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# Manulife Financial Corp. (MFC)

Q4 2018 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Please be advised that this conference call is being recorded. Good morning, and welcome to the Manulife Financial Fourth Quarter 2018 Financial Results Conference Call for Thursday, February 14, 2019. Your host for today will be Ms. Adrienne O'Neill. Please go ahead, Ms. O'Neill.

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### Adrienne O'Neill

*Global Head of Investor Relations, Manulife Financial Corp.*

Thank you, and good morning. Welcome to Manulife's earnings conference call to discuss our fourth quarter and year end 2018 results. Our earnings release, financial statements and related MD&A, statistical package and webcast slides for today's call are available on the Investor Relations section of our website at manulife.com.

We will begin today's presentation with an overview of our 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 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 37 for a note on the use of non-GAAP financial measures in this presentation. Note that certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from what is stated. The slide also indicates where to find more information on these topics and the factors that could cause actual results to differ materially from those stated.

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

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### 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 2018 financial results. Macroeconomic conditions were very challenging in the fourth quarter, with double-digit declines in equity markets and lower crude oil prices, especially in Canada. I'm pleased with the results we delivered in light of this backdrop, and we ended the quarter in a position of strength with strong capital and increased financial flexibility.

Our business fundamentals remain strong, and our hedging strategies functioned as designed. It's worth noting that we've significantly reduced our exposure since the financial crisis. Our sensitivity to a 10% decline in equity markets is less than half of what it was in 2009. And similarly, our sensitivity to a 50 basis point parallel shift in interest rates is approximately one-tenth of what it was in 2009. This, together with the strong capital position of the company, provides a robust foundation to deliver long-term sustainable value.

Turning to slide 6. We continued to deliver strong growth on both a full-year basis and five-year time horizon. In 2018, we reported the highest core earnings and net income in the company's history. We delivered core earnings of CAD 5.6 billion, an increase of 23% from the prior year. And once again, we exceeded our medium-term core

EPS growth target of 10% to 12%. A net income of CAD 4.8 billion increased CAD 2.7 billion compared to the prior year due to the non-recurrence of the prior-year charge related to U.S. tax reform and our decision to change the portfolio asset mix supporting our legacy businesses.

New business value generation increased 20% compared to the prior year to CAD 1.7 billion, driven by continued growth in Asia and solid progress in the United States and Canada and has now more than doubled over the past five years. And our continued momentum and strong financial performance has resulted in progressive dividend increases.

I believe that as we continue to deliver strong results, execute against our five strategic priorities, and make progress against the targets that we've established, we will unlock significant shareholder value.

Turning to slide 7. We continue to execute on our five priorities and have made solid progress in 2018. Our first priority is to raise CAD 5 billion of capital by 2022 through portfolio optimization. In 2018, we sold alternative long-duration assets, which released CAD 1.9 billion of capital. We also announced six reinsurance agreements throughout the year covering legacy universal life and fixed annuity blocks.

We sold Signator Investors, our wholly-owned broker-dealer, and we offered customers within some of our legacy segregated fund products an opportunity to convert to a less capital-intensive alternative. The various initiatives announced to-date are expected to release a total of CAD 3.7 billion of capital once fully executed, representing almost three-quarters of our 2022 goal. We're extremely pleased with our success today and are confident in our ability to achieve our CAD 5 billion target.

Moving to slide 8. The second priority is to aggressively manage costs and our 2022 ambition is to drive an expense efficiency ratio of less than 50% and achieve CAD 1 billion in cost savings. Core expense growth remained modest on a full year basis at only 3%, which was substantially lower than pre-tax core earnings growth of 19% and less than half the growth rate in recent years, driving a 3-point improvement in our expense efficiency ratio.

We also achieved total expense saves of CAD 300 million for the year. This includes some benefit from new initiatives and executing on those previously announced. We expect initiatives that are currently in flight to deliver CAD 700 million of expense savings by 2020. Phil will discuss this in more detail later.

Turning to slide 9. Our third priority is to accelerate growth in our highest potential businesses. We aspire to have these businesses generate two-thirds of total company core earnings by 2022, and in 2018, these businesses continue to perform well accounting for over 55% of total company core earnings. Asia delivered core earnings growth of 20% and a 19% growth in new business value, and sales through DBS increased 20% in 2018. Global WAM core earnings grew 21%, and while net flows were impacted by heightened market volatility in the fourth quarter, we generated net inflows of CAD 1.6 billion for the full year, our ninth consecutive year of positive net flows.

Turning to slide 10. Our fourth priority is about our customers and how we will use technology to delight them and to deliver a great experience. This will be achieved by putting customers first and our 2022 ambition is to increase our Net Promoter Score by 30 points across all markets.

In Canada, we became the first insurer to integrate artificial intelligence in our underwriting of certain products, providing operational efficiencies and allowing us to make faster decisions. In Asia, our Net Promoter Score improved 7 points, and in the U.S., John Hancock Vitality sales increased 52%, and we became the first life

insurance company to comprehensively offer behavioural-based wellness insurance with the launch of John Hancock Vitality GO on all life insurance policies at no additional cost to the customer.

Moving to slide 11, our final priority is to develop a high-performing team and culture. Our target is to achieve top quartile employee engagement compared to global financial services companies by 2022. Our most recent employee survey data tells us our employee engagement remains competitive with global benchmarks. The survey also underscores our team support of our transformation with strong scores on our enthusiasm for embracing the changes that we are making.

In 2018, we achieved several important milestones. We launched our purpose with a new mission statement, "Making decisions easier and lives better", along with refreshed corporate values. This has helped to invigorate our employees and refocus our organization around the customer.

We continue to invest in our team, training several thousand colleagues on agile ways of working to position us to more rapidly progress our transformation agenda. Through targeted technical training as well as recruitment, we're also building stronger capabilities to advance our digital leadership aspirations. And our focus on diversity and inclusion across all our teams resulted in us being named to Bloomberg's Gender-Equality Index for the first time.

Moving to slide 12. In conclusion, we have an incredible franchise with almost 28 million customers, which is diversified by geography and product line. We have derisked the company significantly, and our performance this quarter in light of the macroeconomic conditions is a testament to our strength and resilience. We delivered excellent results in 2018, including the highest level of core earnings and net income in the company's history. We're clear on what our priorities are and how we will measure success. And in 2018, we've made significant progress on each of our five strategic priorities.

I could not be more proud and thankful for the commitment and enthusiasm of our employees around the world. Looking ahead to 2019, we will remain focused on executing on our strategy, and I'm confident that if we deliver against the plan that we've set for ourselves, we will unlock significant and lasting value for customers, employees, and shareholders.

Before I pass it over to Phil, I wanted to acknowledge and thank Warren Thomson as this will be his last quarterly call before retiring. Warren has been with our company for 25 years, the last 10 as the Chief Investment Officer. He's also led programs to derisk the company's equity and interest rate risk exposures and oversaw the establishment and growth of Manulife Asset Management.

In addition, I wanted to extend my personal thanks for his counsel through my transition to CEO. Warren's depth of knowledge, keen insight, and experience at Manulife has been extremely valuable. Thank you, Warren.

Phil Witherington will now review the highlights of our financial results. Over to you, Phil.

