

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

19 June 2020

Update

 Rate this Research

RATINGS

Sun Life Financial, Inc.

Domicile	TORONTO, Ontario, Canada
Long Term Rating	Baa1
Type	Pref. Stock - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Sun Life Financial, Inc.

Diverse operations well positioned to withstand pressure from coronavirus

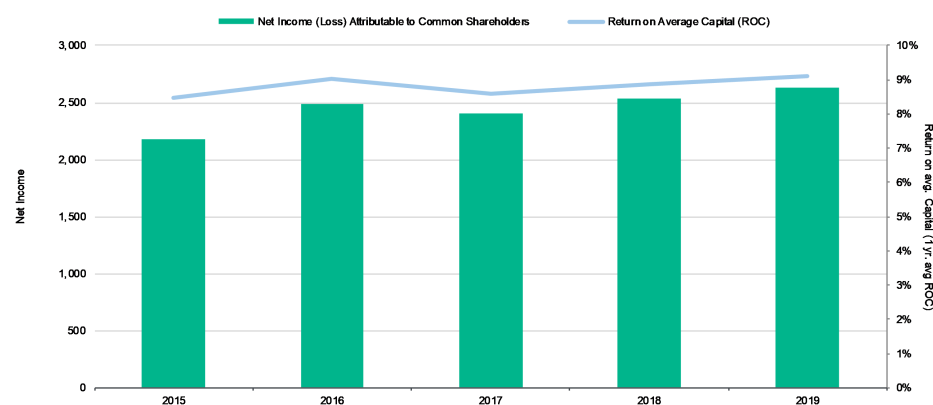
Summary

Our credit view of Sun Life Financial, Inc. (TSX, NYSE: SLF) is based on its excellent business and financial profiles in Canada, which remain the lynchpin of the group's ratings. The holding company owns life insurance and wealth management operations that offer life, health, wellness, disability, critical illness, stop-loss and long-term care insurance, fixed and variable annuities, segregated and mutual funds, as well as financial planning and asset management services. It operates in Canada, the United States, Hong Kong, the Philippines, Indonesia, India, China, Malaysia and Vietnam. SLF has one primary life insurance operating company, [Sun Life Assurance Company of Canada](#) (SLA; insurance financial strength (IFS) at Aa3/stable outlook) – the company's Canadian and international operating subsidiary. SLF sold its US life insurance operating company in 2013, but continues to operate in the US through its SLA Branch. SLF entered the current pandemic-induced downturn on strong financial footing, though the extent of the economic costs will be unclear for some time. Despite reduced profitability, at Q1 2020 capital ratios are at or close to historical highs

Moody's does not rate SLF's senior debt, but does rate a preferred share issue (Baa1 (hyb)). Reported net income contribution by business group (trailing twelve month as of Q1 2020, excluding corporate) was SLF Canada (27%) SLF Asset Management (40%) SLF US (9%) and SLF Asia (24%).

Exhibit 1

Net income and return on capital growing modestly



Sources: Moody's Investors Service and company filings

Credit strengths

- » Excellent market position and brand in the Canadian life insurance market with shares in excess of 10% in nearly all segments
- » Stable profitability from its Canadian operation - a business unit with considerable market clout
- » US asset management franchise adds diversification and provides additional dividend capacity; however, reliance upon asset management earnings could turn into a negative if it becomes a significant component of group earnings

Credit challenges

- » Navigating the uncertainty surrounding the health and economic implications from the coronavirus
- » High total leverage compared to Canadian and similarly rated peers
- » Meaningful exposure to secondary guarantees on segregated funds
- » A business mix that includes a significant wealth management component, exposing the company to equity market and interest rate risks

Outlook

The outlook on preferred shares hybrid rating is stable. Items to watch include significant expansion/acquisition of lower-rated, more volatile insurance operations outside of Canada, maintenance of stable and sustainable consolidated profitability with a return on capital consistently above 12% at SLA. The impact on SLF of the coronavirus and related economic disruption remains highly uncertain, depending on its severity and duration.

