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Manulife Financial Corp. (MFC)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Please stand by. Your meeting is about to begin. Please be advised that this conference call is being recorded. Good morning and welcome to the Manulife Financial Q4 2019 Financial Results Conference Call. Your host for today will be Ms. Adrienne O'Neill. Please go ahead, Ms. O'Neill.

Adrienne O'Neill

Global Head of Investor Relations, Manulife Financial Corp.

Thank you and good morning. Welcome to Manulife earnings conference call to discuss our fourth quarter and year-end 2019 results. Our earnings release, financial statements, and related MD&A, statistical package, and webcast slides for today's call are available on the Investor Relations section of our website at manulife.com.

We'll begin today's presentation with an overview of our fourth quarter and year-end highlights and an update on our strategic priorities by Roy Gori, our President and Chief Executive Officer. Following Roy's remarks, Phil Witherington, our Chief Financial Officer, will discuss the company's financial and operating results. After the prepared remarks, we will move to the question-and-answer portion of the call.

We are aiming to conclude the call in one hour today, and thus ask each participant to adhere to a limit of two questions. If you have additional questions, please re-queue and we will do our best to respond to all questions.

Before we start, please refer to slide 2 for a caution on forward-looking statements and slide 35 for a note on the use of non-GAAP financial measures in this presentation. Note that certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from what is stated. The slide also indicates where to find more information on these topics and the factors that could cause actual results to differ materially from those stated.

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

Roy Gori

President & Chief Executive Officer, Manulife Financial Corp.

Thank you, Adrienne. Good morning, everyone, and thank you for joining us today. Turning to slide 5. Yesterday, we announced our fourth quarter and full year 2019 financial results. We delivered net income of CAD 1.2 billion, more than double the prior-year quarter, and core earnings of CAD 1.5 billion, an increase of 10% versus the fourth quarter of 2018. Core ROE was solid at 12.5%, including the impacts of portfolio optimization actions.

The core EBITDA margin in our Global Wealth and Asset Management business increased 90 basis points versus the fourth quarter of 2018 as we continue to build scale. And we returned to positive net flows, delivering net inflows of CAD 4.9 billion, an increase of CAD 13.9 billion compared to the prior-year quarter. Finally, we achieved our medium-term leverage target of 25%, after taking into account the CAD 500 million debt redemption in January of this year.

Turning to slide 6. We continued to deliver strong growth on both a full year basis and five-year time horizon. In 2019, we delivered net income of CAD 5.6 billion, an increase of CAD 800 million from the prior year. The year-over-year increase was driven by growth in core earnings, the non-recurrence of a 2018 restructuring charge and higher investment-related experience gains, partially offset by a CAD 500 million charge related to updated Ultimate Reinvestment Rate assumptions issued by the Canadian Actuarial Standards Board.

Core earnings of CAD 6 billion, increased 5% from the prior year, driven by double-digit growth in Asia and growth in the U.S., as well as Global Wealth and Asset Management. This was partially offset by portfolio optimization actions undertaken over the last 12 months, unfavorable policyholder experience, and the impact of lower new business volumes in Japan. And it's also worth noting that core EPS grew 8% from the prior year, which we believe is a good result and reflects resilience and the strength of our global franchise, given the headwinds that we faced throughout 2019, including lower interest rates, secular challenges in asset management, and lower new business volumes in Japan related to a change in tax regulation.

New business value generation increased 15% compared to the prior year and reached CAD 2 billion, driven by double-digit growth in Hong Kong, Asia, Other, the U.S., and Canada, partially offset by a decline in Japan.

Turning to slide 7. We are delivering on our ambition and generated top quartile shareholder returns in 2019. And, over the last three years, Manulife's total shareholder return ranked in the second quartile, compared to our proxy peers, which is an improvement from the third quartile rank over the last five years. Despite our progress, we still have more to do, and I believe that as we continue to deliver strong results, execute against our five priorities, and make progress against the targets that we've established, we'll continue to unlock shareholder value.

On the right-hand side of this slide, you will notice that in the last five years, we have delivered a compound annual dividend growth rate of 11%, which has been supported by steady earnings growth. On the basis of our strong operating results in 2019 and outlook for growth going forward, the board has approved a 12% increase to our quarterly dividend.

Turning to slide 8. We are executing on our five priorities and are pleased with the progress that we made in 2019. We made significant progress on portfolio optimization in 2019, releasing an additional CAD 2.1 billion of capital. As a result, I am very pleased to announce that we have successfully completed our 2022 target of releasing CAD 5 billion of capital, three years ahead of schedule.

While we have achieved our target, we will continue to pursue opportunities to further optimize our legacy portfolio. This will include both organic and inorganic initiatives, and we will execute if they are in the best interests of our shareholders. We remain focused on aggressively managing cost to drive expense efficiency, which resulted in modest core expense growth of 3% on a full year basis, which is less than half of our historic average. Now, I would note that this was accomplished during a period when we made significant investments in technology and infrastructure to support our future growth.

We delivered total expense savings of CAD 700 million for the year, putting us in a great position to achieve our target of CAD 1 billion of expense efficiencies by 2022. Phil, will provide some additional details on the success of a number of our expense initiatives.

Our third priority is to accelerate growth in our highest potential businesses, and we aspire to have these businesses generate two-thirds of total company core earnings by 2022. In 2019, our highest potential businesses represented 57% of total core earnings versus 55% in the prior year, and core expense growth outpaced our other businesses by 11 percentage points.

In Asia, we entered into a long-term strategic partnership with a leading online medical platform in mainland China and agreed to enter into an asset management joint venture agreement in India with Mahindra Finance. We continued to expand our behavioral insurance product base globally with the launch of ManulifeMOVE in Vietnam and Cambodia, and the introduction of the Group Insurance Manulife Vitality program in Canada. And in our Global Wealth and Asset Management business, the retail and retirement business lines delivered net inflows of approximately CAD 5 billion for the full year.

Our fourth priority is about our customers and how we are using technology to attract, engage and retain customers by delivering an outstanding experience. We achieved a Net Promoter Score of 8 in 2019, which is a 7-point improvement from the 2017 baseline and a 1-point decline from 2018. In Asia, we launched an end-to-end online insurance platform in collaboration with DBS Bank for the Singapore market and were recognized as the Best Life Insurance Company for Digital Transformation in Vietnam. And in our Global Wealth and Asset Management business, we launched an industry-first voice-enabled retirement product using Alexa.

Our final priority is high-performing team. Our target is to achieve top quartile employee engagement compared to global financial services and insurance peers by 2022. Our 2019 employee engagement survey had a participation rate greater than 90% and we saw an 8-point improvement from the prior year. I am encouraged by our progress and believe that we are making meaningful headway towards building a high-performing team here at Manulife and consistently achieving top quartile employee engagement.

