

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

MFC.TO - Q4 2021 Manulife Financial Corp Earnings Call

EVENT DATE/TIME: FEBRUARY 10, 2022 / 1:00PM GMT

CORPORATE PARTICIPANTS

Anil Wadhwani Manulife Financial Corporation - President & CEO, Manulife Asia

Hung Ko Manulife Financial Corporation - VP, Group Investor Relations

Mike Doughty Manulife Financial Corporation - President & CEO, Manulife Canada

Paul Lorentz Manulife Financial Corporation - President & CEO, Manulife Investment Management

Phil Witherington Manulife Financial Corporation - Chief Financial Officer

Roy Gori Manulife Financial Corporation - President & Chief Executive Officer

Scott Hartz Manulife Financial Corporation - Chief Investment Officer

Steve Finch Manulife Financial Corporation - Chief Actuary

CONFERENCE CALL PARTICIPANTS

David Motemaden Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

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

Gabriel Dechaine National Bank Financial, Research Division - Analyst

Humphrey Lee Dowling & Partners Securities - Research Analyst

Lemar Persaud Cormark Securities, - Equity Research Analyst

Mario Mendonca TD Securities Equity Research - MD & Research Analyst

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

Nigel D'Souza Veritas Investment Research Corporation - 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 Equity Research - MD & Analyst

PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good morning, and welcome to the Manulife Financial Fourth Quarter and Full Year 2021 Financial Results Conference Call. Your host for today will be Mr. Hung Ko. Please go ahead, Mr. Ko.

Hung Ko - Manulife Financial Corporation - VP, Group Investor Relations

Thank you. Welcome to Manulife's earnings conference call to discuss our fourth quarter and year-end 2021 financial and operating results. 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.

Turning to Slide 4. We will begin today's presentation with an overview of our fourth quarter and year-end 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. After the prepared remarks, we will move on to the live question-and-answer portion of the call. We ask each participant to adhere to a limit of 2 questions, including follow-up 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 43 for a note on the non-GAAP and other financial measures used 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, Hung. Thank you, everyone, for joining us today. Yesterday, we announced our fourth quarter and full year 2021 financial results, and I'm incredibly proud of our performance.

You'll see on Slide 6, we delivered record core earnings of \$6.5 billion in 2021, a 26% increase from the prior year, with double-digit growth in our Global WAM business. And we also reported record net income of \$7.1 billion, an increase of \$1.2 billion over the prior year. We continue to focus on growing our customer base and serving our customers' evolving needs better, which is evident in our new business value increase of 31% to \$2.2 billion, with double-digit growth across all segments.

This was a particularly strong result given the COVID-19 restrictions in markets in which we operate in Asia, such as Vietnam and the Philippines. In addition, NBV margin for Asia increased by 6.1 percentage points from the prior year, reflecting both the benefits of scale and favourable product mix.

In our Global WAM business, we achieved strong net inflows of \$27.9 billion, triple the prior year level, primarily reflecting continued strong growth in our Retail business across all geographies. 2021 was a record year for our Retail Wealth business, with net inflows of \$29.2 billion. In addition, we delivered very strong remittances of \$4.4 billion, a \$2.8 billion increase from the prior year.

Turning to Slide 7. 2021 was not without its challenges. Despite the headwinds, we generated strong growth on a full-year basis. Notably, when compared to pre-pandemic, our top line growth and Global WAM net flows exceeded our 2019 results, demonstrating the long-term strength of our franchise. The diversity of our business was a crucial factor in delivering strong financial performance in 2021, as seen in our record core earnings and net income as well as strong growth in new business value.

Our presence in 13 markets in Asia demonstrated the benefits of geographic diversification as strong top-line growth in Hong Kong, Singapore and Vietnam balanced the impacts of COVID-19 and regulatory changes in China, Japan, and other emerging markets. We also gained share in 5 markets during 2021.

Our U.S. business drove continued sales momentum, with sales ahead of prior year in almost every major category, and we also reported record sales in our International business. And Global WAM, one of our growth engines, achieved double-digit growth in earnings and tripled its net inflows.

In the fourth quarter, we announced a dividend increase of \$0.05 per share, resulting in a total quarterly common shareholder dividend of \$0.33 per share or an 18% increase. This increase resumed our track record of sustained gradual dividend increases, which remains one of our top capital deployment priorities. We also recently launched a Normal Course Issuer Bid to repurchase up to 5% of outstanding common shares.

Turning to Slide 8. We are laser-focused on delivering on our strategic priorities, and the 2025 supplemental goals that we announced at our recent Investor Day. Our results this year are a testament to that commitment. Our highest potential businesses accounted for 63% of total company core earnings in 2021, and we're on track to achieve our target of two-thirds by 2022. We aspire to have core earnings from the Asia region contribute 50% by 2025.

In 2021, amid the challenges of COVID-19 in select markets, core earnings from the Asia region contributed 39% of total company core earnings. We're scaling our business to grow across the diverse markets in Asia. For example, in December of 2021, we launched a 16-year exclusive

bancassurance partnership with VietinBank, one of the largest financial institutions in Vietnam. This partnership significantly enhances our distribution capability in Vietnam to offer a full suite of insurance, wealth, and retirement solutions to a significant percentage of the Vietnamese population.

With this transaction, we also acquired Aviva Vietnam, which further enhances our scale in this important and growing market. I'll speak more on this exciting development in a moment.

Our global WAM business expanded the retail product lineup beyond traditional mutual funds with new actively managed Exchange Traded Funds in both Canada and the U.S., and we furthered our separately managed account offering in the U.S., with each category generating over \$1 billion in net inflows in 2021.

And in the U.S., we achieved record sales of products with the market-leading John Hancock Vitality PLUS feature. We believe that our Vitality offering, which focuses on rewarding customers for healthy living, is not only the right solution, but resonates with customers as they focus more on well-being and improving quality of life.

Our ambition is to be a leader in our industry when it comes to digital capabilities and customer experience. And we're executing on our strategy to attract, engage and retain customers by delivering an outstanding experience for every interaction.

During the year, we continued to make progress on our digital journey across all our operating segments. This played a significant role in our ability to listen to our customers, adapt, and leverage our digital capabilities to better serve our customers across the globe. Our continued investments in digital enhancements have contributed to our significant Net Promoter Score improvements. In 2021, we achieved a score of plus 21, which is a 20-point improvement from the 2017 baseline and a 9-point improvement from 2020. In 2021, we achieved straight-through processing of 82%, and we're on track to achieve our supplemental goal of 88% by 2025.

In Asia, ePOS, our digital onboarding app, is supporting our agents with faster, higher-quality new business submissions. Throughout the year, 82% of applications were submitted digitally, representing an increase of 22% year-over-year, and 79% of these applications were auto underwritten. In the U.S., we completed the iPipeline integration with the JH brokerage eApp. This integration provides the majority of our regular distribution partners with access to next-generation sales tools and decreases the overall cycle time for applications submitted via this preferred channel by 49% year-over-year.

It also enabled access to over 250 firms, including a new partnership with Allstate and its more than 11,000 agents. These initiatives contributed to a 15-percentage-point increase in overall new business applications submitted digitally in 2021 to 71 percent. In our Global WAM U.S. Retirement business, 88% of planned participants enrolling have adopted our new digital express enrollment capability that delivers a simple, fast, and seamless way to enroll in their plan and benefit from access to personalized guidance. This resulted in an 11% increase in participation and 6 times the managed account conversion rate when compared to the previous enrollment process.

Turning to Slide 9. We've now commenced our partnership with VietinBank to establish an exclusive 16-year bancassurance partnership to better meet the growing financial and insurance needs of the Vietnam market and to make the lives of millions more of Vietnamese better every day. VietinBank is one of Vietnam's largest financial institutions and this partnership provides us with exclusive access to more than 14 million customers through a network of over 150 branches and 1,000 transaction offices across 63 cities and provinces.