Factors that could lead to an upgrade

The following could result in an upgrade of the hybrid rating:

- » Upgrade of SLA
- » Significant improvement in SLF's asset management affiliate's - MFS and SLC Management - assets under management (AUM) and/or earnings

Factors that could lead to a downgrade

The following could lead to a downgrade of SLF's ratings:

- » Downgrade of SLA
- » Significant deterioration in MFS' or SLC Management's AUM and/or earnings

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators table

Exhibit 2

Sun Life Financial, Inc. [1][2]	2019	2018	2017	2016	2015
As Reported (Canadian Dollar Millions)					
Total Assets	297,202	271,827	269,112	258,238	246,853
Total Shareholders' Equity	24,508	24,570	22,971	22,368	21,418
Net Income (Loss) Attributable to Common Shareholders	2,618	2,522	2,149	2,485	2,185
Total Revenue	39,679	26,997	29,334	28,573	19,274
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	76.8%	72.8%	82.1%	82.1%	81.5%
Goodwill & Intangibles % Shareholders' Equity	34.3%	30.8%	31.6%	33.3%	30.6%
Shareholders' Equity % Total Assets	7.3%	8.2%	7.6%	7.7%	7.7%
Return on Average Capital (ROC)	9.1%	8.9%	8.6%	9.0%	8.5%
Sharpe Ratio of ROC (5 yr.)	3312.7%	1627.9%	1434.5%	752.4%	134.2%
Adjusted Financial Leverage	18.7%	18.3%	20.8%	22.8%	24.4%
Total Leverage	30.4%	31.0%	33.4%	35.3%	36.7%
Earnings Coverage	8.3x	8.8x	8.0x	9.2x	9.3x
Cash Flow Coverage	6.4x	7.1x	8.4x	10.0x	16.2x

[1]Information based on IFRS financial statements as of the fiscal year ended 31 December. [2]Certain items may have been relabeled and/or reclassified for global consistency.

Sources: Moody's Investors Service and company filings

Group profile

SLA owns life insurance and wealth management operations around the globe, with its most significant market presence in Canada, the US and Asia. The company's corporate structure is made up of two major segments:

1. Sun Life Assurance Company of Canada (SLA; Aa3 for insurance financial strength). This entity houses the life, health and annuities businesses of the Company's Canadian operations, the majority of its protection businesses in the United States, and all of its operations in the United Kingdom and Asia.
2. Sun Life Global Investments Inc. (SLGI; unrated). Under this entity, SLF has placed most of its investment management businesses in Canada and the United States. Also owned by SLGI, either directly or indirectly, are MFS and MFS Investment Management Canada, and SLC Management (formerly Sun Life Investment Management).

For the trailing twelve months as of Q1 2020, SLF on a consolidated basis reported net income of CAD2,386 million. Excluding the corporate segment, SLF Canada generated CAD604 million in reported net income, the US segment reported net income of CAD203 million, SLF Asset Management contributed CAD917 million in reported net income and SLF Asia accounted for CAD540 million.