Moving to slide 9. In conclusion, we have an incredible global franchise that is clearly focused on making decisions easier and lives better for our nearly 30 million customers. We achieved solid operating results in 2019, delivered top quartile shareholder returns, and made important progress towards our ambition of becoming the most digital, customer-centric company in our industry. We continued to execute on our five strategic priorities, achieved our 2022 portfolio optimization capital target three years ahead of schedule, executed on initiatives that reduced expenses by CAD 700 million, and are trending in the right direction on the remaining targets.

We continued to strengthen our capital position and have returned over CAD 900 million of capital to shareholders since the start of the program when we consider the net impact of the NCIB and DRIP. Whilst we believe the DRIP can be an effective capital management tool, in order to avoid any confusion at this time, we have decided to no longer issue shares from Treasury at a discount in connection with the dividend reinvestment program. We will continue to use the NCIB to return capital to shareholders as the value of our shares fluctuates.

I'm exceptionally proud of the commitment and winning mindset of our employees around the world, and their enthusiasm is critical to our success. Looking ahead to 2020, we will remain focused on executing on our strategy and I am confident that as we deliver against the plan that we have laid out, we will unlock significant and lasting value for our customers, employees, and shareholders.

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

Philip Witherington

Chief Financial Officer, Manulife Financial Corp.

Thank you, Roy, and good morning everyone. Turning to slide 11 and our financial performance for the fourth quarter and full year. As Roy mentioned, in 2019, we delivered solid operating results, consistent progress against our five priorities, and generated top quartile shareholder returns, and our fourth quarter metrics were generally positive. I will highlight the key drivers of our fourth quarter and full year performance with reference to the next few slides.

Turning to slide 12, we generated core earnings in the fourth quarter of CAD 1.5 billion, up 10% from the prior-year quarter on a constant exchange rate basis. The increase in core earnings was primarily driven by in-force and new business growth in the U.S., Hong Kong, and Asia Other, higher average asset levels in Global Wealth and Asset Management and the favorable impact of strong equity markets on seed money investments in our surplus portfolio compared with losses in the fourth quarter of 2018. This was partially offset by unfavorable policyholder experience in Canada and the U.S., lower new business volumes in Japan, and the impact of actions taken over the last 12 months to improve the capital efficiency of our legacy businesses.

Net income attributed to shareholders was CAD 1.2 billion in the fourth quarter, which more than doubled compared with the prior-year period, primarily due to strong investment-related experience gains versus losses in the fourth quarter of 2018 and a lower charge related to the direct impact of markets. Of note, we delivered strong investment-related experience gains of CAD 282 million in the quarter, driven by fixed income reinvestment gains, higher than expected returns on ALDA and favorable credit experience.

Full-year investment-related experience was a gain of CAD 766 million, CAD 400 million of which was reported in core earnings. The loss from the direct impact of interest rates in the fourth quarter was driven by narrowing corporate spreads and the steepening of the U.S. and Canadian dollar yield curves, partially offset by realized gains on available-for-sale bonds. The impact of equity markets this quarter was a gain of CAD 125 million, in line with our disclosed sensitivities. We took a CAD 34 million charge related to two reinsurance transactions in Canada, which ceded the mortality risk on our closed Par block.

Slide 13 shows our source of earnings analysis. Expected profit on in-force increased 6% on a constant exchange rate basis, driven by in-force business growth in the U.S., Hong Kong, and Asia Other. New business gains were modestly higher than the prior-year quarter as the impact of double-digit sales growth in Asia Other and the U.S. was partially offset by lower sales volumes in Japan and variability in large-case group insurance sales in Canada.

Overall policyholder experience in the fourth quarter was unfavorable, driven by unfavorable claims-related experience in our Canadian retail insurance business and adverse lapse-related experience in our U.S. life insurance business. In the U.S., we saw lower than expected levels of deaths, which resulted in a gain in the life business and an offsetting loss in the long-term care business. Lower mortality in the U.S. is related to seasonality, and we do not believe it to be reflective of a longer-term trend.

Core earnings on surplus increased compared with the prior-year quarter, primarily due to mark-to-market gains on seed money investments in the Corporate and Other segment, partially offset by lower gains on available-for-sale equities.

Turning to slide 14, we delivered double-digit core earnings growth in our Global Wealth and Asset Management business, driven by higher average asset levels. In the U.S., core earnings increased by 8%, driven by higher sales volumes, tax benefits from the closure of prior tax years, and gains from a variable annuity transfer program, partially offset by the impact of actions taken over the last 12 months to improve the capital efficiency of our legacy businesses, and unfavorable policyholder experience compared with net gains in the prior-year quarter.

Core earnings in Asia increased by 5% on a constant exchange rate basis, driven by higher new business volumes and in-force growth in Hong Kong and Asia Other, partially offset by lower new business volumes in Japan. Core earnings in our Canadian business decreased 6%, primarily due to the impact of unfavorable policyholder experience in our retail insurance business. On a full year basis, core earnings increased 5%, driven by in-force growth in Asia and Global Wealth and Asset Management, a higher contribution from new business, higher investment income, and the non-recurrence of 2018 market losses on seed money investments in our surplus portfolio. These items were partially offset by the impact on earnings of actions on legacy businesses, unfavorable policyholder experience, and the impact of lower new business volumes in Japan.

Turning to slide 15, we delivered strong core ROE of 13.1% in 2019, despite the impact of portfolio optimization actions. Our focus is on achieving sustainable consistent performance for each metric through the cycle and we remain committed to our medium-term target of a 13% plus core ROE.

Turning to slide 16. In the fourth quarter, we released CAD 1.2 billion of capital, bringing our total capital release from portfolio optimization to CAD 5.1 billion. We are pleased to have achieved our 2022 target three years ahead of schedule. Initiatives in the fourth quarter included: transferring lease renewal risk, rebalancing our investment portfolio related to previously announced transactions, and executing two reinsurance agreements in Canada, along with other items. We remain committed to continuing to optimize our remaining legacy portfolio through the pursuit of solutions, which are in the best interest of our shareholders. In the spirit of transparency, we will continue to report our additional progress at regular intervals.

Turning to slide 17. The LICAT ratio for our primary operating company was strong at 140% at the end of the fourth quarter, which equates to CAD 22 billion of capital above the supervisory target. The 6-point decline in the ratio was driven by two debt redemptions, totaling CAD 1.5 billion and the impact of higher risk-free rates and narrowing corporate spreads, partially offset by the benefit of portfolio optimization actions.

It's worth noting that the impact of the redemption of CAD 500 million of debt that occurred on January 15, 2020 is included in the fourth quarter LICAT ratio. This is consistent with OSFI regulations, whereby the period of inclusion is based on when the decision to redeem is announced, which – in this case – was November 2019.

We are pleased to have achieved our medium-term financial leverage target of 25%, after taking into account the CAD 500 million debt redemption that occurred in January 2020. The 350-basis-point decline compared with the fourth quarter of 2018 was driven by the positive impact of earnings net of dividends, the redemption of CAD 1.5 billion of debt, and the increase in the value of available-for-sale securities, which more than offset the net impact of our share buyback and dividend reinvestment programs, as well as the impact of a stronger Canadian dollar.

