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PRESENTATION

Operator

Good morning, and welcome to the Sun Life Financial Q4 2022 Conference Call. My name is Michelle, and I'll be your conference operator today. (Operator Instructions) The host of the call is Yaniv Bitton, Vice President, Head of Investor Relations and Capital Markets. Please go ahead, Mr. Bitton.

Yaniv Bitton - *Sun Life - VP, Head of IR & Capital Markets*

Thank you, operator, and good morning, everyone. Welcome to Sun Life's Earnings Call for the fourth quarter of 2022. Our earnings release and the slides for today's call are available on the Investor Relations section of our website at sunlife.com. We will begin today's call with opening remarks from Kevin Strain, President and Chief Executive Officer. Following Kevin, Manjit Singh, Executive Vice President and Chief Financial Officer, will present the financial results.

After the prepared remarks, we will move to the question-and-answer portion of the call. Other members of management are also available to answer your questions this morning. Turning to Slide 2, I draw your attention to the cautionary language regarding the use of forward-looking statements and non-IFRS financial measures, which form part of today's remarks. As noted in the slides, forward-looking statements may be rendered inaccurate by subsequent events. And with that, I'll now turn things over to Kevin.

Kevin Strain *- Sun Life - President, CEO & Director*

Thanks, Yaniv, and good morning to everybody on the call. Turning to Slide 4, Sun Life delivered strong performance during the fourth quarter, contributing to solid 2022 full year results. Our results demonstrate the resilience of our diversified business model and the commitment of our people to deliver strong earnings and continued growth amidst a challenging environment while meeting our commitments to clients and delivering on our purpose.

We've made tremendous progress on our business strategy by driving positive client impact for our 85 million clients around the world. We achieved strong underlying earnings this quarter of CAD 990 million representing 10% growth over prior year, demonstrating the resilience of our business mix. Our growth was driven by strong results from our Protection and Health businesses.

Sun Life U.S. had strong fourth quarter underlying earnings, as a result of solid underwriting performance in Health and Risk Solutions, significant moderation of COVID-related impacts and contributions from DentaQuest.

In Asia, we saw a breakthrough in earnings profitability in Vietnam, driven by the addition of scale in bancassurance and in agency, and we saw higher margins in our international high-net-worth business. Strong results from our Protection & Health business were partially offset by lower income and increased outflows from our wealth and asset management businesses, largely reflecting declines in global equity markets. Underlying ROE for the quarter of 15.7% continues to trend towards our medium-term objective of 16% plus, reflecting our disciplined capital management and growing emphasis on capital-light businesses.

And our LICAT ratio at SLF remained solid at 130% for the quarter. Turning to Slide 5. Our full year 2022 results were driven by similar factors as seen during the fourth quarter. Underlying net income increased 4% to $3.7 billion, supported by growth in our Health and Protection businesses. Underlying ROE for the year at 15.1% was also strong. Over the past year, we increased our quarterly dividend by 31%, following the lifting of restrictions in November of 2021.

Turning to Slide 6. This quarter, we delivered on several key business initiatives that helped drive forward our client impact strategy. The strengthening of our distribution capabilities in growth markets has been a priority for Sun Life in 2022. In Sun Life Asia, we remain focused on building quality distribution channels. We realized a step change in our bancassurance distribution over the last 12 months driven by new marquee relationships and executing on our existing partnerships.

Last month, we announced our first exclusive bancassurance partnership in Hong Kong with Dah Sing Bank. Under the 15-year agreement, Sun Life will be the exclusive provider of life insurance solutions to Dah Sing's retail banking customers with distribution of Sun Life products expected to start this summer. This rounds out our distribution capabilities in Hong Kong and positions us well to compete. With the addition of this bancassurance partnership in Hong Kong, we now have more than 20 quality bancassurance partnerships in 7 markets across Asia.

Our history of execution in Asia has proven that strong bancassurance distribution, coupled with high-quality advisor channels provides a critical platform for growth. One example of this is how we are building our business in Vietnam, executing on transformational bancassurance partnerships with a focus on providing high-quality insurance and wealth products and services to fit our clients' needs. We are now one of the fastest-growing life insurance players in Vietnam. We've improved our market position for insurance sales from 15th position in the full year 2020 to 6th position in 2022.

At SLC Management, we also recently closed our acquisition of a majority stake in Advisors Asset Management. Advisors Asset Management, or AAM, adds distribution capabilities in the U.S. high-net-worth retail market, one of the fastest-growing distribution channels for alternative assets. We're excited to welcome the AAM team to our SLC team.

We are increasingly delivering positive client impact by elevating our focus on health, helping clients access health care and the coverage they need. In the U.S., DentaQuest continues to expand its dental business, advancing our goal to increase access to oral health care in underserved communities. In Q4, DentaQuest expanded its Advantage Dental+ care practices with 4 new offices in Florida. These practices went from start-up to at capacity in 90 days, which demonstrates the need for these services. DentaQuest also had a strong quarter for contracts awarded, including 2 new dental managed care contracts from a multistate health plan provider. The 2 newest contracts expand DentaQuest's partnership with the health plan to 10 states. DentaQuest's unique capabilities continue to contribute to our ability to win and retain state business while also driving higher margins.

