined approach to deploying capital and will only do so if it's in the best interest of our shareholders.

Finally, we remain committed to both our dividend and medium-term financial targets. Given our consistent track record of execution and the fact that the demographics and economic fundamentals underpinning our strategy have not changed. Thank you.

And I'll hand over to Phil Witherington, who will review the highlights of our financial results. Phil?

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thank you, Roy, and good morning, everyone. Turning to Slide 12 and our financial performance for the third quarter of 2020. We achieved solid core earnings of \$1.5 billion in the quarter, and core ROE was 11.4%. NBV declined by 14%, and APE sales declined by two percent compared with the prior year quarter. We view this performance favourably in light of the current environment. Average AUMA in Global WAM increased by eight

percent compared with the prior year quarter, reflecting the favourable impact of markets and year-to-date net inflows of \$6.1 billion, and we maintained substantial financial flexibility with a LICAT ratio of 155% and a leverage ratio of 26.7%. I will highlight the key drivers of our third-quarter performance with reference to the next few slides.

Turning to Slide 13. Core earnings in the third quarter of 2020 were \$1.5 billion, down 6% from the prior year quarter on a constant exchange-rate basis. The decrease in core earnings was driven by the absence of core investment gains in the quarter, lower investment income in corporate and other, unfavourable policyholder experience in our Canadian insurance businesses and lower new business volumes in the U.S. and Asia. These items were partially offset by the impact of in-force business growth, favourable product mix in Hong Kong and Asia Other, and higher average AUMA in Global WAM. We delivered net income attributed to shareholders of \$2.1 billion in the third quarter. Of note, we recognized a gain of \$147 million from investment-related experience, reflecting the favourable impact of fixed income reinvestment activities and higher-than-expected returns on ALDA driven primarily by fair value gains on private equities, partially offset by modest credit losses and the estimated impact of the sale of NAL Resources Limited, which is expected to close on January 4, 2021. The gain of \$228 million from the direct impact of interest rates was driven by nonparallel movement in swap spreads, U.S. risk-free rates and modest gains on the sale of AFS bonds, partially offset by the impact of narrowing corporate spreads, primarily in the U.S. The gain of \$162 million from the direct impact of equity markets reflects the continued recovery of global equity markets in the third quarter of 2020. We completed our annual review of actuarial methods and assumptions, resulting in a charge to net income attributed to shareholders of \$198 million consistent with the estimate that we had provided in the second quarter. The largest component of the net charge related to a review of the lapse assumption for our universal life policies in Canada. This was largely offset by the favourable impacts of mortality and morbidity updates and various other updates. This year's review also included a comprehensive study of our Canadian variable annuity assumptions as well as certain methodology refinements. Finally, the gain of \$276 million from reinsurance transactions was primarily driven by the execution of an agreement to reinsure approximately \$3.4 billion of policy liabilities related to our U.S. legacy bank-owned life insurance business during the third quarter of 2020, which generated a gain of \$262 million.

Slide 14 shows our source of earnings analysis. Expected profit on in-force increased by nine percent on a constant exchange-rate basis driven by growth in Asia and the U.S. The year-over-year growth rate was higher than we would typically expect as it benefited from market movements throughout the year as well as from the impact of the annual actuarial review. We continue to view six percent as a reasonable annual growth rate for our expected profit on in-force. New business gains were higher than the prior year quarter driven by favourable new business product mix in Hong Kong and Asia Other, partially offset by unfavourable new business product mix in Japan and lower international sales in the U.S., reflecting the adverse impact of COVID-19. Overall policyholder experience in the third quarter was unfavourable driven by higher large-case claims in U.S. life and lower lapses in North America, partially offset by the impact of higher claims terminations in Long-Term Care due to the impact of COVID-19. Of note, policyholder experience in the U.S. was flat compared with the prior year as unfavourable life experience, which included modest COVID-19-related claims losses, was partially offset by favourable Long-Term Care experience. Core earnings on surplus declined compared with the prior year quarter, largely due to lower yields and a change in asset mix partially offset by higher average asset levels.

Turning to Slide 15. Core earnings increased by nine percent in our global wealth and asset management business driven primarily by higher average AUMA partially offset by unfavourable impacts from changes in product mix and lower fee spread in the U.S. retirement business and lower tax benefits. Core earnings in Asia increased by six percent driven by in-force business growth across Asia and favourable new business product mix in Hong Kong and Asia Other partially offset by unfavourable new business product mix in Japan, and the nonrecurrence of management actions in Asia Other in the third quarter of 2019. In the U.S., core earnings increased by five percent, primarily driven by higher in-force earnings and a focus on reduced spending in the current economic environment partially offset by the nonrecurrence of a favourable tax item in the third quarter of 2019. Core earnings in our Canadian business decreased by 12%, reflecting unfavourable policyholder experience in our insurance businesses and a number of smaller experience-related items. Core losses in our corporate segment increased by \$128 million compared with the prior year quarter, reflecting the absence of core investment gains in the third quarter of 2020 and lower investment income. We expect lower yields to persist as a headwind to the corporate and other segment, given the prevailing interest rate environment.

Slide 16 shows our new business value generation and APE sales. In the third quarter of 2020, we delivered new business value of \$460 million, down 14% from the prior year quarter. In Asia, new business value decreased 16% from the prior year quarter, primarily driven by lower APE sales in Hong Kong and a decline in interest rates in Hong Kong. In Canada, new business value increased 31% from the prior year quarter due to higher sales volumes in large-case group insurance. And in the U.S., new business value decreased 38% from the prior year quarter, largely driven by lower international universal life sales due to COVID-19. In the third quarter of 2020, we delivered APE sales of \$1.4 billion, down a modest two percent

from the prior year quarter. In Asia, APE sales declined by six percent from the prior year quarter as growth in Japan and Asia Other was more than offset by lower sales in Hong Kong.

In Canada, APE sales increased by 23% from the prior year quarter, primarily driven by higher large-case group insurance sales, partially offset by lower individual insurance sales due to the adverse impact of COVID-19. In the U.S., APE sales declined by 14% from the prior year quarter due to the adverse impact of COVID-19 as lower international universal life, domestic protection universal life and variable universal life sales were partially offset by higher domestic indexed universal life and term life sales.