While the LICAT ratio was impacted by the previously -mentioned debt redemptions, the benefit will not be reflected in the leverage ratio until the first quarter of 2020. All else being equal, the redemption will reduce our leverage ratio by an additional 60 basis points to 24.5%. I am confident that we will continue to maintain a strong capital position with financial flexibility. And as Roy mentioned, we have decided to no longer issue shares from treasury at a discount in connection with the dividend reinvestment program. Instead, we will purchase shares in the open market.

Turning to slide 18. We continued to make meaningful progress towards our target of CAD 1 billion of pre-tax expense efficiencies by 2022 and delivered CAD 400 million of incremental saves in 2019 and CAD 700 million program to-date. The previously announced expense initiatives have already delivered significant benefits. Our voluntary exit and early retirement programs, as well as other restructuring initiatives, have delivered 1,900 departures, including 300 departures in the second half of 2019.

We have streamlined our real estate footprint in the U.S. and Canada and we will continue to look for opportunities globally. We have implemented automation and robotic solutions to drive efficiencies and improve customer experience, and we are now using artificial intelligence to adjudicate transactions. Finally, we renegotiated various contracts with third-party vendors. In total, our expense efficiency initiatives delivered bottom line savings to CAD 300 million in 2018, growing to CAD 700 million in 2019 and we are well-positioned to achieve our target of CAD 1 billion of expense efficiencies on or ahead of schedule.

Turning to slide 19 and core expenses. Our continued cost discipline is delivering meaningful benefits, which are evident through our modest core expense growth. On a constant exchange rate basis, core expenses grew at 5% in the fourth quarter and modest 3% for the full year, including severance costs and increased investment in our infrastructure and digital initiatives. In aggregate, these additional costs exceeded CAD 100 million. Modest core expense growth combined with pre-tax core earnings growth of 3% resulted in a 2019 core expense efficiency ratio of 52%, in line with the prior year.

Slide 20 shows our new business value generation and APE sales. In the fourth quarter of 2019, we delivered new business value of CAD 526 million, up 4% from the prior-year quarter. In Asia, new business value decreased by 4% compared with the fourth quarter of 2018, reflecting a decline in Japan sales, partially offset by higher sales in Japan (sic) [Hong Kong] and a more favorable business mix in Asia Other.

In Canada, new business value increased by 16% from the prior-year quarter, driven by higher individual insurance sales and a more favorable business mix in group insurance. And in the U.S., new business value increased by 61%, primarily as a result of higher sales. For the full year, new business value was CAD 2 billion, up 15% compared with 2018.

In the fourth quarter of 2019, we delivered APE sales of CAD 1.5 billion, which were largely in line with the prior-year period despite headwinds in Japan. This reflects double-digit APE sales growth in Hong Kong, Asia Other and the U.S., offset by the impact of tax changes on COLI sales in Japan and lower sales in Canada due to the variability of large-case group insurance sales. For the full year, APE sales of CAD 6 billion increased 7%, compared with 2018, reflecting growth in all segments.

Turning to slide 21, our Global Wealth and Asset Management business generated net inflows of CAD 4.9 billion in the fourth quarter, compared with net outflows of CAD 9 billion in the prior-year quarter, with positive contributions from all business lines and geographies. In the U.S., net inflows improved for the fourth consecutive quarter, due to higher gross flows from all business lines and lower retail redemptions amid improved market conditions.

In Canada, net flows reflect the continued sales momentum in retail and the funding of several large fixed income institutional mandates. Despite the strong performance in the fourth quarter, we experienced net outflows of CAD 0.9 billion for the full year, driven by higher redemptions in our institutional asset management business, and more specifically the decision by one institutional client in the third quarter of 2019 to internalize the management of several large primarily fixed income, mandates. Our core EBITDA margin was solid at 27.3%, up 90 basis points from the prior year quarter, as we continued to build scale in our Global Wealth and Asset Management business.

Slide 22 outlines our medium-term financial operating targets and our full year performance. Core ROE exceeded our targets for the second year in a row, expense efficiency is trending in the right direction and we have achieved our medium-term portfolio optimization and leverage targets. While core EPS growth for 2019 fell short of our medium-term target, we remain confident in delivering 10% to 12% core EPS growth over the medium-term, given the focus on our five strategic priorities and strong track record of execution.

Before we open the call to questions, I will turn it over to Adrienne for some brief remarks on Investor Day. Adrienne.

Adrienne O'Neill

Global Head of Investor Relations, Manulife Financial Corp.

Thanks, Phil. Turning to slide 23. We are hosting an Investor Day on June 23, 2020 at our offices in Toronto, Canada. Please save the date and registration details will follow later this month. We look forward to seeing you there. Operator, we will now open the call to questions please.

QUESTION AND ANSWER SECTION

Operator: Thank you, Ms. O'Neill. We will now take questions from the telephone lines. [Operator Instructions] And the first question is from Sumit Malhotra from Scotiabank. Please go ahead.

Sumit Malhotra

Analyst, Scotiabank Global Banking and Markets

Q

Thank you. Good morning. First question is probably for Steve. On the Canadian policyholder experience in the quarter, you mentioned there was some issues there and we've seen that from a couple of the other companies that reported last night as well. Any specifics you can provide as to what the issues were and maybe we can talk about sustainability after that?

Steve Finch

Chief Actuary, Manulife Financial Corp.

A

Sure, Sumit. I'll make a comment and pass it over to Mike for more color. What we saw in Canada in Q4, the driver of the negative experience was large claims on our Canadian retail insurance business. It was a handful of large claims and it's not something that we've seen very often. We looked at it and attribute it to normal variability. The other thing that's worth commenting on is, we had been seeing very favorable group claims experience and that moderated somewhat, in Q4, it was more neutral.

Mike, I don't know if you have more to add on the group?

Michael Doughty

General Manager, Canada, Manulife Financial Corp.

A

Yeah. I think that's right. We're going to see some seasonality. There's nothing alarming at this point in the individual claims. So, we do think that that's just normal volatility on the block of that size.

Sumit Malhotra

Analyst, Scotiabank Global Banking and Markets

Q

So, coming after the quarter in which you normally do your actuarial assumptions just to see the experience line turn more negative than we've seen in a while, it doesn't sound like you're saying it's something that is already on the watch list, if you will, to have to be reviewed in terms reserve strengthening going forward, is that accurate?

Steve Finch

Chief Actuary, Manulife Financial Corp.

A

Correct. As I said, this large claim, it's an aberration in terms of what we've seen historically, so no trend there.

