SLF.TO - Sun Life Financial Inc IFRS 17 Investor Education Call

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PRESENTATION

Operator

Good morning, everyone. My name is Katherine, and I'll be your conference operator today. At this time, I would like to welcome everyone to Sun Life Financial's IFRS 17 Investor Education Conference Call. (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 IFRS 17 investor education session. The slides for today's meeting are available on the Investor Relations section of our website at sunlife.com. We will begin the call with Manjit Singh, Executive Vice President and Chief Financial Officer, who will provide an overview of the key takeaways from today's session.

Following Manjit's remarks, Kevin Morrissey, Senior Vice President and Chief Actuary, will walk us through key changes from IFRS 17 and their impact for Sun Life. Natalie Brady, Senior Vice President, Strategic Finance Initiatives, and Lead for our IFRS 17 project, will highlight how IFRS 17 impacts our financial reporting.

After the prepared remarks, we will move to the question-and-answer portion of the call. Kevin Strain, President and Chief Executive Officer, is also here today and will be available for Q&A.

Turning to Slide 3. 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. This means that estimates and directional statements made in today’s presentation are dependent on the economic and operating environment throughout the remainder of 2022 as well as over the medium-term period.

And with that, I'll now turn things over to Manjit.

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

Thank you, Yaniv, and good morning, everyone. We’re pleased to be hosting today’s IFRS 17 investor education session, which builds on the industry education materials that were shared in April.

In today's presentation, we will outline key changes from the adoption of IFRS 17, the expected impact of those changes for Sun Life, along with an overview of the new financial reporting and disclosures.

Before we begin, I want to note that there are some accounting, tax and capital treatments that are not yet finalized and that we are currently working through our comparative transition periods.

In addition, forward-looking projections and estimates will be dependent on the future operating environment. This means that the estimates we provide today may be subject to change. It also means that we may not have answers to all your questions at this time. As we get final guidance and continue to work through our transition, we will provide further updates.

Turning to Slide 5. I’ll begin with some key takeaways from today’s session. First, over the past decade or so, Sun Life has built a strong set of diversified businesses across protection, health, wealth and asset management. Our diversified business mix has been a key differentiator for Sun Life.

And while the transition to IFRS 17 will impact the timing and presentation of financial results, it does not change the underlying fundamentals of our business, how we serve our clients, our core business strategies, the lifetime economics of our products or the long-term value that Sun Life delivers for our clients and shareholders.

Second, we will continue to deliver a strong set of medium-term financial objectives. Upon adoption of IFRS 17, we are increasing the underlying ROE objective to 18% plus and maintaining our objectives for underlying EPS growth and the dividend payout ratio.

We will also continue to grow our dividends in line with our EPS growth objective of 8% to 10%. From a capital perspective, we expect an increase to our LICAT ratio on transition, further bolstering our strong capital position.

Third, the key IFRS 17 change is centered around how we measure insurance contract liabilities. One of the fundamental changes is the establishment of the new Contractual Services Margin, or CSM, for our in-force businesses. The establishment of the CSM at transition will be facilitated by 15% to 20% transfer from shareholders’ equity.

It is important to note that the CSM qualifies as LICAT capital and will be amortized back into income over subsequent periods.

Fourth, there will also be changes in the timing of when earnings are recognized for new insurance contracts. Kevin Morrissey will discuss these aspects in more detail. These changes will result in a mid-single-digit decline in 2022 underlying net income when we restate to an IFRS 17 basis.

Nonetheless, we expect to generate positive year-over-year underlying earnings growth from 2022 IFRS 4 to 2023 IFRS 17 earnings.

Finally, we expect that our underlying net income will be more stable under IFRS 17 than under IFRS 4. We will also provide financial statement users with more information to outline the key drivers of our insurance business. Natalie Brady will provide more details on this in her discussion today.
Turning to Slide 6, which outlines the impact of IFRS 17 changes across our businesses. Asset Management, Wealth and Group Benefits, which comprise approximately 60% of our business, will see little to no impact under IFRS 17.

So MFS and SLC Management, as well as our other asset management businesses in Canada and Asia, will not be impacted. And the Group Benefits businesses in the U.S. and Canada will see very little impact, mostly consisting of changes in financial statement presentation.

20% of our businesses are comprised of pass-through products like our participating policies or products with significant investment-linked features like our variable Universal Life products in Asia. These businesses will experience impacts on transition to IFRS 17 but will have a stable pattern of earnings, going forward.