Turning to Slide 17. Our global wealth and asset management business experienced net outflows of \$2.2 billion in the third quarter compared with net outflows of \$4.4 billion in the prior year quarter. These third-quarter numbers include the redemption of a \$5 billion equity mandate by a U.K.-based institutional asset management client. In Canada, net inflows were \$1.2 billion compared with net outflows of \$6.9 billion in the third quarter of 2019. The improvement was driven by the nonrecurrence of an \$8.5 billion redemption in institutional asset management in the prior year quarter and lower redemptions in retirement.

In Asia, net inflows of \$1.1 billion were lower than net inflows of \$2.3 billion in the prior year quarter driven by higher retail redemptions in Mainland China, partially offset by higher gross flows. In the U.S., net outflows were \$4.5 billion in the third quarter of 2020 compared with net inflows of \$0.1 billion in the third quarter of 2019. This decrease was driven by the redemption of the equity mandate in institutional asset management, which I referred to earlier, coupled with lower retirement plan sales and recurring deposits and higher member withdrawals.

Our average AUMA increased by eight percent compared with the prior year quarter driven by the favourable impact of markets and year-to-date net inflows of \$6.1 billion. And our core EBITDA margin was 30.4%, up 170 basis points from the prior year quarter, reflecting our scale and commitment to expense efficiency.

Turning to Slide 18. Our LICAT ratio of 155% in the third quarter of 2020 represents \$32 billion of capital above the supervisory target. This is in line with the prior quarter as the impact of a net capital issuance and reinsurance of a block of U.S. legacy business were offset by the overall movement in markets and the capital impact of investment activities. Our leverage ratio increased to 26.7%, slightly above our medium-term target of 25% as we have been proactively pre-financing debt that is approaching maturity. In addition, the stronger Canadian dollar also contributed to the increase this quarter.

Turning to Slide 19, and core expenses. Our expense efficiency program is mature and a disciplined approach to expense management is deeply embedded in our culture at Manulife. We've taken action to contain core expenses since the onset of the COVID-19 pandemic and have reduced core general expenses by five percent compared with the prior year quarter and three percent on a year-to-date basis. As a result, our year-to-date expense efficiency ratio is 52.9%.

Turning to Slide 20, which shows the performance of our ALDA portfolio by asset class over the 15-year period since Manulife's acquisition of John Hancock. The average return of the overall portfolio during the period from 2005 to 2019 was 9.4%, and it's worth noting that this was delivered with significantly lower volatility in comparison to public equities. With the exception of oil and gas and Timberland, the average return of each of the underlying asset classes has exceeded its current best-estimate long-term return assumption over this period. Despite this, the overall ALDA portfolio return over this period has exceeded our current aggregate best-estimate long-term return assumption.

Slide 21 outlines our medium-term financial operating targets and recent performance. Core EPS growth and core ROE were below our targets reflecting unprecedented levels of disruption as a result of COVID-19. Nonetheless, our performance during the first three quarters of 2020 demonstrates the resilience of Manulife's business. While it's reasonable to expect COVID-19-related headwinds to persist for the foreseeable future, we believe a 10% to 12% core EPS growth rate remains appropriate for 2021 and beyond. This is well supported by both geographic and line-of-business diversification. In addition, we anticipate continued contributions from our well-established expense efficiency program and robust digital capabilities.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And the first question is from John Aiken from Barclays. Please go ahead.

John Aiken - Barclays Bank PLC, Research Division - Head of Research (Canada) & Senior Analyst

Good morning. In terms of the Long-Term Care experience, the claims terminations, can you give us a sense as to what the split was between the terminations of those policies actively in claims and those that are not? And then as a follow-on, if we continue to see the case counts and deaths increase in the U.S., would we -- should we expect to see the same trade-off in terms of the benefits versus the higher claims on life to basically offset like we saw in the third quarter?

Steven Finch - Manulife Financial Corporation - Chief Actuary

Thanks, John. It's Steve Finch. I'll take that question. The gain that we saw in Long-Term Care in the quarter, that was really primarily driven by deaths of those on claims. So, claim terminations of those that are already receiving benefits. We didn't see a notable increase in in-deaths in our active lives. So that was the driver in the quarter.

In terms of how it trends from here, it's really difficult to say. It depends on how the pandemic impacts different parts of the population. And we certainly saw in -- earlier in the year, and it was widely reported on, that nursing homes, care facilities were disproportionately impacted, and we saw that come through our Q2 results. Hopefully, and it seems that, that situation has improved, and the claim terminations that we saw in Q3 were significantly lower than what we saw and reported on earlier in the year. So, it's hard to predict how it's going to play out. We're going to continue to watch the data closely.

John Aiken - Barclays Bank PLC, Research Division - Head of Research (Canada) & Senior Analyst

Understood. Thanks, Steve. And Phil, if I may, on expenses and the efficiency ratio. Obviously, you feel very confident about hitting the \$1 billion target for 2020. How can we think about expenses going forward in terms of ongoing reinvestment in programs? What's going to fall to the bottom line? And what are your outlooks for ongoing spend in technology? Are we going to continue to see inflation on that in the same degree as we have over the last couple of years?

Philip Witherington - Manulife Financial Corporation - Chief Financial Officer

Thanks for the question, John, and good morning. Yes, so, on expense efficiency, you're right, we have made progress. It continues to be a core part of our strategy, a key priority in our strategy. We do expect this year to deliver the \$1 billion target that we have laid out but we are falling short at the moment of the overall cost-efficiency ratio target that we said that we would get to 50% by 2022. That's still the plan, but there's clearly more work to do there as a consequence of the environment that we're in and the impact that, that has on revenues. So, it does continue to be important.

Now in terms of reinvestment and what -- the component we would expect to fall to the bottom line, the results year-to-date clearly demonstrate that the cost program is having bottom-line benefits, and the same was true in the prior year, with expenses falling by five percent in the quarter, three percent year-to-date, that's clear. We are continuing to reinvest, and one of the metrics that Roy gave in his remarks is that we have invested

\$600 million in digital initiatives. And our intention is absolutely to continue to invest. But despite that reinvestment, we do remain committed to a 50% cost efficiency target by 2022.

John Aiken - *Barclays Bank PLC, Research Division - Head of Research (Canada) & Senior Analyst*

Thanks, Phil. Over to you.

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, John.

Operator

Thank you. The next question is from Humphrey Lee from Dowling & Partners. Please go ahead.

