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CORPORATE PARTICIPANTS

Robert Veloso *Manulife Financial Corporation - VP, IR*

Donald Guloien *Manulife Financial Corporation - President & CEO*

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

Marianne Harrison *Manulife Financial Corporation - President and CEO, Manulife Canada*

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

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

Rahim Hirji *Manulife Financial Corporation - EVP and Chief Risk Officer*

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

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

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

CONFERENCE CALL PARTICIPANTS

Dominic Chan *BNP Paribas - Analyst*

Doug Young *Desjardins Securities Inc. - Analyst*

Gabriel Dechaine *National Bank Financial - Analyst*

Humphrey Lee *Dowling & Partners - Analyst*

Linda Sun-Mattison *Bernstein - Analyst*

Mario Mendonca *TD Securities - Analyst*

Meny Grauman *Cormark Securities - Analyst*

Nick Stogdill *Credit Suisse - Analyst*

Paul Holden *CIBC World Markets - Analyst*

Scott Russell *Macquarie - Analyst*

Steve Theriault *Eight Capital - Analyst*

Sumit Malhotra *Scotiabank Global Banking and Markets - Analyst*

Tom MacKinnon *BMO Capital Markets - Analyst*

PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good morning, and welcome to the Manulife Financial First Quarter 2017 Financial Results Conference Call for Thursday, May 4, 2017. Your host for today will be Mr. Robert Veloso. Please go ahead, sir.

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

Thank you, and good morning, everyone. Welcome to Manulife's earnings conference call for the first quarter of 2017. Our earnings release, statistical package and webcast slides for today's call, as well as the 2016 Embedded Value Report, are available on the Investor Relations section of our website at manulife.com.



We will begin today's presentation with an overview of our first quarter by Donald Guloien, our Chief Executive Officer. Following Donald's remarks, Steve Roder, our Chief Financial Officer, will present the first quarter financial results, and Marianne Harrison, General Manager of our Canadian Division, will conclude today's executive remarks with an update on our Canadian operations.

After the prepared remarks we will move to a question-and-answer portion of our call. We ask each participant to adhere to a limit of 1 or 2 questions. If you have any additional questions, please requeue 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 a note on the use of non-GAAP financial measures in this presentation. Note that certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from what is stated. The slide also states where to find more information on these topics and the factors that could cause actual results to differ materially from those statements.

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

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

Thank you, Robert. Good morning, everyone, and thank you for joining us on our first morning time analyst call. We're now pleased to welcome callers from Europe and Asia to our quarterly conference call. You can now more easily participate. But I humbly apologize to those of you on the West Coast of North America for us having disrupted your sleep schedule so vigorously.

I'm joined on the call by several members of our Senior Management Team, including Roy Gori, the current General Manager of our Asia Division. And, as you know, on March 29 we announced that Roy is going to becoming the President of Manulife effective June 5. In this role, Roy will have responsibility for Manulife's global operating businesses, including Asia, Canada, United States and Investments.

While many of you have had the opportunity to meet Roy already, he is very eager to continue and expand on that outreach when he moves here in June. So please join me in congratulating Roy on his new role.

Yesterday evening we announced our first quarter 2017 financial results. This was a very solid quarter for Manulife, with core earnings of \$1.1 billion and net income of \$1.35 billion. We were pleased with how our operations around the world performed, and our key growth drivers, Asia and global Wealth and Asset Management, once again demonstrated excellent results.

We generated strong top line growth in insurance sales and new business value in Asia. In our wealth and asset management businesses, we continued to generate positive net flows. And our global Assets Under Management Administration achieved a very important milestone, exceeding \$1 trillion for the first time in the company history. And a number of you have told me the first trillion is the toughest trillion.

Steve Roder will now review the highlights of our financial and operating results for the first quarter. Following Steve's remarks, Marianne Harrison will provide an update on our Canadian business. We will then open the call to your questions. Thank you.

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

Thank you, Donald. Good morning, everyone, or good afternoon or good evening, depending where you're located.

Let's start on Slide 7, where we summarize our financial performance for the first quarter of 2017. We continue to generate solid results, and most of our key performance indicators showed improvements during the quarter. I'll discuss some of the key drivers of our performance in the next few slides.

Turning to Slide 8, we continued to demonstrate solid progress on core earnings. Core earnings of \$1.1 billion in the first quarter increased by \$196 million, or 22%, compared to the prior year. On a sequential basis, excluding investment gains and the large tax item last quarter, core earnings were up 9%.

These results were driven by strong new business and in-force growth in Asia; growth in our Wealth and Asset Management businesses; a reduction in equity hedging costs; and core investment gains of \$46 billion -- I'm sorry, \$46 million, versus none in the prior quarter. These benefits were partially offset by the unfavorable impact of foreign currency rates.

Policyholder expense this quarter was roughly in line with the prior year, as improvements in the U.S. from the impact of the annual actuarial review were largely offset by unfavorable long-term disability experience in Canada. Both our Asia and wealth and asset management businesses performed well. Our Asia business grew core earnings by 17% after factoring in currency and additional dynamic hedging, while core EBITDA margin in our Wealth and Asset Management businesses grew 3.1 percentage points, to 26.8%.

Turning to Slide 9, we delivered over \$1.3 billion of net income in the first quarter, primarily reflecting strong core earnings and the favorable impact of markets. We reported gains related to the direct impact of markets of \$267 million this quarter. The gains were primarily due to favorable equity market returns in most geographies and also included a modest gain from a slight flattening of the yield curve, and in Japan from declining swap spreads.

On Slide 10 is our source of earnings. Expected profit on in-force increased 10% from the prior year on a constant currency basis, primarily due to growth in our wealth and asset management businesses and in-force growth in Asia. The impact of new business improved versus the prior-year quarter, reflecting higher insurance sales across Asia and a favorable business mix in Japan and Other Asia.

Experience gains of \$205 million were largely driven by the favorable impact of equity markets. We have unfavorable policyholder experience this quarter of \$28 million pretax, as experience gains in the U.S. were more than offset by experience losses in Canada.

Earnings on surplus in the quarter declined, reflecting less favorable mark-to-market impacts of interest rates and higher financing costs following debt issued to opportunistically pre-finance the recently announced and potential future redemptions. This quarter there was a \$14 million benefit to earnings on surplus from the mark-to-market impact of interest rates.

On Slide 11 you can see that both net and gross flows in our wealth and asset management businesses continue to be strong, and we achieved our 29th consecutive quarter of positive net flows. Net flows of \$4.3 billion were driven by positive net flows across all 3 operating divisions and in each of our global segments: mutual funds, pensions, and institutional advisory.

In the U.S. we achieved strong mutual fund and pension net flows, partially reversing last quarter's net outflows. In Asia, we generated robust mutual fund net flows in Mainland China and pension net flows in Hong Kong. And in Canada, we delivered solid mutual fund and institutional advisory net flows.

Gross flows of \$33 billion were up 21% from the prior year quarter. In the U.S., we achieved record gross flows, including strong mutual fund sales, as a result of robust intermediary sales and model allocations, and strong pension sales in both the small and mid-case markets. In Asia, we delivered strong money market flows and benefited from new fund launches in Mainland China as well as achieved record pension flows in Hong Kong, in part due to the Standard Chartered distribution partnership. And in Canada, we delivered strong mutual fund sales and funded several large institutional advisory mandates.

Turning to Slide 12 and insurance sales, insurance sales in the first quarter were up, were \$1.3 billion, up 39% versus the prior year. This reflects record sales in Asia, with strong double-digit growth in most markets, including a more than doubling of sales in Mainland China and strong growth in Japan; strong insurance sales in Canada, driven by a large-case group benefit sale; and higher life insurance sales in the U.S. due to expanded distribution and the rising popularity of the Vitality feature. This quarter we also completed the orderly wind-down of our retail individual long-term care sales.



On Slide 13 is our New Business Value. In the first quarter we delivered strong growth in New Business Value, which increased 42% from a year ago, to \$394 million, driven by continued APE sales growth, scale benefits and a favorable business mix in Japan and Other Asia. In Asia, New Business Value of \$326 million increased 53% from a year ago. Asia New Business Value margins were 34.7% in the first quarter, up 5.9 percentage points on a constant currency basis from the prior year, aided by improved product mix and scale benefits.

Turning to Slide 14, our Assets Under Management and Administration, or AUMA, at the end of the first quarter were a record \$1 trillion, up \$101 billion, or 9%, from the prior year, driven by investment returns and continued positive customer inflows. Our wealth and asset management businesses achieved AUMA of \$565 billion, up \$77 billion, or 14%, from the previous year, driven by similar factors.