Additionally, the COVID-19 pandemic has exacerbated the mental health crisis in Canada. We know many people are at a breaking point, and we need to offer more resources and more access to tackle this crisis. We know the workplace is an important place to address these concerns, and we're doing our part in Canada by providing clients with better access to mental health solutions. We're also doing our part in our communities and last month, we announced an investment to support mental health programs for at-risk marginalized youth across Canada. Continuing to build capabilities that will expand access to care will support Canadians with early prevention and with faster recovery.

We continue to make great strides in our digital journey. Tied to our commitment of increasing financial security, we continue to work hard to build the capabilities such that our clients can access our spectrum of advisory options through a frictionless digital experience. Sun Life Canada has created more than 65,000 financial road maps for Canadian clients in 2022 using our Sun Life One Plan digital tool. Sun Life One Plan contributes to our goal for all Canadians to have a financial plan.

Finally, we continue to be recognized for our progress in sustainability and our inclusive culture. Sun Life was recognized by Corporate Knights as being among the global 100 most sustainable corporations in the world for the 14th consecutive year. And this year, we were the top-ranked insurance company globally. Additionally, Sun Life received many employer awards in 2022, including being certified as a great place to work in several of our markets. This is especially gratifying because it's the result of direct feedback from our employees. This is recognition of our focus on ensuring we have an environment where diversity is championed in addition to offering resources and flexibility to support mental, physical and professional well-being.

Before turning to Manjit to detail our Q4 financial results, I'd like to share a few final thoughts. First, I'm excited to welcome Tom Murphy, our new Chief Risk Officer, to the Sun Life executive team. Some of you will know Tom from his time with SLC Management, where he headed up our fixed income and institutional business. Tom brings a global depth of knowledge and experience, particularly in asset management and the pension space, which will be a tremendous benefit for all of us. I'd also like to recognize Colm Freyne. Many of you on the phone will know him from his time as the Sun Life CFO and then as our Chief Risk Officer. Colm will retire on May 1 after an illustrious 20-year career with Sun Life. He has played a significant role in our company's growth over the past 2 decades. On behalf of everyone at Sun Life, I want to thank Colm for his service to Sun Life and wish him well in his retirement.

And lastly, I'd like to share a few thoughts on the year ahead. While we expect the environment to remain challenging, we are optimistic about the outlook. Based on recent direction of travel for inflation in North America, we're seeing most economists forecast -- forecasting a plateau of interest rates in the back half of 2023, with some showing reductions in interest rates in 2024. We expect some volatility in rates will persist, but this will likely be within a tighter range. While inflation looks to be moderating, we continue to watch the environment, including geopolitical uncertainty, additional shocks to energy supply, the reopening of markets in Asia and COVID-19. We continue to feel prepared as a result of our resilient client impact strategy supported by our diversified and capital-light business mix.

Recent investments across growing spaces in health, Asset Management and Asia and our sustained commitment to delivering on our purpose to help clients achieve lifetime financial security and live healthier lives will all support us next year.

With that, I will now turn the call over to Manjit, who will walk us through the fourth quarter financial results.

Manjit Singh - *Sun Life - Executive VP & CFO*

Thank you, Kevin, and good morning, everyone. Let's begin on Slide 8, which provides an overview of our Q4 results. Sun Life had a strong finish to the year with record underlying earnings in the fourth quarter, reflecting the strength of our businesses and the benefits of our diversified mix. Underlying net income of $990 million and underlying earnings per share of $1.69 were up 10% from the prior year. Strong results in Protection & Health businesses were underpinned by business growth, the contribution from the DentaQuest acquisition, higher margins in the U.S. and Canada and moderating COVID-related impacts.

This was partially offset by lower wealth and asset management results which were impacted by global equity market declines. Reported net income for the quarter was $951 million, down 12% from the prior year. The results for this quarter include market-related impacts and DentaQuest integration expenses. Our balance sheet and capital position remains strong as reflected by an underlying return on equity of 15.7% for the quarter, a 5% increase in book value per share over the prior year, a strong capital position with a LICAT ratio of 130% at SLF, up 1% from Q3 and 130 basis points improvement in the leverage ratio from 26.4% last quarter to 25.1%.

Let's turn to our business group performance, starting on Slide 10 with MFS. MFS underlying net income of USD 202 million was down from the prior year, driven by lower average net assets, largely reflecting declines in global equity markets. Reported net income of USD 223 million was down 5%, reflecting impacts in underlying net income, partially offset by fair value changes on share-based payment awards. MFS generated a strong pre-tax net operating margin of 40%. AUM of USD 548 billion was up 8% from Q3, largely reflecting higher equity markets, partially offset by net outflows.