Partnering with VietinBank accelerates our growth trajectory in the region, further strengthening our leadership position in Vietnam's fast-growing market and solidifying our position as a leader in insurance and wealth management. We expect the opportunities generated by this exclusive partnership to result in an immediate accretion to our earnings in the first year.

Turning to Slide 10. I want to take a few minutes to highlight our tremendous success story in Vietnam even before this exciting new partnership. Our APE sales and new business value have grown rapidly from 2017 to 2021 at a compound annual growth rate of 27% and 51%, respectively. These are impressive results considering the impact of COVID-19 restrictions during 2020 and 2021. This tremendous growth was powered by our professional agency force and a market-leading bancassurance distribution channel that propelled our market ranking from number 4 in 2017 to the number 1 position, which we've held since 2019.

Our bancassurance channel is anchored by our exclusive partnerships with Saigon Commercial Bank, Techcom Bank and now VietinBank, which gives us access to 24 million bank customers. Vietnam has significant growth potential, with one of Asia's highest GDP growth rates, a high proportion of working-age population and life insurance penetration rates that are well below other emerging and developed markets in Asia.

Looking forward, our focus will be on further expanding and professionalizing our agency platform, deepening customer penetration with our bank partnerships, enhancing digital capabilities for key customer and distributor touch points and finally, further automating processes to harness the benefits of our scale.

Turning to Slide 11. Expense efficiency is deeply embedded in our culture. In 2021, our expense efficiency ratio improved by 4 percentage points, and we have achieved our target of less than 50 percent. We remain focused on driving efficient growth and are committed to consistently achieving an expense efficiency ratio of less than 50 percent going forward, while ensuring scalable growth, outstanding customer experience and digital ways of working. Phil will discuss our progress in more detail.

Turning to portfolio optimization. On a cumulative basis, we've freed up \$6.3 billion of capital through various efforts across multiple legacy blocks. And our commitment and focus on optimizing our long-term care and variable annuity businesses is as strong as ever. And we aim to achieve our 2025 supplemental goal of reducing core earnings contribution from these businesses to less than 15% of total core earnings and would like to see this decline further to less than 10% with inorganic actions.

I'm pleased to report that in 2021, we reduced the core earnings contribution from our long-term care and variable annuity businesses to 20%, supported by the increasing contributions from our highest potential businesses. In addition, we entered into an agreement in the fourth quarter to reinsure a significant portion of our legacy U.S. variable annuity block with Venerable Holdings Inc. I'm pleased to confirm the transaction closed on February 1 and is expected to result in approximately \$2 billion of capital released in 2022. This transaction positions us well to achieve our 2025 supplemental goal. I'll go into a bit more detail on this transaction in a minute.

Our fifth priority is focused on our high-performing team. We recently completed our 2021 employee engagement survey and maintained a top quartile position, ranking in the 86th percentile amongst global financial services and insurance peers. Also, in October, Manulife was named a World's Best Employer by Forbes for the second year in a row.

Turning to Slide 12. I'm pleased with the successful completion of the U.S. VA Reinsurance transaction on February 1. This transaction represents a significant milestone for Manulife, greatly lowering our go-forward risk profile while reducing our exposure to the US VA guaranteed value and net amount at risk. And it reduces our equity market sensitivity from our variable annuity guarantees by roughly 54%. We have unlocked significant shareholder value with an estimated \$2 billion of expected capital release, which includes an after-tax gain of approximately \$750 million, validating the conservatism of our reserves.

This represents a strong multiple of more than 10 times earnings. We plan to deploy a significant portion of the capital released to buy back common shares to neutralize the impact of the transaction on core EPS. We remain committed to optimizing our legacy portfolio, especially LTC and VA, and we'll continue to seek opportunities to reduce risk and unlock value.

Turning to Slide 13. I'm incredibly proud of the way our colleagues around the world have continued to make decisions easier and lives better for our customers throughout 2021. We delivered record results in 2021, underpinned by double-digit growth in Asia and Global WAM. We've commenced the 16-year bancassurance partnership with VietinBank and acquired Aviva Vietnam, which further accelerates our growth in one of the most exciting markets in Asia.

While we've achieved our expense efficiency ratio target of less than 50%, we remain focused on driving efficient growth as we look forward. We executed on optimizing our legacy business by completing the U.S. VA Reinsurance transaction, which unlocked value for shareholders and reduced risk, and we continue to deploy capital by increasing the quarterly dividend by 18% in the fourth quarter and commenced share buybacks under the recently launched NCIB program. A solid foundation, global presence, diverse business and continued strong execution, uniquely positions us to succeed and deliver on our growth targets.

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

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

Thanks, Roy. Throughout 2021, we continued to execute on our strategic priorities, and we delivered strong operating and financial results, with record core earnings and net income. Our fourth quarter metrics were similarly impressive. I will highlight the key drivers of both our fourth quarter and full year performance with reference to the next few slides.

I'll start on Slide 15. We generated strong core earnings of \$1.7 billion in the fourth quarter of 2021, up 20% from the prior year quarter. This growth was driven by a number of factors. The recognition of core investment gains in the quarter, higher net fee income from higher average AUMA in our Global WAM business, higher new business gains in the U.S. and Canada, a decrease in the corporate and other core loss, which benefited from a lower cost of debt and higher investment income and double-digit in-force business growth in Canada and Asia. These items were partially offset by unfavourable policyholder experience and lower net gains on seed money investments.

Net income attributed to shareholders of \$2.1 billion in the fourth quarter was up 19% from the prior year quarter, reflecting growth in core earnings and gains from the direct impact of interest rates compared with losses in the prior year, partially offset by lower investment-related experience gains and lower gains from the direct impact of equity markets.

Of note, we recognized a gain of \$226 million from investment-related experience in the fourth quarter of 2021, reflecting higher-than-expected returns on ALDA, primarily driven by fair value gains on private equity and infrastructure as well as strong credit experience. These items were partially offset by the unfavourable impact of fixed income reinvestment activities, primarily driven by the acquisition of U.S. treasury bills. \$100 million of these gains were reported in core earnings as core investment gains with the remaining \$126 million reported outside of core earnings.

The gain of \$274 million from the direct impact of the interest rates was due to the flattening of the yield curve in Canada and the U.S. as well as gains from widening corporate spreads in the U.S., partially offset by the realization of losses from the sale of AFS bonds. The impact of equity markets in the quarter was a gain of \$124 million.

Slide 16 shows the performance of our ALDA portfolio by asset class since the acquisition of John Hancock 17 years ago. The average return of the overall portfolio during this period was 9.4%, outperforming our current best estimate, long-term return assumption of 9.2 percent. We are pleased with the strong performance of the portfolio in 2021 that not only recovered from prior year losses, but also contributed to the \$1.25 billion of total investment-related experience gains over the past 2 years, which exceeded our core investment gains of up to \$400 million per year or \$800 million over 2 years.

Slide 17 shows our source of earnings analysis for the fourth quarter of 2021 compared to the prior year quarter. Expected profit on in-force increased 8%, driven by in-force business growth in Canada and Asia. New business gains increased 21% from the prior year period, driven by higher sales volumes and improved margins in the U.S. segment from our domestic and international high net worth businesses, higher sales volumes, and favourable product mix in individual insurance in Canada and higher sales volumes and the favourable impact of product repricing in Hong Kong.

This was partially offset by lower critical illness sales and margins in China, lower sales amid continuing COVID-19 restrictions and unfavourable product mix in Vietnam, lower COLI sales in Japan as well as lower sales volumes in several emerging markets that were impacted by COVID-19 containment measures. The experience loss in the quarter was primarily driven by unfavourable policyholder experience due to elevated mortality levels, particularly in U.S. Life, continued low lapse rates on North American protection products and a modest charge in Asia driven by unfavourable claims, partly due to COVID-19 and persistency losses. Canadian Group Insurance was neutral, and long-term care policyholder experience was a modest gain.