Yesterday we released our 2016 Embedded Value report, and on Slide 15 we illustrate the change in Embedded Value for the company. Contributions from new business and in-force increased Embedded Value organically by \$2.9 billion in the year, with new business accounting for a strong \$1.2 billion. Importantly, New Business Value was up 22% on a constant currency basis from 2015. The increase was offset by the impact of capital deployment, such as the payment of shareholder dividends, and increased goodwill and intangibles from acquisitions and partnerships, and currency, which led to a decrease in Embedded Value.

Importantly, Embedded Value of \$46.5 billion, or \$23.53 per share, reflects only a portion of the value of our businesses, as it attributes no value to our new business franchise and only tangible book value to our rapidly growing wealth and asset management businesses and Manulife Bank. We've posted a presentation on our website which provides some additional granularity on our Embedded Value and some Manulife-specific takeaways.

So, in conclusion, in the first quarter of 2017, Manulife delivered over \$1.3 billion in net income; achieved core earnings of \$1.1 billion, up 22% from the prior year; generated solid top line growth in insurance sales overall, and strong sales in Asia in particular; and continue to generate positive net flows in our Wealth and Asset Management businesses; and reached a \$1 trillion AUMA milestone.

Turning to Slide 17, I want to remind you that we will be hosting our 2017 Investor Day from Wednesday, June 21, to Thursday, June 22, in Hong Kong and Ho Chi Minh City, Vietnam. Along with presentations from several of our key executives we will be enabling our investors to get a much better feel for our operations, including both agency and the bancassurance channel.

I will now pass it on to Marianne Harrison, who will discuss our Canadian business in more depth.

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

Thank you, Steve. Good morning and good evening, everyone.

The Canadian Division is a relatively big player in a small, mature market, generating significant earnings for Manulife. In 2016, we generated close to \$1.4 billion in core earnings, and accounted for approximately 1/3 of the company's total core earnings. Over the period between 2014 and 2016, Canadian Division's core earnings grew 22% annually, fueled by organic growth and the acquisition of Standard Life. Excluding Standard Life, core earnings increased by roughly 12% annually.

Assets under management and administration in the Canadian Division of \$235 billion accounted for 24% of the company's AUMA. We experienced strong growth, driven primarily by the Standard Life acquisition, but also the strong performance of our Wealth and Asset Management businesses, which generated \$17 billion in gross flows in 2016.

Our insurance sales remain strong, and we continue to explore opportunities to innovate and optimize our retail and group offerings. Our strategy has 2 lenses: our purpose, which is to help people achieve their dreams and aspirations by putting customers' needs first and providing the right advice and solutions, and ensuring rigorous discipline around delivering value to our shareholders.

Today I will touch on 4 examples that highlight our strategy at work.



Turning to Slide 20, our mutual fund business remains a strong growth opportunity. It strengthens our customer-centric product offering, is crucial to our adviser distribution channel, and we have been delivering outstanding results. We continue to strengthen our market position, with AUM growing 23% annually since 2011, and net sales ranking improving from 9th to 4th, and with this achievement, we surpassed many of the big banks.

We have achieved this success by expanding our distribution network beyond traditional adviser channels into full-service brokerage, and strengthening our fund lineup, as evidenced by significantly more 4- and 5-star Morningstar-rated funds. In 2016, these top-rated funds accounted for 61% of our mutual fund assets under management.

Turning to Slide 21, our group retirement and group benefits businesses continue to advance our technology and product and service offering to capture growth opportunities in the marketplace. We have generated significant growth in our group retirement gross flows and assets under management, growing at 30% and 48% annually, respectively, since 2014, primarily driven by the Standard Life acquisition.

We continue to proactively meet customer needs and differentiate our offerings from our competitors by enabling customer-centric strategies so members maximize contributions, consolidate assets and ultimately convert from group plan members into long-term customers; by providing the right advice and personalized offering to help plan members better prepare for retirement and live financially healthy lives; and lastly, by making it easier for members to do business with us through digitization and automation.

Our ability to retain assets speaks volumes to the quality of the advice we offer today. We retain greater than 50% of assets when plan members leave their employer, an achievement that leads the industry.

Our group benefits business is a strong contributor to earnings, contributing 18% to the Division's core earnings in 2016. We continue to modernize, digitize and simplify the business to drive strong earnings into the future. The work underway will transform our technology platform to substantially enhance the customer experience for both our plan sponsors and their plan members.

On Slide 22, Manulife Bank continues to play a key role in our Canadian strategy, where we are competing in market segments underserved by big banks by focusing on providing simple, easy-to-use products and services aligned to our customers' best interest. Our offerings are unique in that they optimize traditional banking products to better meet customer needs. For example, our flagship product Manulife One is an all-in-one account that combines your mortgage and checking account to help pay off your mortgage faster.

Over half of our business comes from financial advisers who sell our other products as part of broader holistic financial plans, with the remainder coming from other intermediaries and the direct channel. Notably, the bank continues to maintain a strong liquidity and capital position by leveraging a well-diversified funding model which includes significant deposits in everyday transaction accounts.

In Q1 2016, Manulife Bank launched an expansion strategy in the mortgage broker channel which is helping us increase our penetration among the younger demographic and first-time home buyers. We also completed a sales force reorganization in 2016 to increase wholesaling activity, improve productivity, support mortgage brokers, and better engage our adviser base.

The bank uses a single core banking platform, which allows us to get to market faster. Success of several recent initiatives including ABM expansion, mobile banking, Interac Tap, touch ID and remote deposit capture are examples of this.

Collectively, these initiatives will let us capture incremental revenue, grow and deepen customer relationships and achieve expense scale while improving customer satisfaction, and we are already delivering solid momentum. New loan volumes grew 12% year-over-year in 2016, and grew 25% in Q1 2017 versus Q1 2016.

On Slide 23, you can see that in our insurance business our focus is to meet the needs of consumers through our innovative product offerings and by simplifying the process. Our effort to modernize insurance with innovative solutions, such as Vitality, rewards our customers for living healthy lives. Our Quick Issue Term product employs innovative auto adjudication technology, allowing us to issue 80% of these policies in less than 24 hours, resolving a significant pain point for our customers. This platform is now being extended to our other Retail Insurance products.



We have also developed advanced analytics capabilities to eliminate the need for people to meet with a nurse and provide fluids in certain circumstances, which has resulted in accelerated underwriting for some products. Manulife was also the first insurer to underwrite and accept life insurance applications from individuals who have tested positive for HIV. We see these innovations setting a strong foundation for profitable growth as we modernize our insurance business.

Turning to Slide 24, the Standard Life acquisition in 2015 has been a very good fit with our strategy to expand our wealth and asset management business. The transaction was \$0.05 accretive to total company core EPS in Year 1, excluding integration and transition costs, which exceeded our expectations for marginal accretion in the first year.

And while the integration of the business means we are no longer able to separate the earnings of Standard Life, we have incorporated the expected financial contribution of the business into our medium-term financial plan and have been achieving or exceeding our goals. Our integration costs are forecasted to be 23% over our original target as a result of higher than expected infrastructure migration costs and business conversion costs. However, we are seeing favorable results in other areas, and collectively we are exceeding the overall deal expectations. Expense synergies are on track to slightly exceed our original guidance of \$100 million.

A key highlight is that our integration work hasn't compromised our ability to win new business. Group Retirement Solutions achieved record sales in 2015, and exceeded plan in 2016, and our Retail Mutual Fund net sales increased to #4 in 2016 from #8 in 2014.

The Standard Life acquisition broadened the range of asset management products and solutions available to clients in Canada and around the world, and contributed to \$3.2 billion in new institutional advisory mandates in 2016. We view these results as strong indications of the strategic value of this acquisition.

On Slide 25, while the integration effort is not yet complete, the acquisition is delivering ongoing benefits, such as: a more robust investment selection that enhances our competitive position; a doubling in size of our pension investment platform, providing a broader choice of funds for plans and their members; strengthening of our portfolio management expertise, particularly in multi-asset capabilities and Liability Driven Investing, or LDI; and expansion of our distribution network, as we now have former Standard Life advisers selling Manulife retail products, which is making a significant contribution. In 2016, these advisers contributed \$400 million, or 5% of total mutual fund gross flows, and \$200 million, or 8% of segregated fund sales.

Broadening the relationship with customers we have acquired as part of the acquisition will continue to drive future earnings, and we are seeing this with the success of our member retention, which allows -- which involves keeping assets when members leave group plans. In 2016, we retained an additional \$500 million of assets over deal expectations.

Our dual lens focus on customer centricity and delivering shareholder value will help us shape our strategy and guide the Division to invest and grow our key businesses where the returns are strong, such as Manulife Mutual Funds, Group Retirement, and Manulife Bank. It also focuses us on optimizing our business, modernizing customer and member experiences, and improving profitability of our two largest businesses, Group Benefits and Individual Insurance. Lastly, we are completing the successful integration of Standard Life, which is scheduled to wrap up this year.