The remaining 20% of our business is traditional insurance, which will see a more significant impact, and Kevin will be outlining the key changes in a few minutes.

Turning to Slide 7, which outlines the overall impact by business pillar. Asset Management will experience no impact. The U.S., which is largely comprised of shorter-term Group Benefits businesses, will see a fairly low impact.

In Canada, the majority of earnings are driven by Group Benefits and Wealth Management, which have low impacts, while traditional insurance will have higher impacts, largely reflecting the deferral of pricing gains.

And finally, Asia will experience more significant impacts under IFRS 17. This reflects the mix of products and businesses, developing scale in some of our markets, as well as the significant growth we have seen in recent years.

Turning to Slide 8. Sun Life’s diversified set of businesses will continue to deliver attractive medium-term financial objectives. We are maintaining our medium-term objective for 8% to 10% underlying EPS growth.

We are also maintaining our underlying dividend payout ratio at 40% to 50%, which reflects our continued financial strength under IFRS 17. You’ll recall that in the third quarter of 2021, we increased our underlying ROE objective from 12% to 14% to 16% plus, reflecting our diverse business mix and shift towards capital-light businesses.

Effective January 1, 2023, we are increasing our underlying ROE objective to 18% plus. This update reflects the impact on shareholders’ equity from remeasuring our insurance contract liabilities as well as good earnings from our attractive mix of businesses.

I will now hand it over to Kevin Morrissey, who will take us through some of the key changes and related impacts from the transition to IFRS 17.

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thank you, Manjit, and good morning, everyone. I’m going to provide an overview of some of the key changes as we transition to IFRS 17 and the impact of the changes on our balance sheet at transition and how the changes impact some of our key financial metrics.

Turning to Slide 10. Our presentation today will cover 4 main themes. First, IFRS 17 is an accounting regime change that impacts our balance sheet and the timing of income recognition for some of our insurance businesses. It does not impact the underlying fundamentals of our products or our strategies.

Second, at transition we expect to transfer 15% to 20% from shareholder equity to insurance contract liabilities to fund the increase. This represents a relatively small increase of 2% to 4% to our $146 billion insurance contract liabilities as of December 31, 2021. Most of the impact is from the new CSM liability, which counts as capital, and will come back into income over time.

Third, I will provide some detail on the impact on underlying earnings in the comparative year. Sun Life restated 2022 underlying net income on an IFRS 17 basis, is expected to modestly decrease relative to IFRS 4.
Underlying net income is expected to be more stable than IFRS 4 and will be more transparent as key components of the liabilities like CSM will be disclosed separately.

Fourth, I will highlight the impact on LICAT capital at transition. We expect our already-strong LICAT ratio to improve, with neutral impact on capital generation and capital volatility.

Turning to Slide 11, we show an overview of the key IFRS 17 changes that impact reported net income. A big change is that IFRS 17 defers the timing of recognition of new business gains. These gains will now be recorded in the CSM liability, which will amortize into income over the lifetime of the contracts.

New business losses are recorded in net income immediately as they are today. Remember that today, the reported new business gain is net of gains and losses. More on this later.

Next, IFRS 17 requires liability discount rates based on current risk-free rates, with an illiquidity premium that reflects the characteristics of the liabilities. Our liability discount rates will no longer be directly linked to the portfolio of assets supporting our liabilities. This will result in more reported earnings volatility than we have now.

Measurement of financial guarantees like minimum interest rate guarantees, will change as IFRS 17 requires a valuation that is consistent with market option prices. This also results in higher volatility during the life of the contract, but much of this volatility will impact the CSM and not earnings.

Importantly, even with the new earnings and CSM volatility, overall capital volatility is expected to remain low, similar to today. A ripple effect of these discount rate changes can be seen in the timing of recognition of investment profits.

Today, investing activity gains are recognized into income in the quarter the trading activity takes place. Going forward, the incremental value generated by investing activity will be recognized into income as it is earned over time.

Similarly, changes in investment strategies like asset mix changes, which record value of future reinvestment trades under IFRS 4 will also be recognized as earned.

Finally, the assumption changes and management actions, ACMA, are treated differently under IFRS 17. ACMA related to insurance risks, like mortality or policyholder behaviour assumptions, will be recorded in CSM rather than in income. This treatment removes many of the ACMA items currently impacting net income.