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## Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

Thank you, Roy, and good morning, everyone. Turning to slide 14 and our financial performance for the fourth quarter and full year. As Roy mentioned, in 2018, we delivered the highest core earnings and net income in our company's history, 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 15, we generated core earnings in the quarter of CAD 1.3 billion, up 8% from the prior year on a constant exchange rate basis. The increase in core earnings was primarily driven by new business growth in Asia, the impact of lower U.S. tax rates, improved policyholder experience, and greater expense efficiency. This was partially offset by the impact of lower equity markets on seed money investments and fee income, and our actions to optimize our portfolio, such as reinsurance agreements and the sale of alternative long-duration assets.

While most of the equity market impact flows through non-core earnings, the portion relating to fee income, mark-to-market on seed money investments, and realized gains on available for sale equities, flows through core earnings.

The decline in equity markets lowered fee income by roughly CAD 35 million in the fourth quarter and impacted seed money investments by roughly CAD 115 million. Therefore, the total impact of equity markets on core earnings was approximately CAD 150 million.

Of note, this does not include approximately CAD 50 million of realized gains on available-for-sale equities, which is within the range of what we have typically delivered. For increased transparency, we have expanded the sensitivity slide in the appendix of this presentation to highlight the nuance between the impacts of equity markets on core and non-core earnings.

Net income attributed to shareholders was CAD 593 million in the fourth quarter of 2018. Of note, we delivered investment related experience losses of only CAD 30 million in the quarter despite headwinds from lower crude oil prices. Full year investment related experience was a gain of CAD 600 million. The strong full year gains have allowed us to report CAD 100 million of core investment-related experience gains this quarter which is why we have reported negative CAD 130 million outside of core earnings.

The gain from the direct impact of interest rates from widening corporate spreads was partially offset by the realized losses on available for sale bonds and a lower yield curve in Mainland China. The impact of equity markets this quarter was in line with our disclosed sensitivities, taking into account the core earnings components I described a moment ago.

We increased our estimate for restructuring charges which I will cover in more detail later. And the gains this quarter from reinsurance transactions of CAD 163 million was less than the CAD 250 million we had previously indicated as the closing of the New York portion of one of the U.S. payout annuity transactions announced last quarter was delayed, but has closed in the first quarter of 2019.

Slide 16 shows our source of earnings analysis. Expected profit on in-force declines 2% on a constant exchange rate basis due to the impact of reinsurance transactions and legacy blocks, our ALDA portfolio mix initiative, additional hedging of our VA business in Japan, and lower fee income in North American VA businesses due to the recent downturn in equity markets. Excluding these items, expected profit would have increased by approximately 5% from the prior year consistent with what we would typically expect.

The impact of new business improved primarily due to strong sales of the recent launches of our Corporate segment term product in Japan, and the Manulife Par product in Canada, as well as, our ongoing focus on margins. Overall policyholder experience in the fourth quarter of 2018 was favourable, driven by group insurance in Canada and insurance in the U.S. Long-term care policyholder experience was neutral this quarter and continued its trend of being roughly neutral on average since our last triennial review. Earnings on surplus declined compared with the prior year primarily due to mark-to-market losses on seed fund investments in the Corporate and Other segment.

Turning to slide 17. You can see that we delivered double-digit growth in core earnings in each of our operating segments in 2018. In the fourth quarter, we delivered double-digit growth in Asia, Canada, and Global Wealth and Asset Management, while the U.S. declined modestly due to the impact of equity markets and re-insurance transactions and the non-recurrence of favorable items in the prior-year quarter.

Turning to slide 18. We generated a strong core ROE of 13.7% in 2018. However, we are not ready to claim victory. Our focus is on achieving sustainable, consistent performance for each metric through the cycle, and we remain committed to our target of a 13% core ROE.

Turning to slide 19, we are making meaningful progress towards our target to save or avoid CAD 1 billion in annual costs by 2022. The initiatives we announced last year are progressing well. Earlier in 2018, we initially estimated annual savings of CAD 300 million pre-tax, largely to be achieved by the end of 2019 from real estate optimization in Canada and the U.S., IT vendor and systems consolidation in the U.S., restructuring of our Canadian operations and a voluntary early retirement program.

These initiatives are tracking ahead of our initial expectations and we have updated our estimate of annual savings to CAD 375 million. We have also taken a corresponding additional CAD 63 million post-tax restructuring charge.

In addition, we have also added initiatives that are expected to provide a further CAD 325 million of pre-tax annual savings once fully implemented. These include further rationalization of vendors and negotiation of rate reductions, process redesign and digitization. These initiatives are already underway and have contributed to the 2018 savings.

In total, our expense efficiency initiatives delivered savings of CAD 300 million in 2018, are expected to deliver at least CAD 500 million in 2019 and CAD 700 million in 2020 once we fully execute on the in-flight initiatives.

Turning to slide 20, our success in the execution of expense initiatives is delivering bottom line benefits and was evident through modest core expense growth and improving expense efficiency ratios. Our core expenses in the fourth quarter of 2018 declined by 1% on a constant exchange rate basis from the prior year and, on a full year basis, increased a modest 3%, less than half of our historical average. This compares favourably to our pre-tax core earnings growth, driving a decrease in our expense efficiency ratio both for the quarter and the full year.

Slide 21 shows our APE sales and new business value generation. Our sales momentum improved in the second half of the year and we delivered APE sales of CAD 1.5 billion in the quarter, up 14% from the prior year. This reflects APE sales growth of 15% in Asia, driven by Japan, Hong Kong and Asia Other and 25% growth in Canada, following the success of our recently launched Manulife Par product and a large case group insurance sale.

In the fourth quarter of 2018, new business value increased 27% to CAD 501 million. In Asia, new business value increased 23% from the prior year driven by higher sales, scale benefits and improved product mix.

In Canada, the benefit of the launch of Manulife Par was partially offset by the less favourable business mix in group insurance. And in the U.S., despite lower sales, new business value almost tripled due to the improved margins and business mix. Asia new business value margin was 40% in the quarter, up over 2 percentage points from the prior year. And full year new business value in 2018 was CAD 1.7 billion, up 20% compared to 2017.



Turning to slide 22. The fourth quarter was challenging for active asset managers industry-wide and across all of our major markets. Specifically, the U.S. retail market experienced its worst month of net redemptions ever in December. Our Global Wealth and Asset Management business experienced net outflows of CAD 9 billion during the fourth quarter driven primarily by our U.S. retail business, where we experienced significant redemptions from model allocation changes by some large intermediaries that rebalanced their portfolios. However, despite the challenging environment, the benefits of our diversified business model were evident and for the full year, we generated net inflows of CAD 1.6 billion, our ninth consecutive year of positive flows.

Our Asia and Global institutional businesses attracted inflows on a quarterly and annual basis. And our Canadian business remained in positive flow territory for the year despite outflows in Q4 and finished the year fourth in the industry in net flows despite being ninth in assets.

Turning to slide 23. Total company AUMA at the end of the fourth quarter of CAD 1.1 trillion was up in dollar terms but down on a constant exchange rate basis due to challenging macroeconomic conditions in the fourth quarter. Global WAM AUMA was CAD 609 billion, flat in dollar terms but a decrease of 6% compared to the prior year on a constant exchange rate basis.

Turning to slide 24. The LICAT ratio for our primary operating company was strong at 143% at the end of the fourth quarter, which equates to CAD 23 billion of capital above the supervisory target. The 9-point increase in the ratio despite lower equity markets and net share buybacks was driven by our portfolio optimization initiatives and widening of corporate spreads. The widening of corporate spreads is favourable to the LICAT calculation and can provide resilience in periods of equity market declines. As you are aware, spreads will continue to change in the future which may reverse this quarter's benefit.