Thank you.

Robert Veloso - Manulife Financial Corporation - VP, IR

Operator, we will now take questions.



QUESTIONS AND ANSWERS

Operator

Thank you, we will now take questions from the telephone line. If you have a question and you are using a speakerphone, please lift your handset prior to making your selection. If you have a question, please press *1 on your telephone keypad. If at any time you wish to cancel your question, please press the pound sign. Please press *1 at this time if you have a question. There will be a brief pause as participants register. Thank you for your patience.

Operator

The first question is from Meny Grauman, with Cormark.

Meny Grauman - Cormark Securities - Analyst

I wanted to ask about Manulife Bank and just a few related questions. One, just in terms of what you're seeing in terms of loan volumes, or how to square the information you give us in terms of the very strong growth in new loan volume, and then if I look you see net lending assets up just 1% year-over-year, so I just wanted to understand the dynamics a little more in what's going on there. And then a broader question, you might have heard there's a mortgage lender being shopped around, and just wanted to gauge your interest in that, either in whole or in part. Anything you can add on that would also be interesting. Thanks.

Donald Guloien - Manulife Financial Corporation - President & CEO

Okay, Meny, I'll have Marianne answer the first question, and then I'll go for the second.

Marianne Harrison - Manulife Financial Corporation - President and CEO, Manulife Canada

Okay, so in terms of the loan volumes, we've been seeing recent growth in the loan volumes, so we've seen growth year-over-year of about 25% in our bank loan lending volumes. And a lot of this has to do with some of the restructuring work that we have done. As I mentioned, we have restructured the sales process and how we actually go about the business, and that has really helped us from a lending perspective, and that is why you're seeing the growth. But it's been more recent that we've seen that growth in the lending volumes.

Donald Guloien - Manulife Financial Corporation - President & CEO

And with respect to the company that's being shopped around, we have a longstanding policy of not talking about mergers and acquisitions on a forward-looking basis for a lot of good reasons. But suffice to say that that property is involved in an area of the mortgage business that we've had no aspiration to be in, and I guess that's all I would say.

Meny Grauman - Cormark Securities - Analyst

Okay. And then if I could just follow up again more broadly in terms of the mortgage market, the kind of growth that you're seeing now, some people would say maybe now is the wrong time to put the foot on the pedal and be more aggressive in terms of new loan volumes. When you look at the banking environment in Canada, what do you see, and what's your general view of the outlook for the bank?

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

I guess I would say in terms of our banking portfolio, our mortgages that we're putting on our books are prime mortgages, so we're feeling very comfortable in terms of the quality. And we have a very rigorous process that we go through in terms of our underwriting practices and making sure that we are taking on good credit as part of our books. So I would say that we're feeling very comfortable in terms of the loans that we're taking on. We have a lot of breadth across Canada, so we are in all of the markets across Canada, not just in Toronto and Vancouver, as examples, where we're seeing extremely high housing prices and a lot of activity in those marketplaces. So I would say that the breadth of our portfolio is strong. And in a lot of spots we were in more rural areas as well as sort of around in the commuter type of community. So I think that the growth that we're seeing, although it may seem like a lot from a 25% perspective, we are -- it is very good quality credit that we've been putting on, and happy with that business.

Operator

The next question is from Linda Sun-Mattison, with Bernstein.

Linda Sun-Mattison - *Bernstein - Analyst*

I have two questions. First is regarding your Asia growth, both in the insurance and in the WAM business. I want to know the Other Asia breakdown. So I know you're trying to grow by more than 100%. So how about Singapore and the rest of the Other Asia? And on the WAM business, I noticed the net flow is very, very strong. I just look at a simple ratio of net flow to gross flow. So is this kind of structural in your business, or is it just lumpy? Sorry, and the second question is about EV, and I hope that's a simple question. On your Slide 15, the Other you have a negative CAD 3 billion negative active impact on EV, and that is investment operating assumption change and investment operating experiences. So I'm just wondering whether you can break that down for me. Thank you.

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

Hi, Linda, Roy here. I'll take the first question, then I'll hand over to Steve Finch to take the second. And I guess your observation around Other Asia is absolutely right, and it's been a focus for us. We've really tried hard to diversify our business. We've been historically very much, I guess, dependent on Japan and Hong Kong for our growth, and we've been deliberately focusing on growing Other Asia. Other Asia, in fact, has grown from contributing just 30% to our sales -- of our sales -- to now contributing over 40% of our sales. And we grew APE by 43% in the first quarter. We don't provide a breakdown by market, but what I will say is that China, as you highlight, is a significant contributor for us. A lot of that has come from the scaling up of our agency business in China and also improving the productivity of our agency force. Bancassurance is also another big growth driver for us, DBS in particular. This is now -- we are moving into our second year with DBS. We had a significant lift from the DBS contribution in 2016, and that growth momentum continues. So we're delighted with that and the partnership that we have with DBS, and therefore Singapore's growth is also very strong. But we're also getting really strong growth from our other markets in the Other Asia category. Vietnam, Cambodia are just 2 of the other big contributors, but the Philippines also. And many of our markets in Other Asia are growing 30-plus percent. So very much a part of our deliberate strategy to diversify our franchise. Other Asia contribution now is much more significant. Banca, bancassurance, also contributing more significantly for us. Again, 15% of our sales 2 years ago came from banca, now more than 30%. So I guess that would be my summary thoughts on the Other Asia piece. I'll hand over to Steve on the second question and if you've got any follow-ups.

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

Great. So the question on the Embedded Value and the \$3 billion item that you mentioned, there are a variety of items in there. The largest pieces relate to really movements in market interest rates, such as in Hong Kong on the local basis decline in interest rates delays some of the future earnings on embedded value. We also saw that some of the movements in interest rates reduced our PfADs, which emerge into the embedded value over time, causing a reduction in the reported embedded value. In addition, there's fair value adjustments on some of our long-term debt and preferred shares. So, as you can see, quite a bit of interest rate-related noise. In the operating piece, it's our annual update to actuarial assumptions in Q3 of last year that goes through there as well as the unallocated expenses and policyholder experience. Those are the biggest drivers.



Linda Sun-Mattison - Bernstein - Analyst

Can I just ask a quick follow-up question on the Embedded Value in terms of rate? So, of course this is movement from end of 2015 to end of 2016. So because, that year, I think overall the rate still kind of, from year end to year end, is still a decline, that's why -- that's what -- the reference you made to declining rates in Hong Kong. Is that right?

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

That's correct. That's correct.

Operator

The next question is from Nick Stogdill, with Credit Suisse.

Nick Stogdill - Credit Suisse - Analyst

First just a quick one for Marianne. Could you just clarify what you mean by the underserved markets on Slide 22 in terms of the competition with the banks? Are you referring more to the rural areas that you mentioned, the commuter areas, or a different demographic in the market?

Marianne Harrison - Manulife Financial Corporation - President and CEO, Manulife Canada

I'd say it's a combination. It is part of the other rural area and it is a little bit of the demographic. Our product is very different, the Manulife One, which is our flagship product. We call it an optimizer product, so it combines the mortgage with the checking account at the same time, and a lot of people deposit their pay directly into that. So it helps reduce the interest on the mortgage and pay off the mortgage much faster. So I would say that in terms of meeting consumers' needs it is very different than the big banks in terms of the offering that we have, and that is really what I was referring to.

Nick Stogdill - Credit Suisse - Analyst

Okay, thank you. And then just my other question's on the pickup in the margin in Wealth and Asset Management this quarter. I'm just hoping to get a little bit more color on the drivers, I believe, on the release side, the higher asset levels. But we seem to see similar asset growth for the last few quarters and obviously not a similar pickup in the margin. So does it really have more to do with mix? And is there any changes to the investment spend this quarter that had an impact? Thank you.

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

Yes, this is Kai Sotorp. I'll address that question. It is a combination, so both asset levels were up, but we had a positive shift in business mix to higher margin product. When you look at segment by segment, on the retirement side, they had successful expansion of the small to mid-case market in the U.S. That notably is a higher margin and a higher fee business as a pool. And globally in wealth and asset management we had a shift toward higher margin products. Unique specialized fixed income products would be one example. So it's a combination of the two.

Nick Stogdill - Credit Suisse - Analyst

Is that sustainable, in your view, or is it more of a one quarter phenomenon in terms of the nexus of flows this quarter?