Assumption changes related to financial risks, like discount rates, will continue to go through income for most products. For products that are measured using the variable fee approach such as segregated fund guarantees, financial risk ACMA will go through CSM. Note that there are fewer financial assumptions under IFRS 17. For example, no reinvestment risk assumptions, no equity or real estate assumptions. So there will be fewer financial risk ACMA items impacting net income. Overall, the number of ACMA items impacting earnings will be much smaller than today, and the ACMA impact to CSM will be a new and important lens on results that will drive future earnings.

Continuing with the key IFRS 17 changes on Slide 12, the diagram illustrates changes to the components of insurance contract liabilities and the related changes to the sources of future expected profit. The diagram is meant to be illustrative and should not be interpreted as to scale.

On the left, you can see the components of the liabilities today under IFRS 4 and how they change as we transition to IFRS 17. On the right side of the page, you can see the implications of these changes on sources of future profit.

In total, the IFRS 17 liability is expected to be about 2% to 4% higher at transition, driven by the new CSM liability. The amount of CSM we establish at transition represents profits considered unearned on our in-force business under IFRS 17.
The CSM amortization will provide a large source of stable and predictable future profits. The CSM balance and amortization pattern will be highly visible in new IFRS 17 disclosures. The risk adjustment component of the liability is very similar to insurance PfADs today, and so the income from this source is relatively unchanged.

Present value of future cash flows is not a best estimate liability. It implicitly includes margins for financial risk, like credit losses, and financial guarantees, for example, minimum interest guarantees.

This means that the present value of future cash flows will generate 2 sources of future expected profit: one, from market consistent provisions for financial guarantees, which will unwind over time; and two, from asset returns in excess of the new IFRS 17 discount rate.

The latter source is expected to be driven mostly from equity and real estate returns. Note that IFRS 17 requires that only expenses that are directly attributable to insurance contracts can be provided for in the liabilities.

We will continue to incur the non-attributable expenses on our in-force, and we will price for these in our new business. Accordingly, they will be largely offset by the amortization of the CSM, going forward.

Slide 13 summarizes the final 3 themes, which are all related to IFRS 17 impacts. At transition, the impact to shareholder equity is driven by changes to the composition and remeasurement of insurance liabilities, largely to establish the new CSM liability.

Since IFRS 17 defers profits over the life of the contract and we are required to apply IFRS 17 to all existing in-force contracts, this requires a significant transfer from shareholders’ equity to liabilities.

After transition, we expect to see a modest reduction to underlying income in the 2022 comparative year. Again, the deferral of profit is a key driver.

Due to the growth of profitable sales in recent years, the deferral of new pricing gains is not immediately fully offset by the CSM amortization, and the income growth is reduced in 2023 then accelerates, going forward.

The majority of our diverse business mix is largely unimpacted and continues to grow. And overall, we expect positive underlying net income growth from 2022 under IFRS 4 to 2023 under IFRS 17.

And for capital, we expect our LICAT ratio to improve on transition and capital generation and capital volatility to be neutral, going forward.

Slide 14 provides details on the 15% to 20% transfer of shareholder equity to IFRS 17 liabilities. Approximately 2/3 of the impact to equity is driven by the establishment of the CSM and our in-force business.

As you can see in the diagram, a significant portion of the transition CSM does not impact equity, that’s the blue-shaded area, as it just replaces existing IFRS 4 provisions for reinvestment risk and nonattributable expenses.

The entire amount of the CSM will count as available capital in the LICAT ratio formula. Under current draft guidelines, the CSM is Tier 1 available capital, equivalent to shareholders’ equity.

The remaining 1/3 of the equity impact arises from other changes in liability measurement, mostly related to discount rates and financial guarantees. Again, this change generates a new source of expected profit as the incremental value of our investment strategies related to equity and real estate will be recognized into income over time.

Turning to Slide 15. We provide more details on the drivers of CSM at transition. The equity impact at transition represents a relatively small percentage increase in our liabilities. This increase of 2% to 4% is within our expected range, given the nature of our IFRS 17 changes and the characteristics of our in-force book.
It is worth noting that publicly available information provides an incomplete view of the inputs needed to accurately estimate the transition CSM. I will explain why. To do so, we have shown the CSM equity impact in 3 distinct pieces.