Humphrey Lee - *Dowling & Partners Securities, LLC - Analyst*

Good morning and thank you for taking my questions. Maybe a question for Steve. Just wondering if you can go into some additional colour in terms of the assumption review, specifically on the key changes to lapses, and then also the one for morbidity and mortality?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Sure. Thanks, Humphrey. In terms of the lapse review, the charge that we took there is primarily from the review of our yearly renewable term and level cost of insurance products in Canada. And the reserve strengthening was primarily driven by the experience that we're seeing emerge on our larger policies, so, \$1 million plus. We think one of the drivers of the experience that we're seeing is the persistent low interest rates that we've seen over the past many, many years. And we've been tracking this block quite closely. The last detailed study that we did was in 2017. Since that time, as the block has matured, we've got a lot more data points at the later duration so, after a policy has been in place, in-force more than 15 years, the data points that we've got there are more than doubled. And we are seeing lower experience, lower lapses, and that is what we've reflected in the experience. And just for context, so you get a sense of what the assumption is on these large policies, our ultimate lapse rate now after this change is 0.25% per year so, 0.25% of customers stopping paying premiums and lapsing each year. That's the best estimate, and we add a margin of 20% onto that as well to get to the padded assumption.

So, I feel good that we've reflected all this emerging experience and I think we are at the prudent end of practice in the industry.

In terms of mortality, the changes that we saw there, we strengthened reserves in our U.S. life insurance business as emerging experience showed the need to increase assumed mortality rates at the older ages. We saw gains in Canada. We reviewed certain reinsurance agreements and have undertaken some recaptures, which is a benefit. And in Canada, we also did a review of the mortality margins on our preferred business. We've got a lot more experience, and we've harmonized those assumptions with our U.S. business.

And finally, in Japan, we have been observing gains in our retail business there, primarily related to hospitalization benefits and cancer benefits, and that resulted in our release of reserves there.

Humphrey Lee - *Dowling & Partners Securities, LLC - Analyst*

So I guess when we think about how the basis change is affecting the run rate earnings for the different segments, but how should we think about that uplift?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Right. Thanks, Humphrey. So, we're seeing it come through in a few places and the uplift is on the order of \$15 million per quarter. Some of that's coming through in terms of an increase in earnings on in-force in the U.S. from the mortality basis change, also some of the true-ups in our models. We're seeing a pickup in Asia, offset by a decrease in Canada. And then we're also seeing it come through the policyholder experience line. But all in, roughly \$15 million a quarter.

Humphrey Lee - *Dowling & Partners Securities, LLC - Analyst*

That's helpful. Thanks.

Operator

Thank you. The next question is from Tom McKinnon from BMO Capital Markets. Please go ahead.

Tom MacKinnon - *BMO Capital Markets - MD & Analyst*

Yes, thanks, morning, could start with Phil, just really on the earnings on surplus and the impact on new business. You mentioned lower yields and asset mix changes impacting this quarter and lower investment environment, certainly a headwind going forward. So, just trying to gauge as to how we should be thinking about earnings on surplus, just given where we are at the third-quarter level and as well as the impact of new business, certainly better in Asia, you know, helped by better sales and a more profitable sales mix. Is this kind of more indicative of what we should probably expect going forward in terms of impact in new business in Asia as well? And I have a follow up. Thanks.

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Great. Thanks, Tom, for the question. This is Phil. I'll cover the earnings on surplus points, and then maybe hand over to Anil to cover the Asia new business question, then we'll take your follow-up.

So, earnings on surplus. As you probably know, a variability in earnings on surplus is one of the key drivers between quarters in the corporate and other earnings variability. In the third quarter, earnings on surplus pretax was \$126 million. That's in the order of \$50 million to \$60 million lower than the third quarter of 2019. And as I said in the prepared remarks, and as you've called out, key drivers there, lower yields, which really reflects the lower interest rate environment that we're in, as well as asset mix changes, and there was a tactical change in asset mix in our surplus portfolio during 2020. We reduced the component of the portfolio that is invested in public equities, switched those into fixed income, just in view of the environment that we're in. We're not completely out of equities, but we're just -- we've approximately half the exposure there to equities. And there was a slight offset from that, from higher average asset levels. I think it's also worth noting the quarter-on-quarter movement in earnings on surplus. And in the second quarter, as we called out, I think, in our earnings call last quarter, there was a gain from the impact of seed capital, so that was a bit of a bounce back in seed capital valuations. That was a -- in the order of \$150 million. The third quarter also saw favourable seed capital returns, but at about half that level, \$70 to \$75 million, so that really explains the quarter-on-quarter movement. I think I'll hand over to Anil to talk about the Asia new business question.

Anil Wadhvani - *Manulife Financial Corporation - General Manager, Asia*

Thanks, Phil, and thanks, Tom, for the question. So, if you look at the new business gain for Asia, and let me start with providing a little bit of colour of quarter-on-quarter. Our sales were up by 31%, though our new business gain was up by 66%. And as you rightly pointed out, it was on account of better product mix, largely predicated on the back of the increase that we saw in health and protection. In fact, our health and protection sales jumped by 27% quarter-on-quarter. In addition to that, we were very disciplined on our expenses, as Phil alluded to in his opening comments.

From a year-on-year perspective, again, while our sales were down six percent, our new business gain was up 24%. And a couple of reasons for that. Firstly, again, improved product mix -- so, shift to health and protection, as that continues to be a top-of-mind topic for our customers on the back of the outbreak in Hong Kong. For example, we repriced and launched our par critical-illness product as well as a new par savings product, both with improved margins. We continued to be very disciplined on expenses and our expenses, despite Asia being the growth engine, declined year-on-year by 5%. So, we saw expense reductions in Japan, in Hong Kong, and continue to be very prudent about that, as I mentioned earlier. And last, but not the least, if you look at it from a year-on-year perspective, we had lower VHIS sales in quarter three of 2020 as compared to quarter three of 2019. And as you would have noted that VHIS, while has a healthy new business value margin, from a core earnings perspective, it does kind of create a new business strain and that strain was significantly lower for us in quarter three of 2020. So, a combination of factors around improved product mix, better expense discipline and the VHIS resulted in the new business gain, increase that you see in quarter three of 2020.

Roy Gori - *Manulife Financial Corporation - President & Chief Executive Officer*

Yes. Tom, I might just also just supplement to Anil's comments. Anil has just done a phenomenal job of growing our agency force in Asia as well. In fact, we've grown our agency by 27% on last year, which has been a huge source of strength for us, and the focus for us in agency is on a premier agency where we really look for higher productivity than what most would see in the marketplace. So that's been another tremendous driver of growth for us as has been our strong bancassurance agreements that, again, Anil has been really driving with a great emphasis. They certainly have helped us with the momentum that we've had in sales in Asia as well.