Sumit Malhotra
Analyst, Scotiabank Global Banking and Markets
Q

And second and last question is for Phil. Does the removal of the discount on the DRIP have any impact on how the company considers share repurchases, the two – the NCIB and the discounted DRIP – were obviously announced at the same time. You've removed one of them, does not having that capital inflow, if you will, via the heavier share issuance that come through the discount, does that change how you think about buybacks?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Hey, Sumit. Thanks for the question. This is Phil. So, we've always looked at the NCIB, net of DRIP, and that's consistently how we've reported our progress. And I think it is worth highlighting that when we look at our capital deployment priorities, NCIB does remain part of that. And I think that's relevant in the context of the strong capital position, 140% LICAT. But in particular, this quarter, given that we have achieved our medium-term leverage target, I think it's worth saying that we do have substantial financial flexibility.

So, when we look at the capital deployment priorities, at the top of the list really is organic growth and continuing to invest in organic growth, particularly when we look at our ability to expand our distribution channels in Asia, and also building the scale of our Global Wealth and Asset Management business. We also believe in sustainable dividend growth and that really is the context for the 12% increase in the dividend this quarter. And when appropriate, we will buy back shares, we continue to believe that buying back shares is an efficient use of capital.

Sumit Malhotra
Analyst, Scotiabank Global Banking and Markets
Q

Thanks for the time.

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

Tom MacKinnon
Analyst, BMO Capital Markets
Q

Yeah. Thanks very much. With respect to hitting the CAD 5 billion target at three years ahead of time in terms of capital free up, I think you mentioned you're going to sort of keep your foot on the gas here and look to further optimize the legacy portfolio. Is there any low-hanging fruit still left in the legacy portfolio to optimize here, what are your plans with respect to this, if you want to continue to move forward and go beyond this CAD 5 billion target?

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

Yeah. Thanks, Tom. Let me start and I'll hand over to Naveed. As we highlighted, we're really pleased with the progress we've been making on portfolio optimization and to achieve our goal three years ahead of schedule is obviously something that we're extremely proud of. But perhaps more so was the trade-off that we were able to make in terms of freeing up that capital and the net core earnings give on the CAD 5 billion effectively on a full year basis is actually less than CAD 200 million. And as we said earlier, we're not going to wave the victory flag at this point. We're going to continue to focus on portfolio optimization and making sure that we're looking for the most efficient use of our capital. So, our further work, both organic and inorganic is certainly on our horizon and what we're going to be absolutely laser focused on. And we clearly feel that there is much more opportunity for us to progress on that front.

But I'll let Naveed sort of share a little bit more on that and perhaps more detail.

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

A

Yeah. Thank you, Tom, for the questions. Naveed Irshad here. I'd say we're still working on some inorganic reinsurance transactions. So, I think there's still some runway there. So, it's an area we'll continue to focus on. I'll say though that in terms of where the team is spending its time, there's been a bit of a shift towards more of the organic side. So, this includes in-force management, rerates, buyouts, and transfer programs, claims management. So, I'm really actually quite excited about those opportunities, because I think there's even more runway to go on there.

Tom MacKinnon
Analyst, BMO Capital Markets

Q

Okay. Thanks. And as a follow up, assuming that the businesses that you freed up are probably consuming more capital, is it safe to say that you have increased the ability to sort of organically generate excess capital in your business now? And can you put any metric around or have you thought about trying to put any metric around which you just organically free up in terms of capital, outside of these extra initiatives, especially given the fact as you've got a 140% LICAT?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Yeah. Tom, it's Steve. Overall, we're happy with the capital generation, whether it's with respect to portfolio optimization or organic. I don't think we've parsed it in terms of looking at the generation of capital from the businesses where we've been lightening up. But just overall, in general, very focused on continuing to generate capital organically.

Tom MacKinnon
Analyst, BMO Capital Markets

Q

Okay. Thanks.

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

Mario Mendonca
Analyst, TD Securities

Q

Good morning. This question is for Phil. Phil, so when I look at the year, it looks like a pretty strong year, markets were great, no issues on changes on assumptions, solid experience, very solid investment gains, but yet the company didn't meet the 10% to 12% target. In fact, I think if I remember correctly, it was about 5%. So, where I'm getting at is, does the 10% to 12%, what kind of year does it take to generate 10% to 12%? Or maybe you could answer it by saying, what was it about 2019 that prevented you from making the target this year?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Hey, Mario. Thanks for the question. This is Phil. So, the 10% to 12% target relates to core EPS growth. And in 2019, our core EPS growth was 8%, so slightly short of that target range that's correctly called out. The historic experience is that we have in fact, overachieved the 10% to 12%. But when we look at 2019, there were some specific factors that were certainly headwinds for us. The low interest rate environment, of course, is one and that maybe something that persists, but we are, I think well prepared to be able to deal with a low interest rate environment.

It was also a challenging time for the Global Wealth and Asset Management business, particularly off the back of the market declines we had seen in the fourth quarter of 2018, which presented a headwind throughout 2019. And then when we look at our Asia business, the tax changes that we had seen around COLI products in Japan, that was a headwind. And also the protests in Hong Kong were also a headwind for us to deal with. And for us to get to 8% core EPS growth in a year like that, we're actually very pleased with the outcome.

When I look forward from here, there are factors that are quite different to a year ago. So, if we look at where, for example, in Wealth and Asset Management, the AUMA landed at the end of 2019 with 16% above the level of 2018. And so, you can see that through the numbers when you look at the earnings growth in Wealth and Asset Management in Q4 of 15%. I think that's potentially a tailwind, and a positive story for 2020. So all in all, we feel good about the year ahead and the medium term targets that we have.

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

A

Yeah. Mario, let me just add. I think that's a great summary by Phil. I would also say that the 8% core earnings per share outcome, in quite a challenged environment was also delivered despite the portfolio optimization actions and the earnings impact of those actions off the back of a very solid 2018 starting point as well. And as Phil said, I feel that we really a have strong momentum. There are a lot of opportunities on the horizon, but there's clearly not going to be a shortage of challenges either. I think to think that 2020 will be without its challenges would be incorrect.

Mario Mendonca
Analyst, TD Securities

Q

Okay. Maybe just a quick follow-up. Is there anything you would point us to – or you'd have us think about regarding the coronavirus that could impact next quarter or 2020 generally?

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

A

Yeah. Thanks, Mario. Look, it's really too early to say anything meaningful about the coronavirus at this point and certainly, as it relates to a forecast of 2020. We're obviously watching the situation very closely as is everyone else that has a business in that part of the world. And obviously, the safety of our staff, agents and customers is our highest priority. But from a forecast perspective, the message I'd leave you with is that it's way too early to make any predictions on how that will pan out at this point. We're watching it closely, and as we get more information, we'll obviously be willing to share that.

Mario Mendonca
Analyst, TD Securities

Q

Thank you.

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

Scott Chan
Analyst, Canaccord Genuity

Q

Good morning. Just a focus on Japan. Noticed kind of the insurance or the APE sales were kind of flattish quarter-over-quarter. I thought that we would kind of maybe see gradual improvement with the new regulations and maybe you could just provide an update on that?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Sure. Thanks for the question. This is Anil Wadhwani here. So, despite the headwinds in Japan on account of the new tax rules governing COLI, we were able to deliver a resilient 5% core earnings growth in quarter four and 11% for the for the full year. We continue to see very strong momentum in geographies like Hong Kong and Asia Other. So, despite some other challenges that were mentioned earlier in the call as well, I think overall we're sort of pretty pleased with the resilient performance that we showed in Asia.