Exhibit 3

Revenue by segment

Trailing twelve months as of Q1 2020

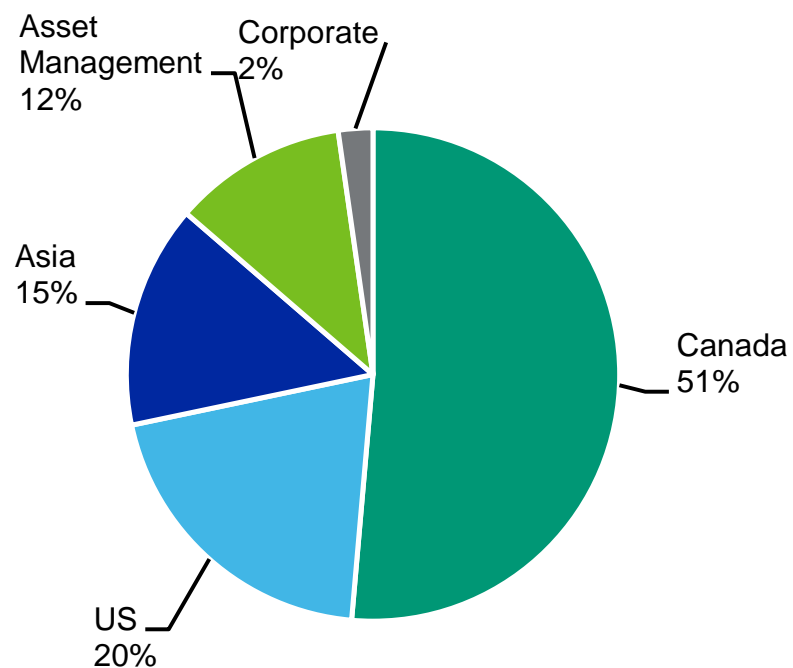
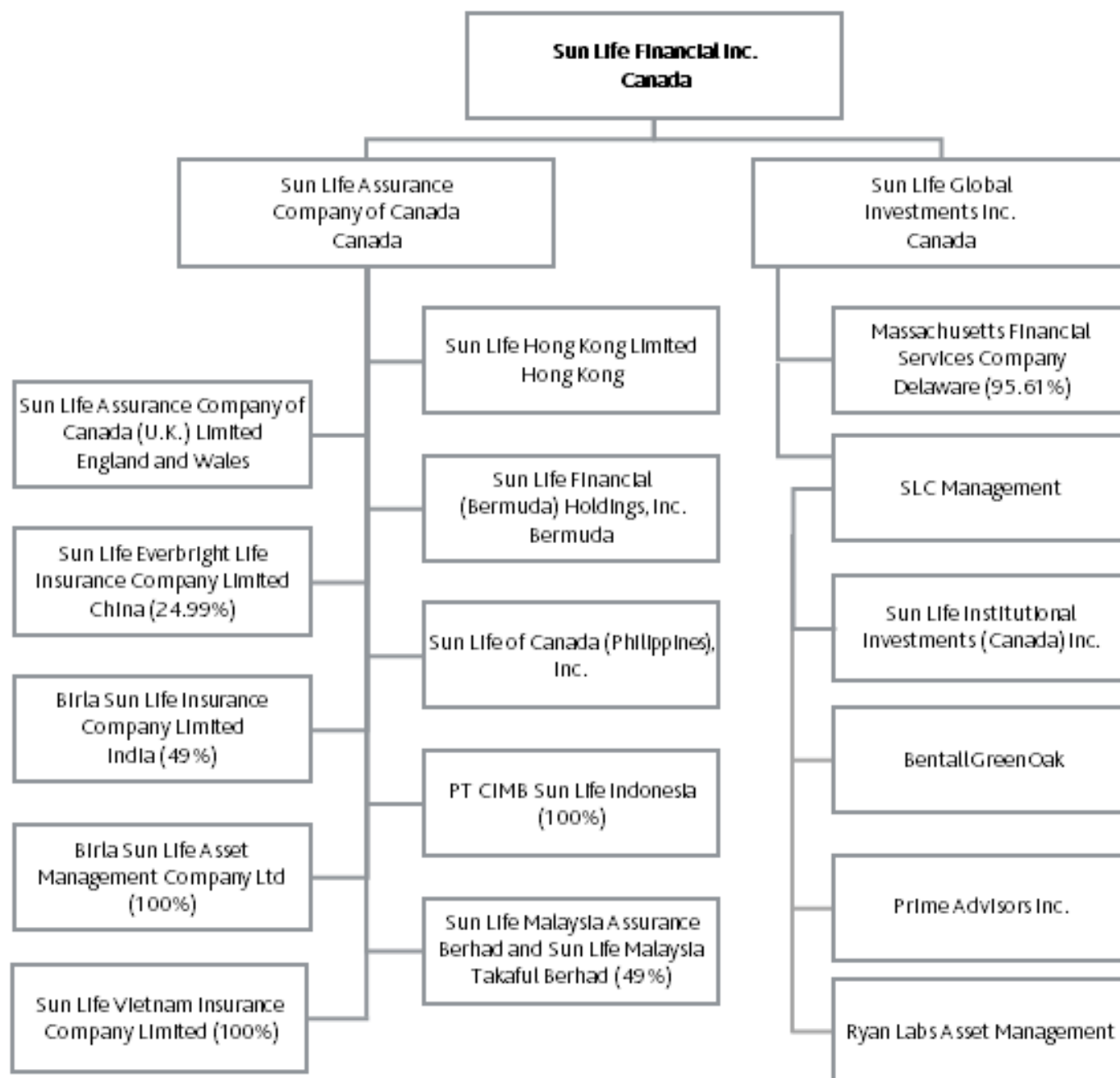
*Source: Moody's Investors Service, data from company reports*