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

So, quarter-to-quarter is going to be somewhat lumpy, because you're going to have mixed changes based on client demand. But net-net we've been investing in our business over the past 18 months in terms of infrastructure. That has done some things to obscure the gains in terms of efficiency, and as those investments mature we think that that scalability and the benefit is going to be sustainable. So there will be lumpiness, but overall we see a continued upward trend as a result of those investments coming into play. Secondly, in Asia we spent a lot of attention on redoing the marketing and distribution engines in the region as we regionalized the wealth platform over the past 1.5 years, and those investments are starting to pay off, as well.

Operator

The next question is from Dominic Chan, with BNP Paribas.

Dominic Chan - *BNP Paribas - Analyst*

First of all, congrats on your great set of first Q results. I have two questions on your Asia division. My first question is, of your strong 44% NBV growth in Hong Kong in the first quarter, how much of that growth was driven by ManulifeMOVE, or were there any other reasons for such a strong growth in Hong Kong? I understand that you have not been too active on Mainland Chinese sales, so I'm just wondering what drove the strong growth in Hong Kong in the first quarter. My second question is for Asia other than Hong Kong and Japan. Could you elaborate more on what products or which countries drove such a large 6 percentage point increase in NBV margin? Thank you.

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

Thanks, Dominic. Roy here. So, I guess the comment I'd make on Hong Kong NBV and your question on MOVE, we don't disclose any of our specific programs or products in terms of their contribution. But what I would say is that we're really delighted with how MOVE has worked for us. From a branding perspective it's been tremendous, but also from a business contribution perspective, it's been very significant. And more than 20% of our sales now in Hong Kong are MOVE-attached. And then beyond our launch of MOVE in Hong Kong we've expanded to the Philippines and China and we're now looking to roll out MOVE more broadly. So, delighted with the MOVE program. And it really does change the way we look at our business, and we're creating a much closer tie between ourselves and the customer such that we're actually engaging with them on a daily basis, which is quite unusual for our industry, as you know. The other drivers of our Hong Kong business have been just a continued focus on agency. Agency growth was very strong in Q1, and we've been, again, very focused on driving a more professional agency force and focused on the productivity and the equipping of our agency force with new technology. That's certainly been one big driving force for us. But also we now have a much greater contribution in Hong Kong from bancassurance. Bancassurance was a relatively small contribution for our business, and with the DBS partnership now that's becoming a more significant contributor. So Hong Kong now has a much more balanced contribution from a variety of different sources. The MPF business in Hong Kong also has been a bright spot for us. We became the #1 scheme sponsor, and that was a huge milestone for us. We benefitted obviously from the Standard Chartered acquisition, and the distribution agreement now that we have with Standard Chartered is contributing significant volumes for us in Q1, and we see big upside for that partnership ongoing. And we're also selling MPF through DBS, which is our other big partnership. In terms of your Other Asia question, I guess I sort of made some of the commentary in the earlier, or through the answering of the earlier question, but I guess I'd say that we really have been growing Other Asia, and China has been a big contributing force for us. Vietnam's been very significant. We've got a very strong position in Vietnam and a very large agency force there. But we've also signed new bancassurance agreements in Vietnam. Saigon Commercial Bank was a new partnership that came onboard over a year ago, and that's been a huge driver growth for us. And Singapore, obviously, again, not just through the DBS partnership but through the expansion of new channels, like the new independent financial planning channel that we've recently launched. So good growth across most of the markets that we operate in, and Other Asia has certainly been a big focus for us, and we're getting contributions from many of the big markets there. And I would highlight, I guess, China, Singapore, Vietnam as the larger contributors.



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

Dominic, it's Steve Roder here. You had a question, you asked about the mainland Chinese visitors, and I think it's fair to say that that has not been a major component for us in the quarter. It was far more moderated than some of our competitors have articulated. And I think, Roy, it was around 20%?

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

It was around 20%, and in fact down on where we were last year, again, still a modest contributor for us. Mainland China visitors contribute only 4% of our total Asia sales. And our Hong Kong business is primarily focused on the domestic market. So that hasn't been a big contributor for us. And that's very intentional.

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

Lest some of the people not in Asia misunderstand, our sales in mainland China to mainland Chinese nationals are very, very strong. So what is being discussed here is sales in Hong Kong from mainland Chinese visitors.

Operator

The next question is from Gabriel Dechaine, with National Bank.

Gabriel Dechaine - *National Bank Financial - Analyst*

Good morning. First question is on strain. I know a lot has changed in your business over the past few years. What you were selling you don't sell anymore, and rates are higher, and things of that nature. But we are seeing strain repeat as a -- return as a positive driver of your earnings growth, and it's \$160 million pretax this quarter, which is looking pretty topky, and Asia in particular was very beneficial to your strain line. I'm just wondering what part of the shift is maybe unusual this quarter and what we could expect as a more normalized level of strain going forward. Presumably it's going to remain positive?

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

It's Steve Finch here. Hi, I'll take that question. Some of the drivers of the growth in the new business gains have been in Asia, and to the points that Roy just raised around the sales success that we've been achieving there. The one thing I would point out that is footnoted in our statistical information package this quarter is that the new business gains are gross of our minority interest, and we -- so that's particularly relevant for China, where we back out all the impacts of the minority interest through the other line. So in terms of the economics to the company, the new business gain is not quite as high as is indicated on the source of earnings. And given this success we will -- we'll be discussing the disclosures around this. But in general the positive here is the really strong growth, the gain in the scale in some of these Other Asian markets, and those kind of drivers will continue. The only other caution I'd give is that we do see new business gains on a quarterly basis can bounce around. So I tend to look at the longer term trends as opposed to any one quarter.

Gabriel Dechaine - *National Bank Financial - Analyst*

So that number is gross. Where does the -- it nets out through a less positive number somewhere else, I guess?



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

It does. It goes through the Other line of the source of earnings.

Gabriel Dechaine - *National Bank Financial - Analyst*

Oh, okay. Got you. All right. Perfect. Another question on the alternative long duration asset portfolio, so the investment gains were positive this quarter, but were less positive than they would've been if not for some \$150 million of losses in that ALDA portfolio. Could you break down which sub-portfolios drove those losses? And we had this situation last year, not just in oil and gas, but also in real estate and private equity. Is there any particular trend that's behind the -- maybe some of the real estate losses, any of the other portfolios, as well? I know when people see these experience losses in ALDA you start thinking about the return assumptions in ALDA, and the earnings sensitivity to reducing those -- that assumption is pretty substantial. So maybe we could talk about that.

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

Sure. Hi, Gabriel. It's Scott Hartz. Thank you for the question. And as you know, but just to remind folks, that when we talk about a loss, there it really means we didn't quite achieve our assumed returns. There weren't actual losses on the investments. And it's a large portfolio that's marked-to-market and run through earnings each quarter, so there is certainly going to be volatility quarter-to-quarter and year-to-year. And this particular quarter -- we talk about 6 different alternative categories -- real estate, private equity, infrastructure, timber, agriculture and oil and gas -- and 5 of those 6 categories didn't quite achieve their assumed returns this quarter. Private equity was the lone bright spot that did. And it was fairly evenly distributed across them. Some of them were for reasons you'd see in the market. Oil and gas prices were down a bit in the quarter, which contributed to a loss there. In our agriculture business, the first quarter's always a loss relative to assumed returns because there's really no harvesting in the first quarter. And then the others are just more variability in the marketplace. So I wouldn't read too much into one quarter's results. On the other hand, your question of can we achieve these long-term assumptions, and they are long-term assumptions and we do review them each year -- we'll be reviewing them in the third quarter again this year -- but the lens really is can we achieve these over the long run. And in the short run, any given quarter, any given year is not too meaningful. I would say, though, we're in a lower rate environment than we were, say, 5 or 10 years ago, and in a lower rate environment it is -- the returns you would expect to be lower. But we do think through the cycle and through the long term these returns are achievable.

Gabriel Dechaine - *National Bank Financial - Analyst*

I guess the real estate component, you know the thing that was outside, there's a lot of concern about the cap rates there, and then some particular segments of the commercial real estate portfolio, like retail, with shifts in consumer behavior and what the long-term returns are in that category. Was there anything -- are you making any changes to that portfolio at all?

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

We're diversifying it a bit. We've traditionally been in Class A office space in big, gateway cities, which is a very conservative sort of low-risk approach. In the last 5 years or so we've done a bit more in multifamily, which has been a good contributor, as there's been a shift, particularly in the U.S., from single-family home ownership into apartments. So we've done some of that. We're expanding the industrial a little bit. We really have no exposure to retail, however, and do not intend to. So that's sort of the composition.

Operator

The next question is from Steve Theriault, with Eight Capital.



Steve Theriault - *Eight Capital - Analyst*

So just going to the Wealth and Asset Management division for a couple of questions, the margin was much higher this quarter. It looks like -- I think it's over 300 basis points wider. I know we've asked questions in the past on that margin and the guidance has been positive. But we haven't seen a move that big for quite a stretch of time. So maybe we could talk a bit about whether it was mix, whether it was volume, and the sustainability of the improved margins in the WAM business this quarter, please.