Tom MacKinnon - *BMO Capital Markets - MD & Analyst*

Okay, thanks. And then the follow-up has to do with Canadian individual insurance sales, which are down, I think in year maybe 23% year-over-year. I think you've mentioned you're still getting quite a few being able to send in apps electronically, but is it just the fact that you can't have sort of a paramedic visits? What's slowing down the sales? Is it strictly COVID, which we anticipate sales to pick up post-COVID as a result of that? What would be driving those insurance sales down year-over-year in Canada? Thanks.

Michael Doughty - *Manulife Financial Corporation - General Manager, Canada*

Thanks, Tom. It's Mike Doughty, and I'll take that question. Yes, you saw in our -- overall, in our Canadian segment because we have a diversified business; we actually had a pretty strong quarter in total sales, but definitely, you're seeing the impact of COVID on our individual insurance line. You'll remember, we entered the year in a very strong position. But -- and really what you're seeing now is the -- is kind of the delayed effect of the early lockdown, where the paramedics were closed. So, at the higher face amounts, it was very difficult to get new business written and into the pipeline. We have seen an improvement throughout the quarter. So, activities are certainly coming back, and we're optimistic that that's going to continue, of course, absent more sort of severe shutdowns. And the one exception I would reference is, of course, we do write travel insurance, and that will certainly be depressed until borders reopen and people are traveling again.

Tom MacKinnon - *BMO Capital Markets - MD & Analyst*

Are you working at all on any kind of simplified underwriting product where you wouldn't need any kind of paramedic visit? Or what would be the appetite for that just that you see in the market or you see with brokers?

Michael Doughty - *Manulife Financial Corporation - General Manager, Canada*

Yes. We've actually -- very early on in the pandemic we actually worked with our reinsurance partners, and were very quick to actually expand the agent amount limits so that we can actually process quite a bit of business, under \$2 million at the sort of younger ages, without needing medical evidence. So that has been very popular. The other thing that we did, we've had an electronic application for some time and have really been promoting that; 83% of our insurance business was processed through that electronic application in the third quarter. So, we do think -- our products are available virtually, all of them virtually now. So that's not an issue for us.

Tom MacKinnon - *BMO Capital Markets - MD & Analyst*

Okay, thanks.

Operator

Thank you. The next question is from Gabriel Dechaine from National Bank Financial. Please go ahead.

Gabriel Dechaine - *National Bank Financial, Research Division - Analyst*

Good Morning. Thanks for the additional information on the ALDA portfolio returns, but it's something that investors highlight as one of the main concerns that they have, returns in that portfolio and a potential charge if you have to lower them. I'm just wondering if it's — there's anything else you can provide on the disclosure side, and not for this call really, but similar to what you've done for Long-Term Care, give more granularity on the best estimate versus PfAD, some sensitivities to changes that might arise? And basically, stuff that would downplay, or at least from your perspective, downplay the risk of a possible charge. I'm wondering if that's something that you guys would be considering presenting. And actually, if there's anything you'd say about the CRE and the (inaudible) GAAP performance this quarter, that would be great, too.

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Okay. Thanks for the question, Gabriel. So, on your point on disclosure, that's something we can take away and think about. It's certainly a good suggestion, and we're very open to providing transparent disclosures. And Scott, I don't know if there's anything else you wanted to add with respect to ALDA returns and the disposal of NAL?

Scott Hartz - *Manulife Financial Corporation - Chief Investment Officer*

Sure. And let me back up a little bit here. Thanks, Gabriel, for bringing this up. Our assumed returns are long-term returns, 50-plus years, so the experience in any given quarter and any given year doesn't really influence us that much. With that said, we do look at those returns each year to make sure we continue to be comfortable with them, and that starts with looking at history; and hence, Phil showed the longer-term history we have here, where we have actually achieved the current assumptions over 15 years. But as everyone knows, past performance is no guarantee of future performance, so we do look at what drove those returns and whether we think conditions have changed. And there certainly were some tailwinds over that period, but there also were some headwinds, and I'll just point a few of them out.

First, we did see interest rates drop, and hence discount rates drops over this period, which was a tailwind. But on the other hand, this is largely a real asset portfolio. It's got infrastructure, real estate, timber, agriculture, oil and gas and inflation is a big component of the returns there; and that inflation has come down, inflation expectations have come down even more, and that's been a bit of a headwind for the portfolio.

And then if you look at that time period, it's been — especially the last 10 years, a really good one for equities, a bit of a bull market. But reaching back to 15 years does take us through the global financial crisis when equities performed poorly, and real estate certainly performed poorly. So again, as you saw on Phil's exhibit, U.S. equities were — had about a nine percent return, Canadian equities about seven percent return, which is pretty consistent or even maybe a little below the really long-term returns in those markets. So, we don't feel like it was an unusual period from that perspective. And then you pointed to oil and gas, which certainly has been a headwind for us over those past 15 years, returning less than five percent and even worse in more recent times. So, we did sell NAL, with it closing in January, this past quarter and with that, our oil and gas exposure falls to below five percent of the overall ALDA exposure, and that's [a low point] (corrected by company after the call) over the last 15 years, where it's been as high as nearly 10% at certain points, so we do feel like a lot of that headwind is behind us at this point. And so, you put all that together, and we do get comfortable with our current assumptions.

I guess -- your other question was -- sorry, just to follow up on real estate and sort of looking forward on real estate. So, I think I indicated on prior calls, it is an area that I'm concerned about, and retail, obviously, would be a big concern. We have very little there, three percent of the portfolio. Industrial and multi-family, I feel actually very good about, particularly industrial. But office is the biggest question mark, and that is the biggest part of our portfolio with little over 2/3 of the portfolio in office -- although we do occupy a lot of that space. And so, looking at just what we would call investment office properties, that's a little less than half the portfolio. And that is where I am most focused and listening to a lot of folks as to where that's going. And of course, I've been very concerned that the longer we continue to work from home, the less amount of people will go back. But on the other side of that, people would argue that when we do go back, we won't be cramming people into smaller and smaller space, which has been a bit of a trend, so it's hard to say where those two will play out, but it is certainly concerning. I think the news on the vaccine this past week has been pretty helpful because my biggest concern was, we go through a really long extended period out of the office, and a lot of that sticks. I certainly think some of it will stick, but the sooner we can get back, the less apt it is to be a large chunk. So, we had modest losses on our real estate portfolio this quarter, and modest loss means just we underperformed the assumption. It was still actually a slightly positive return, and we'll be watching it closely. That is probably my biggest concern in that portfolio.