Slide 18 shows the history of our policyholder experience, excluding the charges related to Hurricane Ida and the European floods in 2021. The pandemic and related macroeconomic environment impacted our policyholder experience differently across product lines. The diversity of our businesses and our use of reinsurance, provided an offset between these experiences and on a cumulative basis over 2020 and 2021, reduced the impact to a net charge of less than \$30 million post tax.

Slides 19 and 20 show our earnings by segment and return on equity. I will comment on the fourth quarter results compared with the prior year quarter. We delivered core earnings growth of 30% in our Global WAM business, reflecting growth in net fee income, driven by higher average AUMA that benefited from the favourable impact of markets and net inflows as well as favourable business mix and higher tax benefits.

Core earnings in Asia was consistent with the prior year as in-force business growth was offset by modestly unfavourable policyholder experience, which included COVID-19-related claims losses, lower new business gains and lower investment income on allocated capital.

Core earnings in Canada decreased by 9% as less favourable policyholder experience in group insurance, lower investment income on allocated capital and the non-recurrence of a release of tax provision in the fourth quarter of 2020 were partially offset by higher expected earnings across all businesses and higher individual insurance sales.

Core earnings in the U.S. increased by 1%, reflecting new business gains from higher sales and improved margins, partially offset by lower investment income on allocated capital, lower, but still favourable, long-term care policyholder experience and lower tax benefits. The core loss in corporate and other improved by \$217 million, primarily driven by the recognition of core investment gains in the quarter compared with nil core investment gains in the prior year quarter, lower interest on allocated capital to operating segments, lower interest on external debt and higher investment income and gains on sales of AFS equities. These gains were partially offset by the unfavourable impact of markets on seed money investments compared with gains in the prior year. We delivered core ROE of 12.7% in the fourth quarter and 13% for 2021.

Turning to Slide 21, which shows our new business value generation. In this uncertain environment, we have adapted to better serve our customers across the globe, resulting in the double-digit growth in our NBV in 2021. In the fourth quarter of 2021, we delivered new business value of \$555 million, up 17% from the prior year quarter. In Asia, NBV increased 11% from the prior year quarter, reflecting higher sales volumes, favourable interest rates and disciplined expense management in Hong Kong as well as favourable product mix in Asia Other, partially offset by lower sales in Japan and China.

In Canada, NBV increased 26% from the prior year quarter, primarily due to higher margins in annuities and higher volumes in individual insurance. In the U.S., NBV increased 51% from the prior year quarter, primarily driven by higher sales volumes and favourable product mix, notably from our international business, which is reported as part of the U.S. segment. And on a full-year basis, NBV grew at a double-digit rate compared with both the prior year and the pre-pandemic level in 2019.

Our Asia business generated the majority of total NBV of the company and delivered a growth of 27% in 2021 compared with the prior year, reflecting the diversity and distribution strength of our franchise, which also allowed us to gain share in various markets across the region.

Slide 22 shows our APE sales. In the fourth quarter of 2021, we delivered APE sales of \$1.4 billion, a 5% increase from the prior year quarter. Asia APE sales declined by 6 percent. In Hong Kong, APE sales increased 11%, despite the effect of COVID-19 containment measures that continued to constrain cross-border travel between Hong Kong and Mainland China. The increase in APE sales reflects strong growth in our bank channel and demand from Mainland Chinese visitors through our Macau branch.

Asia Other APE sales were in line with the prior year quarter as expansion in the bancassurance channel was offset by lower agency sales, which were adversely impacted by COVID-19 containment measures in markets such as Vietnam and the Philippines. The growth in Hong Kong and overall stability of Asia Other markets was more than offset by a 44% decline in Japan COLI sales, reflecting a continuation of the trend seen in previous quarters.

In Canada, APE sales increased by 20%, primarily driven by increased customer demand for our lower-risk segregated fund products and higher individual insurance sales. In the U.S. segment, APE sales increased by 41% due to strong customer demand for our international high net worth solutions and our differentiated domestic product offerings, which include the John Hancock Vitality feature. For 2021, overall APE sales grew at a double-digit rate compared with the prior year and also exceeded the pre-pandemic level in 2019.

Turning to Slide 23. Our Global WAM business continued to benefit from our geographic and line of business diversification, as evidenced by strong net inflows of \$8.1 billion and gross flows of \$36 billion in the fourth quarter. In retail, net inflows were \$7.5 billion compared with net inflows of

\$3.6 billion in the prior year quarter. The increase reflects strong intermediary sales and higher institutional model allocations in the U.S. as well as higher gross flows in Japan and China.

Institutional Asset Management net inflows were \$1.6 billion compared with net inflows of \$1 billion in the prior year quarter. The increase was driven by lower redemptions in timberland and real estate mandates, partially offset by lower gross flows in fixed income mandates. During the fourth quarter, we continued building out our private markets business with the successful fundraising of approximately \$7 billion on 2 funds with commitments from both third-party investors and Manulife's general account. Approximately ¼ of the fundraising from third-party investors has been deployed and reflected in our AUM, with the remainder to be deployed over the next several years.

In retirement, net outflows were \$1 billion compared with net outflows of \$1.8 billion in the prior year quarter. The reduction in net outflows was driven by higher gross flows across all geographies, reflecting higher growth in new plan sales and member contributions, partially offset by higher plan redemptions. Close to \$0.6 billion of the retirement outflows were captured in our retail net inflows as we rolled over planned participants to our retail platforms.

We continued to see strong net inflows in the Hong Kong MPF business, retaining our number 1 market rank by assets under management and net flows. Overall, Global WAM's average AUMA increased by 17% in the fourth quarter compared with the prior year quarter, driven by the favourable impact of markets and higher net inflows.

Turning to Slide 24. Net fee income yield remains resilient, reflecting our diversified business mix and our core EBITDA margin increased 70 basis points, driven by a combination of higher net fee income, operational benefits from increased scale and continued disciplined expense management.

Turning to Slide 25. In 2021, we achieved annual savings of \$100 million resulting from the restructuring announced in the first half of the year. Our culture of expense efficiency has resulted in a modest growth of 5% in core general expenses in 2021, which was far outpaced by the 25% increase in pretax core earnings. This contributed to a 4-percentage-point decrease in our expense efficiency ratio to 48.9% in 2021 and as Roy mentioned, we have achieved our target of less than 50%. We remain focused on driving efficient growth and are committed to consistently achieving an expense efficiency ratio of less than 50%, with scalable operations to support growth and digital tools to provide an outstanding customer experience.

Turning to Slide 26. We continue to maintain a strong balance sheet and capital position. We have \$27 billion of capital above the supervisory target and our LICAT ratio of 142% is strong. The 4-percentage-point increase compared with the third quarter was driven by a net capital issuance and favourable market movements, primarily from lower risk-free rates. Our financial leverage ratio increased 0.3 percentage points, driven by the net capital issuance, largely offset by growth in retained earnings and an increase in the value of AFS debt securities.

I would note that we have recently announced our intention to redeem \$725 million of preferred shares. The impact of these redemptions will be reflected in the LICAT and leverage ratios for the first quarter of 2022. Adjusted for these redemptions, the pro forma LICAT and leverage ratios would be 141% and 25%, respectively.

Turning to Slide 27 and our financial performance for the fourth quarter and full year 2021. As mentioned, in 2021, we delivered double-digit net income, core earnings, NBV and APE sales growth and achieved strong net inflows in our Global WAM business. Our strong balance sheet, as evidenced by our LICAT and leverage ratios, provides us with financial flexibility to deliver on our strategic and capital deployment priorities. Remittances increased by \$2.8 billion to a total of \$4.4 billion in 2021 with positive contributions across all geographies.

We continued to execute on our capital deployment priorities, including a strong track record of delivering progressive dividend increases. We're pleased to have made an 18% increase in our quarterly common share dividend in the fourth quarter, which combined the annual increase for 2021 with an accelerated annual increase for 2022. In addition, we will be deploying capital to buy back shares under the recently launched NCIB program of up to 5% of outstanding common shares to generate shareholder value and to neutralize the impact on core EPS from the U.S. VA Reinsurance transaction.