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

Yes, this is Kai Sotorp. I think I partially answered the question in the previous -- it's a combination of mix, asset growth and productivity gains. So in the mix side we've had stronger flows in our mutual fund businesses across the board. Asia, Canada and U.S. all hit positive. The U.S. returned to positive net new money from 3 quarters that were quite challenging prior, partly as a result of strongly performing funds and also unique type of funds that we put into the market. We also had growth in terms of our retirement businesses across the board, and we had very positive growth in segments that have a higher margin. And, third, the product mix was in unique and specialized fund products that carry a higher margin with them. So it was a combination of those factors, plus, as I mentioned, we have made a series of investments both in terms of infrastructure and in terms of distribution which are now, on the latter point, beginning to pay off well in Asia, and on the former point are lumpy in terms of their investment cycle through the P&L. And so there were some combination factors in Q1 that drove this expansion. Now, we have previously indicated we expected also benefits of scale, so further strong markets and overall strong investment performance, where 76% of our strategies outperformed the universe, were a contributing factor. So those are the reasons.

Steve Theriault - *Eight Capital - Analyst*

Well, that sounds relatively sustainable if the results remain strong.

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

Yes, I would say I'll leave you to draw a conclusion. I can't do forward looking. But yes, we've diversified our business consistently over time into higher quality business. We've invested to get stable distribution outcomes and more efficient processing outcomes.

Steve Theriault - *Eight Capital - Analyst*

Second question on Asia, probably for Roy, a lot of attention around Other Asia and Hong Kong, but I'm seeing Japan look pretty solid this quarter, the best wealth quarter we've seen in some time. And even on the insurance side, the insurance sales were quite solid, as well. So maybe just an update in terms of what's going on there, sustainability if it's new products, that would be helpful, as well.

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

Yes, thanks. Well, Japan's been a big focus for us, and it's been a focus for us on several fronts. I guess firstly on distribution we've really worked hard over the last 18 months to expand distribution. We've got an agency force, a captive agency force. We've got independent planners that we work with. And now we have a much greater partnership with banks, and some of the big banks in Japan. So Part A of the answer to your question is that we've expanded distribution quite significantly, and we've really worked hard to build some great diversification in terms of our acquisition channels. And that's been very fruitful and productive for us. The second thing that we've done is we've had a much more deliberate focus around product and product profitability. We've worked very hard to either eliminate or reprice products that were low return, and as a result that's really contributed to a significant margin lift. And in fact last year that was despite some of the big headwinds in Japan coming from interest rate reductions that were not insignificant. So for us the other big factor has been, just really, repricing product. The third one was -- third aspect has been around new product launches. And we've really expanded the suite of products that we've got on the shelf to again create some diversification but also

to capture some segments that perhaps we weren't looking at as thoroughly as we could've. So those have been really strong contributions for us. We're a niche player in Japan. As far as we're concerned it's a very attractive market for the niches that we're focused on, but we have to be very disciplined with the pricing, and exiting products that aren't as profitable as we need them to be is certainly a big part of our game plan. And, again, last year we exited some yen-based whole life products that, given the interest rate environment, were just not going to deliver the returns that we needed. So I guess it'd be a combination of those factors, but Japan specifically.

Operator

The next question is from Scott Russell, with Macquarie Securities.

Scott Russell - Macquarie - Analyst

Can I pick up on the EV operating experience losses in 2016, so Slide 15 of the pack. I think most of that you said was investment related, but I'm more interested in the operating side. You've made references to the scale benefits coming through in Asia, which is clearly driving up the margin despite lower interest rates. But when I look at the movement in the EV, there's some pretty negative operating experience and assumption changes coming through. Now, this isn't broken out by division, so maybe that's the answer. But we're looking at over \$800 million during the year and \$800 million processing losses in the prior year. So I'm not seeing any of the scale benefits coming through in the back book. I'd be interested in any thoughts and comments on that, please.

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

Yes, so the operating experience on the Embedded Value, there's a few main components there. One which we've talked at length about on previous calls was the annual basis change, the annual review of assumptions. So that's the biggest piece that's in there. And the other items that go through there are the unallocated corporate expenses, the overall policyholder experience, which was a charge in 2016, and, you're right, that was not -- that was more on the -- heavily weighted to the U.S. and a bit in Canada, not in Asia. And then the other -- there was another relatively small item in there which I would say is a bit more noise. It was some capital changes in China and the Philippines that impacted the cost of capital. Those are the biggest drivers.

Scott Russell - Macquarie - Analyst

If you were to break that \$823 million out by division, can you give us an idea of how each market is trending? I hear you that U.S. is clearly negative, but it doesn't sound like Asia is positive, though.

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

Well, I think the positive results that we see on Asia are coming through. Where we see those come through are the New Business Value, which was highlighted, the growth there. We're seeing growth in our in-force margins coming through regularly on a quarterly basis. But some of the -- as I highlighted, some of these operating items were more related to North America and some of the unallocated expenses.

Scott Russell - Macquarie - Analyst

And just while I've got that page open, the impact of acquisitions and distribution was just over a billion dollars last year. That seems like a relatively low number, given I think you did more deals and there was also most of the DBS payment. Are you able to reconcile that? I think in the previous year you had a reconciliation of consideration versus acquired EV. Maybe it's a bit technical for now, but I'd be interested to understand that number.



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

Yes, Standard Chartered was the biggest piece of this year's number. And just for everyone, we don't reflect these impacts of acquisitions in our embedded value. They will -- the value of those transactions will come into our earnings over time.

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

So just to make sure everybody understands that, we laid out money to do Standard Chartered acquisition, took over their Mandatory Provident Fund. That will show up as wealth management earnings that are not in the embedded value calculation. So we don't take the present value of those.

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

Correct. Yes.

Scott Russell - *Macquarie - Analyst*

So if I look at the DBS payment, seeing \$1.6 billion wouldn't have come with any EV, of course, because there's nothing tangible on Day 1. How does that reconcile on its own with the CAD 1 billion that impacted EV during the year?

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

The DBS was prior year.

Scott Russell - *Macquarie - Analyst*

Oh, so that's in the \$2.5 billion during calendar '15.

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

Correct.

Scott Russell - *Macquarie - Analyst*

Okay, thank you, and thanks also for the Asia-friendly time of the call.

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

Thank you, Scott. Happy to accommodate.

Operator

The next question is from Sumit Malhotra, with Scotiabank.



Sumit Malhotra - *Scotiabank Global Banking and Markets - Analyst*

I wanted to start with Kai back in the Wealth and Asset segment. And in talking about the improvement in margin and how mix has helped, I just want to look at a couple of simple numbers here. Your AUM in this segment is up 16% year-over-year. Obviously markets have been pretty good. Your flows have been consistently positive. But when I look at your revenue,

that's up a much less robust 4%. We've heard a lot about fee pressure across the industry. Is that the only issue at play, or when you mention some of the asset mix that you've had, whether it's pension, whether it's money market, is the mix also having a dampening impact on revenue keeping pace with asset growth?

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

Yes, this is Kai Sotorp again. You're correct inferring there's an effect from institutional business which has a lower fee in aggregate relative to the assets that are brought onboard. The positive aspect there is they have a stronger and longer persistence. We also have had an expansion in overall core EBITDA quantum on the retirement side from a broad range of segments. And the quantum is going to be lower in the higher end of the segment, so you'll see a revenue mix shift on that side. But net-net the biggest probably single impact has been there's been a shift towards fixed-income content versus equities, and so that's one area where you've seen somewhat of a lag. And our -- I hope that answers the question.

Sumit Malhotra - *Scotiabank Global Banking and Markets - Analyst*

I know you're giving me some of the mix issues, and I guess the way I'd ask it, at least the way I'm calculating it here, the fee ratio on your asset base has been continually declining since you started disclosing the segment based on some of those answers in terms of mix and fixed-income shift. In your view, I think you're sitting around 90 basis points now, is it reasonable to expect that fee ratio to continue to trend lower?

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

Well, we think we have strong insulation around that for a couple of reasons. We do expect some fee compression pressure for everyone in the industry. But we're benefiting from a highly diversified business in markets that are less subject to compression. Asia and Canada are notable, where, for example, the passive impact is much more curtailed. We think fee compression in the retirement business is somewhat occurring, and it's in part because as we're growing we're increasing the segment of exposure in the larger case market, which by definition is subject to a lower fee base. However, again, there our retirement business is very nicely diversified, and we're seeing strong growth in areas like the MPF, where we're not subject to a lot of fee compression. So overall, I would say relative to industry we should see much less impact on fee compression. And the primary impact that you might see is simply business mix as things shift in and out of equity versus fixed income or balance products. So I think we're not going to be insulated in its entirety, but we are going to be much more protected through diversification. Secondly, on the expense side we have a tremendous benefit here in terms of the increasing scale as we start spreading the cost benefit of the investments we've been making in infrastructure across a larger base of assets. That has a positive counter-impact.