Our financial leverage decreased 60 basis points from the prior quarter due to the weaker Canadian dollar and the CAD 250 million subordinated debt redemption, partially offset by cash dividends and net share buybacks. As I stated last quarter, we are committed to reducing our leverage ratio in 2019 and have announced our intention to redeem a further CAD 500 million of subordinated debt next week. We also announced our intention to more than double the capacity of our share buyback program to 99 million shares.

Net share buyback activity in the fourth quarter was CAD 300 million after taking into account dividend reinvestment. This had a net negative 0.5 point impact on the LICAT ratio and increased our financial leverage by 15 basis points. In 2018, Manulife's operating subsidiaries delivered remittances of CAD 4 billion with contributions from all segments. This is well in excess of the amount needed to fund dividends and net interest expense.

Turning to slide 25. We continued to make progress on releasing capital from our legacy businesses in the quarter. In addition to executing on the previously announced transactions, we released CAD 600 million of capital through ALDA sales and released capital from a segregated funds transfer program in Canada where owners of certain legacy products were given the option to switch to less capital-intensive alternatives. In Canada, we also signed two new reinsurance agreements for group annuities. The initiatives announced to-date once fully executed are expected to deliver CAD 3.7 billion of the overall CAD 5 billion target.

On slide 26, you can see that the impacts of equity markets and interest rates on our business have decreased considerably since the financial crisis as a result of our hedging programs. In 2012, we achieved our targets for equity market and the interest rate exposure and since the beginning of 2012, markets have generated a modest average quarterly charge of approximately CAD 25 million per quarter to the direct impacts of markets. We are satisfied with the effectiveness of our equity market hedging program during the fourth quarter.



Slide 27 outlines our medium-term financial operating targets and our full-year performance. Core EPS growth and core ROE are both exceeding our targets and expense efficiency, leverage, and capital released from our legacy businesses are trending in the right direction.

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

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] The first question is from Paul Holden from CIBC. Please go ahead. Your line is open.

Paul Holden

*Analyst, CIBC World Markets*

Q

Thank you. Good morning. So wanted to ask you a follow-up question on your comments regarding the LICAT ratio, because there was a big swing quarter-over-quarter. My math suggests roughly 3 points of that came from portfolio optimization, the other 6 points from other factors, including change in AOCI. So what's the conclusion here, because I would expect LICAT to be a little bit more of a stable ratio than it showed. And as you pointed out, it could reverse in the future. So, how do you view available capital today and movement in the LICAT ratio?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Paul, for the question. This is Phil. So, your observation is correct, a 9-point improvement in the LICAT ratio at 143% at the end of the year. That's a strong capital position. We're very pleased with that. There are really three categories of items that are driving that improvement. The first I'll highlight is the impact of the portfolio optimization initiatives, the benefit that has delivered is in the order of 3 percentage points on the LICAT ratio in the fourth quarter.

The second point I'll highlight is the impact of markets, in particular the widening spreads. So, in aggregate, the impact of markets in the fourth quarter has had a positive 3 percentage point impact on the ratio and the remaining 3 percentage points is really a collection of what I would call normal course organic items that had a favourable impact to the ratio.

I'll hand over to Steve Finch to see if there's anything else he would like to add.

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

I just want to supplement. Paul, you had mentioned the AOCI. We do see currency grossing up both the available capital and the denominator, the base solvency buffer. It was a modest, a very modest benefit to the overall ratio in the quarter, but that's where you see it show up.

Paul Holden

*Analyst, CIBC World Markets*

Q

Okay. And then the follow-up question I'll have on that then is how do you view deployable capital given that large excess number you've highlighted?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Paul. This is Phil again. Yes. So we are very happy that we've further improved the balance sheet strength of the company. In terms of looking at how we deploy the capital that we have and any further capital that we're able to generate, as we said before, our priority is to further strengthen the balance sheet position, including reducing the leverage ratio. So, whilst the current leverage ratio is not considered a constraint for us, we have made the commitment to achieve our medium-term target of 25%.

And you'll note that we had redeemed CAD 250 million of debt in the fourth quarter. We've announced the redemption of CAD 500 million later in February. We don't intend to refinance that CAD 500 million redemption. And then, as we go through the course of 2019, we will carefully monitor market conditions and our capital position when considering actions to take with respect to the remaining CAD 1 billion of issuances that mature later in the year. In fact, both of those issuances are in the fourth quarter.

I'll also highlight that from a capital deployment perspective, we are focused on funding organic growth. We're pleased that both through capital generation and remittances, we have sufficient resources to fund the organic opportunities that we have.

The final point I'll make is that we have this quarter announced that we will extend, subject to regulatory approvals, the NCIB from 2% of our issued capital to 5% of our issued capital. And that's something that provides us with additional flexibility in determining how to manage our capital base.

Paul Holden

*Analyst, CIBC World Markets*

Q

Okay. That's two questions for me, so I'll re-queue. Thank you.

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Paul.

**Operator:** Thank you. The next question is from Sumit Malhotra from Scotia Capital. Please go ahead.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Thank you. Good morning. Just, Phil, a quick numbers clarification on your leverage commentary. You mentioned those redemptions last quarter as well, the CAD 250 million in Q4 and then the CAD 500 million in Q1. When I look at your balance sheet, it looks like the long-term debt was actually higher sequentially in Q4. Was there some refinancing or reissuance that was done or is this FX, foreign exchange volatility, if you could just help me understand why the long-term debt was actually higher quarter-over-quarter?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Sumit. So, we didn't have any issuances in the fourth quarter. It was net redemptions of CAD 250 million. So, the movement that you see in the balance sheet is a function of currency, reflecting the fact that some of our debt is denominated in U.S. dollars and some of it is Singapore dollars.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Okay. So, the more important thing for us is you redeemed CAD 250 million in Q4, CAD 500 million in Q1 and then, as you say, there's a CAD 1 billion that is scheduled later in the year?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Correct, and we'll look at market conditions and the capital position in the company in determining whether or not to refinance any portion of that CAD 1 billion that's maturing in the fourth quarter.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Okay. So now on to the actual questions. This is probably going to be for Roy. Roy, in regards to the capital optimization target that was first communicated to us last June, the CAD 5 billion number that was provided, you had already made some progress on that, at the time you shared that with us via the ALDA sale. And now, we sit here with a few years to go until 2022 and you're already two-thirds of the way there. So, in establishing that CAD 5 billion, was that a forecast on what you expected could reasonably be accomplished in terms of reinsurance or divestiture opportunities? And maybe more to the point, what would you have to see in order for that target to be increased by the company?

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Yeah. Thanks, Sumit. Look, I think the first thing I'd say is when we established the targets, and the priority of focus at Investor Day, the real intent there was to really, I guess, give the market a better understanding of where we're going to be focusing our attention or where the priorities of the company were. So when we went through the five priorities, we started with portfolio optimization and it wasn't a fluke that that was the first, because we acknowledged and realized we needed to do a lot to free up capital, and especially capital that's associated with our legacy businesses.

We set a target of CAD 5 billion because we felt that we had a clear line of sight to that. But you can be assured that the targets that we're setting for ourselves internally are obviously in excess of the targets that we're sharing more publicly with the Street. We're really delighted with the progress that we've made. As Phil said earlier, the initiatives that we have announced today that have already released CAD 3 billion. And once we fully executed against the initiatives that we've already announced, we will deliver CAD 3.7 billion. And we're not going to stop at the CAD 5 billion. This is a priority and an important area of focus for our franchise and we're going to continue to drive that agenda.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Does the capital being allocated to share repurchases – and I'll stop here and re-queue – does the capital being allocated to the share repurchases, which is another CAD 1.5 billion via the increase you've announced relative to what you've already bought. You and I have had some conversations in the past about how perhaps buybacks weren't the best use of capital given all the opportunities the company had presented to at both in terms of divestitures and potentially investing in the business as well. Is the buyback in any way a restricting factor to some of the potential opportunities you have to free up some capital and if any kind of shareholder equity hits are

required? Does a buyback restrain you from doing anything that you want to in terms of that capital liberation, if I can use that term?