Slide 28 outlines our medium-term financial targets and recent performance. We're pleased with our strong results in 2021, which met or exceeded most of our medium-term targets. Core EPS growth of 18% exceeded our target, while core ROE was in line with target and the dividend payout ratio remains within our target range. The leverage ratio was modestly above target but would be at 25% after adjusting for the announced preferred share redemptions.

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 Scott Chan from Canaccord Genuity. Please go ahead.

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

Thank you very much. Good morning. So just on the rate environment, a lot has changed over the last 2, 3 months in terms of the futures, market pricing, both in U.S. and Canada. I think 5 rate hikes for both in 2022 is the consensus and outside the negative impact to the LICAT ratio. Can you kind of talk about and remind us kind of the puts and takes or positives on the changing rate environment that we could see this year?

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

Yes, thanks for that question, Scott. Roy Gori here. I'll start, and I'll ask Phil to chime in with some thoughts from his perspective.

Obviously, higher inflation often translates into higher interest rates and that is generally a positive for our organization. I'll remind everyone that a 50-basis-point increase in fixed income market yields translates into a positive PV improvement of \$1.85 billion in embedded value. Now clearly, there are some puts and takes, and the negatives of higher inflation is that you have higher costs and expenses. But for our organization, we've been very focused on driving the benefits of scale and digitizing our business, which has translated into us improving our efficiency quite significantly over the last few years and achieving our less than 50% efficiency target in 2021, which we believe, again, will be a tailwind for us as we look to '22 and beyond.

So again, there are puts and takes, but I would just generally conclude that higher rates are a positive for us. They're a bit of a tailwind. There are some aspects of our business where higher rates will create some headwinds, but we have flexibility as it relates to driving scale through expenses or price changes to offset those. And generally, we think that that's a positive for us. But Phil, you may want to supplement.

Phil Witherington - Manulife Financial Corporation - Chief Financial Officer

Sure. Thanks, Roy, and thanks for the question, Scott. The only point that I would supplement there is that when the rates go up or go down, much of our portfolio is now either participating or pass through. And what that means is that we are, to some extent, insulated from the liability impact where we're able to share that with policyholders. And in some cases, the same is true with inflation as well, and we do see that correlation between interest rates and inflation. That's what's playing out in the current environment.

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

Okay. And to my second question, if I look at Manulife Bank core earnings, it was down for the first time in a while. I think it was down quarter-over-quarter and 17% year-over-year, where we see all bank earnings being positive in this environment. So, I see the assets were up quarter-over-quarter, but just wondering if there was any drivers of that net income decline that you can call out?

Mike Doughty - *Manulife Financial Corporation - President & CEO, Manulife Canada*

Hi Scott, it's Mike Doughty. On the Bank, there was in the - in Q4 of last year, there was an accounting policy change, which didn't recur this year. So that was primarily the drop in the fourth quarter. Over the course of the year, the bank actually did grow. That was largely driven by the release of credit provisions that we had set up in the previous year, some equity gains that we got off of good markets and then offset by the net interest compression that we experienced during 2021.

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

Thanks a lot.

Operator

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

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

Hi, good morning. A little bit of a bigger picture question. There's been a lot of ink spilled over the last little while on Hong Kong population declines there, brain drains, expats leaving, locals fleeing. I'm just wondering, obviously, you know this market very, very well. It's an important market for you. What's your perspective there? And the impact -- the potential impact on your business there?

Anil Wadhvani - *Manulife Financial Corporation - President & CEO, Manulife Asia*

Thanks for the question, Meny. This is Anil Wadhvani here. So, if you look at our Hong Kong business, it has been exceedingly resilient and strong despite some of the challenges, and you can go back to 2019. And if you look at our last 17 quarters, we have been able to deliver positive core earnings growth in Hong Kong year-on-year for the last 17 quarters. And even if you were to kind of simply look at our quarter 4 earnings in Hong Kong or for that matter, full year earnings in Hong Kong, we were able to deliver 17% growth on the back of a 32% new business value growth in that market. This pretty much kind of underscores a few things.

One, it underscores the quality of our franchise and the way we have been investing in expanding our distribution, our digital and our people capabilities. It also kind of underscores our execution capabilities and as a consequence of that, and Phil mentioned that in his opening remarks, we have been able to gain market share for consecutive years in this important market. Our drivers be it our agency now stands at over 11,600. Our partnership with DBS and brokers have never been stronger. And we feel very confident that Hong Kong is well positioned to be able to navigate some of the headwinds as we have demonstrated now for a few years.

Additionally, Hong Kong will benefit from the opening of borders and with the greater velocity of Mainland Chinese visitor customers as well as initiatives like GBA, that's going to result into further acceleration of the movement of resources and capital in Hong Kong and Macau, where we have very strong distribution, we are likely to benefit from that.

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

Thanks for that, and maybe just as a related question, just if you could update us on the COVID environment in the Asia region, how you're seeing that play out in terms of your business? We're seeing, obviously, lockdowns in Hong Kong intensify. I'm just wondering if you go across your key markets, are there any areas where we should expect an improvement in Q1 in particular?

Anil Wadhvani - Manulife Financial Corporation - President & CEO, Manulife Asia

Sure. Thanks for the question, once again, Meny. So, as I said, our results have been quite resilient, and we have been working with the backdrop of COVID now for couple of years. And in line with that, our results both in quarter 4 as well as for the full year 2021 has been quite resilient. Now obviously, the onset of Omicron kind of creates a bit of uncertainty. And that makes it a little bit hard for us to kind of predict given the fact that it's unknown as to how the spread as well as the containment measures are going to pan out in the different geographies.

But what our strength has been is the diversified nature of our markets. That's really been a source of strength for us and a key contributor to the way we've been able to navigate some of the headwinds over the last couple of years. So that might kind of pose a challenge or 2 for us in the short term but given the secular trends, given the under-penetration in Asia, the demand for protection and retirement products is quite undeniable. And again, given our market-leading positions in many of the significant geographies, we are very well positioned to be able to address that opportunity.

Paul Lorentz - Manulife Financial Corporation - President & CEO, Manulife Investment Management

Hi Meny, it's Paul Lorentz here. I just wanted to add a couple of comments from the Global Wealth and Asset Management side because, while Anil has commented from an insurance perspective, our platforms that we have in Asia have really been able to kind of weather through the COVID impact. We haven't seen a material impact on our Wealth and Asset Management business and the flows have been quite strong even with -- just because of the digital platforms we have there and the reach.

And to your first question, from a retirement perspective, we haven't seen a material impact at all from the immigration concerns that you mentioned, nor do we expect it to have an impact on our Retirement business. In fact, 2021 was our best year ever. Our flows in AUM increased year-to-date versus prior year, they were both faster than the market. Our net flow market share was 48%. And our market -- our AUM market share was 27%, which was up from 24.6% the year before. So, we actually think we're really well positioned, particularly as immigration picks up and comes back in Hong Kong, that we've got just such a great franchise there that will benefit over time.

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

Thank you, Paul.

Operator

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

Humphrey Lee - Dowling & Partners Securities - Research Analyst

Good morning and thank you for taking my questions. Just staying with the question with Paul. Looking at the Global WAM, retail flows were really strong. This is actually surprising given many of your asset manager peers had sizable outflows due to rebalancing. I was just hoping if you can provide a little bit more colour in terms of the geographies and the products that you're getting the inflows? And how should we think about the outlook for 2022?

Paul Lorentz - Manulife Financial Corporation - President & CEO, Manulife Investment Management

Yes. Thanks, Humphrey, and it's Paul here. Yes, we're really pleased with the flows of the continued momentum we've been driven for the business and you mentioned retail, I'll start with that. We had \$7.5 billion in flows in retail. A lot of that growth was driven by pretty much all regions contributed to the strength. I'll start with the U.S. though. The U.S. definitely was the biggest contributor. It was our sixth consecutive quarter of positive net flows. What we're seeing there is continued strength into our fixed income franchise, particularly core fixed income. We also saw a

rotation to value last year, and we have a very strong lineup as it relates to some of our value-focused equity funds, and so we're benefiting from that.