As far as Japan is concerned, the sales were, as I said, challenged on account of the tax rules that pretty much came into force in quarter three of 2019. We delivered CAD 45 million on COLI as opposed to CAD 21 million of COLI sales in quarter three. But the year-on-year comparison would obviously be challenged, because we had an exceedingly strong quarter four of 2018 on back of some strong momentum at that point in time on COLI.

Now, we're putting a number of initiatives in flight. So, firstly, we are launching a new COLI product. We are also launching a new FX Life, a product with Nomura. We're expanding our distribution, so we are onboarding new MGAs to offer other wealth and retail products. We have launched more recently the MFA channel in Japan on the back of the success that we had witnessed in Singapore, as well as we are looking at and taking actions on reshaping our cost base in Japan, so as to drive ongoing efficiency in the Japanese market. So, number of initiatives as you can tell in the pipeline and we continue to watch the COLI situation very closely.

Scott Chan
Analyst, Canaccord Genuity

Q

Thanks. And my second question just on Global WAM. Nice total net inflow quarter of CAD 4.9 billion compared to last year and last quarter, you called out some large fixed income mandates that were won. And I was wondering if you can kind of quantify that like you did last quarter, just to kind of see maybe to help us kind of think about the visibility going forward over the next few years?

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

A

Okay. Thanks, Scott. Paul Lorentz here. Yeah. In terms of the fixed income mandates, they weren't as material as some of the other ones we typically disclosed, I think if it's in the billions. This was a number of smaller mandates less than a billion that contributed to the quarter, so it was more wide based. It wasn't one particular mandate. It was actually two different teams that were split. So, we feel quite good just about the momentum.

I think if you look at particularly the net flows in the quarter and just looking at how we're starting this year versus the last year, we're just in a completely different position, net flows were positive as you would have seen across all geographies, all business lines. We had our fourth consecutive quarter of improvement in net flows in our U.S. business as well as our retail global product line and then gross flows were up from last quarter as well as from last year, again, across all geographies and all business lines.

We feel we're starting from a position of strength and that was supported by some wins as you mentioned in the fourth quarter; strong market share, but our investment performance also improved across the franchise and we launched a new product in our product markets business, a private equity fund on fund in the quarter that was successful and contributed. So, we feel quite good just about the broad-based momentum we have and our ability to continue to generate net flows over the medium and long-term.

Scott Chan
Analyst, Canaccord Genuity

Q

Right. Thank you.

Operator: Thank you. Your next question is from Gabriel Dechaine from National Bank Financial. Please go ahead.

Gabriel Dechaine
Analyst, National Bank Financial

Q

Good morning. Quick numbers one, can you remind me of the earnings impact of the portfolio optimization and the transactions that you executed on this year, and what the full run rate would be in 2020?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Sure. Thanks, Gabriel. This is Phil. So, in the fourth quarter, the cumulative impact was in the order of CAD 45 million and we look at the ongoing run rate impact, including the actions we've taken in the fourth quarter. A good rule of thumb here would be about CAD 50 million a quarter. So, we're looking CAD 200 million on an annualized basis. If we compare the fourth quarter of 2019 to the fourth quarter of 2018, the incremental impact on run rate there is in the order of CAD 20 million. So, in terms of the extent to which that has been a headwind, it's in the order of 2 percentage points of growth.

Gabriel Dechaine
Analyst, National Bank Financial

Q

Thank you. And then my real question I guess, in Japan as well, was there anything else going on other than the sales that led to the earnings drop, because it did take a step down in the quarter versus Q2 and Q3? And COLI in particular, I know this has been an older issue, but I guess, how does that compare in terms of the strain or gains or the impact versus product you sell across the region, or is that one of the juiciest, because if there's a sale slowdown in other areas caused by other factors, I'm just wondering if that's sort of a linear type expectation I should have?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

So, thanks for the question. This is Anil again. So, on Japan, the difference, as you pointed out, is on account of two reasons. One is, obviously, the lower volumes on account of COLI as well as we had a certain product mix that kind of caused the variation on new business quarter-on-quarter. We also took certain expense calls – one-time expense calls to reshape our expense base in Japan, so that we kind of drive ongoing efficiency. So a combination of the product mix as well as the one-time expense led to the decline that you were referring to.

In respect to your second question on COLI margins, we continue to be very satisfied with the COLI margins. So, they are not that different from what they were before the tax rules were introduced. And again, we keep a very sharp eye on volumes versus value. And as we mentioned earlier, we do prioritize value over volume. So, we do keep an ongoing and a very sharp eye in driving the right balance.

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

A

Yeah. Gabriel, just to add a quick comment to Anil's, I'd say, that we're really quite frankly pleased with Asia's performance in 2019. They obviously had some significant headwinds, not just COLI, but interest rate movements, which is something that we've obviously dealt with across the entire franchise. But despite that headwind, core earnings grew 11% for the full year and new business value grew 8%. And if you take out Japan, we grew core earnings and new business value in excess of 20%.

So, really it does, I think, underscore the diversity of the franchise that we have both at the global level, but then in particular in Asia, where over the past few years we've really worked hard to build scale in markets outside of Japan and Hong Kong, which have historically been the real drivers of growth and momentum for us. Now, we've got Singapore, Vietnam, Philippines, Indonesia, China that are now contributing much more significantly to our business there and will in the future.

Gabriel Dechaine
Analyst, National Bank Financial

Q

Thank you.

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

Darko Mihelic
Analyst, RBC Capital Markets

Q

Hi. Thanks. Just a quick follow up on the coronavirus. I'm just wondering, I mean trying to interpret when you say it's too early to sort of think about the impact of it. Is that to say that so far in January and February, sales and everything else is fine and you haven't seen an impact, or is it, there has been an impact and you're just hoping that it's going to subside?

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

A

Yeah. Let me start, Darko, and I'll hand over to Anil. He might want to provide some extra commentary. I think the bottom line for us is that, when I say it's too early, we just don't have enough data points to really drive a trend line. From a year-on-year comparison perspective, we've got obviously Chinese New Year, that's in the mix. And certain markets are more impacted than others. Obviously, we kick into high gear with business continuity plans. We have folks working from home to really minimize the disruption. But it's really hard to declare whether this is something that's going to impact our momentum and our results or not. So, we really want to be cautious and not call something out prematurely or inaccurately.

Anil, anything you'd like to add?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

No. Specifically, just the outbreak got into focus towards the end of January and since then, as I said, our preeminent focus has been the safety of our people as well as our agents, and we've kind of taken enhanced steps to ensure that we are able to service customers during these times. That's really been our primary focus.