Exhibit 4
SLF organization structure



Moody's Investors Service, data from company reports

Credit profile of significant subsidiaries

Canadian life operations

SLA's IFS rating is based on its exceptional market position in Canada, strong product risk and diversification profile, strong and predictable Canadian earnings, and solid capitalization. This franchise is solidified by a large career insurance sales force, with improving retention metrics. The strong and generally predictable profitability generated by the company in Canada is the central pillar supporting the company's high IFS rating.

SLA holds the number one or two market share positions in virtually all its market segments which gives it the pricing power to maintain attractive margins. The Canadian life insurance industry benefits from two long-term trends that should continue to generate strong demand for insurance and wealth management products. The first trend is the many baby-boomers entering or approaching retirement. Second is the increasing efforts of employers and of governments to shift health and pension costs and responsibilities to employees and citizens. Therefore, the challenge for the industry continues to be designing products to satisfy this consumer demand without retaining excessive risks for the insurance company.

These strengths are tempered by a business mix that has a pronounced weighting in "wealth management" products. These products - which include segregated funds (i.e., variable annuities) - expose SLA to equity market and interest rate risks, and drive a higher degree of earnings volatility than protection products. At March 31, 2020 the firm reported that a 10% drop in equity markets could reduce its Life Insurance Capital Adequacy Test (LICAT) ratio by 0.5% and a 50 basis point increase in interest rates would reduce its LICAT ratio by up to 4%.

The group's acquisition activity has led to a high level of goodwill relative to its equity base, which strains its overall asset quality and financial flexibility to some extent.

US life operations

In the SUS, SLF has two business units; Group Benefits and In-Force Management. Group Benefits provides insurance solutions to employers and employees, including group life, disability, medical stop-loss, dental and vision insurance products, as well as a suite of voluntary benefits products. In-force Management includes certain closed individual life insurance products, primarily universal life and participating whole life insurance.

Asia operations

SLA also operates in Hong Kong, the Philippines, Indonesia, India, China, Malaysia and Vietnam. The product offerings in these geographies are oriented towards straightforward protection products distributed through independent agency channels and a growing bancassurance capability. SLA plans to grow these operations to become a more significant contributor to earnings (approximately 24% earnings). In Q1 2020 the Asia segment was reorganized into two business units. Local Markets which sells insurance and wealth products, and International Hubs which focuses on high net worth clients.

Asset management operations

SLF also has substantial equity positions in several U.S. and Canadian investment management companies and operates them under its asset management segment SLF Asset Management which reported AUM of CAD703 billion at March 31, 2020. The segment owns 96% of U.S.-based Massachusetts Financial Services Company (MFS). At \$436 billion in AUM as of March 31, 2020, MFS has significant scale. Investment performance has been positive over time, supporting growth. AUM diversification is balanced with approximately 55% of AUM in retail mutual funds, 31% in traditional institutional funds and 13% in assets managed for insurance companies, a niche in which it is a leader. Global institutional distribution is through an internal sales force and independent consultants. Mutual and segregated funds are distributed in Canada through SLF's peer leading proprietary sales force, and elsewhere through financial intermediaries such as full service brokerage firms and banks. Although controlled by SLF, MFS maintains distinct branding, which we view as an advantage in seeking new mandates.

MFS is primarily an active manager with an emphasis on equity funds (approximately 80% of total AUM) of which more than half are invested in international equities. MFS, together with all active managers, has been negatively affected by the continuing trend away from active management, as net outflows for 2019 were CAD12 billion.