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

Yes, I guess -- Donald Guloien here, I wanted to jump in, what really matters is net margin, and I think net margin in dollar terms. And I think people sometimes get confused. So if you move to a, let's say, institutional asset management that has much lower fees but basically 0 marginal cost of production, most of those fees flow to the bottom line, and if there's big volume associated with those low fees, that flows to the bottom line very nicely. So your average fee could go down but the bottom line will grow, as opposed to growing in another business where you have high fees but also high distribution expenses, for instance, which would be more like the retail mutual fund business. What matters at the end of the day is not the average margin or the average revenue per dollar of asset. It's how the bottom line is growing. And that's happened -- it's not necessarily the result of this question, but as just a broader, people look at the average margin. If we sell more of a lower margin business than higher margin



business our bottom line will go up, but the average will go down. It's still a good thing for shareholders. So Kai and our people around the world who are generating this business aren't in total control of where the demand goes, but you can be very satisfied that in virtually every line of business, except for I'm sure there's some tiny exception, we are profitable on a unitized basis, and the more we sell the more we make.

Sumit Malhotra - *Scotiabank Global Banking and Markets - Analyst*

Guys, don't get me wrong. I'm asking about revenue, but expense growth is 0 and profit growth is 30%, so I think everybody's going to take that trade.

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

Thanks. I just wanted to make sure everybody got that. That's great. Sumit.

Sumit Malhotra - *Scotiabank Global Banking and Markets - Analyst*

Let me wrap up with one for Steve Roder, and it's just when we look at the geography of core earnings, you're not one we usually ask about that much, but your corporate segment loss has expanded pretty substantially this quarter. Now, I know if I have this right I think a lot of the debt funding, prefunding that you've been doing runs through that segment, so that's going to have an impact. But when I look at the sequential move being something like \$90 million worse in terms of a loss, it certainly seems like it's more than just debt issuance. Can you help me understand what's going on there and whether there was something unusual that pushed that up this quarter?

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

Yes, thanks, Sumit. So, first of all, yes, you're absolutely correct. So the prefunding that we did in Q1, the debt issue we did to prefund a call that we've already made or announced and potential future calls, that would've driven up our cost of debt in the quarter. And the other thing is that in Q4 we had some very beneficial tax items. So that flattered Q4. And so the sequential movement is exaggerated by that item, as well.

Sumit Malhotra - *Scotiabank Global Banking and Markets - Analyst*

So is this number -- and, sorry, I know I said I'd wrap it up here, like the tax rate on an overall core basis did seem to be a lot higher than we've seen since you started reporting this measure. When you think about both the 21% tax rate and the 166 as a loss in corporate, are those more sustainable numbers, or do you think both are on the heavy side?

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

So, the tax, the overall effective tax rate this quarter in core was, as you point out, a bit higher. The effective rate is a function of, obviously, of the distribution of earnings and where the earnings lie. And U.S. earnings this quarter were particularly strong, so the U.S. carries a high rate of tax. Japan was also strong, and that also carries a high rate of tax. And therefore -- and it's probably worth pointing out that our Canadian tax rate has ticked up a bit, and we think that that is more the sort of rate that we're likely to have to live with, because the level of permanent tax differences that we have in Canada has come off a little bit. I would say that on an ongoing basis, and it will vary from one quarter to another, but on an ongoing basis we'd still regard, for modeling purposes, 20 is not a bad number, but we will see fluctuation.

Operator

The next question is from Tom MacKinnon, with BMO Capital Markets.



Tom MacKinnon - BMO Capital Markets - Analyst

A question maybe for Steve Finch and/or Craig Bromley, just really looking at the U.S. and the growth in the expected profit here. Obviously you've got drivers here of interest rates, sort of an unwind of that additional PfAD on the long-term care reserves, fee income from the WAM business. So maybe you can describe, we got about 11% growth year-over-year in expected profit in the U.S., and if you can give us a little bit more color on what's been driving that and what we should be looking at how that should continue going forward, that'd be great. Thanks.

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

Sure, Tom. It's Steve. You hit a number of the key factors. So last quarter we had highlighted that the increase in interest rates that we saw in North America would impact the earnings on in-force in Q1 of around \$15 million post-tax, and that's roughly what we saw.

Tom MacKinnon - BMO Capital Markets - Analyst

For the U.S. division? Is that correct for the U.S. division, \$15 million?

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

For the total company, but the U.S. would be the disproportionate amount of that. And then the other factors, as you mentioned, it's the unwind of our PfADs as we move over time on some of the on-balance sheet insurance businesses. Those were the biggest drivers. Then what we talked about before in the total company, but we saw this in the U.S., as well, is the favorable results in the WAM business.

Tom MacKinnon - BMO Capital Markets - Analyst

And how should we be looking at that going forward? And if you can let us know what the impact was from the additional long-term care reserve that you would've booked up, does that give a bit more tailwind, if you will, for PfAD unwind for this business going forward, and how should we be looking at expected profit growth for the U.S.?

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

Right. So in terms of the update to actuarial assumptions last year, the long-term care changes that we made, we talked about an increase in ongoing run rate profit from the change of the assumptions was roughly CAD 30 million post-tax per quarter. Most of that shows up through the policyholder experience line. In general, I probably stay away from guidance, but we do see natural ongoing growth in the earnings on in-force, both from the new business as well as the unwind of the margins that we established.

Tom MacKinnon - BMO Capital Markets - Analyst

And the additional -- the fees you're getting from the growth in the WAM business there, as well.

Steve Finch - Manulife Financial Corporation - EVP and Chief Actuary

Correct. That's right.



Operator

The next question is from Mario Mendonca, with TD Securities.

Mario Mendonca - *TD Securities - Analyst*

If we could go back to sales, sales and insurance sales, particularly in Asia, the last -- this quarter and the last few quarters have been sort of reminiscent of what Manulife delivered pre-crisis. There were a number of quarters back then when Manulife would deliver huge numbers, and not necessarily in Asia, but just throughout the company. In retrospect, like fast forward 8 years or so, some of those categories turned out to be sort of damaging to the company. What would be helpful to understand from you is, do any of these sales, particularly on the insurance side, I'm not so sensitive about the wealth, but do any of these sales carry with them certain insurance risks, whether it's policyholder behavior, or macro risks that could lead to disappointment down the road? Or how do you satisfy yourself that that's not going to happen?

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

Mario, that's a great question. It's a very fair question, really. So we're going to have Rahim Hirji, our Chief Risk Officer, answer it, and if Roy wants to chime in, but suffice to say we feel very good about the profile of the business, but it's a perfect question to ask, in my opinion.

Rahim Hirji - *Manulife Financial Corporation - EVP and Chief Risk Officer*

So, Mario, thank you for your question. We've looked at our sales, and, to be honest, we have a process where if our sales increase in any particular region we take a closer look to understand whether there is any behavior or assumption in there that we've missed. And in Asia the sales growth largely is coming from distribution changes and what we are doing rather than products that are hot, that are underpriced or that we are concerned about. In general, we have moved toward having less guarantees across the globe as a result of our experience 10 years ago. And so generally we feel pretty good about the assumptions. In terms of policyholder behavior, increasingly we are pricing with either close to -- sort of most efficient behavior in terms of policyholders and what they would do from insurance products and how they would actually be utilizing the product. Lapse rates that we use in Asia reflect our North American experience. Even though we have not seen that in the past in those Asian products, we think that as the demographics change that we will see ultimately the same type of lapse experience as North America, and so we reflect that in terms of our product pricing, as well. So overall we feel quite good about that.

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

Yes, I'll just add I think Rahim's covered the point around the stringent process that we have in terms of product approval and pricing, and that includes governance not just from the risk family but from controls and compliance, and that's not just in Asia, but it is from the globe. And we've obviously been also reinforcing the support functions in terms of staffing quite significantly. But, as Rahim points out, a big part of our scale growth in Asia has been in unlocking the channels that we have. So we had, even before DBS, five exclusive bank partnerships in Asia that allowed us access to more than 12 million customers, and our penetration of that customer base was actually very low. So it's really about activating those channels to deliver the growth that we had as our potential and as the ambition when we started off with those partnerships. And then obviously driving greater productivity from our agency force is also key. So I'll just add those supplementary remarks to Rahim's comments.