We have taken actions obviously in the City of Wuhan and so we have temporarily obviously shutdown the office. Wuhan contributes to a very small proportion of the China sales. But temporarily in the short-term, it will cause a little bit of disruption in terms of people flow. But it's kind of hard for us to kind of gauge the impact, as Roy mentioned, and it's too early for us to be specific about it.

Darko Mihelic
Analyst, RBC Capital Markets
Q

Okay. Thank you. And my other question is for Phil. Phil, can you just remind us what happened to remittances, why they feel so precipitously this year? And if there are one-offs in there and what the expectation would be for 2020, given that you've increased your dividend significantly?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Thanks, Darko. Yeah, you may recall that remittances in 2018 were CAD 4 billion. That was an historic high, something that is a great outcome in 2018. For 2019, our remittances were CAD 2.8 billion. And you may recall on – I think it was the third quarter call we had a question about the potential impact of interest rates on remittances, we said at that time that interest rates are one factor that can impact remittances from year-to-year.

And we had decided to defer some remittances that had been scheduled from Hong Kong in response to the low rate environment. And that's an example of one of the items that has caused this year's number to be lower than last year. But overall, I feel good about remittances and that's part of the context for the increase in the dividend that has been proposed. Announced, not proposed. It's there, 12%.

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

It's Steve. Just want to add that we don't expect sort of a linear growth in remittances. There will be variability. What we really look to is, long-term sustainability and we feel confident with our medium-term, long-term remittance capabilities.

Darko Mihelic
Analyst, RBC Capital Markets
Q

Great. Thank you.

Operator: Thank you. Your next question is from Humphrey Lee from Dowling & Partners. Please go ahead.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners
Q

Good morning, and thank you for taking my questions. My first question is for Naveed. So, about the VA transfer program in the U.S. I was wondering if you can kind of share some color in terms of the benefits that you got in terms of de-risking your exposure. It is kind of hard to tell, based on the change in the net amount of risk, since there was the tailwind of a strong equity market. So, I was wondering if you can share anything in terms of maybe the risk reduction, where there's net amount of risk or account value or the guarantee amount related to the block that you have to buy out.

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

A

Okay. Thank you for the question, Humphrey. So, the buyback program was sort of phase one and we have further phases planned. The block that we targeted in this phase has about $4 billion of guaranteed value and 35,000 policies, representing about 15% of our overall U.S. GMWB block. So, we started in early November and it run through early February.

Essentially, the program offers customers with Principal Plus for Life product, an account value enhancement in exchange for forfeiting withdrawal and death benefit guarantees. At year-end, we were at an 8% acceptance rate. And actually, as of the end of the program, which was early February, we ended up at 17%. In terms of the actual risk reduction, it was approximately CAD 40 million of net amount of risk that was reduced as of year-end, as part of the 8% acceptance rate, so that number will be higher as of the end of the phase.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners

Q

Got it. Appreciate the colors. So, this is helpful. And obviously, you'll continue to do that throughout 2020. Shifting gear, I just want to follow up on Japan with Anil. So, in terms of the management actions that you've talked about being in flight, how should we think about the impact in the current quarter? And then also, should we expect any kind of more expenses related to these management actions in the coming quarters as you continue to right-size your expense base and then also kind of adding new distribution and kind of all the turnaround efforts?

Anil Wadhwani
General Manager, Asia, Manulife Financial Corp.

A

Thanks for the question, Humphrey. Unfortunately, I can't make any forward-looking statement. So, I can't be specific about the impacts in the current quarter. I guess what we are very focused on is ensuring that we are taking initiatives around launching new products, as I mentioned, the new version of COLI. Also, given the fact that on account of the diminished tax advantage, COLI is going to be a smaller proportion of the Japanese market, we are focused on introducing newer products on the retail as well as on the other wealth side.

We have also, Humphrey, been focusing on expanding our distribution. So, motivating and training our MGA partners to offer other wealth and retail products as well as, as I said, we've taken certain expense actions to reshape our expense base in Japan. So we, as I said, have a number of initiatives that are in-flight, but unfortunately, I can't kind of talk about the current quarter and the specific impact of that on a go forward basis.

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

A

Humphrey, sorry, Roy here. I was just going to say, it's probably important to note that the tax regulation that Anil has been talking about, specifically as it relates to COLI was enacted in Q2 of 2019. So, basically it rolled through accordingly.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners

Q

No. Just is it fair to assume, because you still have some actions that is going to be ongoing in 2020? I know you don't want to provide any guidance, but there will be some additional efforts or expenses you could incur because of these initiatives?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Yeah. Humphrey, this is Phil. Maybe it will help if I quantify the impacts on the fourth quarter on the restructuring charge and then what payback that may have. So, in the fourth quarter, the additional expense that we had seen from the restructuring actions was in the order of CAD 8 million to CAD 10 million. And when we take these actions, we really do look for a one-on-one payback and we expect that to flow through in 2020.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners
Q

Got it. This is helpful. Thank you.

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

Meny Grauman
Analyst, Cormark Securities
Q

Hi. Good morning. Just a question on the portfolio optimization. Will you be releasing a new target in the coming Investor Day or any time in the future, is that up for consideration?

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

Hi, Meny. Roy here. Look, at this stage, we're not planning to reissue a target and that's not to imply that we're not going to continue to focus on portfolio optimization. We feel that that guidance that we provided at the previous Investor Day was critical to illustrate, A, the commitment that we were going to make and the accountability that we wanted to drive. Having achieved that goal, as I mentioned earlier, we're going to continue to focus on the efficiency of our capital and the allocation of our capital across our franchise through the various inorganic and organic measures. So, at this stage, no plan to reissue target.

Meny Grauman
Analyst, Cormark Securities
Q

Thanks for that. And then just on the P&C Reinsurance business. We don't talk a lot about it, but given talk on climate change, I'm just wondering if you've changed your view of the risk profile of that business? If you could comment on how you view that business and why you feel that it's an important part of your overall business.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Thanks, Meny. This is Phil. We're still very positive about the P&C Re business. It provides diversification, very much contained risk, given that it's a short business that we know very quickly whether or not there's been a catastrophe. And if we look at our experience over a number of years, it has actually been very favorable. It tends to be five, six years where we get no very minimal claims and then there'll be a seventh year, when there is a significant claim.

I think the other point to make as well with respect to the P&C Re business is because it's a short-term business, it's something we can re-price annually and our experience over the past 12 months and going through the current new business cycle is that the market is hardening, partly because of concerns potentially about increased risk of natural catastrophes. But certainly, a hardening market is something that's favorable. So, no change in view from us on the P&C Re business.

Meny Grauman
Analyst, Cormark Securities

Q

Thank you.