I think private equity on the other hand is a bit of a tailwind as I think you know those returns are a bit lagged and we -- and third quarter was a good quarter for public equity and continues to be a good quarter -- in the fourth quarter. So, I think that all will provide us pretty good returns, absent markets changing radically over the next couple of quarters in private equity. So, I think those two largely balance each other out at this point.

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

And it's Steve. I just wanted to add, very briefly, add my comments in terms of my review, the assumption, Scott and I and his team work very closely together. I continue to be confident in our ALDA assumptions over the long term. And the key things there that Scott pointed out that I'll reemphasize is it is a very long-term assumption. We have a really strong team and demonstrated track record for delivering the returns that on a risk-adjusted basis are as you saw and what Phil presented earlier. The other thing, Gabe, just to remind you of is we put significant margins on ALDA assumptions, so we put margins on growth, income, and we're also required to shock the portfolio at the time that's the least favourable, so our all-in average padded assumption is 6.1% annual return. Thanks.

Gabriel Dechaine - *National Bank Financial, Research Division - Analyst*

Thanks. You know, I had a second question, but I'll graciously leave time for my fellow analysts.

Operator

Thank you. The next question is from Meny Grauman from Scotiabank. Please go ahead.

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

Hi, good morning. Question about the annual assumption review, and I'm wondering if COVID considerations played any role in that review. Did that factor in at all to what you did this quarter?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks, Meny. It's Steve. The short answer is no. We're still tracking these trends that we're seeing from COVID. And we're not taking the view at this point of updating long-term assumptions. And that is consistent with what I've seen for peers across the globe and the industry. I've seen surveys from some of the audit firms, and consistently, people are saying -- we need to see how all this experience develops. We'll form views and we'll factor in, in the future, but not part of this year's study.

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

Now that was the second part of my question, whether you would ever consider being proactive given the nature of the shock, I know one of your peers has talked about that. And I'm just wondering, under what circumstances would it make sense to be proactive? Or how much time do you need to see things develop before you would feel comfortable doing something on this particular issue?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Yes, it's a good question I think, what people are thinking about in the industry. I just remind you that we have a diversified book of business. So, we've seen gains in some product lines. We've seen some modest life claims from COVID. It can impact policyholder experience. So, we've got a diversified book. So, I would be cautious that we don't look at any one assumption. We need to look at it holistically in terms of how it's impacting us, and that will be part of all the data that we look at going forward.

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

Thanks.

Operator

Thank you. The next question is from David Motemaden from Evercore. Please go ahead.

David Motemaden - *Evercore ISI, Research Division - Research Analyst*

Hi, good morning. I had a question for Naveed and Phil maybe. I guess just wanted an updated view on the variable annuity book, and particularly in the U.S., and just your view on risk transfer opportunities there. We saw a large transaction recently, and a stock there that was involved meaningfully re-rated after that. So, wondering, you know, what your current view is on potential risk transfer opportunities on the U.S. book on the variable annuity side?

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

Hi David, it's Naveed here. So that transaction was certainly interesting. It's one that we're reviewing closely and seeing if there's any applicability for us. We know that it was a significant process that took over a year to complete. We also know that there are potential buyers of VA blocks who recognize that the market may not be appreciating the value within. So, we do regularly explore inorganic options, and we'll transact if it is in the best interest of our shareholders; that said, our VA business continues to perform really well to generate earnings and cash. We're well hedged. The hedging program is holding up well through periods of high volatility. Historically, we've seen 95% hedge effectiveness, so it's working well. We're also pleased with the success we're having with organic initiatives like the buyback program and have plans to continue our organic work. So, I'd say it's looking at both options. But again, we're happy with the performance of the business.

David Motemaden - *Evercore ISI, Research Division - Research Analyst*

Got it. And if I could just follow up. Any sort of — you know, you guys obviously give capital and reserves back in the entire VA book. Is it safe to assume that the majority of that is back in the U.S. book, given that's where the majority of the — I guess the net amount at risk is?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

It's Steve. I can comment on that. It — I don't have the split in front of me, David, but the largest part of the block and relatively higher risk benefits are in the U.S. So it would be — it would certainly be more than half. The majority would be in the U.S., but we can circle back if we're willing to provide that information.

David Motemaden - *Evercore ISI, Research Division - Research Analyst*

Okay. Okay. Great. That's helpful. And then my second question is on the ALDA portfolio, and you guys have given disclosure of the book value and net income hit from a 100-basis-point reduction. And if I look at that reduction, if I just look at year-end 2018, there was \$3.9 billion of an impact to net income, and that's increased by 30 — over 30% to a \$5.2 billion impact to net income from a 100-basis-point reduction in that return assumption. I guess I'm just wondering why that's gone up so much over the last several years. It's definitely more than the overall portfolio has grown. I think the portfolio overall has grown about 15% over that time period. But is there something — I guess I'm just wondering why that sensitivity continues to move upwards.

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks, David. It's Steve. I'll take that one. There are two drivers of what's increased that sensitivity. The first was in the basis change in 2018. We saw some lengthening of our liabilities. Long-Term Care was one of those drivers, and what that means is we hold the ALDA in our model for longer so we're getting the benefit of the — ALDA the returns over a longer period of time, which impacts the sensitivity. And the second driver, which is a little bit bigger, is the significant drop in interest rates in 2020. And what that does, when we run our sensitivity, we've got lower returns for ALDA, so we've got less ALDA in the model and the spread because of the lower rates between the fixed income and the ALDA is larger, that increases the sensitivity, so it's really a modeling thing as opposed to growth in the portfolio.

David Motemaden - *Evercore ISI, Research Division - Research Analyst*

Got it. That makes sense. Thank you.

Operator

Thank you. The next question is from Doug Young from Desjardins Capital Markets. Please go ahead.

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

Good morning. Steve, you're a popular person today, so I'm going to stick with you. You took a sizable hit in the actuarial assumption review related to lapse. You did have some negative lapse experience in Canada again this quarter so I'm just hoping you can unpack that and maybe give a sense of what you're seeing. And you also had some negative lapse experience, it sounds like, in the U.S. as well and so I'm hoping you can elaborate on that.