Retail net outflows of USD 8.3 billion in the quarter were impacted by industry-wide redemptions as investors remain cautious in an uncertain macroeconomic environment. Institutional net outflows were USD 3.6 billion in the quarter.

Turning to Slide 11. SLC Management delivered underlying net income of $38 million and reported net income of $19 million. We are pleased with the attractive business fundamentals at SLC Management. This includes good momentum on capital raising across all asset classes, including $3 billion in the current quarter as well as 22% growth in fee-related earnings, reflecting the deployment of capital into fee-earning AUM. Total AUM of $210 billion were up 14% year-over-year. This includes $21 billion that is not yet earning fees. Once invested, these assets are expected to generate an annualized fee revenue of more than $180 million.

Turning to Slide 12, Canada's underlying net income of $324 million was up 22% from the prior year, driven by strong insurance sales, improved disability performance in Sun Life Health and higher investment gains. This was partially offset by lower fee income in wealth management businesses. Reported net income of $367 (corrected by company after the call) million was up slightly from the prior year. Total Protection & Health sales were up in the quarter, reflecting an increase in large case sales in Sun Life Health. On the wealth side, retail sales were impacted by the market environment. Group Retirement sales increased year-over-year, reflecting our differentiated products and services as well as the strength of our client relationships.

Turning to Slide 13, U.S. underlying net income of USD 177 million was up $121 million from the prior year. Reported net income of USD 81 million was up $13 million. The results were driven by strong performance across all businesses, including the contribution of DentaQuest. Group Benefits results were driven by a 16% increase in expected profit and a significant moderation of COVID-related mortality and disability impacts. Business fundamentals remain strong, including good client persistency, strong premium and fee growth and solid stop-loss underwriting margins. The Group Benefits after-tax profit margin increased to 8.4%. Sales in the U.S. were up 11% year-over-year. We saw good momentum in employee benefit sales, reflecting our investments in technology partnerships and new digital capabilities. Stop-loss sales were lower, reflecting a more competitive pricing environment. Despite the changing competitive dynamic, our focus remains the same: provide value to our clients and maintain good pricing discipline. We're very pleased with the DentaQuest results. We are on track with our integration milestones and are confident that we will achieve our synergy targets. DentaQuest delivered strong sales for the year, adding approximately 3 million new members in 2022, bringing the total number of members to 36 million.

Slide 14 outlines Asia's results for the quarter. Underlying net income of $152 million was up 16% year-over-year on a constant currency basis. The results were driven by insurance business growth and moderating COVID-related experience. Wealth and fee-related earnings were impacted by lower equity markets in Asia. Reported net income of $98 million was down from the prior year, largely driven by the gain from the IPO of our India asset management joint venture in October of last year and market-related impacts.

Asia generated double-digit insurance sales growth in most markets. We continue to gain momentum, reflecting the benefits of our continued focus on client experience, roll out of new products and expanded digital capabilities as well as the easing of pandemic restrictions.

In corporate, underlying net loss of $39 million reflects a higher effective tax rate compared to the prior year while reported net income was in-line with the prior year.

Turning to Slide 15, we outline the progress on our medium-term financial objectives. Despite the challenging operating environment in 2022, our resilient set of businesses delivered a 9% underlying EPS growth over the 5-year period. Underlying ROE over the 5-year period was 14.7% and 15.1% for 2022, reflecting the shift in our mix to capital-light businesses. And the payout ratio was in our target range of 40% to 50%. We continue to maintain a strong balance sheet and capital position, which provides support to execute on strategic priorities and is a key strength to manage through an uncertain environment.

Looking ahead to 2023, we remain optimistic about the fundamentals across each of our businesses. While we expect the operating environment to remain challenging, we are confident that our leading business positions, focus on client outcomes, disciplined capital and expense management and strong talent will help to drive continued growth. And of course, this will be our final quarter -- this will be our final quarter under the current reporting framework as we transition to IFRS 17 in Q1 2023.

As we've noted before, IFRS 17 does not impact our core business strategies or the fundamental economics of our businesses. It will, however, impact the timing and presentation of our financial results. Based on our parallel runs for the first 3 quarters, we have provided some updated disclosures this quarter. First, we updated the estimated earnings impact for the 2022 restated comparative year from a decrease of mid-single digits to a decrease of high single digits. This is largely driven by higher investment activity gains for the year. Our investment team has a proven track record of identifying and executing on opportunities to enhance the spread for our investment portfolio in volatile market environments like we saw for most of 2022. The present value of the higher spread is recognized immediately into earnings under IFRS 4, but will be recognized over time as we transition to IFRS 17. While the economics and earnings benefit from the higher yield is the same over time, it results in a higher IFRS 4 versus 17 difference at transition.