Mario Mendonca - *TD Securities - Analyst*

Okay, so if I just take it to the next sort of logical step, when I look at the required capital on Page 32 of your supplement, I look at -- and this is actually what drew my attention to it in the first place -- I look at asset default and market risk, and I also look at here, interest rate risk. The numbers are climbing, especially in the case of asset default and market risk. Those increases that we've seen, from \$11.5 billion to \$13.5 billion over a year, that's a fairly big increase in required capital, especially if you put it to 200% MCCR on that. Are those being driven by the sales we're seeing in Asia insurance or wealth, or is that -- what would account for that?

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

Hi, Mario. It's Steve Finch here. A lot of the increase that we're seeing there is related to our existing book in North America. The growth in Asia would have a contribution to that, but it would be relatively smaller than the existing business in North America.

Mario Mendonca - *TD Securities - Analyst*

So what is it about North America, then, that's driving it?

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

Well, on some of our longer term businesses, on the insurance business and the long-term care business, the reserves are growing. We're still in a position of receiving more premiums, and the claims will be in the future. So the reserves are growing, and then the factors under the capital formula are reflecting that and we're seeing the increase in the required capital.

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

So that business that you described, Mario, written prior to the crisis still requires more capital every year and will for some time before it starts to level off and then decline. That's the challenge of the insurance business. You've got to make sure the business you're putting on the books not only looks good at the time you write it, and, as I said before, this is the easiest business in the world for optimists. You put optimistic assumptions down. I think that's the heart of your question, and it's a great question, and that's why I highlight it. The other aspect, I would say, about Asia is important. If a market is flat in terms of growth or growing at 1 to 2% and a company's growing at 30 or 40%, I think that warrants you looking at it really closely. In the case of Asia you've got market growth in most territories of 7, 8%, and then you've got the growth of the middle class maybe roughly doubling the opportunity, and most of the companies are growing at very fast rates, 20, 30% is not uncommon, and that's sort of what we're experiencing, in some cases because of distribution relationships and so on, unique things that we've done growing faster than that, but you've got very fast market growth. I think the one reflecting on the experiences of earlier days, which if one doesn't learn from the past you're doomed to repeat it, and I think that's the nature of your question is when you're suddenly growing in a fairly stagnant market without a good explanation of what's different, that's when you have to be concerned.

Mario Mendonca - *TD Securities - Analyst*

Yes, your point is great on the growth in the middle class and the fast growth in those economies. The thing that I'm sensitive to is economies that are growing that quickly are also sort of subject to big changes in behavior, as well. And I guess that's what you've got to wrap your mind around, that you're accounting for that. And I take seriously the point you made about applying the same lapse assumptions that you see in North America. I guess that's the conservatism you're building in.

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

Yes, and we also have more adjustable products, too, than some of those. Some of those so-called adjustable products that were sold in North America came with huge guarantees like this no-lapse guarantee. Universal life at a superficial level was an adjustable universal life product. But when they have a guarantee that they'll never lapse, that quickly becomes almost like a guarantee that somebody's going to earn 7% on someone's money, which is a very tough guarantee to sustain. And we've learned from the past and are studiously trying to avoid that in anything we do in Asia. And I must say, so are our competitors. I mean, they are very responsible people, and a businessperson's first choice is an absolute monopoly. The second choice is to be surrounded by intelligent competitors, and I think that's what we've got in Asia.



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

Mario, it's Steve Roder here, just a quick add. I think the other point is that if you look at our business today compared with where it was 3 or 4 years ago we were very dependent on Hong Kong and Japan, and it's now much more diverse. So we also get a bit of a portfolio effect. So you can get a situation where a particular economy is facing some headwinds. So in fact we saw 2 or 3 years ago the Vietnamese economy was not in a good place. There were problems in the credit markets, and it was pretty moribund there. And at that time Indonesia was growing very strongly. And now the Indonesian economy has been problematic for everybody, but Vietnam is back on track and growing very strongly. So I think that's also good. It means that we have more of an ability to withstand the phenomenon that you articulated.

Operator

The next question is from Paul Holden, with CIBC.

Paul Holden - *CIBC World Markets - Analyst*

Thank you. So, first question is regarding the Canadian Division and the negative experience in long-term disability. And it's not the first time we've heard of negative experience in that line of business. And that's not just for Manulife. That goes across your peers, as well. So I guess the question is - is this just a structurally challenged business, or do you feel there are some remedial actions you can take to improve the profit profile and maybe, most importantly, maybe even to smooth out experience in the future?

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

So, I guess I'll start by saying -- it's Marianne here -- that in terms of the experience we've actually had several quarters of good experience on the LTD side. So this is somewhat of a blip in terms of our experience. And it is something that you can't necessarily predict. We did see an uptick in incidents in the month of March, which caused that blip that we have. But just as an FYI, we do have the ability to reprice this business, as well, when it comes up for renewal, and it's renewable on an annual basis. So there are actions that we can take from a pricing perspective, and of course you can continue to look at the claims management side of it. And we do that on an ongoing basis and update sort of the actions that we take on a claims perspective. But the ability to reprice is pretty key for us, and we can do that on a pretty regular basis.

Paul Holden - *CIBC World Markets - Analyst*

And that annual repricing is sort of -- is it the typical Jan. 1?

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

No, it's all over. It depends on when they renew. So it depends on when the client came on.

Paul Holden - *CIBC World Markets - Analyst*

Understood.

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

There's more so at the Jan. 1 time frame, but it can be throughout the year.



Paul Holden - CIBC World Markets - Analyst

Understand. Okay. And then second question is there was a change to your hedging policy on interest rates, particularly, so just wondering what the potential tradeoff is there, because I'm assuming the past structure was in place for particular reasons and now you've decided to change it for particular reasons. And there must be some tradeoffs maybe in terms of how it impacts a core, if it all, and then maybe how it would impact the headline number, if at all.

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

Yes, hi. It's Scott Hartz. So I'll address that. There were really two changes we made in the quarter, and not big changes. They're kind of -- we are always managing that interest rate risk profile and our hedging, because it's impossible to get it nailed down completely. You're always going to see quarter-to-quarter variability in our results there. But over time we refine it and try to reduce that variability. And so the two changes we made this quarter were, as I said, sort of ongoing changes. One, we repositioned some of the swap book in the U.S. to better match us from an accounting perspective to yield curve changes we saw in the fourth quarter, a good loss from steepening a yield curve, and it was a very extreme steepening move, which we wouldn't expect to happen very often. But regardless we did reposition the swap book of debt. And I don't believe there's really any ongoing ramifications of that, but I'll leave it to Steve Finch to add in if he'd like. And the other change we made has been a continuation of trying to move ourselves away from swap spread risk. Just as a reminder how that works, we have to, in our reserves, make assumptions what we're going to earn on investments we make for premiums coming in in the future, and we largely assume we're going to invest in corporate bonds. So as corporate bond rates move around, that can affect our reserves and our earnings. And so as you know we have exposure to corporate spreads, which are very hard to hedge, but the underlying risk-free rate we do try to hedge. And we've been doing that with swaps, but swaps come with a swap spread associated with it, and that's not a match to our liability. So in the U.S. we've been trying to roll those hedges more into U.S. Treasury-based hedges. We've been doing that for some time and we did more of that. And so our exposure to U.S. swap spreads has been mitigated very significantly. We still have swap spread exposure, more in Canada and even more so in Japan. And so I think -- in this quarter we had swap spreads widen in the U.S. and it did not hurt us that much, whereas swap spreads actually narrowed in Japan, which helped. So we've really been trying to reduce our exposure to swap spreads. But, again, that has no sort of ongoing income implications, in fact, frankly, in the U.S. swap spreads are negative. So moving to Treasuries provides a little bit of ongoing extra income. But it's fairly small.

Rahim Hirji - Manulife Financial Corporation - EVP and Chief Risk Officer

The only other thing that I would add is that some of the changes that we made in terms of how we are a swap book position in the U.S. has increased our perils, sensitivities. But we think overall our sensitivity to all shapes of yield curves has actually come down as a result of the changes.

Paul Holden - CIBC World Markets - Analyst

Okay. So it sounds like from these changes you're saying no expected impact to hedging costs and reduction and volatility. So kind of a win-win. Is that fair?

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

Yes, I think that's right.

Donald Guloien - Manulife Financial Corporation - President & CEO

Less opportunity for gains from that source in the future, but that's part of less volatility, yes.



Operator

The next question is from Doug Young, with Desjardins Capital.

Doug Young - *Desjardins Securities Inc. - Analyst*

Just on the U.S. insurance division, it lost money, lost \$21 million, and it's been bouncing around from quarter-to-quarter. And this quarter has drawn policyholder experience gains on the long-term care insurance. So I'm just curious as to what were some of the drivers. I guess it's the legacy book. Just trying to flesh that out.