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks, Doug. Yes, we — so they're not directly connected really. I mean, the lapse review in Canada, as I talked about earlier, it's reviewing the emerging experience. In terms of the quarter, what we're seeing — what we believe we're seeing — just like in Q2, we saw people not going to the dentist, not going for routine care that drove gains. We're seeing higher claims terminations in Long-Term Care. What we're seeing across North America, across our protection products, is lower lapse rates than a trend. So, we're seeing people hanging on to their coverage in a situation where there's a global pandemic. And Mike referred me to some studies, Mike Doughty referred me to some studies that are showing that consumers are valuing their life insurance more in this environment. So, we think it's — you know, just like we saw in the global financial crisis, where you can see

off-trend experience in terms of what customers might be doing, we think we're seeing some trends here on the North American lapse, where people are holding on to their coverage.

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

I mean is there a risk that you didn't take the lapse assumption down enough? Is that what the experience is telling us? Or is this just something that, you think it's more of an unusual event right now, given COVID, and that it will go back to more what you've assumed in your assumptions?

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

We think it's -- we think it's an unusual trend. I mean we took those level COI lapse rates, as I mentioned, at the ultimate and the larger policies, down to 0.25%, 0.2% on a padded basis, so they're pretty low. We think this is unusual trends that are likely to revert over time.

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

Fair enough. And then, Phil, I know there's been discussions on these calls in the past about trapped capital. And you obviously have a strong LICAT ratio of 155%, but there is concerns, and I get questions on in certain regions, your requirements would be higher than what would be required under LICAT. Is there any kind of additional colour you can provide around what is trapped capital, if there is any? And maybe put that 155% in context?

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Hi Doug, thanks for the question. And you're certainly right that our capital position is strong, and it has strengthened substantially in recent years. And just to put a reference point behind that, when we adopted the LICAT methodology in the first quarter of 2018, we had \$16 billion of capital above the supervisory target at that point. When you look at the Q3 results, with a LICAT ratio of 155%, that's \$32 billion of capital above the supervisory target. Now, we very deliberately well-capitalized our operating entities around the world. And so, in all of our operating entities, we're above the supervisory targets. And we do hold quite a substantial cushion -- that is very deliberate in order to really provide resilience to market shocks that may occur. And it's actually quite efficient to do that when we think about potentially withholding taxes that are levied when we provide remittances to the holding company. Having said that, we do maintain sufficient flexibility at the MLI level to be able to fulfill any calls that may be necessary on the resources centrally.

And just to give a few examples of what we have done to deploy capital in the past couple of years. If we look 2017 through to 2020, we've increased the dividend by 11%, and I think that speaks to the confidence that we have in capital fungibility and flows from subsidiaries to the parent. But we've also deployed on top of that \$1.2 billion of capital into share buybacks and that's net of the treasury drip that we had in place. And beyond that, we've also been redeeming debt, so in 2018, 2019, that was \$1.5 billion of net redemptions. So, I think you can see that we do have flexibility to deploy capital as needed. And one thing that I'd just call out from Roy's remarks earlier, we are absolutely committed to the dividend, and we feel very confident in the medium-term remittance flow to support that.

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

And just a quick follow up. I mean is there a rule of thumb, and, so, you know, a LICAT of -- and this is my number, but 130% would get you kind of -- if you looked across all of your operations -- would leave you in an excess capital -- give you above-target capital requirements in all your jurisdictions with a little cushion. Is there like a rule of thumb we could think about?

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Right. I think you called out 130%. 130% is actually very close to where we transitioned to LICAT in the first quarter of 2018. We had a LICAT of 129%, and I do consider 130% to be a strong capital position. So, I think it's a good rule of thumb. But there is no magic number. The amount of capital that we feel is appropriate will depend upon market conditions and market circumstances. And in this environment, we are remaining very cautious. There's an uncertain outlook. We do continue to see volatility, both upwards and downwards. And I think that's a good reason for us to continue to hold — maintain a very strong capital position.

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

Thank you.

Operator

Thank you. The next question is from Paul Holden from CIBC. Please go ahead.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Hi, thanks, good morning. First question is related to the Asia business and specifically Hong Kong. If I look at the reported COVID cases post-quarter, they've trended down significantly, so, wondering if that — if you're seeing a correlation between that decrease in COVID cases and improvement in sales.

Anil Wadhvani - *Manulife Financial Corporation - General Manager, Asia*

Thanks for the question, Paul. This is Anil. So, Hong Kong, as you know, has been exceedingly resilient, and that's not only in the light of the current challenges that we've kind of witnessed in 2020, but even if you were to kind of trace back to quarter two of 2019 when Hong Kong was witnessing disruptions, we were very resilient throughout 2019 and getting into 2020. If you look at our Hong Kong business, we were able to deliver a core earnings growth of 15% year-on-year. Importantly, we saw strong traction quarter-on-quarter, so our new business value and our new business volume, both were up by eight percent. And what we are really kind of focused on, COVID notwithstanding, is to focus on the fundamentals of the business, the drivers of the business. So we have a very strong agency in Hong Kong, which now stands at north of 10,000. We've grown that at seven percent year-on-year. We have strong broker and bank partnerships. We are investing significantly in virtual face-to-face capabilities -- which, in case of pandemic, proves to be a great defensive tool, but even without the pandemic, it's a great productivity tool for our agents and our customers alike to utilize. We have also, on the back of the demand that we are witnessing on health and protection, we have launched new critical illness products, which, again, have found good favour with our clientele in Hong Kong. So, we feel very confident the way our Hong Kong business is positioned: strong brand, diversified business, diversified channel mix. In fact, we have been able to prove that track record and execution, and if you were just to kind of compare our market share first half '19 to first half 2020, we've almost doubled our market share in Hong Kong, so we feel very confident. I've not even mentioned the fact that we have a very strong position on NPS. As Roy mentioned in his opening comments, we are number one, and we continue to solidify our market position on the NPS business as well.