The second update is that we expect a high single-digit increase in the LICAT ratio on transition to IFRS 17. This is higher than our estimates in May of last year, reflecting updates to our capital projections under the new LICAT guidelines as well as refinements to our estimates as we complete our quarterly IFRS 17 parallel reporting. We are currently in the process of finalizing our dual reporting for the 2022 comparative year and look forward to sharing additional details in May with you with the reporting of our first quarter results. With that, I'll turn the call back to Yaniv for Q&A.

Yaniv Bitton - *Sun Life - VP, Head of IR & Capital Markets*

Thank you, Manjit. To help ensure that all our participants have an opportunity to ask questions this morning, please limit yourselves to 1 or 2 questions and then requeue with any additional questions. I will now ask the operator to poll the participants.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Meny Grauman with Scotiabank.

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

Manjit, you concluded your remarks by talking about expecting the operating environment to remain challenging in 2023. And I was hoping you could go into more detail. When I look at it, I see some improvement in equity markets at the start of the year, the reopening in Asia. So when I look at it, it seems like there's more reason to be optimistic for the outlook. So I'm wondering if you could just go into where the causes for concern as you see them in 2023 are.

Manjit Singh - *Sun Life - Executive VP & CFO*

Thanks for your question, Meny. I think you're right. I think we are seeing some signs of improvement, but I don't think we're ready to declare victory yet in terms of the overall operating environment. We do sort of see some potential for things to move back and forth over time. But more importantly, I think for us, we are very pleased with the diversified set of our businesses and our leadership positions within those businesses. And we feel that, as we've shown over the last couple of years that we can manage pretty well through very different types of environments.

Kevin Strain - *Sun Life - President, CEO & Director*

Meny, it's Kevin Strain. The equity markets year-over-year are starting off still down, although they're up a little bit at the start of the year, and that puts pressure on fee income, which impacts MFS, impacts SLGI, impacts our GRS and pension business in Asia, but also a lot of our universal life business in Asia is tied to fee income as well. So it's a bit of a headwind, but we are seeing the start of the year look good. I sort of addressed that in my comments as well. We'll see how the year performs, but it's really a factor on the fee income from our equity businesses.

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

And if I could just follow up, you gave an interview about a month ago talking about M&A opportunities in Asia and the potential opportunities created by the reopening that maybe some deal competitors potentially would be distracted. So I'm wondering if you could provide a little bit more colour on those views in terms of how you see opportunities for M&A in Asia in 2023. And maybe more specifically, what specific areas are you looking at in Asia for deploying capital in 2023?

Kevin Strain - *Sun Life - President, CEO & Director*

Yes. Thanks, Meny. Well, post the interview, we did the bancassurance deal in Hong Kong, and we're quite excited about that. That really rounds out our capabilities in Hong Kong. It gives us bancassurance alongside of our agency distribution. We have brokerage there, and we have the second largest pension business by flows. So we're quite happy with where we ended in Hong Kong with that Hong Kong bancassurance deal.

As you know, we've done a bancassurance deal, a fairly sizable one in Vietnam that I talked about with ACB Bank in my remarks, and that built on our position with TPBank. We redid our licensing agreement with Grepa, which is RCBC Bank in the Philippines. So we were quite active in Asia and have been quite active. I'm pretty pleased with where we are now. If you look at our capabilities, across Asia, ability to do multichannel distribution. With the addition of bancassurance in Hong Kong, we now have bancassurance in every market except for Singapore. So we're well suited in Asia. I think that, that piece of the puzzle of adding bancassurance in Hong Kong was an important step for us.

You're right to note that -- and Ingrid may want to talk about this a little bit more, that the border is opening, and we see that as a good thing for Hong Kong and the Hong Kong economy, which should be a good thing for sales in the Hong Kong business. Now that will take a little while. It just opened in January, and those sales take a little while to come through, and they are still working through getting the momentum and sort of that travel back and forth across the border. I don't know, Ingrid, if you wanted to add anything?

Ingrid Johnson - *Sun Life - President of Sun Life Asia*

You've captured it well, Kevin. Just additionally, in Indonesia, also expanding our bancassurance deal with CIMB Niaga is very important for us. So definitely optimistic about the potential as well as the underlying momentum that we're seeing in the insurance sales, which were almost 30% in all of our other markets, except Hong Kong and China. So we are well placed. But clearly, with some of the headwinds Kevin described.

Operator

Our next question comes from Scott Chan with Canaccord Genuity.

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

So on DentaQuest's second quarter contribution, I remember when you announced the acquisition, you talked about robust growth and kind of cited a 14% revenue CAGR from 2018 to what was probably near 2021 to $2.7 billion. If I look in the supplemental on your gross premiums on Dental, it seems to be tracking in line with 2021 in terms of sales growth. Am I reading that right? Or is it more stable growth that you witnessed within that platform in 2022?