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Yeah. I'd say no, Sumit. The way I look at the buybacks is really as a tactical strategy. Again, we're delighted with the progress we're making to create excess capital. The priority for us from a capital perspective is to strengthen our balance sheet, as Phil mentioned earlier. And you know we've got very clearly in our line of sight reducing our leverage ratio. We're happy with the progress we've made on leverage in 2018, and we're really progressing very ambitiously in 2019 on that focus area as well.

But equally important is to fund our organic growth. We've got an incredible franchise globally with incredible opportunities, and the organic growth opportunities we have within our franchise will provide a real strong runway to deliver the earnings growth ambition that we've set for the company. So, priority one is to strengthen the balance sheet, reduce leverage, and fund organic growth. And tactically, we're going to continue to look at the share buyback and repurchasing shares as a way to drive value for our shareholders, especially when we see that our shares are significantly undervalued.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Thanks, guys. I'll re-queue.

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

Doug Young

*Analyst, Desjardins Capital Markets*

Q

Hi. Good morning. I just wanted to go back to the LICAT, Phil. The sensitivity to interest rates that you show in the MD&A has increased materially quarter-over-quarter. And I think in the last quarter, a 50 basis point increase in rates had no impact on the LICAT. Now, it's got a negative, I think, 3-point impact on LICAT. So, I mean, not huge, but I just want to understand the moving pieces. Why did that sensitivity move so much sequentially?

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

So, Doug, it's Steve. I'll take that one. And remember, we've got rounding on the LICAT ratio, about CAD 500 million of available capital is about 1 point. So, the interest rate sensitivity can bounce around a bit. It's largely attributed to basis changes, but it's within the range of what we're happy with in terms of that interest rate sensitivity.

Also point out that we did enhance our disclosures to show the sensitivity to corporate spreads, which Phil mentioned was a positive impact on this quarter's LICAT ratio, but corporate spreads may come in again. So, we're viewing that as more temporary.

Doug Young

*Analyst, Desjardins Capital Markets*

Q

So this had nothing...

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

But, overall, very, very happy with the strength of the capital position.

Doug Young

*Analyst, Desjardins Capital Markets*

Q

Yeah. And it had nothing – Steve, it had nothing to do with the ALDA repositioning or anything like that is – and/or is this just kind of you broke out the corporate spreads so the sensitivity is going to look different because it would have been embedded in there before?

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

We looked at our disclosed sensitivities. Originally, we were disclosing the same sensitivities that we did under the MCCSR regime. And as we looked at those sensitivities and we looked at the impact of corporate spreads, we decided to enhance our disclosures and put that in there. The ALDA program, it does result in some more fixed income in our guaranteed segments, but it's not driving material changes in our sensitivity.

Doug Young

*Analyst, Desjardins Capital Markets*

Q

Okay. And then just second, I guess while I have you, Steve, the long-term care insurance book. And I know the experience trend was neutral. Can you talk a little bit more about the underlying moving parts, maybe around frequency, severity, morbidity trends? Was there some moving parts in there? Maybe you can kind of flesh out what happened in the quarter.

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

Sure. On long-term care, so for the quarter it was neutral. We tend to look at the longer term. We don't get too excited about any one quarter where there's losses or gains, we look more at the long-term trends. And this quarter, consistent with what we've seen and said in the past, we saw higher claims than expected – than in the valuation assumptions – but also offset by higher lapses or partial surrenders. So that's been a continuing theme that we've seen.

Doug Young

*Analyst, Desjardins Capital Markets*

Q

And how are the buyout programs going? And I don't know if there's any way you can quantify or talk about the buyout programs and how that's been progressing relative to what you've expected.

Naveed Irshad

*Head of North American Legacy Business, Manulife Financial Corp.*

A

Hey, Doug, it's Naveed Irshad here. So, on LTC, we don't really have a buyout program yet. We have what we call landing spots where we offer customers an option to take lower benefits in exchange for not having premium rate increases. So, where we've implemented those – and we continue to implement those as we ask for rate increases – we've had good success. And so, that's been continuing.

The buyout program we did offer was on the seg funds in Canada, where we offered an opportunity for customers to transfer from the higher risk GMWB, guaranteed minimum withdrawal benefit, Income Plus to a lower-risk

product, Investment Plus. And as you saw in the capital release numbers that Phil and Roy shared, the results were quite good.

Doug Young

*Analyst, Desjardins Capital Markets*

Q

Yeah. I think I had my terms incorrect there. I meant the landing spots, so thank you for the color. Thanks.

**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. Good morning. Two quick questions here. One, just with respect to LICAT again, I think under the old regime, you sort of talk about a target ratio. I don't know if you've actually shared with us a target under the new regime. Other companies have. I wonder if you do have a target that you'd be willing to share. And then, I have a follow-up question.

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Okay. Thanks, Tom, for the question. This is Phil. We're not publicly sharing a LICAT target ratio. But upon adoption of LICAT in the first quarter of 2018, we did give a comparison point, an indicative comparison point to the MCCSR regime. So, at that point, we said that a 200% MCCSR ratio was consistent with a 115% LICAT ratio. So, I think that's a good benchmark to look at.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

I mean, if that's the case, you've got – at 143%, you're probably well more than CAD 10 billion above that, if not more. Am I to read that 115% is a target or would that be north of that or you just don't have one?

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

It's Steve here. The comment that we made around the 200% versus 115%, I think many in the industry viewed 200% as sort of you got to be well above that benchmark. And as you know, we operated significantly higher than the 200%, and consistent with that, we'll operate significantly higher than the 115%.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

All right.

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

But your point, Tom, is that we're obviously very comfortable with our LICAT position. And again, I would sort of just remind everyone that 3 points of the 143% does come from the corporate spread movement, which we're not banking on that. That could move around a little bit. But regardless, it's still a position of strength and is a function of the very deliberate actions on capital, which we're looking at ways to ensure that we optimize.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

And what was the thinking behind increase in the NCIB? And did the bump up in the LICAT ratio have anything to do with that?

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Yeah, it certainly is a factor. But for us, the NCIB, Tom, is just about making sure that we've got tactical strategies that can help us repurchase shares and, again, deal with the significant, in our mind, undervalue (sic) [undervaluation] of our share price. But I'd look at it as another tool in our toolkit to ensure that we can optimize the capital for our shareholders.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

Okay. And then a quick one here on seed capital. I was wondering, as your funds grow here, do you intend to harvest some of the gains that you've put in terms of seed investments here? Or do we expect the seed investments that you have to remain constant or increase going forward?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Tom, for the question. This is Phil. So you're absolutely right that the approach to seed capital is that we do seed new funds to get them to critical mass as part of the new fund launch process. But we also repatriate that seed capital once a fund can stand on its own with third-party funding. So, we see a cycle of new funding and then repatriation. And the current level of seed capital is well within our risk appetite. It's in the order of CAD 1.5 billion.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

And as AUM grows, would we expect that to remain at CAD 1.5 billion?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

It may increase, it may decrease, but I wouldn't say materially above the CAD 1.5 billion.