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

Hi, Doug. It's Steve Finch. You said the U.S. -- I might've misunderstood. Did you say the U.S. division had a loss? I can handle your question --

Doug Young - *Desjardins Securities Inc. - Analyst*

U.S. insurance division.

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

I'll have a look at that, but I'll answer your question on policyholder behavior first. You were asking about what we saw in long-term care this quarter. So in the quarter in long-term care, and I would back up to when we did our assumption review in Q3 of last year, for the first couple of quarters after we made that change we saw experience that in aggregate for long-term care was about neutral, and then in Q1 we saw a gain in long-term care. It was a few factors. We saw, actually, increased deaths across all of our businesses in the U.S., and that impacted long-term care in a positive way in terms of financial results, with higher claims terminations. We saw higher incidence rates, which partially offset that. And we also saw policyholders taking reductions in benefits as in-force premium rates came through. And all in all it resulted in a gain for long-term care in the quarter.

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

Steve, do you want to -

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

I think the number you're referring to is net, and so some of that is noncore, as well. So that's probably why there's a bit of people looking a bit puzzled by the question. But it's the net number.

Doug Young - *Desjardins Securities Inc. - Analyst*

Okay. So was there -- was the negative policyholder experience in the U.S. division -- obviously there was positive in long-term care insurance. Was there any noise in policyholder experience elsewhere in the insurance book in the U.S.?

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

Yes, the higher deaths that I mentioned impacted all the businesses, so it resulted in a gain in annuities, but it resulted in a loss in life-insurance claims. So that's where we saw some ongoing losses. And Steve Roder jogged my memory. It's the -- we see some of the investment gains come



through differently in different lines of business, but we really manage it at the total company level. So that was the comment that Steve Roder made.

Doug Young - *Desjardins Securities Inc. - Analyst*

Okay, so I just -- I think I picked up the wrong number. Okay, so and then just Marianne, just a quick question on Canada. If you back out the group long-term disability negative experience, would core earnings have grown?

Marianne Harrison - *Manulife Financial Corporation - President and CEO, Manulife Canada*

Yes, it would've been up. Yes. It would've.

Operator

The next question is from Humphrey Lee, with Dowling Partners.

Humphrey Lee - *Dowling & Partners - Analyst*

Just a follow-up to Mario's question earlier. So when we think about the Asia sales, it definitely is a very strong and good number. But if we were to think about the mix of business in terms of whether it's purely underwriting or kind of pure fee-based versus those who have some type of guarantees or lapse supported, how would characterize the mix of those sales?

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

So I guess in terms of mix what I'd say is that we're reasonably diversified on the product front, and, again, I'd say that's a blend across protection as well as savings and wealth. And, again, we've been much more focused on looking for regular premium as opposed to single premium. So, again, more than 80% of our business is regular premium. So I guess at a high level I'd sort of just share with you that a very even mix across various product categories meeting the various needs of our customers and a much stronger focus on protection, but also on regular premium business. I'm not sure if Rahim or Steve want to add anything.

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

I think also you can see from the Embedded Value report, you can see the growth in New Business Value and the margin, so this -- Roy's made the point about the focus. I think there's been just a huge focus over the last two or three years particularly on improving margins. And that's come about. So we're seeing New Business Value increasing as a result of volume and margin. And as to the earlier point Rahim made around the products, we're very happy with the nature of the products we're selling, so this isn't a case of us selling large quantities of product that we shouldn't be selling, as it were.

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

I'll just add that our margin, while it's improved quite significantly over the last couple of years, still actually lags some of the leading competitors in Asia. And that's a function of some of the product mix changes that we just referenced, but it's also the scale question. Again, we've very much been dependent on Japan and Hong Kong. And obviously in the other markets the benefits of scale really come through on margin, and we're now starting to see the contribution on margin and therefore NBV coming through those other geographies. DBS is certainly helping with that. DBS was a significant addition of scale and volume for us. In a market like Singapore, for example, where we basically had something like 4 or 5% market share and now we've got about 20% share of new business, and in some channels we're #1. Overall we're #2 in Singapore. And then the



other benefits that we're getting from DBS across markets like China, Hong Kong, Indonesia are also very significant. So that's also provided a big scale play for us. And the scale play obviously means that your expense advantages really effectively drop to the bottom line and provide for significant margin uplift.

Humphrey Lee - *Dowling & Partners - Analyst*

Thank you for the color. And then maybe shifting gear to the U.S., so in WAM, both pension business and mutual funds business seems to be pretty strong in driving the net inflows in the U.S. for the quarter. Can you kind of talk about like some of the moving parts and what is driving the net inflows in the quarter and kind of what are you seeing in the marketplace for the products that you offer in the U.S.?

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

Yes, sure, I'll start off and Kai can jump in if needed. It's Craig Bromley. Thank you. I guess it is a bit complex. There's a lot of different parts as to what is driving net flows. We've had great success with our fixed income products, particularly those manufactured by our affiliate in MAM, and that has been a big driver of the turnaround in the net flows within our mutual fund business. The pension business is strong across the board. And I think a big part of that is actually the actions that we've taken in anticipation of the Department of Labor. The kind of transparency that we offer to our clients is very attractive right now as some of our competitors are still scrambling to line themselves up in compliance with new regulation. Whether it comes or not is still to be seen, but clearly clients are looking for the type of services that we offer, DOL or no DOL. And we've seen strong flows across the board from our small case all the way to our large case. As Kai mentioned, it's very important for us to manage the mix of business. So if we were seeing all of our growth on the large case size we would have some concerns about margin. But we see a very balanced growth across the book, so our margins will remain strong. So those are really, I think, the major components, and as of now we don't see any reason why that would change going forward.

Humphrey Lee - *Dowling & Partners - Analyst*

And then just a housekeeping item. So I noticed that you shifted some of the institutional advisory account business from corporate to each segment. Did that have any impact in terms of the -- from an earnings perspective in the current quarter, especially in the U.S.?

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

No. Nothing material. No.

Humphrey Lee - *Dowling & Partners - Analyst*

Okay, got it. Thank you.

Operator

Thank you. Once again, please press *1 at this time if you have a question.

Operator

The next question is a follow-up question from Linda Sun-Mattison, with Bernstein.



Linda Sun-Mattison - Bernstein - Analyst

I just want to ask the new license you just got from China, the fully owned foreign investment company, what impact on your WAM business? I assume it's mainly a WAM business license. And are you essentially taking money from Chinese retail consumers to invest outside or are we talking about a purely China-focused investment for the Chinese consumers? Thank you.

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

So, this is Kai, and I will go first and then Roy can amplify. It is a multiline license. It's quite unique in that respect. And it will actually allow us to bring a broad range of capabilities to market. We have a very successful joint venture with M-TEDA. The joint venture is focused on domestic products. So the WFOE will be the platform for bringing in global competencies, both across private markets and public markets capabilities. Our initial primary focus will frankly be the institutional investor base, the midsize to small insurance companies, for example, who cannot access global markets that easily on their own. But ultimately over time we should be able to leverage that into intermediary distribution. When we do so it will be after close partnership discussions with our M-TEDA colleagues in terms of the existing platform that we have. Over time that license actually gives us much broader capabilities to even then include domestic capabilities, evolution, leveraging our global competencies, and we think, particularly in the private alternative space, there will be a lot of appetite and opportunity for that.

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

Yes, look, I'll just add a couple of comments. I think Kai covered it quite well. But I would say that we're very proud of the fact that we were the first financial institution to receive the investment company WFOE license in China. That's a huge milestone for us and really complements the history that we have in China and also the partnerships that we have there. We've got a strong partnership with M-TEDA on the Wealth and Asset Management side and with Sinochem on the insurance side. It wasn't long ago that we were the first insurance company to get a license to sell mutual funds through the agency force. So this is a complementary add to our capability there. We think that there's tremendous opportunity with China. As Kai pointed out, the first port of call or focus for us will be on bringing our international capability to basically the institutional segment in China, but this is a complementary capability that we think is going to really allow us to capture what is a very attractive market and a growing market.

Linda Sun-Mattison - Bernstein - Analyst

And we know China has huge problem in terms of capital control. The government regulators are not encouraging money outflow. So I'm just wondering if I look at two years' time frame, would this license give you additional fund flow realistically?

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

Yes, so we're going to access that in two ways. One is through our own quota applications. That's part and parcel of the next step we're taking. But there's also a number of established pools of monies that are sitting in Hong Kong. And so we can leverage our Hong Kong platform and partner up there with Chinese institutions that have already been able to allocate funds outside and that are now going to reallocate those among asset classes. So we expect to see benefit from both those aspects, our own quota license application and leveraging existing allocations out there.

Operator

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

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

Thank you, operator. We'll be around after the call if there's any follow-up questions, so have a good morning, everyone. Take care.

Operator

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

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