Canada continues to drive strong net flows for the franchise. We've got a very strong performing platform there. I think we've been recognized 3 years in a row with the top-performing fund platform. And in Asia, we saw very strong growth, as I just mentioned, particularly in the retail platform relative to our size last year. Our flows -- our net flows in Asia relative to our AUM, I think, we're close to 40%. So, we saw very strong flows in Asia across the board.

Just in terms of what's selling in some of those outside of the U.S., we've got a pretty balanced franchise in Canada. So, as you would have seen in the asset mix, we have seen -- started to see more equity flows and balance flows and you would see that through the change in our asset mix from about a year ago. So, we feel really good about just the strength of the retail franchise, our overall performance in our distribution reach and then the fact that the contribution is coming from all 3 regions.

The only other comment worth noting, and Phil mentioned this, because we showed this at Investor Day, is we also had -- saw some success in our private markets business on our institutional channel in the fourth quarter with the closing of 2 funds, our Manulife Infrastructure Fund II and our Private Equity Manulife Co-Investment Partners Fund II. And again, not all of those flows are reflected, about 1/4 of that is reflected in the AUM. So, we do expect that, that money gets invested in the coming years, that will also show up.

So, we're really -- feeling really good just about the diversification of our business by channel, by platform, the broad base of what we have to offer to investors and the overall quality of the investment performance that the teams delivered.

Humphrey Lee - *Dowling & Partners Securities - Research Analyst*

The 40% of AUM inflows in Asia was really, really impressive. I guess, is it a result of adding distribution channel? Or what's the driver for getting that level of inflows?

Paul Lorentz - *Manulife Financial Corporation - President & CEO, Manulife Investment Management*

Yes, so, it's a combination of just continued expansion in terms of the types of products and distribution reach that we have, but we are seeing really strong progress through our digital platforms. We launched a digital platform called iFunds in Asia in a number of markets and that's leveraging our insurance segment distribution, our life agents, but it's a complete end-to-end digital platform for consumers to access our lineup there, and it integrates the adviser into that process. And we're seeing some really solid growth in a number of markets in an area we continue to invest in.

Humphrey Lee - *Dowling & Partners Securities - Research Analyst*

Got it. Thank you.

Operator

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

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

Hi, good morning. Just back to Anil, I think two areas where you've had some weakness in Asia is Japan and China. And I think both related to regulatory changes that have occurred over the last little while. So, what I'm hoping to get is just an update in terms of the launch of new products in Japan as a result of the change around the COLI product? And in China, just some of the changes that have made around the regulatory side

that have impacted sales and core earnings. Can you give us a bit of an update where you stand like what inning are we in, in terms of turning those around?

Anil Wadhvani - *Manulife Financial Corporation - President & CEO, Manulife Asia*

Great question, and I'll be happy to answer that, and thanks for that. Let me start with Japan first. As we have indicated in the past, our primary focus in Japan has been on in-force and on expense efficiency and you've can see that translated to a 9% core earnings growth in quarter 4 in Japan, and for the full year, a growth of 7 percent. We have directed our resources to some of our high-growth markets, for example, in Asia Other. And Asia Other, today contributes to 36% of our core earnings as opposed to 16% of our core earnings back in 2015.

On an ongoing basis, our emphasis in Japan will be value maximization through our focus on in-force and expense efficiency. And we will, in parallel also -- we're making efforts to change our product mix away from COLI to drive better product mix on other wealth and retail. And again, we are starting to see significant progress on that in Japan.

With respect to China. So, China, we delivered a 12% growth on sales and 14% on new business value. And given the backdrop of what you mentioned, the regulatory changes as well as COVID, we thought that was a very creditable performance. There are a few things going on in China. And again, on the regulatory front, there are a couple of things that we are obviously navigating.

So firstly, on account of the regulatory changes that impacted the critical illness product that was announced in quarter 1 of last year, the industry has seen a contraction of demand on critical illness and that has led to a different product mix, which obviously has a knock-on impact, then on new business gains as well as on a new business value. And while we believe that these changes are good for the sustainable growth, they do require a bit of an adjustment in the shorter term. What we are also witnessing in China is a very strong growth on retirement needs that will go and sit on top of some of the protection needs that we believe will rebound in the medium term.

The second piece of change that we are seeing in China is the regulators are getting increasingly focused on driving quality agency distribution. And that is squarely in line with the way we would like to grow our distribution. So just to kind of give you a stat, the industry is witnessing a decline of roughly about 30% to 35% on agency. In contrast to that, we are witnessing a 15% decline. And I think as the market evolves and we make the necessary adjustments, I think quality distribution is going to hold us in good stead for quality growth in China.

Now we have access to 52 cities across 15 provinces. We have a very strong joint venture partner. The under-penetration in China and the secular trends will be positive to drive growth. So yes, in the medium term, we believe that China will still remain an accelerator of growth for us as we transition to the new landscape in that market.

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

So it sounds like China has kind of hit the inflection point. Maybe my question around Japan is Japan turning into a closed block? Is that the way to think of it? I don't know if that's for you, Anil or for Roy?

Anil Wadhvani - *Manulife Financial Corporation - President & CEO, Manulife Asia*

So I'm going to start off and then I'll ask Roy to add his comments. So, we believe that our focus is going to be, as I said, on driving a different product mix. So, if you were to kind of go a year back, COLI was 50% of the sales mix. COLI is now less than 10% of our sales mix. Now what this does is, it also helps us improve our new business value margin, which you can see in our quarter 4 results in Japan. So, on top of that, as I said, our efforts of in-force management as well as expense efficiency is resulting into the core earnings growth that we are witnessing. But we feel that in Japan, we also have an opportunity to drive a product mix with a higher margin away from COLI as opposed to what we have been doing in the past. Roy?

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

Yes. I'd just add, Doug, that Japan is clearly still a very important market for us and a market that provides a lot of opportunities, the third largest insurance market in the world. We've operated in the market for a long period of time, which has allowed us to establish a really strong and credible brand and over the years, we've improved our margins quite considerably.

As Anil highlighted, there are some regulatory pivots that we're navigating. We see them as short term from a headwind perspective. And in the medium to longer term, we still feel very positive about the opportunities that Japan represents. And as Anil highlighted, we're going to continue to focus on driving maximum value, which is focused on profitability, but we still see lots of upside in new business, and we're making some pivots given the COLI changes that we think are going to help us actually navigate the situation quite well.

And I just -- just one point on China. I think Anil hit the nail on the head. We do feel good about the changes, the regulatory changes that are being implemented there. We think that they will enable a more sustainable growth in the future. We've been very focused on quality of our products and quality of our distributors. So, this is a good thing. Some short-term headwinds there. But in the medium to longer term, we feel again very positive and you've seen that despite the challenges of COVID and regulation change in 2021, Asia through its diversity has still been able to demonstrate outperformance. And we've, quite frankly, grown share in most of our markets, which I think is a hallmark to highlight the strength of our business.

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

Good. Thank you.

Operator

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

Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst

Just a question with respect to the remittances. Up considerably in 2021 versus 2020 and versus the trends we saw even prior to 2020, kind of maybe comments as to what drove that geographies, any details there? And how we might see that continuing, especially given that interest rates continue to rise. Thanks.

Phil Witherington - Manulife Financial Corporation - Chief Financial Officer

Great. Thank you, Tom. This is Phil. And you're right, it's certainly a strong year for remittances, \$4.4 billion. And what that reflects is really strong underlying business performance, combined with a favourable macroeconomic environment. You asked about the sources of remittances. They do come from all of our geographies and material contributions from all of our geographies. I think what's particularly topical is, if we reflect back on a year ago, go back to 2020, that's a period when we had injected capital into Asia.