Roy Gori - *Manulife Financial Corporation - President & Chief Executive Officer*

Paul, if I could also chime in, just beyond Anil's comment specifically as it relates to Hong Kong and Asia. I would say the global diversity of our business across all of our geographies and business lines has been a really key source of strength for us for navigating this COVID environment. And the fact that we've had some markets in lockdowns and experiencing significant challenges, while others have emerged out of a more stringent lockdown environment -- that's been a real source of strength for us, and for me, that's contributed significantly to the fact that our APE sales in the quarter were only two percent down on prior year. I'd highlight in that a really strong result for our Canadian division -- in fact, sales up 23%. Group benefits was a key driver that helped us there. Our U.S. domestic business, again, was a source of strength. And then reflecting on our WAM

business, where we saw gross flows year-to-date grow 20% on the prior year. To me, that just paints a picture of how the global diversity of our business across business lines and geographies has really helped us navigate the difficulties and the challenges of COVID, which have been significant and has impacted certain markets in very significant ways. But we've been able to offset some of that through the improvements or the benefits that we're seeing in other geographies.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay. Got it. I do want to -- so my second question is related to WAM, and as you already pointed out, you have a diversified global model and across a number of different product categories as well. But if I look at results, it seems like the U.S., in terms of a flow perspective, has been softer than some of the other geographies. So, wondering if there's particular drivers behind that, and if there is a strategy in place to help prop up those net flows in the U.S. market specifically?

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

Yes, thanks, Paul, it's Paul Lorentz here, I'll take the question. Yes, as you mentioned around the flows we have, and Roy spoke to the diversification across the different business lines. Particularly in the U.S., we do see some headwinds as it relates to the U.S. retirement business generally for the industry, just because of the impact of COVID on the small business owner and what that means. And we have seen a little bit of an uptick in terms of some of the withdrawals that participants are accessing, in light of just wanting more cash flow in this particular environment. But having said that, the impact of that has been offset somewhat by lower lapses of plans that aren't moving as much. And frankly, the impact of the withdrawals and flows is quite small relative to the AUM and earnings base of that business. So, we do think there are some temporary headwinds. But speaking more to just taking a step back and looking at it, you would have seen, excluding that large-case redemption, U.S. in aggregate would have been actually positive net flows this quarter. And, in fact, our U.S. retail business was positive in the third quarter, which was the first time this year, and that has been slowly picking up business across the globe. And so, I think if you kind of just take a step back, and again look at the large institutional client, which we do get variability in, we have positive net flows across every geography and every business line. The gross flows were up 20%. And we do have different businesses offsetting some of these headwinds. And Anil talked about our MPF market share. Just to give some perspective, in Q3, we led market share in net flows, and we were 30% ahead of the next close competitor, just to give you a sense of the strength. That's really helped offset where we do see short-term challenges in the business in other business lines, and has given us a lot of confidence in our ability to continue to drive positive net flows over the long term.

Paul Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

That's great, thank you, that's all for me.

Operator

Thank you. The next question is from Nigel D'Souza from Veritas Investment Research. Please go ahead.

Nigel D'Souza - *Veritas Investment - Investment Analyst*

Thank you. Good morning. I had a question for you on interest rate sensitivity. With rates declining in the past, LICAT has benefited from fair value gains related to AFS bonds held in surplus. So, I'm wondering, if that trend reverses and we see rates rise due to a successful vaccine, a quick return to normalcy and high inflation expectations, would you look to crystallize the gains in AFS bonds to reduce the drag to LICAT in a rising rate environment? Is that the right way to think about it? And, could you also touch on, outside of AFS bonds, how you expect LICAT to be impacted if rates do continue to rise, let's say, over the next few years?

Philip Witherington - *Manulife Financial Corporation - Chief Financial Officer*

So Nigel, this is Phil, and just to clarify -- on a LICAT basis, we -- the value of the AFS bonds is fair value, as carried in the balance sheet. So, whether it's an unrealized gain or a realized gain, the impact is neutral, and that's a notable difference to the old capital regime, the MCCSR regime, where the gains only qualified as capital upon realization. So, that would be neutral, and I think the point that you highlight, that the LICAT ratio has benefited from the lower interest rates environment because of a combination of the impact on the fixed income portfolio, but also the fact that we had invested surplus assets substantially in fixed income treasuries that therefore didn't suffer from the widening credit spreads in a stressed environment. And if we see interest rates rise further, some of that benefit to LICAT will unwind. So, we're currently at 155% LICAT. I think that's higher -- it certainly is higher than what I would expect to be reporting in normal times. So, it's hard to say exactly how much that would reverse out. But I think we could see quite a notable reduction in LICAT if interest rates rise, and therefore, the fair value of AFS bonds subside.

Steven Finch - *Manulife Financial Corporation - Chief Actuary*

Sorry, it's Steve. I was just going to add a couple of quick points. Certainly, in these uncertain times, we've stressed the balance sheet under a variety of scenarios, including scenarios with higher inflation, higher interest rates and the capital position remains strong. And if interest rates were to rise, in general, that would be good for Manulife, good for the industry. It's good for the products and the underlying economics. Thanks.

Nigel D'Souza - *Veritas Investment - Investment Analyst*

Okay great, thank you, appreciate the colour.

Operator

Thank you. The next question is from Scott Chan from Canaccord Genuity. Please go ahead.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Good morning. I just wanted to go back to ALDA. And again, appreciate the performance update over the past 15 years, averaging 9.4%. But during that time period, the risk-free rates have gone down about 500 bps. So how can you expect those returns to continue to that similar level in terms of your best estimate? And I guess put it another way, it seems like your equity risk premium or ALDA equity risk premiums have increased.

Scott Hartz - *Manulife Financial Corporation - Chief Investment Officer*

Yes. Thank you for the question, Scott. This is Scott Hartz. So, I sort of went through this a little bit earlier. But absolutely, declining rates is, in general, a positive thing as your discount rates come down. But on the other hand, offsetting that significantly, as I said, it's largely a real asset portfolio. And inflation has come down as well and inflation expectations, and that's sort of mitigated that impact of the lower discount rate. And what I would probably add here as well is that our ALDA strategy, we think, is really an appropriate strategy for long-tail liabilities and particularly in a low rate environment where we don't see returns compressing as much as risk-free rates would compress. And so, you've seen a lot of investors and other life companies talk about transitioning more to ALDA-type assets. And for us, it's been a strategy for 20-plus years. We have teams that do most of the investing in-house and have 20-plus years of experience. So, you know, others are moving into this market in a new way, whereas we're very experienced. We think it's a great fit for our long-term liabilities. It's even more attractive in a low-rate environment. And as you saw in the numbers, we've put together a really diversified portfolio that has about 1/3 of the risk of public equity. So, it will create some noise quarter-to-quarter and particularly when we have things like a pandemic, but over the long term, we think it's the right strategy and much more attractive than putting everything into fixed income.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

And just lastly, thanks for that, going back to Paul at WAM, your EBITDA margin exceeded 30%. And can you remind us, was that kind of the target you envisioned? And assuming normal markets, equity markets or just markets in general, is that sustainable heading into next year?