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

Steve Theriault
Analyst, Eight Capital

Q

Thanks very much. We talked about leverage and now that you're on a pro forma basis below that 25% level, I did want to ask how proactive you think you'll be in managing that? And some time ago, but I remember a time when the leverage drifted down to the 20% range. Would that be an acceptable outcome here that could happen naturally, or would you expect to use buybacks, debt issuance or other tools and kind of want to be close to that 25% level to optimize ROE and all that stuff?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Steve, this is Phil. Thanks for the question. I think the first thing I should say, of course, we're very pleased that we've achieved our medium-term leverage target with a pro forma of 24.5%. I think it's important to highlight that 25% is not a cap for us. So, what the 25% or below 25% means is that we do have quite substantial financial flexibility in the leverage ratio. But equally, I don't think it's necessary for us to try and manage exactly to 25% either.

So, I think what we have here is some flexibility either side of 25% and looking at how we deploy capital and we talked about capital deployment earlier, but our highest priority is that the opportunity to organically invest. And we are in a fortunate position that we do generate organic capital. But we'll also be looking for opportunities to accelerate the organic deployment opportunities and that of course, to some extent may mean NCIB. But also, it means that if there are inorganic opportunities out there, we may consider them. But one thing you can be assured of is that we'll be very disciplined when we're looking at inorganic transactions.

Steve Theriault
Analyst, Eight Capital

Q

Okay. And last thing from me – thanks, Phil – on the value of new business side, I noted that the U.S. was up around 60% from run rate. Looks like it's from strong sales from John Hancock Life, but can you provide a little detail on what's going on there and driving that?

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

A

Yeah. It's Marianne here. You're absolutely right, it was from the strong sales. We had a very strong fourth quarter. Our Vitality product has been very effective for us, and we've seen a lot of sales as it relates to that. We also saw there were some changes that were regulatory changes being made in the fourth quarter, so that was also a reason why the sales went up. We saw it around the industry where there were a lot more sales in the fourth quarter, and that's helping to drive the new business value. We also have taken a lot of actions over the last couple of years as well in terms of getting unprofitable products out there and lowering our acquisition costs as well. So, there's been a lot of focus on that to drive the new business value higher.

Steve Theriault
Analyst, Eight Capital

Q

Have you been happy with the take up on the Vitality side in terms of utilization rates or however – adoption rates, however you think about that?

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

A

Yeah. We are very happy actually. In 2019, Vitality sales represented about 45% of our overall sales. And in the fourth quarter, it was a lot higher than that. So, we are seeing a lot of take up. We just launched a new product as well at the end of the year called John Hancock Aspire, which is the first ever integrated diabetes specific product, and we're seeing a lot of excitement around that. So, we have been very pleased with the Vitality take up.

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

A

Yeah. Steve, I'll just add that the whole push around behavioral insurance is something that we're really very passionate about. It's true in the U.S., but it's also true for us in Canada, where we have Vitality as well, but then in Asia with ManulifeMOVE. And in addition to the interest and the sales growth that we're able to generate across all those geographies, we're seeing a real step up in customer satisfaction. The NPS scores that we use to measure how satisfied or loyal customers are, are of many multiple of the traditional products. And we really think that is a key driver for future engagement with customers and ultimately, that will translate also to sales.

Steve Theriault
Analyst, Eight Capital

Q

Thanks for that color.

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

David Motemaden
Analyst, Evercore ISI

Q

Hi. Good morning. Just a question for Phil, and following up on the remittances. Just wondering where you think the remittances will be as a percentage of core earnings over the medium-term, just assuming rates are at these levels? And also, if you could give some sense for the expenses at the holding company in terms of interest expenses and other costs outside of the dividend and share repo that would be helpful as well?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Hi, David. Thanks for the question. This is Phil. So, the target dividend guidance is 30% to 40% of core earnings. And what we target is for remittances to at least cover that and any debt servicing costs. I can quite confidently say that our experience in recent years has been absolutely that, but we've been able to cover through remittances the dividend and debt servicing costs. So, when I look at the CAD 2.8 billion for 2019, that is the case there as well.

So, I don't have particular concerns about future remittances, but as Steve said earlier, it's a number that will bounce around from year to year.

David Motemaden
Analyst, Evercore ISI

Q

Okay. And I guess no sort of outlook – I know it bounces around, but no sort of outlook in terms of where you think that conversion ratio in terms of level of remittances as a percentage of core earnings that you think you should be able to generate over the medium term?

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

No. It's not something we've issued guidance on, David.

David Motemaden
Analyst, Evercore ISI

Q

Okay. Fair enough. And if I could just squeeze in a quick one on long-term care, I was a bit surprised to see the adverse experience there. I was wondering if you could quantify the dollar amount that it was adverse.

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

David, sure. It's Steve here. So, the dynamic of what we saw, and it was covered in Phil's remarks, but I'll repeat for the group here, that we saw lower rates of mortality across the U.S. businesses and that manifested itself in a gain in claims in U.S. life, and a loss in LTC. That was the driver of what we saw in LTC this quarter. I won't quantify the exact number, but I would categorize it as modest. And we have seen this type of seasonality in the past. It's not every year, but we have definitely seen the seasonality in the past. And we don't adjust our reserve assumptions to reflect the seasonality. It's not that granular.

David Motemaden
Analyst, Evercore ISI

Q

Got it. Okay. And if I could just ask a high-level one to Roy, just on overall earnings growth for the company, the 8% EPS growth. I guess, I'm just wondering, I've calculated the drag from low rates to really be like about 2 points off of earnings growth for the entire company. I guess, is that about right and where do you see that going if rates remain at these levels?

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

A

Yeah. We don't disclose the impact on rates specifically. And over the longer period, obviously, we think that there are mitigates that we can put in place. The 8% core earnings per share growth is something that we're really quite pleased with. We feel 2019 was a year with significant headwinds. And as Phil highlighted, we obviously started the year on the wealth side with quite a dramatic equity market, which meant that starting positions were under some pressure.

And then obviously, interest rates in Japan also posed significant headwinds for us as well. So, delivering 8% in that environment and then adjusting for portfolio optimization impacts, you'd be closer to 9%. It's actually a pretty good outcome. We feel good about the 10% to 12% target. Specifically, to your question on interest rates, we feel that lower rates for longer is par for the course. So, we're not working on an assumption of rates bouncing back any time soon and we feel that the efforts that we put in to really right-size our cost base and other actions we're taking to really drive the performance of our franchise will put us in good stead to really deal with some of those headwinds.

The only other thing I'd say, and we've talked about this at Investor Day and at previous forums, there are three big megatrends that we see that are really shaping the economies of the world. And we'll continue to do so over the next decade. And we think that we're really well-positioned to capitalize on those three megatrends.

The first is that of an aging population. There's 900 million people aged 65 and above in the world today and that's forecast to grow to 2 billion by 2050. The retirement gap is currently CAD 70 trillion, that's going to grow to CAD 400 trillion. And given the focus that we have in retirement and the presence and capability that we have across the other geographies, we think that's certainly a growth driver for us.

The middle class in Asia in particular is also growing at a rapid pace. About two years ago, the middle class in Asia was about 1.4 billion people. That's forecast to grow to 2.8 billion by 2025, representing 60% of the world's middle class. That growth comes with demand and certainly for our products as you see that middle class seek to grow wealth, but also protect themselves.