What we've seen in 2021 is that trend reverse, where Asia continues its historic trend of being a net remitter to the group. And just to put a number on that, given your question, the remittances that came from Asia in 2021 were \$900 million. And that's very much within the range of what I've seen happen in recent years from Asia. And of course, it is a wide range because of the sensitivity of a number of Asia local bases to interest rates. But I think that's more of a normalized environment for Asia. The remainder of the remittances really come from the balance of our U.S. and Canadian geographies.

When I think about that \$4.4 billion and the future, although it's a great result, it's not out of line with the range that we've seen in previous years. I think it was 2018, I recall, we delivered \$4 billion of remittances. But I do remain somewhat optimistic about remittances in the medium term. And a couple of reasons for that. One is that we know higher interest rates are a tailwind for our remittances from Asia. But then also, as we spoke

about at Investor Day, when we look at our embedded value and in particular, the PVIF within our embedded value and the translation of that PVIF to net assets to cash. There is a really favourable trend that we're looking at -- looking at about half of our PVIF being realized as cash over the next 10 years. So that provides confidence in our remittance power in the medium term, and therefore, the progressive dividend policy.

Tom MacKinnon - *BMO Capital Markets Equity Research - 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. First question on the buyback. I'm sure there's a technical reason probably tied to the VA transaction there, but there's a little bit delayed in terms of getting approval for the buyback? And having said that, are you -- I haven't seen any January data, but you're committed to doing the full 3%, maybe not the full 5% of your capacity in buybacks this year?

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

Thanks, Gabriel. This is Phil. So, we were really pleased to announce on the 1st of February, the completion of the VA transaction. And on the same day, we announced the approval of the launch of the NCIB following the approvals for that so, I think that's all very much routine. And we are really happy to have approval for a 5% program or up to 5% program. As is normal with buybacks and NCIBs, we will report our progress as we go through this in a routine manner. But also, on a quarterly -- as a quarterly process, we'll transparently share with this group in this forum what our progress is, but I'll just highlight that when we announced the VA transaction, 15th of November, one of our very important priorities was to neutralize the EPS impact from that transaction and I think that's a very important baseline for the NCIB so that we -- to neutralize the EPS impact of that transaction, it would be approximately 3% of the NCIB. The dollar cost of that, of course, will depend upon what the price of the shares are at the time that we repurchase them.

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

Right. Then on the expenses, congrats on the progress of -- towards that efficiency ratio target, 49 percent but you're still -- I look at the notes of financials here, you're running at an expense overrun for a number of years now. A), could you quantify how much that represents as a drag on your earnings, the expense experience loss, I suppose? And then what you need to do to eliminate it? And is it the longer-term efficiency ratio target? When does that go away? And how?

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

Thanks, Gabriel. This is Phil again. And you're right to call out the favourable outcome on expense efficiency ratio. We have hit that 50% threshold, the target that we set ourselves early in 2018 but it doesn't mean that we're done with respect to expense efficiency. You do highlight maintenance expenses and the over on there -- I will point out that within maintenance expenses we do, include in that classification, entity sustaining costs, which are not necessarily costs that should be allocated to our underlying businesses as well as the cost of certain components of our Asia regional office, which doesn't necessarily again flow through to each of our businesses. Many of those costs -- some of those costs are strategic in nature.

But over the course of the coming years, we will continue to focus on expense efficiency and I do think there is further opportunity for us. And when you look at the JAWS that we're being able to create, the JAWS between cost growth and core earnings, there is a substantial gap and that I think does speak to the discipline that we've exercised in recent years. So, there's certainly more value to be generated there.

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

Is there an expense overrun figure or something you can quantify? Do I just look at that overhead allocation? Or is it smaller than that?

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

That's something I have to take away and get back to you on, Gabriel.

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

Okay. Well, thank you. Happy New Year.

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*

Thank you. Good morning. So, I want to go back a little bit to the discussion on potential risks related to inflation, I guess, in particular, what that might mean for the long-term care business. Some of your competitors in that business have flagged cost inflation as a potential risk to assumptions and reserving. So just wondering how you're thinking about that.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks, Paul. Steve Finch here. And I'd start by saying that, overall, I've got confidence that our LTC reserves remain appropriate in aggregate with sufficient levels of conservatism. We've seen through the pandemic we've actually booked gains. Your question is more on what trends might we see in the future? And certainly, inflation is in the news in a broadly, and cost-of-care inflation is a question out there. So, we do reflect inflation of cost-of-care in our long-term assumptions and this is one of the trends that could impact long-term care over time. So, if we saw higher cost-of-care, that would result in higher costs if it's higher than our assumptions. We would and we could request appropriate rate increases to offset that. And as you've seen, we have a really strong track record of achieving rate increases as of Investor Day, middle of last year, we disclosed that we had achieved USD 9 billion at present value of rate increases so, we feel good about that.

The other thing I'd point out is that there are -- I think there's the potential for headwinds like inflation, but there's the potential for tailwinds as well from some of the other trends that we're seeing in long-term care. For instance, what we've seen through the pandemic is hesitancy to receive care. But what we've seen is a shift in site of care from facility care towards home care. And home care is on average about 30% less expensive than facility care. So, if that trend were to continue, that would be a tailwind. So, I'm just sort of flagging the fact that there are uncertainties around what trends we'll see post-pandemic, but I think there could be pluses and minuses along with our ability to re-rate.

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

Understood. That's helpful context. And then second question, and it's related to interest rate impacts. I think you've made it clear that you're effectively immunized on in-force. And then I think you've suggested that on new business because of the portion of par and pass-through, also

largely agnostic to rates. But my question would be related to earnings on surplus. That's maybe one area of the P&L that's still rate sensitive. Maybe you can just give us some color there in terms of what higher rates might mean for run rate earnings on surplus?

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

Thanks for the question, Paul. Maybe I'll start on that one and hand over to Scott, who manages the portfolio. So, as you've probably seen in the results in 2020 compared to 2021, we've seen a decline in earnings on surplus and really what that is triggered by is the lower rate environment that we've seen in 2020, giving rise to a reset of our IOS allocations to segments that takes place at the beginning of each year. And that's why you see the run rate that's allocated to segments go down year-on-year 2020 compared to 2021 because we set those rates at the beginning of the year and the decline in rates happened during 2020.

Now the extent to which the lower interest rates actually flow through to a lower yield depends upon how much turnover there is in the portfolio. And in 2020, we had realized some gains on the AFS portfolio that sits in surplus, and that lowered the yield for 2021. So, I think where we look from here in terms of how a very stable portfolio, how much of the higher rate environment flows through to yield, it would really depend upon how much turnover there is in that portfolio. But Scott, I don't know whether you would like to comment further on that.

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

Sure. Just briefly, I think that's all correct, Phil. And our surplus portfolio is fairly long. And as you point out, Paul, our accounting earnings are pretty well hedged to higher rates going forward but we do have a fairly long AFS bond portfolio to hedge, the economics beyond the accounting, and since it's fairly long, it doesn't on its own turnover very rapidly. So yes, higher rates will ultimately increase surplus earnings but unless we're actively turning over the portfolio, in the short term, you're not going to see much of that.

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

Thank you.

Operator

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

David Motemaden - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Hi. Good morning. Just a question, Phil, you talked about within the \$4.4 billion of remittances, \$900 million of that came from Asia. Could you just share the other pieces of that? How much came from the U.S.? And how much of that came from Canada?

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

Yes, David, this is Phil. So broadly speaking, \$2 billion was from Canada, and that was supported by a favourable macroeconomic environment. The balance was the U.S.

David Motemaden - *Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst*

Got it, thanks. And how much of that from the U.S. was coming from the VA book that has since been reinsured?