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Well, thanks for the question. This is Dan Fishbein. One thing to point out is that we are reporting commercial dental, which includes the legacy Sun Life commercial business and DentaQuest in that segment. So it's important to look at both pieces. So first of all, commenting on the commercial, we've actually had really great sales growth in the past year on commercial dental. That was up about 50%. It's obviously still very early. We've only reported on 7 months of DentaQuest results. But their sales results have continued to be quite strong. They added 3 million government programs members last year, for example.

We mentioned -- Kevin mentioned in his opening remarks, some significant sales in the fourth quarter and that momentum has actually continued in January. But to specifically answer your question, overall, both their sales and revenue growth, have been roughly in line with the past trend. It is -- the sales in the government programs business tends to be quite lumpy. You get big sales infrequently. So a 7-month period is a little bit hard to establish a trend on, but so far, so good.

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

And when I look forward and looking at growth outside of the revenue synergies, how do we kind of maybe track that? Is it more like the industry trend on like government program growth? Or is it more on DentaQuest maybe taking market share and expanding into certain states like you did in Florida last year?

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Yes. We -- I would suggest you look at our growth specifically, but the -- there's lots of good tailwinds going on there. There's a very robust pipeline that DentaQuest is working on right now. I think it's -- we view it as just about the strongest that they've ever had. There are states continuing to move their programs from regular fee-for-service to managed care, and we're certainly participating in all of those RFPs.

There are health plans, as we noted in the fourth quarter, who continue to outsource their dental business in the Medicaid and Medicare programs to us. And we also have quite a bit of momentum on the commercial side. So we're optimistic about the growth trajectory here. The pipeline is very strong.

Operator

Our next question comes from Gabriel Dechaine with National Bank Financial.

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

I got a couple of questions. First here, the group results have been both in Canada and the U.S. really strong. And I'm wondering if that's the claims costs have been inflated at all because of interest rates. I guess my question is, despite the impact of interest rates, you're still generating these strong results? Or has that not been a material thing?

Kevin Strain - *Sun Life - President, CEO & Director*

We'll let Dan maybe start and Jacques may want to jump in on the Canadian experience.

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Yes. The group results are strong. I think as you noted, improving morbidity and mortality, of course, are the primary reasons for that and kind of overwhelm all of the other factors. In the U.S., our mortality moderated significantly, still elevated, but moderated significantly throughout the year and certainly in the fourth quarter. Disability morbidity has improved and stabilized. You're right, there is a little bit of an impact around interest rates on long-term disability liabilities, but it's relatively small compared to the morbidity and mortality incidence.

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

Got it.

Jacques Goulet - *Sun Life - President of Sun Life Canada*

To answer, Jack. In the case -- in the case of Canada, -- and then you would know that there's essentially 3 things we're looking at here. And a few years ago, we started repricing the business in line with the higher volume of claims that we were seeing in the disability group side. And that's obviously now contributing nicely to our results. The other 2 things that we watch very closely are the volume of claims. This past quarter, I would say those were a little bit better than we are expecting, but not materially. And the other area is the duration of the claims. And there, we have better experience than expected.

On that one, Gabriel, I would be a little bit careful because as we've said in the past, one of the drivers of experience and duration is access to care. And it's not clear in my mind that this has changed materially in Canada. We still see some challenges in the health care system. So we had a great quarter. We're pleased with that, of course. But as you can imagine, this is an area that we've always continued to watch very closely, and we'll do that. And one of the levers we look at very carefully is the pricing. And we think we're pricing in the right place.

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

Well, we'll save the pricing discussion for the conference in March there Jacques. My second question is -- my next question is on the real estate experience losses. I get why it's happening. Just wondering what sectors, what geographies may have yielded that result? And two, could we be in another phase like the one we saw in most of 2020 where real estate experience losses where we have them for like 3 or 4 quarters in a row?

Randy Brown - *SLC Management - CIO*

Gabriel, it's Randy Brown. Thank you, good question. So let's take a step back for a moment on commercial real estate. We've seen very strong growth in this sector over the last couple of years broadly, although you did see within that, weakness in office and retail, because of the whole shift in office because it was exacerbated by the pandemic.

With that said, the total return of our portfolio in Q4 was positive. So what you're seeing come through is the deviation relative to the long-term expectations of what we would earn. Right? And so within that, though, very -- the sector has broadly performed in line. So we weren't seeing a major deviation between the various subsectors. So that would be one point.

The second point would be, as you think about real estate as we go forward, yes, we do expect some cap rate decompression given the speed of risk-free rates increasing. And we're seeing that. Now in some sectors, it's been offset by fairly robust rental inflation, think industrial, multifamily in others, weakness in rent growth, think office. With that said, we had talked about a pretty major repositioning of our real estate portfolio over the last number of years, anticipating a downturn.

And so to give you an example, our office portfolio went from 39% to 24% over the last -- from basically beginning of 2019 to the end of 2022. The majority of that coming early in that transition. At the same time, our industrial portfolio more than doubled. So we are positioned well within the real estate portfolio for what we believe may be coming.