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

Yes. Thanks, Scott, it's Paul. Yes, you're correct in noticing, we have driven significant improvement in the EBITDA margin. And I would say you do get some volatility quarter-to-quarter in the margin. There are a few onetime items in there, so we tend to look at the year-to-date, year-over-year, just to be a little bit better proxy for that, and we are moving in the right direction. I think we have disclosed before that we do think 30% is a viable target for us in terms of our EBITDA margin. And I've said this consistently -- and you'll see it, and Phil made the comment on expenses -- we continue to get leverage out of the global organization as we brought it together. Despite some of the shift in business mix and our fixed income base, despite that, we were still able to improve EBITDA margin this quarter, which I think it really speaks to the diversification, the leverage you're getting from an efficiency perspective, and gives us a lot of confidence that, that 30% target reset is definitely quite achievable for us.

Roy Gori - *Manulife Financial Corporation - President & Chief Executive Officer*

I just -- I might add to Paul's comments. I think whilst 30% is certainly a target that we sort of have as a guidepost, there are headwinds and tailwinds. And for us, clearly, there's margin compression in certain geographies -- the U.S., in particular, has seen a shift to passives and ETFs, which has created some pressure. But as Paul highlighted, the diversity of our business and the fact that we've got operations in Asia, and obviously in Canada as well, has certainly helped us offset some of these headwinds. And the margins that we see in our WAM business in Asia are significantly higher than what we see in other geographies, and they are growing at quite a rapid pace. And we, again, see that our footprint is a source of strength for us as we look to continue to grow our WAM business in Asia. So certainly, the 30% is the guidepost. And the WAM organization led by Paul has just done a phenomenal job of driving up our margins and our profitability. The diversity of our franchise is, again, the key factor that's going to help us make that sustainable in the long run.

Scott Chan - *Canaccord Genuity Corp., Research Division - Director of Research of Financials & Financial Services Analyst*

Thanks for the additional colour.

Operator

Thank you. The next question is from Mario Mendonca from TD Securities. Please go ahead.

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

Good morning. I'll try to keep this quick. The -- going back to Asia and the new business gains, that number does bounce around a fair bit. And I understand the comments you've made around mix of business and the VHIS being a lot lower. What would be helpful to understand then is, if I look at the three main geographies, Hong Kong, Japan and Asia, could you talk about -- and this is not new business value, but new business gains, as a general rule, would it be fair to say that Hong Kong generates the lower new business gains and the other two generate higher new business gains? I'm asking it this way because I'm trying to think how might I look at this on a go-forward basis, the new business gains in Asia.

Anil Wadhvani - *Manulife Financial Corporation - General Manager, Asia*

Yes. Mario, thanks for the question. I think the good indication of that would be also the contribution that each of the geographies make to our core earnings. So, Hong Kong, by definition, just kind of given the scale of in-force as well as the scale of the new business that we put on in Hong Kong every quarter, I think just kind of signifies and underscores that Hong Kong is a significant contributor to our new business gain line. In addition

to that, we've also seen markets like Vietnam and China that have been kind of growing at a fair clip over the last couple of years. And their contribution, Mario, has started to kind of increase on the new business gain line as well.

I guess going back to Roy's comment on diversification. I think that is where the diversified nature of our markets in Asia becomes such an important factor for us because what we witnessed during 2020, and specifically when one market was kind of affected on account of containment measures, we saw the other markets kind of pull up and really kind of contribute to the Asia's new business gain and overall core earnings story. So, we continue to kind of pursue that, and as I said, Hong Kong continues to be the largest, but the Asia Other segment is becoming an increasingly bigger player, both in terms of new business gain as well as in terms of its contribution to core earnings.

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

So just to put a final point on this then. If Hong Kong is the biggest contributor to new business gains in Asia, and sales were down 30% year-over-year, you still had sharply higher new business gains in Asia, total. So, is it just specifically the mix of business within Hong Kong that will have the greatest effect on this number?

Anil Wadhvani - *Manulife Financial Corporation - General Manager, Asia*

Right, I think there were two factors. So, one was the mix, as you rightly pointed out. The second, as I explained earlier, was that if I were to try to take you back to quarter three of 2019, that was the strongest quarter for our VHIS product. And VHIS was launched in quarter two of 2019. VHIS, while it has a very healthy new business value, it does kind of create that strain on new business. And as we have penetrated VHIS over a period of time, the trajectory, Mario, of VHIS volumes has calibrated over the past quarters. And as a consequence of that, we saw a significantly lower new business strain in quarter three of 2020 that really kind of contributed to the core earnings that you're witnessing in Hong Kong. So, it was a mixture of product mix, combined with the lack of -- or the lesser new business strain that we witnessed in quarter three of 2020.

Roy Gori - *Manulife Financial Corporation - President & Chief Executive Officer*

Mario, we also saw a strong focus on expense management across the board and certainly in Asia, which contributed to giving also to our core earnings in the quarter.

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

Okay. Could I just ask it one final way then? This quarter was about \$170 million. If you look at the last couple of quarters, it was about -- about \$100 million, which one seems more reasonable going forward, \$100 million or the \$170 million?

Anil Wadhvani - *Manulife Financial Corporation - General Manager, Asia*

Yes. I think the \$100 million, you need to kind of take it with the backdrop on the fact that we were witnessing COVID in many of our markets in Asia. So, the containment measures were pretty much at its peak. As the containment measures have receded, what we have seen is a resurgence of volumes quarter-on-quarter. Our quarter-on-quarter new business sales were up by 31%. So, it is a hard comparison to make, Mario, because the situation, unfortunately, continues to be quite, quite fluid. So, on one side, what we witnessed in quarter three is that while certain markets got better, we also saw the third wave -- the onset of a third wave of COVID in Hong Kong. So, it becomes a bit of a challenge for me to kind of predict as to what would be the point for new business gain kind of going forward. But as I said, we did see a very strong rebound in quarter three over quarter two, as was witnessed pretty much on all our value matrix, volumes value as well as core earnings.

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

Okay, thank you for that, I appreciate it.

Operator

Thank you. There are no further questions at this time. I'd like to turn the meeting back over to Ms. O'Neill.

Adrienne O'Neill - *Manulife Financial Corporation - Global Head of Investor Relations*

Thank you, operator. We'll be available after the call if there's any follow-up questions. Have a great morning.

Operator

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

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Refinitiv. All Rights Reserved.