Number one is the open blocks with recent new business gains. This information is partially available from past-reported pricing gains. However, the deferred gains included in the CSM are gross gains, and the current reported new business gains under IFRS 4 are net of gains and losses. This accounts for about 50% of the CSM impact to equity.

Number two is the closed blocks of business. Blocks like the U.S. In-force Management, the U.K., and other smaller blocks, which have not had any pricing gains for a long time, however, still have unearned profit under IFRS 17. This represents about 30% of the total.

Number three is variable universal life products in Asia, which contribute the remaining 20% of the total. These UL products have unit-linked investment accounts, and these products are sold mainly in the Philippines, Hong Kong and Indonesia. They do not currently have any pricing gains at issue.

However, the income under IFRS 4 is skewed to early years, based on the pattern of fee income. Under IFRS 17, the fee income will be replaced with a sizable CSM that will be recognized evenly over the life of the contract.

Turning to Slide 16. We are expecting to see positive underlying net income growth from 2022 IFRS 4 to 2023 IFRS 17. This is made up of a mid-single-digit decrease in 2022 as we restate the comparative year on an IFRS 17 basis, plus growth in other businesses not impacted by IFRS 17 and growth in our insurance businesses under IFRS 17.

What is driving the decrease in 2022? There are two main drivers. The first is the deferral of pricing gains and the second is the deferral of Asia VUL profits skewed to early years. Both of these sources were previously mentioned as drivers for the size of the CSM and the impact to shareholder equity. I will cover each of these in a little more detail on the next two slides.

Before I move on, it is worth noting two other changes in net income. Both of these sources are significant, each on their own, but together are not expected to result in a material net change.

On the plus side, the value of equity and real estate investments will be recognized over time under IFRS 17, creating a new sustainable source of underlying earnings. This new source of income is expected to offset the deferral of investing activity gains under IFRS 4 that are recognized into income in the period the trading activity takes place.

The size of the new annual income stream from returns above the IFRS discount rate is expected to be roughly the same size as our historical investing activity. Taken together, these changes result in no net significant change to underlying earnings.

On Slide 17, I want to drill down on the concept of pricing gain deferral. In today’s accounting regime, impacts of new business, the net of both gains and losses, are recognized into net income in the quarter in which the contracts are issued.

Typically, we see new business gains in well-established businesses that are at scale, such as our Canadian business, while we may see strain at issue in less mature high-growth markets like many of our Asia businesses.

The diagram illustrates how reported net new business gains are made up of gross gains and losses. As I noted earlier, IFRS 17 moves gains at issue into the CSM and amortizes these. But losses at issue will continue to be recognized in net income immediately.

Note, that the pattern of reported gains, the blue dots, have been increasing in recent years. This trend line, along with the IFRS 17 rules, results in a transition point in 2022 for Sun Life, where the CSM amortization of deferred profits is expected to be less than the size of the gross pricing gains in that year.
Turning to Slide 18. I want to take a few minutes to discuss the Asia VUL product, which is sold, as I mentioned, in Philippines, Hong Kong and Indonesia. These are Universal Life products with a significant investment component, where clients earn returns linked to external funds.

As you can see in the diagram, for this product, the IFRS 17 pattern of earnings is quite different than we see under IFRS 4, lower in the early years and higher in the later years. IFRS 4 income is skewed to early years due to the timing of fee income. Currently, these products have zero pricing gains.

Although there was no pricing gain to defer, IFRS 17 levelizes the income over the life of the product, resulting in an income deferral compared to IFRS 4. As our Asia pillar has been growing, the VUL sales have been on an upward trend and so, similar to pricing gains on the previous slide, the IFRS 17 impact across our growing in-force VUL portfolio, results in a transition point in 2022 for Sun Life, where the CSM amortization from VUL is expected to be less than the size of the deferred profits on VUL in that year.

Turning to capital on Slide 19. Based on the latest OSFI draft guideline and the economic environment as of March 31 this year, we expect our LICAT ratio to modestly improve at transition. I want to caution that changes to market factors can impact results and that the LICAT guideline is not final.

It is worth repeating that the reallocation of equity to the CSM liability at transition is neutral to the LICAT ratio as CSM is considered Tier 1 capital in LICAT framework, the same as retained earnings.

Our capital generation and cash deployment capabilities will not be impacted by IFRS 17. Strong growth of the new business CSM is expected to translate into a growing total CSM, providing a growing high-quality source of capital.