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

And just -- you appraise a quarter of the portfolio per quarter, like you don't do it all in 1 shot, right?

Randy Brown - *SLC Management - CIO*

Right. It's a rolling appraisal. So everything gets externally appraised periodically, and then we will reappraise, using those benchmarks we'll use internal appraisals on everything every quarter.

Operator

Our next question comes from Doug Young with Desjardins.

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

Maybe this is for Dan on DentaQuest, I mean, if I look at the dental operation, and I know it's got the legacy business in there, but there was a loss of $22 million. If we back out the acquisition-related costs in the U.S., which I assume is all related to DentaQuest, I can triangulate back to $33 million of earnings. And I know there's going to be a little bit in there for, again, the legacy business. Just curious, is the math correct? And then I've got a follow-up on the U.S.

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Yes, Doug, I think that is a good way of looking at it. I think you're thinking about that the right way. The integration expense you're seeing there is virtually all related to DentaQuest. And I can share in the quarter that the legacy commercial Sun Life business generated about $3 million in after-tax underlying earnings. So the balance would be from DentaQuest.

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

Okay. Perfect. And then -- just looking at the U.S. group business as a whole, you've expressed a margin target of around 7%. For the quarter, I know last 12 months, it was 8.4%. But for the quarter, it was 10.4%. I guess my question, Dan, like what causes the margin to migrate down to 7%? Or is there a need to push the 7% target higher? Do you see more comfort in the outlook for that group business over the coming years?

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Yes, a great question. Of course, we just went back over the 7% threshold on a trailing 12-month basis because of the -- primarily because of the very adverse COVID mortality experience earlier in 2022. So we've just gotten above that metric again. We're obviously pleased to be there. And we don't anticipate right now a return to the COVID mortality that we saw in the fourth quarter of 2021 or the first quarter of 2022. But having just hit the threshold again, I'm not sure we're ready yet to raise the threshold at this point.

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

And then just when I look at that business, stop-loss sales were down. It seems from the prepared remarks, you're seeing a pickup in competition. I mean we've seen this trend happen in the past. And margins be negatively impacted in stop-loss. And I think that's where you're punching above your weight in the margin side. Are you comfortable that the competition isn't getting irrational in that stop-loss business? Anything to be concerned there?

Dan Fishbein - *Sun Life - President of Sun Life U.S.*

Yes. I think historically, and we've said this before, stop-loss has always been a cyclical business. Margins improve, competitors decide they want to take some share. They get a little less disciplined, a little more aggressive. We've had a history of being a very disciplined underwriter and pricer of the business. And you see that in our experience, we actually anticipated this. Our sales were down a bit in the fourth quarter versus the prior year quarter. But we actually plan for that.

Now a little bit of that is we had a big block of business that came in, in the fourth quarter of 2021, and we knew that, that would not recur. So we actually -- our sales for the year were a little bit above our expectations, which is good. But we will not break our discipline around our view of trends and pricing in order to acquire market share. There are some competitors who are probably doing that right now. So the market is getting a little bit more competitive. But we think, as you've noted, we can continue to outperform the market on that basis.

Kevin Strain - *Sun Life - President, CEO & Director*

Doug, it's Kevin Strain. And we're also finding new ways to compete for business by adding things like PinnacleCare on top of the stop-loss business, which helps to take the conversation away from being solely price to being ways of adding value. And because we're one of the larger players, we have unique capabilities to do that sort of thing.

Operator

Our next question comes from Tom MacKinnon with BMO.

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

A question with respect to Asia. If I look at the impact of new business it was positive 1 in the quarter. Now we've seen that similar positive 1 in the fourth quarter of 2021. But historically, this has always been negative. And the sales were up nicely in international, or they're flat year-over-year in the International Hubs and up maybe about 10% or 11% in the Local Markets.

So I'm just curious as to what's driving this in this quarter? Is it more profitable new business? Is it a better mix? How sustainable would that be, granted there is going to be an accounting change as to how this stuff is going to be booked. So any colour there? And then I have a follow-up.

Ingrid Johnson - *Sun Life - President of Sun Life Asia*

Thanks very much, It's Ingrid Johnson here. You're exactly right. So this quarter, we are very pleased with the new business gains, so particularly in Vietnam and International, where it's been a focus to improve product economics and margins relating to that, so that we're very pleased about. And then you are seeing also just some changes if we look versus the prior year on just the absence of some of the benefits that we would have had in prior if we had reversed mortality and some investment-related gains.

Kevin Strain - *Sun Life - President, CEO & Director*

I think on new business strain specifically, there's a combination of things. Ingrid's approach of selective underwriting for the International high-net-worth has made that business more profitable. And then as we've added scale, that also helps in terms of business strain. So adding the bancassurance agreements and focusing on building out agency helps with the new business strain item that you were talking about. And Tom, as you noted, of course, goes away under IFRS 17, but we're happy to see a positive result from the selective underwriting and the addition of scale.