Phil Witherington - Manulife Financial Corporation - Chief Financial Officer

Roughly speaking, it was equivalent to the level of profitability So, in the order of USD 130 million, USD 140 million as a ballpark.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

Okay. Great. That's helpful. And then maybe a bigger picture question for Roy. Obviously, good to see the VA transaction and good to see the offsetting the dilution from that or neutralizing the impact of the lost earnings from that with the NCIB. I guess I'm wondering just overall, how you're thinking of M&A and specifically the JV in China? And if that's something you're considering taking up your share in, a few of your peers, HSBC, and Allianz, they've got approval to go up to 100% of their China JVs in the last few months and Chubb also said they were going to buy up to close to 90% of their China JV. So, I'm wondering, is that something you guys are thinking about as well?

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

Yes. Thanks for the question, David. I think, firstly, you're right in highlighting our U.S. VA transaction. It's something that we're very proud of executing and completing that deal. We think it's a great transaction, frees up \$2 billion worth of capital. And the after-tax gain of \$750 million or 10x earnings, I think, really goes to the heart of demonstrating the conservatism of our assumptions so, we really feel very proud of that transaction and for us, the NCIB was about ensuring that we could deploy the capital that we freed up there to make sure that we are driving value of the shareholders. We're in a very strong capital position. Phil highlighted that earlier in the presentation, and that puts us in a position where we have significant flexibility. At the same time, we don't need M&A to deliver against our medium-term goals as it relates to earnings, which is, I think, an enviable position to be in.

Having said that, we will opportunistically look to deploy capital where it can make sense beyond buybacks and obviously increasing our dividends. We did that through the acquisition of the Aviva book in Vietnam. We did it through the bancassurance agreement with VietinBank in Vietnam. The extension of our banca partnership with Danamon as well is another good example of that. And clearly, for us, Asia and WAM are areas where inorganically, we would continue to look to deploy capital. If the opportunity is right and if we can demonstrate the value accretion, it's easy to announce the transaction. It's another thing to make sure you're creating value from it.

Now specifically to China, we've been in China for a long period of time, both through our JV with Sinochem on the insurance side and with TEDA on the Wealth and Asset Management front. As Anil highlighted earlier, we feel very optimistic about the opportunity that China represents and we would look to continue to grow our businesses organically there and if the opportunity is present to grow inorganically, we would definitely look at that. At the same time, I would not underestimate the power and value of having a strong partner like we do with Sinochem in China. It's an incredibly valuable asset for us as we navigate, obviously, the local changes and regulatory nuances. So that's a valuable asset. And again, the partnership we have with Sinochem is a tremendous one as it contributed to the success we've had in China over the years but if there was an opportunity to increase our stake, we'd definitely look at that. And yes, I'll probably leave it at that. But thank you for the question, David.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

Thank you.

Operator

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

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

Good morning. I want to go back to the interest rate discussion. You'll recall that in Q1 '21, Manulife's book value per share was down sequentially over 6%, and the LICAT came under pressure when the yield curve steepened, and rates moved higher. Now a big portion of that related to your AFS portfolio. Is there anything that the company has done since Q1 '21 that would mitigate that effect going forward? Specifically, if we do get a big move in the long end again because of interest rate increases at the short end, if we get that sort of parallel shift, could we be facing that same predicament where -- sorry, the LICAT comes down fairly meaningfully and book value per share declined sharply? Is that scenario still possible for Manulife?

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

Mario, this is Phil. Maybe I may start by touching on the AFS portfolio and then hand over to Steve to talk about the steepening flattening of the curve. And for the AFS portfolio, we haven't made any significant changes to that portfolio since - during the course of 2021. About 80% of our surplus portfolio is held in long AFS bonds. Scott touched on that earlier. And we like that for a couple of reasons. One is that the -- you know, investing in U.S. treasuries allows us to go long in that portfolio, of course, without credit risk, but we also like the liquidity of that portfolio and it does form an important part of our overall risk management program.

The movement in value of that portfolio is the inverse of the impact of rates on our liabilities and it doesn't create income statement volatility in itself because, of course, it's an AFS portfolio so it would be upon realization gains and losses flow through. But where it does create some volatility as you saw is book value per share, but also in the capital ratio. However, when we do look forward to IFRS 17 implementation, one thing that we do expect is that we'll see less variability in the capital ratio as a result of this factor. So, we -- clearly, there's a lot of moving parts. There's more to come on IFRS 17, but we think that, that is something that will be less acute in the future. But Steve, would you like to comment further?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Yes. Thanks, Phil. I think that last point was a key one. The other is that the sensitivity that we had in the LICAT ratio to rise in interest rates back in terms of what we saw in Q1. That was a 7% change in the LICAT ratio sensitivity back in Q1 2021. That has dropped due to rates and due to moderate changes in the hedging program to only 4% now. So almost a 50% reduction in the sensitivity is something I wanted to highlight as well.

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

If I could just follow up on that one thing about the available-for-sale portfolio. Phil, you said that they offer like a good offset or maybe, let's call it, a hedge against changes in the value of the liabilities the reserves. The reason I found that one -- that explanation -- it was odd to me, is that these available-for-sale securities support surplus, they're in surplus so why are they relevant then to the liabilities? I would have thought that the liabilities have their own assets matched against them. So, what was that reference to the AFS portfolio offsetting changes in the value of the liability?

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

Thanks, Mario. I'll make a start. Scott will wish to comment on this. But to the extent, we have various options in terms of how we manage interest rate risk. One option is the assets directly backing the liabilities, including the extent to which we hedge. The other option is how we utilize the surplus portfolio, and we have chosen to utilize the surplus portfolio to manage overall interest rate risk within the entity. Another option would, of course, be to do more hedging within the liability segment. But this is currently where we are. And Scott, I don't know whether you'd like to comment further.

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

Sure. I'd just point out that hedging interest rate risk at a life insurance company is pretty complicated. There's a lot of competing objectives. We're trying to reduce the accounting, the quarterly accounting noise. And as I think you know, the accounting is very sensitive to interest rates in current IFRS 4, but not completely. We have the URR out there, which is an indication that there is more sensitivity to interest rates.

So, if we put all our hedges our economic hedges in the liability segments and we do use both cash instruments and derivative instruments there, that would flow through to the accounting and we would really be over-hedged from an accounting perspective. So as Phil pointed out, by putting those hedges in surplus in AFS, that does not flow through to the accounting results, but is the economic hedge that we're looking for, which is frankly really important. I mean we saw this in the pandemic when rates went way down. Currently, people are talking about rates going up, but bad things happen in the world, rates go down. We feel it's a very important part of our risk management exercise to be as economically hedged as we can be.

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

Okay. My second question is about IFRS 17. I think there have been a number of occasions on calls like this where I think Phil and Roy, you folks have said, hey, this IFRS 17 is accounting. You don't say just accounting, but you do highlight that it really -- it affects the timing and the emergence of profitability, but it really doesn't affect the value or the economics of the company. Now I always sort of nod in agreement when I hear that, except now that I've read what you've included in your MD&A about IFRS 17, specifically, the company makes reference to things like possibly changing reinsurance. What else do you say, reinsurance, hedging strategies, investment portfolio? Now if you start making changes of that nature, then it really does have a meaningful economic effect on the company. So, help me reconcile those two messages. One, it's accounting versus two, it's going to change the way you operate your business.

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

Thanks, Mario, for raising the IFRS 17 topic. This is Phil again. I will specifically address your question in a moment. But given that we've raised IFRS 17, I would like to acknowledge the interest that you and the broader analyst community and shareholder group have and the demand for more information. We do continue to work through the implementation. We're making good progress, and we look forward to sharing more directional information with you later this year.

Now specifically on your point that you picked up on our risk management disclosures in the MD&A, the IFRS 17 is a significant accounting change. And while that doesn't directly impact the economics of our business or the way in which we manage the business, I think it does highlight areas that where there may be opportunities to optimize under a particular framework. And there's potentially greater flexibility to make changes in certain areas, but that doesn't mean we plan to do so. It just highlights that this different accounting regime may provide a different perspective in certain elements of how we manage the business, but I don't see those as material changes to our business.