And again, the fact that we've been in Asia for 120 years puts us in good stead to capture that opportunity. And then finally, the digitization of the consumer, we talked a little bit about Vitality earlier. But this is a significant trend and we think, A, it'll simplify the way we actually engage with customers and obviously help reduce cost, but at the same time, allow us to access customers that historically we perhaps weren't able to.

So, I know it's a long answer to your question, but the 10% to 12% target is something that we feel reasonably optimistic about. We do say that that is the medium-term through the cycle target. And yet, there are certainly headwinds like interest rates, but we feel that there are equal opportunities.

David Motemaden
Analyst, Evercore ISI

Q

No. That's great. I really appreciate the color, Roy. Thanks.

Operator: Thank you. The next question is from Doug Young from Desjardins Capital Markets (sic) [Desjardins Securities]. Please go ahead.

Doug Young
Analyst, Desjardins Securities

Q

Hi. Good morning. I'll try to keep this relatively quick. The core expense last year was CAD 143 million. In the press release, you called at CAD 38 billion related to policyholder experience. I think that was Canada and the U.S. Just trying to get a sense, what was the other items, because that was on a core basis?

And then, if you can kind of maybe push that in to the CAD 62 million of negative experience in the U.S.? And it sounds like the mortality was an offset between life and long-term care insurance, or was the CAD 62 million mostly lapse, maybe you can give a bit of color on that? Thank you.

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Sure, Doug. So, in terms of the core experience, a reminder of what's in there, it's policyholder experience, expense impacts which would include expenses where we don't reserve for them, and Asia regional office expenses. And then, there are other experience items which are dominated by reinsurance related items. So, the CAD 143 million, which you mentioned in terms of core experience and you've noted correctly CAD 39 million of that was policyholder experience.

In the fourth quarter, the remainder is primarily expense results. And then when we go to the U.S., you were asking about the core experience there. Again, similar drivers in terms of policyholder experience and expense. On the policyholder experience front, correct, in terms of the life claims and the LTC, which we covered. The remainder was, we saw some adverse lapse experience. It was spread across a number of product lines. About half of it is on certain products where we saw some, let's say, early duration or shorter-term issues, which we don't expect to persist.

We did see some lower lapse rates on guaranteed UL business, which we had not really seen in 2018. Too early to say whether that's a trend or not, but a reminder that, we've strengthened lapse assumptions materially over time and these long-term products' lapse rates – our current lapse assumptions are for lapses well under 1%, often under 0.5%. So, just some context for what we're seeing.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

Doug, this is Phil. Just to elaborate on the expense component. The year-on-year impact of expenses, there is about CAD 40 million of adverse experience. Part of that is the restructuring costs that we referred to earlier in the context of Japan, but also the impact of the investments we're making in some of our platforms and digital initiatives. And one example of that is something that we've talked about before in the U.S., the fact that we are consolidating various legacy systems on to a single platform. And that really has the benefit of changing a fixed cost into a variable cost, which is really important given the portfolio optimization strategy.

Doug Young
Analyst, Desjardins Securities
Q

And so this is something that it sounds like the expense item could persist. It's not something you built into your reserve assumptions, but it is something that could persist the 2020 essentially. And, Steve, of the CAD 62 million, how much of that was expense, because I get the sense from the CAD 143 million, but for the CAD 62 million, how much was expense versus lapse?

Steve Finch
Chief Actuary, Manulife Financial Corp.
A

Yeah. So, I'll take the first part and Phil can comment on the ongoing or Marianne. We haven't disclosed the split within that core experience line. But they're both material items of the total there.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.
A

And so, from my perspective on the – this is Phil – the impact of expenses, I said earlier, it's about CAD 40 million. So, it's fairly equivalent in terms of impact to the policyholder experience.

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

And most of that work that's been done on the outsourcing happened last year and this year, and we'll probably see a little less next year. So, I don't expect it to continue.

Doug Young
Analyst, Desjardins Securities

Q

Great. Thank you.

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

Paul Holden
Analyst, CIBC World Markets

Q

Hi. Thank you. I'll just ask one question that's related to the US business. So, saw a nice uptick in expected profit I think this quarter, which is the first quarter we've seen positive in almost a year-and-a-half. So, maybe you can comment on that, are the headwinds of portfolio optimization behind this business segment or expense initiatives having a positive impact? You can talk about some of the dynamics driving that?

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

A

Yeah. And I guess from a U.S. perspective, we're seeing the regular release on the emergence on the in-force. Yes, we have had negative impacts as it relates to the portfolio optimization. And as we said in the quarter, it's about CAD 10 million for the quarter. But there was sort of nothing unusual that was happening outside of that.

Paul Holden
Analyst, CIBC World Markets

Q

Okay. So, I mean, the change in trend, right, so from negative to positive and we should expect positive expected profit growth going forward is kind of the message here?

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Yeah. I think – it's Steve. So, clearly, we've seen the headwind from the portfolio optimization initiatives in the U.S. And I'd say, all else being equal, we would see that return to growth. Overall company-wide, if you normalize for the portfolio optimization, our growth in earnings on in-force are 6% for the year, which is around what we would expect with higher growth in Asia and relatively lower growth, but growth in both Canada and the U.S. Obviously, if Naveed's team continues to have the success, there could be headwinds, but they would be based on very favorable trade-offs for shareholders overall.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

Yeah. Just to clarify one thing there. We did have a significant portfolio optimization transaction that was executed in Q3 last year and that is impacting the run rate, as Steve said. The expected profit growth that is actually reported in 2019 is 6%. And if we adjust that in the fourth quarter, 6% growth, if we adjust that for the impact of the portfolio optimization initiatives, it would actually be 8%.

Steve Finch
Chief Actuary, Manulife Financial Corp.

A

Correct. 6% was for full year.

Philip Witherington
Chief Financial Officer, Manulife Financial Corp.

A

That is correct.

Paul Holden
Analyst, CIBC World Markets

Q

Okay. That's helpful. Thank you.

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

Darko Mihelic
Analyst, RBC Capital Markets

Q

Hi. Thank you for taking my follow-up question. I'm going to ask this only because I just saw Industrial Alliance's report. In their report, they've taken a litigation provision of about CAD 15 million after tax. Obviously, I'll ask IAG what it's related to, but I thought may I just ask you guys while we have the floor. Is there any sort of update in that case in Saskatchewan that's been appealed?

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

A

No. Darko, thanks for that. Roy here. So, as you know, we had the case last year and as expected, we had a favorable ruling. We continue to believe that that case – or the foundation of it's legally unfounded and that we're in a very strong position. The appeal was heard in January of this year. I expect that there'll be some time before a judgment is made. But our position on that case has not changed. We feel very confident about our position and the foundation that we're on.

Darko Mihelic
Analyst, RBC Capital Markets

Q

Okay. Great. Thanks very much.

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

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

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

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