SLF has completed a number of asset management acquisitions, including Excel Funds, Prime Advisors, Ryan Labs Asset Management, BentallGreenOak in recent years. These acquisitions are consistent with SLF's strategy to build on its existing third-party asset management capabilities and will be accretive to earnings going forward.

Financial flexibility

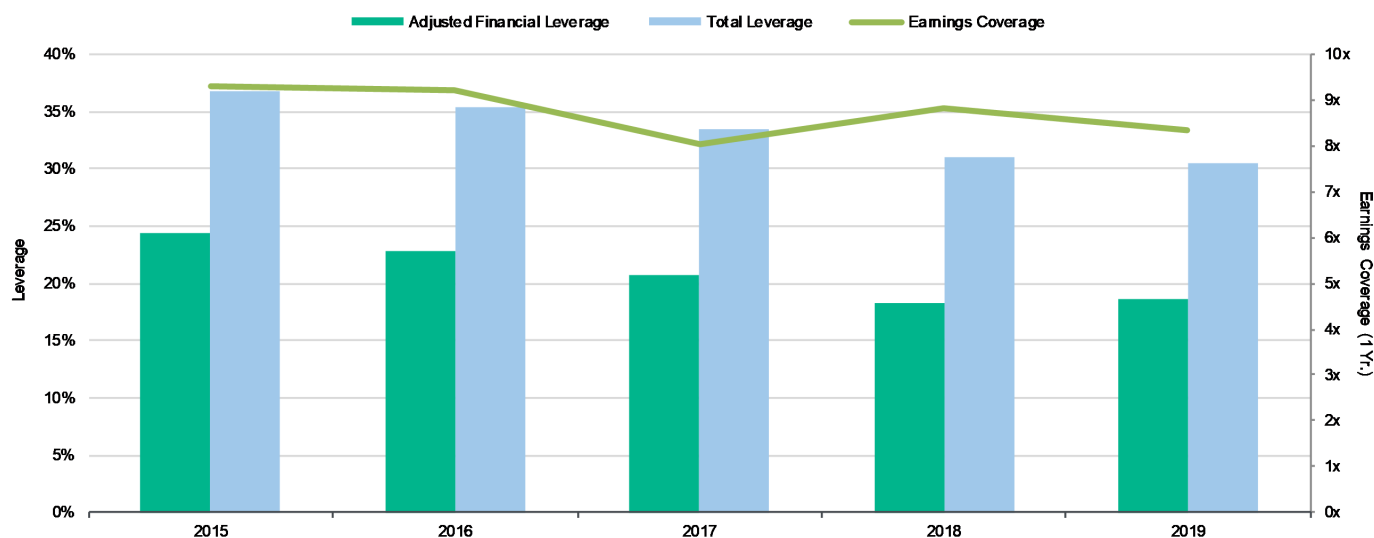
To understand capital structure and liquidity at SLF overall, Moody's believes it is critical to understand its corporate structure, as discussed in the group profile section.

On comparative IFRS basis, financial leverage metrics have improved since 2015 due to strong earnings from positive operating performance as well as a reduction in financial debt. The adjusted financial leverage has decreased to 18.7% in 2019 from 24.4% in 2015. Total leverage was high at 36.7% in 2015, but has trended lower for the past five years to 30.4% in 2019. The primary driver of SLF's higher total leverage is the inclusion of captive reinsurance arrangements related to closed blocks of individual universal life insurance with no-lapse guarantee benefits. These structures provide financing of US statutory reserve requirements in excess of those required under IFRS and are supported by a guarantee from SLF. We expect leverage to increase, as SLF opportunistically issued CAD1 billion of subordinated debentures in May 2020 at low all-in coupons ahead of upcoming debt redemptions and maturities, as well as to bolster capital levels during uncertain times.