Finally, our capital volatility to market factors, which is currently low, is expected to remain low after transition to IFRS 17. The sensitivity to market factors, like interest and equity, will change. However, at this point, our analysis indicates that the overall sensitivities stay low.

As we work through our dual reporting this year, and we get more experience with the impact of changes in market conditions on LICAT under IFRS 17, we will be able to share more details at a later date.

Moving to Slide 20. In closing, on transition to IFRS 17, we expect an increase in liabilities and a decrease in shareholders’ equity, largely driven by establishment of a transition CSM. The increase in liability will lead to new and growing sources of future income that will be both transparent and predictable.

IFRS 17 underlying income for the 2022 comparative year is expected to decline moderately. However, we still expect to generate underlying net income growth from 2022 under IFRS 4 to 2023 IFRS 17.

And finally, our capital strength will improve at transition and our ability to deploy capital will not be impacted by the move to the new regime.

And now, I’ll turn the call over to Natalie Brady.

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Natalie Brady  -  Sun Life  -  SVP of Strategic Finance Initiatives

Thank you, Kevin. Good morning, everyone. Now that we have outlined the key changes, let’s turn to Slide 22 for an overview of how these changes will be reflected in financial reporting post implementation.

Overall, the new financial reporting under IFRS 17 will provide a number of enhancements to the reporting of insurance financial results. Specifically, the new income statement will provide additional transparency into the sources of profits for insurance businesses.

However, the income statement alone will not provide the information needed to understand the drivers of our insurance income. To address this, we will be providing a new Drivers of Earnings analysis and continuing to provide an underlying net income metric.
As Kevin mentioned, under IFRS 17, a key new concept is the CSM. We will provide details on the CSM that will highlight the organic CSM growth, driven by our businesses, separate from one-time items or impacts from market movements.

Overall, we believe that compared to current reporting, the new reporting being introduced with IFRS 17 will bring increased transparency, stability and predictability to the financial results for our businesses.

Turning to Slide 23. There will be significant changes in the presentation of our results with the new income statement. One of the key benefits of this new income statement is the logical separation of earnings into 3 sections.

The first section is the insurance service results section, which will include both the revenue earned and expenses directly associated with our insurance contracts. The second section on net investment results will include our total investment-related earnings.

The third section includes the revenues and expenses not related to our insurance businesses. This will include the fees and expenses associated with our Asset Management and Administrative Service Only businesses. It will also include the expenses that are not directly attributable to our insurance businesses.

Turning to Slide 24. We provide a simplified view of how our various businesses will be presented in the new income statement.

This view highlights how traditional insurance products, which, as Manjit mentioned, represent approximately 20% of our overall business, will see the results reported across all 3 sections of the new income statement. The accounting for the remaining 80% of our business is much simpler.

For pass-through and fee-based insurance, the insurance service results section contains the majority of the accounting for these products. There is no impact in the net investment results section as the impact of market experience is recorded in the CSM as long as there is sufficient CSM to absorb it.

For our Asset Management and Group Benefits businesses, the accounting is concentrated in just a few lines, which is similar to the current accounting for these products.

Overall, we believe this new presentation, compared to the current income statement under IFRS 4, provides a more transparent view of the sources of earnings generated from Sun Life businesses.

Turning to Slide 25. To complement the income statement, we will provide a new Drivers of Earnings analysis. We expect a version of this additional disclosure to be used by all large Canadian insurers.

As we transition to IFRS 17, the volatility mentioned in Kevin’s presentation will be focused within the net investment results section of both the income statement and the Drivers of Earnings analysis.

There are 3 main sources of period-to-period volatility that will impact our reported net income, all of which are related to our traditional insurance products.

The first source of volatility relates to the removal of the direct link between the asset and liability discount rates. This disconnect means that market movements will impact our assets and liabilities differently in a given period, causing volatility in the net investment results.

A second source of volatility will come from the new requirements related to the measurement of financial guarantees, which will fluctuate with market movements.

Finally, a third source of volatility relates to the impact on earnings from assumption changes. As Kevin mentioned, changes to insurance and financial risk ACMA go through reported net income today.
Under IFRS 17, only financial risk ACMA on our traditional insurance products will impact the income statement. All other changes will be recorded in the CSM as long as there's sufficient CSM.

For our pass-through and fee-based businesses, these same 3 sources of period-to-period volatility will be recorded in the CSM, and only impact reported net income if the CSM is insufficient to absorb them.