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

Okay. That's great. And then the follow-up here is, just curious as to what's driving the increase in the LICAT on transition. If I look back, OSFI has said the movement -- accounting doesn't -- this accounting change is not going to drive capital. I think they had said for the industry as a whole, the movement to IFRS 17 would be capital-neutral. So just curious as to if you can put your now high-single digit, I think it is impact upon transition to your LICAT ratio in that context. Is there -- what is driving your increase? And any commentary you can share with what I said about the industry would be helpful as well.

Kevin Morrissey - *Sun Life - Chief Actuary & Senior VP*

Sure. Thanks for that question, Tom. It's Kevin Morrissey. So yes, we are expecting a favourable high single-digit LICAT ratio increase at January 1, 2023, as part of the transition to IFRS 17. You're right to point out that OSFI did set a target for industry neutrality, recognizing that there will be pluses and minuses. Some companies will be more favorable, some less. So that was an overall. What's driving our specific increase? I think there's a lot of moving pieces, Tom. As you know, LICAT ratio is quite complex and has moving pieces across the numerator and the denominator. But I think that we can highlight probably the one driving factor that accounts for Sun Life's increase is the change to the scalar. So OSFI scalar, on the base solvency buffer reduces from 1.05 to 1 and this accounts for approximately a 7-point increase at transition for Sun Life.

Maybe the one final thought I'll leave with your question with regard to colour on the industry. I think that one of the challenges around the final calibration OSFI had is the changing market conditions and the volatility of LICAT under IFRS 17 as it responds to changes in market conditions, especially interest rates. And so I think with that kind of moving ball throughout the year of 2022, it's I think quite difficult to set that exact point. And I think that where we landed with interest rates higher, that was probably a bit overall favourable for the industry.

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

Okay. And your $1 billion, I think it's your capital generation annually after investing in the business and paying your dividend is still $1 billion annually. Is there any colour you can share with respect on that?

Kevin Morrissey - *Sun Life - Chief Actuary & Senior VP*

Yes, Tom, it's Kevin again. Yes, that's right. We're seeing the IFRS 17 outlook largely the same in terms of capital generation.

Operator

Our next question comes from Paul Holden with CIBC.

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

Want to continue with the same topic. It's an important one given the change in your LICAT ratio. And sort of in the context of given what you were just saying regarding increased volatility under IFRS 17. Does all of the additional capital margin become deployable capital? Or will you have a bias to maintaining more of a LICAT margin because of that increased volatility under IFRS 17.

Kevin Morrissey - *Sun Life - Chief Actuary & Senior VP*

Thanks for the question, Paul. It's Kevin Morrissey. I'll answer the first part around the volatility and then I'll pass it to Manjit around the deployability of that. So when we're thinking about the LICAT volatility, the comment I made around volatility is largely with regard to interest rates. And I did mention the changing interest rate environment, volatility of interest rates that we saw throughout 2022. Where we are now with interest rates, we see our interest sensitivity for LICAT to be largely in line with our reported sensitivities now.

However, one of the things to note is the sensitivities can change quite a bit with changing market conditions. So for example, with interest rates being lower or higher, those sensitivities will change more rapidly than they do under IFRS 4. And a lot of that is driven by the IFRS 17 market consistent cost of guarantees in the new accounting and actuarial basis. So that is something that we're aware of, that we're going to be monitoring, and we're ready to manage, but it is something we do expect will create some inherent increase in underlying volatility.

Manjit Singh - *Sun Life - Executive VP & CFO*

And then just on the second question, Paul. It's Manjit. Overall, the higher capital will lead to higher Holdco cash and deployable capital, but I would just sort of note two considerations. The first is that some of the LICAT increase we're getting is related to businesses outside of Canada, and for those businesses, they continue to be subject to their local regulatory requirements. So there can be some timing differences between when that -- when we can bring that cash balance back up to Sun Life.

And the second factor to consider is obviously, as we've talked about in Kevin's remarks and mine, we also look at the overall operating environment and kind of base our capital levels in that environment. And so those would be two additional considerations.

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

Got it. And then second question is with respect to SLC, another year of strong sales. There has been some industry news regarding certain alternative managers, closing funds for redemptions, maybe some sales headwinds because of higher rates and concerns regarding valuation of the private asset classes. So I think it would be helpful to just give an update on what you're currently seeing and expecting for SLC flows in 2023?

Steve Peacher - *Sun Life - President of SLC Management*

Thanks, Paul, it's Steve Peacher, I'll comment on that. Just quickly looking back at 2022, obviously, a volatile market environment, but we feel really good about the capital that we were able to raise in the past year. I think total capital raise was $18 billion for the year. AUM, depending on whether you look at fee-earning AUM or total AUM, was up double digits. Net flows are over $20 billion for the year. So when I look back at 2022, despite a challenging environment for institutional investors, it was a good capital raising environment for us.