In 2019, equity benefited from CAD2.6 billion in net income. Sun Life's one-year earnings coverage ratio stood at 8.3x at year-end 2019 – up from 8.0x for 2017. Consolidated interest expense at the holdco was CAD335 million for the trailing twelve months as of Q1 2020. SLF's more normalized earnings levels observed from 2015 to 2019 have restored a healthier level of financial flexibility. That said, Sun Life's high total leverage ratio implies the company could have less marginal debt capacity in a stress period than similarly rated peers. In response to COVID-19, the Office of the Superintendent of Financial Institutions (SLF's regulator) halted share buybacks and dividend increases at Canadian financial institutions for the time being.

Exhibit 5

Financial Flexibility: Declining leverage and relatively stable coverage



Sources: Moody's Investors Service and company filings

Liquidity analysis - solid holdco coverage

The firm's liquidity policies require each operating subsidiary to keep sufficient liquidity to meet expected liabilities in both a one month and one-year stress test. The holding company targets CAD500 million in excess cash and has access to \$1 billion in fully committed credit facilities as at December 31, 2020. SLF ended Q1 2020 with CAD2.4 billion of cash and liquid assets at the holding company, up from CAD2.3 billion at year-end 2019 primarily attributable to earnings of CAD391 million and favorable exchange rate movements. Partially offsetting this was CAD200 million of common share repurchases and CAD323 million of common

share dividends. There is dividend capacity available to the holding company from its Canadian life insurance and US investment management franchises. SLF's unrestricted subsidiary dividend capacity totaled approximately CAD2.9 billion at year-end 2019. Moody's calculates SLA's dividend capacity on the basis of the company maintaining its LICAT ratio above 130%.¹

These sources, in total, exceed the 2019 major uses of cash at the holding company, which include CAD1,331 million in common and preferred share dividends paid and CAD239 million of interest expense paid. In 2019, SLF increased its dividend per share twice for a total increase of 10% representing a payout ratio of 41% of underlying net income. Scheduled maturities within the next five years include CAD300 million of Series E senior unsecured debentures due 2021 and CAD500 million of Series 2015 subordinated debt due to 2025. The company has no commercial paper outstanding

Environmental, social and governance considerations

Environmental

An increased focus on environmental risks by life insurers is net credit positive for the industry. A responsible investing approach encourages insurers to think long term, diversify their portfolios, manage regulatory trends, and consider more broadly the material risks and opportunities across all asset classes.

Social

Life insurers have a moderate overall exposure to social risks. Given this sector's reliance on handling customer data and privacy, customer relations are important. Regulatory, demographic and societal trends related to regulatory rules and practices, taxation of products, people living longer, and an aging population will affect products that are sold for retirement and estate planning, and the ability of insurers to effectively distribute and price these products.

Governance

Corporate governance is highly relevant to life insurers and is important to creditors because governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit a company's credit profile. The governance considerations most relevant to our credit analysis are (1) management credibility & track record, (2) ownership structure (e.g. privately held, publicly traded, or mutual), (3) growth and financing strategy, (4) risk management, and (5) Board oversight.

Support and structural considerations

The spread between SLF's Baa1 (hyb) preferred shares and SLA's Aa3 IFS rating is four notches. This reflects a two notch differential between SLF's implied senior debt rating and the Aa3 IFS rating of SLA. SLF has considerable latitude to upstream dividends from its life insurance operating companies, particularly from Canadian-based SLA, because the dividend regulations are relatively liberal in Canada. The company also receives dividends from its intermediate holding company SLGI.

Moody's related publications

Outlook

[Insurance – Canada: 2020 Outlook](#)

Sector in-depth

[Q1 2020 Earnings — Balance sheet resilience evident despite earnings declines](#)

Issuer profile

[Sun Life Financial, Inc. Key Facts and Statistics - FYE Dec 2019](#)

Methodology

[Life Insurers](#)

Ratings

Exhibit 6

Category	Moody's Rating
SUN LIFE FINANCIAL, INC.	
Rating Outlook	STA
Pref. Stock	Baa1 (hyb)
SUN LIFE ASSURANCE COMPANY OF CANADA	
Rating Outlook	STA
Insurance Financial Strength	Aa3

Source: Moody's Investors Service

Endnotes

¹ 2017 and prior cash flow coverage metrics are based on MCCR ratios above 200%.

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