Tom MacKinnon

*Analyst, BMO Capital Markets*

Q

Okay. Thanks.

**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. A question on flows in WAM. Just wondering if you can give us an update on what flows look like quarter-to-date?



Paul Lorentz

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

A

Yeah. Thanks, Meny. It's Paul Lorentz here. Maybe just to provide some context of the flows, I think Phil and Roy talked to the strength of our franchise over the full year and some of the strength, even within the fourth quarter with the volatility. What we saw in the U.S. retail was really due to a number of factors. One is a general slowdown because of the volatility. But we did see funds move to safety in the U.S., and that favoured ultra-short duration bond funds, of which we don't have a solution in our lineup to capture that short-term money movement.

And then we also saw some significant model allocations where some of our large retail clients reduced their credit exposure because of where we are in the economic cycle and because of our strength in fixed income, that had a negative impact on us over the short term as they decide to reduce credit, both of which we would expect – over the long term – to benefit from as money starts moving back into long-term investments.

In terms of the first quarter, it's too early to really predict what it's going to look like. What I can say is that some of that model allocation is strictly into Q1, but to a much lesser extent than what we saw in Q4. But we've also seen investor confidence improve in the retail space in North America and gross flows in January have improved from what we saw in December. So, we're feeling quite optimistic. And because of the diversification of our franchise, feel we're well positioned to capitalize that as money moves back into the markets.

Meny Grauman

*Analyst, Cormark Securities*

Q

Thanks for that. So just as a follow-up question how confident are you that 2019 will be the 10th consecutive year of positive flows for the group?

Paul Lorentz

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

A

Well, I wish I could be confident at this point. It's too early in the year to make that judgment and markets are so unpredictable, particularly in the retail space. But I think what you saw, particularly in the fourth quarter as well, there was some pressure on retail because of market volatility. I think you saw the strength of the diversification that we bring because of our Asian footprint which was up in the fourth quarter despite that volatility. Our institutional business was up in the fourth quarter despite that volatility.

Phil mentioned we finished the year quite strong relative to peers based on our size in Canada. And on our record-keeping platforms in Hong Kong and in Canada, we're number one in market share based on the latest market share reports we have available. So, we're feeling really good about the platform we've got, the diversification. And I think that gives us an opportunity to withstand some of these short-term fluctuations.

Meny Grauman

*Analyst, Cormark Securities*

Q

And just a final follow-up, you mentioned one product gap, are you making any changes as a result of the experience in Q4?

Paul Lorentz

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

A

Yeah, we are going to look at it. I mean, you have to keep in mind the ultra-short duration bond funds, there's very little margin on it, so it's not really an earnings question for us. Just a question of whether having that allows us to

capture that money when it moves back into the market, or whether the strength of our lineup as it stands will capture that anyways, without having that. And that's a decision that the U.S. team is looking at.

Meny Grauman

*Analyst, Cormark Securities*

Q

Thank you.

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

Gabriel Dechaine

*Analyst, National Bank Financial*

Q

Hey, good morning. First of all, on the buyback, it's great to see you taking a more aggressive stance there. It makes the capital position more tangible. But I'm just wondering why you didn't also go with maybe a smaller increase and then eliminate that DRIP discount because the way I see it, you're issuing under the DRIP at below CAD 19 and change during the quarter and then you bought back at around CAD 20 and change. So you're issuing below where you're buying it back. Why don't you get rid of that?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Gabriel, for the question. This is Phil. So, we spoke a little bit about this during the Q3 process. The combination of the DRIP and the buyback does give us increased flexibility in terms of tools with which to manage our capital position. Our priority has been executing on the NCIB that we had announced just before our third quarter results.

If we look at what we had executed in the fourth quarter combined with what we have now executed from the NCIB in the first quarter, we're about 75% of the way through that program. It makes sense for us to extend the program to the maximum amount that we're permitted to under a normal course arrangement, so that was to go for the full 5%. And we'll tactically execute against that based on various factors, including the capital position of the company and market conditions. We do believe that the current valuation of the company's stock is below the intrinsic value. So, that's why it makes sense for us to execute to the maximum extent.

Gabriel Dechaine

*Analyst, National Bank Financial*

Q

I'm not quite sure I got the answer to the why have the DRIP part.

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Well, retaining the DRIP is really a part of an ongoing capital management process. It provides us with a tool alongside the NCIB, and we'll balance the DRIP and the NCIB over the course of the next few quarters and potentially years.

Gabriel Dechaine

*Analyst, National Bank Financial*

Q

Okay. Just a couple of quick numerical questions here. In the non-core investment experience, what were the moving pieces? Oil and gas, how much was that a factor? And then the remittances, CAD 4 billion in 2018. I recall

a number about half of that size in prior years. Is that really a reflection of all the portfolio optimization and a little bit unusually high?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

So, Gabriel, this is Phil. I'll cover the remittances question and hand over to Scott to talk about investment experience and oil and gas. So, remittances, yes, very strong in 2018, CAD 4 billion, almost double the amount that we had received by way of remittances from subsidiaries in 2017. The number will bounce around from year-to-year reflecting market conditions and reinvestment decisions. But we're very pleased with the outcome this year, and we're confident that, looking forward, the level of remittances we're able to achieve from our subsidiaries are at least sufficient to cover our dividend and net interest expense obligations. So, we're feeling good about capital, remittances, and the progress on leverage.

Scott Hartz

*Head of General Account Investments, Manulife Financial Corp.*

A

Hi, Gabriel. It's Scott Hartz. To answer your question on investment experience. So, the total investment experience as had been described was CAD 30 million loss for the quarter. And our perspective is in a quarter where we had public equity markets down double digits globally, spot oil prices down nearly 40%, it was really quite a good result.

To give you a little more detail on the CAD 30 million, there was a little over CAD 300 million loss on our ALDA portfolio, largely offset by strong fixed income results. So, looking at the alternatives portfolio, it was still I would consider a very good result given those market conditions. Total returns on the alternatives portfolio was positive for the quarter. It was just below our long-term assumptions, which you would expect in a challenging quarter. And of that, about two-thirds of that was due to the oil and gas.

Gabriel Dechaine

*Analyst, National Bank Financial*

Q

Thank you.

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

Mario Mendonca

*Analyst, TD Securities*

Q

Good morning. Just real quickly first on the universal life lawsuit. I understand that there's activity there in the last I think today and perhaps yesterday. Is there any update you can offer us there?

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Okay. Thanks, Mario. Look, I think the big update I'd provide is that with – this is obviously something that is going to be in the courts for some time we expect. The Saskatchewan court is currently hearing submissions from us and other parties regarding the impact of the new regulations that were announced. Both as it relates to the Mosten litigation and the other cases. We're not sure when a decision is going to be rendered. But again, as we've said in the past, we remain confident in our position.

Mario Mendonca

*Analyst, TD Securities*

Q

Yeah. This is just my paranoia kicking in. And I have no special knowledge. But is there any possibility here that we could get bad news in the near term?

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Well, I'm not going to speculate on what the judges are going to say, Mario. Again, what I'd tell you is that we've said all along that we're highly confident about the position that we have, and that we're ultimately going to prevail in this matter. So, there's really nothing more for us to say other than that and we're very much prepared to see this through.

Mario Mendonca

*Analyst, TD Securities*

Q

Okay. Quickly on Japanese COLI sales, that has been a good contributor recently to the new business gains. Could you just talk a little bit about why that product is so popular? Like, what is it about it and could you expect this sales momentum to continue?

Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Yeah. Hi, Mario, and thanks for the question. This is Anil. So, if you look at the Japan APE sales, grew 34% year-on-year in quarter four (sic) [Q4] and we established the new COLI term product in quarter three (sic) [Q3]. We got some terrific response in quarter three (sic) [Q3] and we saw the momentum pretty much continue in quarter four (sic) [Q4].

In Japan, as you know, we are a significant player when it comes to the COLI market. We have a broad range of a product suite to offer in Japan. And the new COLI term product basically kind of rolled on the COLI capabilities that we have in that market. We made certain adjustments in terms of the features and benefits to be able to prioritize in line with the customer needs, and we got some very strong response to that.

In addition to that, we also simplified the onboarding as well as the underwriting process and made it a lot more easy for our distributors to be able to offer these products to customers. So, that's really the driver or the source of the momentum that we saw in quarter four (sic) [Q4].

Now, we also understand that we work in a very dynamic market, and obviously we're going to face competitive pressure. As well, there could be other environmental reasons that could impact COLI. And that's something that we are working towards. We already have crafted a product suite for 2019, and pretty much doing our utmost to be able to ensure that we continue the momentum that we have in Japan.

Mario Mendonca

*Analyst, TD Securities*

Q

Do you see any potential that tax changes in Japan could lead to an erosion of the popularity of that COLI product or is it not a tax-driven product?

Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Yeah. So, there is some discussion and that doesn't come as a surprise because we already had some advance notice for us. It's a little premature for us to determine what that impact is because we don't know the nature and the timing of that, but we are pretty much acutely aware.

I do want to make the point that COLI contributes to roughly about – in the range of 50% of our sales. So, we do have some other value propositions in Japan. And I also wanted to underscore the point that, if you look at Asia broadly, right, the strength of our business is just the diversified nature of the portfolio that we have, and we've illustrated that in 2018 where, from time to time, you will face a headwind in a market or two, but we've been resilient and we've been able to pick up the momentum on account of the diversification strength that we have in Asia.

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Mario Mendonca

*Analyst, TD Securities*

Q

Thank you.

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

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Stephen Theriault

*Analyst, Eight Capital*

Q

Thanks very much, a couple of things for me. Maybe just a clarification to be sure on expenses. You've given us an additional piece of the puzzle with the visibility out to CAD 700 million of cost saves by 2020. I just want to make sure that extra CAD 325 million we're sort of delineating today, are you expecting to need to take a restructuring charge maybe next year as we get closer to – or as we get up to that CAD 1 billion? I think there may have been a prior discussion around that first set of restructuring maybe doing the trick for the entire program. So maybe just a refresher on that.

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Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Steve, for the question. This is Phil. So you're correct in your hypothesis that in order to deliver the additional CAD 325 million that we've laid out, we don't expect to incur a further restructuring charge in 2019 or beyond. Very often is cost associated with taking expenses out of the organization, but to the extent that arises outside of the programs that we had announced last year, we will self-fund those costs through further expense reductions. So, you won't see another non-core restructuring charge.

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Stephen Theriault

*Analyst, Eight Capital*

Q

Okay. That's great. Thanks, Phil. And probably for Anil, turning to Asia, a couple quick items, but first expected profit. When you look at core earnings growth, it was obviously very strong this year and new business gains remain strong. But the expected profit's been pretty flat the last five quarters and a big delta has been those new business gains and we worry about those from time to time. But just turning to expected profit, is there any visibility 2019 or going forward to see that growth start to ramp. It's been pretty much unchanged the last five quarters?

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Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Yeah. Thanks for the question. And I just wanted to complement, supplement the comments that Phil made on what was really driving our EPIF. So, if you were to normalize for some of the noise on account of the VA hedging, on a full year basis the EPIF growth is in the range of about 8% to 9% which is pretty much on expected lines. As you know, Asia is a growing part of our franchise. And you would expect that the contribution of new business gain in percentage terms would obviously be higher than the earnings growth that we're expecting or anticipating in our Asian markets.

So, on a normalized basis, as I said, it's pretty much on expected lines. And just given the fact that we're in growth mode, we are investing in both our distribution as well as in our digital capabilities, we are obviously consciously working on driving a better product mix. You would expect the new business momentum to be a strong contributor going forward. But I can't, as I said, make any forward comments, but we feel reasonably comfortable with the mix that we have as of date.

I would like to ask Steven if he wants to add to the comments.

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**Steve Finch**

*Chief Actuary, Manulife Financial Corp.*

**A**

Thanks, Anil. Yeah, just some additional context for the total company. So, Anil, I think focused on the full-year growth excluding that geography of the VA hedging, so 8% to 9%. We do expect the highest growth in earnings on in-force in the company, in our insurance and annuities businesses to come from Asia. The growth in North America will be somewhat lower. And you also see the value generation in Asia coming from the value of new business. And we see that coming through the new business gains as well as the earnings on in-force.

For overall context, new business gains have stayed consistent as a percentage of pre-tax core earnings total company at roughly 13%, that was consistent for full-year 2018 and full-year 2017. And new business gains for the full year were a consistent percentage within Asia, as well as a percentage of pre-tax core earnings.

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**Stephen Theriault**

*Analyst, Eight Capital*

**Q**

Okay. That's helpful. And if I could just finish with, I noticed that – for now just a detail item here – but the Hong Kong agency force was up around 900, after being pretty stable. We're used to seeing those big fluctuations in Asia, are they across all the various countries? What drove that this quarter?

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**Anil Wadhvani**

*General Manager, Asia, Manulife Financial Corp.*

**A**

The Hong Kong sales, just to clarify?

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**Stephen Theriault**

*Analyst, Eight Capital*

**Q**

The Hong Kong agents went to...

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**Anil Wadhvani**

*General Manager, Asia, Manulife Financial Corp.*

**A**

Oh, the Hong Kong agents. We have been focused in terms of growing our distribution, and we have been pivoting very strongly not only in Hong Kong, but if you look at even in some of our other Asia markets – to be able to ramp up the growth of our agency. We're very conscious of the fact that if we have to demonstrate foreseeable growth in the future, our agency is going to be a big part of it.

And we have significant strengths in our agency distribution business in Hong Kong, and we're simply building on it. And honestly, if you look at the Hong Kong franchise, as Paul mentioned, we are the number one player in MPF business. We now have a demonstrated track record of growing the business year-on-year. And we have slowly been climbing up the league tables, so that all makes a compelling reason for more agents to join Manulife, and that's why you're seeing the double-digit growth on the agency force in Hong Kong.

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

And Steve, this is Phil. Just to go back to your previous question as well, when we're talking about sources of earnings growth. We covered there the earnings from expected profit from in-force business and new business growth in Asia. I'd just like to highlight that we are confident and stand by the 10% to 12% earnings growth, medium-term operating targets that we've highlighted and that Wealth and Asset Management is a key source of that growth, as is the bottom line impact of our expense initiatives that as we've said before. We're committed to seeing those flow through to the bottom line.

Stephen Theriault

*Analyst, Eight Capital*

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. Good morning, and thank you for extending the call to take my question. I appreciate it. I have a series of questions that all relate to your Wealth and Asset Management business and I'm looking at your supplemental pack. So hopefully, you have a copy in front of you and we can just talk about a couple of things that I'm noticing here. The first is in terms of just thinking about this on an annual basis, one of the things that is rather notable in this business is the growth in the EBITDA of Asia – using the annual number of 23% – far exceeds the growth in the assets growth in Asia. So, I wonder if you can just talk to what is driving that EBITDA growth in Asia, and then similarly, why did it drop off in the fourth quarter given that AUM did not drop off in the fourth quarter?