We certainly see some pressures in the institutional market looking forward because if you're making decisions at a large pension fund, insurance company, the volatility of the markets makes decision-making harder. The other thing is that we have something called the denominator effect. And so as public markets have traded off more dramatically than private markets, the weighting in a portfolio to private markets increases. And so when a Chief Investment Officer is thinking about allocating their next dollar and they see their alternative weightings are higher, they may be a little bit less prone to allocate there. And so that created some headwinds in the fourth quarter. You saw that our fundraising was positive in the fourth quarter, but lower than it had been earlier in the year. I think that pressure is going to continue a bit -- continue in the first half of this year.

Having said that, it's against a backdrop, both institutionally and now on the retail front of a trend toward alternative asset classes. So you'll have some fluctuation in trends as the economy moves, its interest rates move, but the basic trend is towards higher allocations. And we don't see that stopping, and we think it's a multi-year trend.

Operator

Our next question comes from Nigel D'Souza with Veritas.

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

I wanted to go back to SLC management. And when I look at the revenue line item, that's up materially quarter-over-quarter. It looks like that's related to Crescent's carried interest and there's a corresponding increase in expenses. Just wondering, was there anything that particularly drove a bit more lumpiness this quarter for that item because there's a bigger divergence between total revenue and fee-related revenue and how we should think about that going forward?

Steve Peacher - *Sun Life - President of SLC Management*

Thanks for the question, Nigel. The way I would -- I really think, given our disclosures now, which I think we improved last year and expanded, really, if you want to look at the core trends in the business, I think you should look at management fees. You can -- I know in the supplement, it's the revenues are on Page 87, I think in the supplement. And management -- if you just isolate management fee revenue for the quarter, it was $234 million, up from $204 million last year. And for the full year, it was $862 million, up from $755 million or about a 14% increase. And those are core management fees for managing assets under management and those revenues are because AUM is up.

If you look at -- and then the core earnings measure that we look at it and also you look at across the industry is fee-related earnings and fee-related earnings for the quarter were $73 million, that was up 22% from the fourth quarter of last year. And for the full year, fee-related earnings were up 20%. So that's really, I think, the way to look at the core business. In terms of performance fees, we don't have a lot of performance fees yet coming through. Those actually, I think, are recorded below underlying income in the reported net income. Over the coming years, you will start to see, I think, more performance fees impact results.

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

Okay. That's helpful. And if I could switch to IFRS 17. I believe Manjit mentioned that the impact was on investment activity gains running lower, and the benefit of the spreads being recognized over a longer period of time. Just wondering if you could expand on that, what is the spread benefit you recognize over the duration of that underlying asset? And could you size the expected decrease in the run rate of investment activity? Would it be 20%, 30%, 40% lower under IFRS 17?

Manjit Singh - *Sun Life - Executive VP & CFO*

So Nigel, it's Manjit. So yes. So under IFRS 4, when we trade up in our investment portfolio, that excess spread, as you know, is present valued into our earnings. Under IFRS 4, you get the same excess spread. So economically and from an earnings standpoint, over time, the benefits will be the same, but that spread now instead of being present valued into earnings, in the quarter that you undertake the activity will come in over time over the duration of the assets. So that would be really a function of the duration of the assets that we traded up into.

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

Okay. So no sizing there. But just to circle up on the guidance you had earlier, I think you mentioned previously that you expect underlying net income under IFRS 17 in 2023 to be higher than underlying income under IFRS 4 in 2022. Is that still the guidance outlook you expect for this year?

Manjit Singh - *Sun Life - Executive VP & CFO*

Well, I think what you have to do, Nigel, is that we just updated our impact from going from IFRS 4 to IFRS 17 to be high-single digits. And then if you want to take a look at what happens in 2023, then you have to factor in the current operating environment that we're in and take account of how that would impact all of our businesses. And I will say, as we said in May, that 2/3 of our businesses are not impacted by IFRS 17, so a business like MFS, SLC, our group businesses, you could kind of just look at what you would normally expect to come out of those businesses in this kind of environment.

Operator

Thank you. We have no further questions at this time. I will turn things over to Mr. Strain for closing remarks.

Kevin Strain - *Sun Life - President, CEO & Director*

Well, thank you, operator, and thank you, everyone, for the great questions. Before we close today's call, I would like to take a moment to thank our employees for their dedication, resilience and persistence over the course of the year. The strength of our people and culture, combined with our focus on execution has been instrumental in achieving great progress on our strategy in 2022. A big thank you from me and the executive team to all of our people. Thanks, operator.

Yaniv Bitton - *Sun Life - VP, Head of IR & Capital Markets*

Thank you, Kevin. This concludes today's call. A replay of the call will be available on the Investor Relations section of our website. Thank you, and have a good day.