When I think about earnings in an IFRS 17 environment, one thing that we do highlight in those risk management disclosures is the potential for variability. But I do want to be balanced and say that as well as the potential for variability, there's also potential for greater stability in an IFRS 17 environment and that comes from the fact that, for example, new business gains won't be a feature of earnings, they'll be outside of earnings and also changes in noneconomic assumptions will be recorded, not -- bulk of which would be recorded in the CSM to the extent there is CSM available. And interest rate movements would be recorded principally in the -- within OCI or CSM, reflecting the fact that we are considering adopting the OCI option. So, I don't think IFRS 17 is all bad news. But we'll have to provide an update -- more of an update as we go through the course of 2022.

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

Yes, I might just chime in as well, Mario. We definitely stand by our view that the economic fundamentals of our business don't change after an accounting transition like this. It is a huge accounting change, though, for our industry, and it's one that's been the making for many, many years. And it would be silly to assume that there wouldn't be tweaks or modifications to the way we execute as a result of it, but they wouldn't be significant

in my mind. And I do feel that there are a lot of positives that will come from IFRS 17 to be perfectly frank. The focus on new business, on CSM and the growth of CSM for a fast-growing insurance company like ours is a really big positive. The fact that new business gains aren't going to be capitalized into earnings, but rather capitalized into CSM and then amortized, we think that is a positive like investment earnings.

So, we will, in due course, provide much more information around the implications of IFRS 17 to our business and the outlook. But we feel that there are many positives that come with IFRS 17 that we'll be able to share in more detail at a future point in time.

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

Okay, thank you very much for that, appreciate it.

Operator

Thank you. The next question is from Lemar Persaud from Cormark Securities. Please go ahead.

Lemar Persaud - *Cormark Securities, - Equity Research Analyst*

Yes, thanks, good morning. Just thinking about ROE, if you get to your core earnings targets from the highest potential businesses to 75% and Asia to 50%, what could that -- what could the ROE look like in that scenario out to 2025? I guess where I'm going with this is, if I look at all your targets: efficiency, portfolio optimization and growth in high potential businesses altogether and 13% for 2021, it's not the first time Manulife has hit that ROE level. And I guess the bottom-line messaging that you're trying to convey is that you're going through all this effort to just end up at 13 percent. So, anything you could speak to breaking out of that 13% range would be helpful. Thanks.

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

Yes. Lemar, this is Roy. Let me start and I'll ask Phil to chime in with any supplementary thought. But you're absolutely right. As we've focused on portfolio optimization and freeing up capital of those businesses that are generating returns that are less than the company average, that is a tailwind to ROE for us. And as you highlighted, as we continue to grow WAM in Asia, where the ROEs are significantly higher than our average, we're going to start to see an improvement, a consistent improvement in the ROE of our company. So yes, we feel really very optimistic about the outlook as it relates to return on equity, both through the combination of growth and acceleration of our fast-growing businesses that generate higher ROE, but also through the inorganic actions that we've been driving to reduce the capital that's being allocated towards lower ROE businesses. And that's only reinforced through our portfolio optimization and in-force assets.

So, we are optimistic. At this point in time, we're really not prepared to provide new targets as it relates to ROE. But in due course, that's something that we'll certainly consider.

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

Yes, this is Phil, just to add. We did subtly change our 13% target. So, we introduced the 13% target in the beginning of 2018, but we did make a subtle change to that to put a plus onto it since then, reflecting the fact that there is upside. And when we think about in particular, Roy talked about Asia and GWAM, but we look at the expected returns on new business in Asia. It's in excess of 20%. So that's certainly a tailwind to ROE over the long term, and there's upside to that 13% figure.

Lemar Persaud - *Cormark Securities, - Equity Research Analyst*

Okay, thanks. And would it be fair to suggest that as you guys move through the IFRS 17 implementation, you're going to revise these targets?

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

This is Phil again, Lemar. That's a great question. As we proceed through the IFRS 17 implementation and share more directional information with you, what we intend to do as part of that is really look at the key metrics, core earnings and other KPIs that are relevant in an IFRS 17 environment. Share with you how we look at defining those metrics and also indicate what we think that would mean in terms of medium-term financial operating guidance. And I think ROE is one that's very relevant under IFRS 17 so, we will provide updates on that, more to come.

Lemar Persaud - *Cormark Securities, - Equity Research Analyst*

Great, thanks.

Operator

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

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

Thank you, good morning. I have a few questions for you on policyholder experience, if you could bear with me. The first was on the lapse rates in the quarter. You noted lower lapse rates in North America and I was wondering if that could perhaps signal a structural shift in lapse rates. Have your customers changed how they value insurance benefits provided by policies, given the experience of the COVID-19 pandemic? And, if lower lapse rates are a possibility, how would that translate into policyholder experience and the potential impact to LICAT ratio?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks Lemar (sic) [Nigel]. It's Steve Finch here. So, you're right, what we saw when the pandemic started was we see -- we saw customers valuing their insurance benefits and we saw a reduction in lapse rates on protection products in North America by about 20 percent. It is my expectation that over time, these lapse rates will trend back to pre-pandemic levels. We saw -- you know, it's a different shock to the system, but we saw in the global financial crisis, a similar phenomenon where customers sort of rethought what their priorities were, but lapse rates did trend back to pre-pandemic levels. So that's certainly the expectation. I think we'll need the pandemic to be more in the rearview mirror, not in the news every day. We can't say when that will be, but that's clearly the expectation. We'll monitor the trends closely.

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

That's helpful. And the second question, experience was long-term care, I believe that was a modest gain this quarter. So, the question really is on mortality and the hedge of long-term care. Are there different levels of vaccination rates in your long-term care policy block versus your U.S. Life policy block? So, in other words, will long-term care continue to be an effective hedge on mortality experience due to COVID-19 and how do you see that playing out over the longer term?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Yes, thanks Lemar (sic) [Nigel]. The short answer is, yes, we do expect the diversification benefits to continue. And so, what we've seen over the course of the pandemic, we saw significant gains in LTC at the start of the pandemic as the older age population was adversely impacted. And we've seen that kind of come back a little bit over time. But the expectation is that we will continue to see those mortality diversification benefits. We've seen -- if you look at our MD&A, we actually provide a mortality sensitivity and that clearly demonstrates the mortality benefits, the diversification benefits that we see over time. And Nigel, my apologies, I was responding to the wrong name, my apologies.

Nigel D'Souza - Veritas Investment Research Corporation - Investment Analyst

No problem. Lemar is a smart guy, so I'll take that as a compliment. The last question is morbidity. And could you maybe shed some light on how morbidity might play out because of the COVID pandemic? There's growing evidence of long COVID and increased morbidity in the U.S., especially in the unvaccinated population and how does that play out for you? Because when I look at your disclosures, you are more sensitive to morbidity assumption changes, but is that due to long-term care policyholder exposure? Or is that for your overall policyholder exposure?

Steve Finch - Manulife Financial Corporation - Chief Actuary

That exposure that you're flagging is to -- that exposure is to long-term care. When I think about sort of long COVID, we're certainly tracking what the impacts could be over time on mortality. And as we just discussed, we have seen those benefits of diversification is still flagged. Since the pandemic started, policyholder experience has varied quarter-to-quarter, but those diversification benefits have been there, \$27 million post-tax charge over the course of 2 years. And then we talked earlier in the call about what we might see in terms of long-term trends. It's really too early to say what morbidity trends might be in the long term. There could be some tailwinds, there could be some headwinds, and we'll have to track that carefully over time.

Nigel D'Souza - Veritas Investment Research Corporation - Investment Analyst

Okay, that's it for me, thank you.

Operator

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

Hung Ko - Manulife Financial Corporation - VP, Group Investor Relations

Thank you, Operator. We will be available after the call if there are any further questions. Have a good day, everyone.

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.

©2022, Refinitiv. All Rights Reserved.