Paul Lorentz

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

A

Yeah, Paul here. Thanks for your question, Darko. I'll start with the second part. The reason it dropped off in the fourth quarter is the mix of business. Even though AUM went up, it was more institutional sales versus other and that does have a lower margin. It's still really good business from an ROE perspective, but it would pull that down. And relative to the third quarter, we do have some seasonal spend in our retirement business in Hong Kong in Q4 and you tend to see that every year. So, that's the primary drivers of why it came down from that perspective.

In terms of the overall growth relative to AUM, our goal is really to try and get leverage out of our operating model on a global basis. And as we grow, we're trying to do that as efficiently as possible. And our goal, as we look forward, is to continue to improve EBITDA margin despite some of the pressures on fees by leveraging our scale and continuing to write good business.



Darko Mihelic

*Analyst, RBC Capital Markets*

Q

Okay. And one of the things that we don't get here in the supplemental is the fee. So, one of the things that I look at is I look at the EBITDA as a percentage of AUM. And in Asia, it's double that of the U.S. And so, presumably, it would be because fees are much higher in Asia versus the U.S. But I wonder if you would be willing to share the fee per AUM in Asia, Canada and the U.S.; and if not, give me sort of directionally the difference? And more importantly, for modeling, for my purposes, how should I think of the overall fee per AUM for 2019 and 2020? I mean, the pressure on this business is pretty intense. The feeling is that in the U.S. fees are going lower and lower for active management every day. So, I wonder if you can just speak – I would love it if you can give me individual fee numbers, but if not, just speak directionally to what you think's happening there.

Paul Lorentz

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

A

Yeah. So, I think, we typically don't disclose the individual fee numbers. I would say you are going to get some volatility in this metric from quarter to quarter, but we do feel confident long term in terms of our ability to improve this margin because of the diversification of our business, because of the leverage we expect to get out of the global business and frankly, how we prioritize our spend to make sure that we're capitalizing on the biggest opportunities by geography and by product line, which was really one of the attempts to pull this business together is to make sure we do that. So we're constantly looking at fee compression. We assume it's going to happen and trying to build that into our action plans as we look forward.

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

Hey, Darko. Let me just add. I'd say that one of the things that we will significantly benefit from and one area that we're very keenly focused on is leveraging our global footprint. We see big drivers coming from the fact that household wealth in Asia is going to grow; in fact it's going to more than double over the next five years. We're seeing an aging population. That's true globally, but certainly is true in Asia. And we're seeing a much stronger focus on retirement.

So the fact that we have established ourselves and have a brand and presence in Asia, it really puts us in good stead. And those markets, as you rightly point out, do have higher returns, higher margin, higher fees. And while there will be pressure, actually, for those fees to compress somewhat, the tailwinds that we have is some real big driving forces towards greater wealth management and a much stronger focus around pension and retirement planning. So, I think we're really well positioned to take advantage of that.

Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Yes. Hi. This is Anil. So, just one other supplemental point is that, if you look at the Asia flow mix, we control 75% of the flow directly given the fact that only 25% comes from intermediated channels. So, that allows us to control the client experience a lot more closely, whether it is institutional sales or, for that matter, retirement. And just given the strength of the business that we have – and both Roy and Paul mentioned our strength in Hong Kong – that obviously adds to the strength of our Asian franchise.

Darko Mihelic

*Analyst, RBC Capital Markets*

Q

Okay. That's very good color. And if I can just end on one last question, if I may. Just with respect to new business value add, you notice it's up quite a bit in the U.S. Still relatively small at CAD 98 million of the significant number that you have. My question is how much of that NBV comes from the International segment?

Marianne Harrison

*General Manager, U.S., Manulife Financial Corp.*

A

Hi, Darko. It's Marianne Harrison here. Actually, the biggest driver of the increase in the NBV for 2018 was actually around our brokerage business. International sales were actually a little weaker than what we had expected in 2018, and that really was a result of the increase in the interest rates, because it's mostly premium finance. So, we did see a little bit of a drop-off, or weaker sales on the international side.

We laid out our strategic plan just about a year ago, and one of the big focuses in that plan was to really focus on the brokerage business and improve the profitability. So, we undertook a number of management actions during 2018 that really helped to drive up that NBV. Some of it was pricing actions. Some of it was acquisition expenses in terms of becoming a lot more efficient. And then we also saw favourable product and business mix, again, all on the brokerage side of the business. So, I would say that that has been pretty much primarily driven by the brokerage side.

Darko Mihelic

*Analyst, RBC Capital Markets*

Q

Okay. Thank you very much.

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

Scott Chan

*Analyst, Canaccord Genuity*

Q

Yeah. Thanks a lot. I'll be very brief due to time. Just following up on WAM in Asia. Throughout the call, you've talked about the tailwinds in Asia wealth. But if I look at the gross flows, it has materially declined sequentially and flattish over the last three quarters. You talk about strength in institutional. What's on the negative side that is impacting the flows trend in Asia?

Paul Lorentz

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

A

Yeah. Thanks, Scott. It's Paul here. What you're seeing here is the general slowdown in retail, which was across the board because of the markets in Asia. You'd remember, markets were down for pretty much the full year last year, and that really pretty much left a lot of money on the sidelines in the retail space. So, that's what you're seeing. That's not unique to us. It's across the board. And in fact, we fare quite well relative to peers when we look at that. But we feel we're well positioned when the markets stabilize and we start to see money come back. But that's the primary driver you're seeing there, and you'll see it in our gross flows number, particularly in China.

Scott Chan

*Analyst, Canaccord Genuity*

Q

Okay. And just lastly, Paul, just on the institutional side which is probably the one bright spot in WAM in the quarter in terms of net flows. Can you maybe talk about what drove the flows in the quarter and the outlook in the segment in 2019?

Paul Lorentz

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

A

Well, I think what we're starting to see on the institutional side is the ability to sell the strategies that we have in all other countries in multiple jurisdictions, not just in the country that they're at. So, we are starting to see some interest in some of our Asian strategies from European investors. As an example, we're starting to see some interest in our Asia institutional clients for U.S. strategies and that's really helping us leverage really what we bring to bear more broadly than the strategies that are more domestic in nature.

Scott Chan

*Analyst, Canaccord Genuity*

Q

Perfect. Thank you very much.

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

David Motemaden

*Analyst, Evercore ISI*

Q

Hi. Thanks for extending the call for my question or my questions. Just a question for Steve on long-term care. The Society of Actuaries just released their morbidity improvement study. Just wondering your view of the results of that and whether that impacts your view at all on the morbidity improvement that you have embedded in your long-term care reserves?

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

Thanks, Dave. Yes, we saw that study, and what it really attempted to do was lay out, for practicing actuaries in the field, methodologies that would be appropriate for looking at trends in morbidity. The paper did not explicitly draw any conclusions on whether there are improvements or not. As I stated in the last call, we've been looking at additional data. The way that we analyze it is consistent with the methods talked about in the SOA study. And as I said before, we've seen nothing that would change our point of view on morbidity improvement.

David Motemaden

*Analyst, Evercore ISI*

Q

Got it. Thanks. And then, I guess, maybe just a question on the COLI business in Japan. Just wondering what are really the profit drivers in that business. Is it more spread based or is it more underwriting mortality based? If you could just provide some colour on what's really driving the underlying earnings there.

Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Hi. This is Anil. And I'm going to start, and then probably offer Steve to supplement. But if you look at the COLI product and the construct of it, it has elements of both savings and protection. So the source of earnings or the source of profit comes from your normal insurance margins as well as some of the gains that we get on investments. So, it's really the combination of the two things that really drives the source of earnings for us in COLI.

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

Nothing to add.

David Motemaden

*Analyst, Evercore ISI*

Q

Got it. And that's a yen-based product, so are you guys investing in yen-based securities, or are you using more of a global approach to investing in the assets and hedging that back to yen, just in terms of the assets back in that business?

Scott Hartz

*Head of General Account Investments, Manulife Financial Corp.*

A

Yeah. Hi, Dave. It's Scott. And yeah, you're exactly right, we try to take advantage of our global sourcing ability, but we absolutely will not take currency risks. So, we do swap it all back again.

David Motemaden

*Analyst, Evercore ISI*

Q

Got it. Thank you.

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

Humphrey Lee

*Analyst, Dowling & Partners*

Q

Good morning, and thank you for extending the call. Just a follow-up question to Anil about the agency count in Hong Kong. I just want to get a sense, is it a result of you kind of more actively poaching from your competitors or because of market changes there? My understanding is a few of the players there, they are subscale and agents being unhappy and wanting to leave. So given the success of Manulife in Hong Kong in recent years, kind of being attractive landing spot for them, so if you can give some color in terms of the dynamic.

Anil Wadhvani

*General Manager, Asia, Manulife Financial Corp.*

A

Yeah, I think the primary focus, Humphrey, on the agency growth is to be able to attract some of the younger talent and that's something that we've been making a conscious attempt toward. So, the success that we've seen in recent times, or recent quarters and recent years in Hong Kong, obviously, as I said earlier, makes it very compelling for the folks who want to build a career in Hong Kong to choose Manulife. And added to that the fact that we have a relationship through our MPF business with one out of three adult customers in Hong Kong, really provides a huge opportunity for us to deepen and build relationship with our customers.

In addition to that, we have also been making significant investments in digital which does a few things. One is it makes life simpler for our agents and our customers and that has a knock-on impact on productivity. And obviously, if we make life simpler for our agents and customers, that of course is a very motivating opportunity for the agents to build on.

Humphrey Lee

*Analyst, Dowling & Partners*

Q

Appreciate the colour. And then maybe a question for Naveed. I understand that your discussions with potential counterparties on legacy transactions is private. But I guess from a sentiment perspective given the macro

environment has changed a bit and then the concerns for credit cycle and all that, has the discussion with any kind of potential counterparties been different, say, from early in 2018 versus now?

Naveed Irshad

*Head of North American Legacy Business, Manulife Financial Corp.*

A

Hi, Humphrey, Naveed here. Thanks for the question. I would say actually throughout 2018, we saw more interest in these blocks. And that's partly why we sort of overachieved early on the capital release target. I haven't really seen any pullback from counterparties. We continue to be engaged actively on a lot of the remaining blocks. And again, just to your question, I haven't seen any pullback at all.

Humphrey Lee

*Analyst, Dowling & Partners*

Q

Got it. Thank you.

**Operator:** Thank you. The next question is from Tianjiao Yu from Sanford Bernstein. Please go ahead.

Tianjiao Yu

*Analyst, Sanford Bernstein*

Q

Good morning. This is Tianjiao from Bernstein. Congratulations on the results. I have two questions here. The first one is a follow-up question on the NBV growth in U.S. You mentioned about the margin, the 200% NBV growth is driven by margin expansion. And you mentioned about the improvement on product mix. Can you further elaborate on that? I was just wondering, is there any help on the Vitality products that you launched?

Marianne Harrison

*General Manager, U.S., Manulife Financial Corp.*

A

Hi. It's Marianne Harrison here. Yeah. In terms of the NBV margin, we did see some favourable impact from the product and business mix. And it was primarily more on the universal life and less on the term. One of the areas where we're improving margins actually was on the term products. So, we increased pricing on that. So, we did see more of a shift on the UL side. We are also seeing significant uptick on the Vitality offering. And as Roy had mentioned, we are offering that across all of our insurance products, the behavioural insurance. And those sales in the fourth quarter alone were up 75% versus a year ago, and for the full year it was up 52%. So, we are seeing quite a favourable pickup from that Vitality offering as well.

Tianjiao Yu

*Analyst, Sanford Bernstein*

Q

Okay. Thank you. And the second question is regarding the core earnings. You previously mentioned the target of having two-thirds of the core earnings from the high potential businesses which includes Asia WAM Group – Canada Group and the U.S. behavioural insurance. We're just wondering, what is the targeted contribution from each segment broadly?

Phil Witherington

*Chief Financial Officer, Manulife Financial Corp.*

A

Thanks, Tianjiao. This is Phil. So, yeah, we absolutely do stand by this target of two-thirds of our core earnings coming from our high potential businesses. We've also laid out a medium-term operating target of a 13% plus ROE and we stand by that 13% plus, in aggregate. We absolutely expect that the higher ROEs will come from the

highest potential businesses. But overall, I think that 13% is a good number to go with for now and we'll evaluate once we have consistently achieved the 13%.

Roy Gori

*President & Chief Executive Officer, Manulife Financial Corp.*

A

If I can also just clarify, you mentioned that the categorizations of our high potential businesses correctly, but you said behavioural insurance in the U.S., it's actually global behavioural insurance, which includes our efforts on Vitality in the U.S., but also in Canada as well as our MOVE program in Asia.

Tianjiao Yu

*Analyst, Sanford Bernstein*

Q

Okay. Got it. Thank you.

**Operator:** Thank you. The next question is from Sumit Malhotra from Scotia Capital. Please go ahead.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

Thanks, guys. I didn't think you'd get me back on so I'm going to try to keep this really quick. For Steve. Just on the long-term care. We've talked a lot about the potential changes you may or may not have to make to morbidity. One of the things you didn't mention to us in the past was you've been conservative on the assumption of price increases in your reserves. One of your competitors did note that they've been able to successfully embed some new price increases on policies in-force. Just kind of going back to the numbers that you gave us, Steve, I think it was something like your reserves only included CAD 800 million for price increases not yet approved. As you think about the 2019 review, can you give us an update on how your pricing increase actions have trended and what that may mean for the back and forth in reserves that you conduct in 2019?

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

Sure, Sumit. And that's correct. At the time of Investor Day, we had disclosed that there were CAD 0.8 billion that were embedded in our reserves for filings that we had made but not yet achieved, and that was a very conservative portion of the overall ask. So, this will be one of the assumptions – we will update all the assumptions – that we're reviewing for the Q3 basis change.

Since that time, we have made considerable progress. We have achieved another CAD 500 million out of that CAD 800 million in increases. And we still have many billion above that that we are continuing to pursue and expect to get over time. Our progress has been consistent with our expectations, so we're very pleased with this result. And as I said, it will factor into our Q3 review.

Sumit Malhotra

*Analyst, Scotia Capital*

Q

So, a potential offset to what – we've talked a lot about morbidity maybe being a headwind, you might not agree with that, but I think your comment here is that there are a few things in the other direction as well.

Steve Finch

*Chief Actuary, Manulife Financial Corp.*

A

We believe we will continue to have success with the rate increases, yes, and we'll consider how to factor that into the reserves.

Sumit Malhotra

*Analyst, Scotia Capital*



Thanks for your time.

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

Adrienne O'Neill

*Global Head of Investor Relations, Manulife Financial Corp.*

Thank you, operator. We will 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 we thank you for your participation.

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