Given this temporary volatility within our results, the Drivers of Earnings will also be provided in a format that outlines the underlying net income, which excludes these impacts.

Turning to Slide 26. Our philosophy for underlying net income is not changing when we transition to IFRS 17. Items not representative of long-term economics or the future earnings power of our business will continue to be excluded from underlying earnings.

Sun Life holds assets for the long term to support its liabilities. Period-to-period changes in market movement, which impact our assets and liabilities, are expected to largely offset over the long term.

Given that the impacts of these short-term market fluctuations are not representative of the underlying earnings generation of Sun Life, they will be adjusted from our reported net income similar to today.

Turning to Slide 27. The CSM represents both the stored value of our in-force insurance business and the growth derived from our new insurance sales. Understanding the changes in the CSM balance period-to-period, will be important to understanding the future growth potential of our insurance businesses.

Similar to the Drivers of Earnings analysis, we will separate the business-driven items impacting our CSM from those items that are impacted by temporary fluctuations in markets and other one-time items. This will provide a view of the organic movement of the CSM.

The growth in our organic CSM balance and in the CSM generated by new business will be key metrics for our insurance businesses. We expect to see solid growth in our overall CSM balance and low- to mid-teens growth in our new business CSM post implementation.

Taken together, the Drivers of Earnings analysis and CSM movement analysis will provide additional important information to assess our financial results.

Turning to Slide 28. Overall, the new financial statement presentation and additional disclosures that will be included as part of IFRS 17 will bring more transparency, stability and predictability to our results, compared to our current reporting and disclosures under IFRS 4.

The change from the present valuing of sales and investment trades to the amortization of CSM and risk adjustment will result in more stable and predictable underlying income under IFRS 17.

The removal of the link between the asset and liability discount rates and the new measurement requirements related to financial guarantees are both expected to increase temporary volatility for our traditional insurance products.

But this volatility will be focused in one section of the new income statement, the net investment results section, and will be excluded from our underlying earnings.

The move of insurance assumption changes to the CSM will decrease some of the reported earnings volatility we see today and will be neutral on capital.

And finally, the clear separation of noninsurance earnings such as Asset Management, will provide greater transparency into our results. Overall, the reporting changes from IFRS 17 will lead to more transparent, stable and predictable insurance results when compared to existing reporting.
Now, I will turn it back to Yaniv for the question-and-answer session.

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

Thank you, Natalie. Our call today is scheduled to end by 10:00 a.m. (Conference Instructions) I will now ask the operator to poll the participants.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

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


Just a question on the -- I guess, a duration-type question. You gave a slide there on the Asia VUL earnings emergence under both accounting models. And I know it’s illustrative, but I mean I’m sure you’re not going to use something completely ridiculous. I’m wondering if you can -- it sounds like after year 4, the earnings range are somewhat in the same range.

I’m wondering if you can give us a sense of the rest of the businesses that are impacted, like the legacy blocks and the recently -- or the in-force that’s still generating new business gains. Are those like much longer, I guess, amortization of the CSM before we get to similar profit levels?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thanks for the question. Gabriel, this is Kevin Morrissey. So I’ll start off with the VUL. You’re right, that is indicative. You can see that in the first 3 years, currently under IFRS 4, we do have relatively high income, and that does follow kind of the fee patterns under the product. So it does represent kind of that pattern accurately, I would say, for the VUL products in Asia.

Relative to some of the other products, when you’re thinking about the duration, probably 10 to 15 years would be a reasonable approximation to use when you’re thinking about kind of the profit pattern and the duration of those businesses that are impacted.


Got it. And then I’m surprised a bit by the amount of the CSM increase, its creation that’s tied to the legacy blocks. Like can you just -- I might have missed it on the call, but why is there even anything impacted from there? Because they’re not generating new business. Is it all investment related?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes. Thanks, Gabriel, it’s Kevin again. The impact related to the closed blocks of business, the way we have to restate the balance sheet as a result of IFRS 17, you kind of have to go back and look at all the blocks. And when you measure those under IFRS 17, they still have some of the profits that are currently unrecognized, and so those have to be set up as a CSM.

When you think about the size of that, as I mentioned, that’s about 30% of the total -- the CSM-related impacts. And that business is, it’s going to be still running off. It is really long-duration business.
As I mentioned before, a lot of that is the U.S. IFM business, which is traditional life insurance business, which has a long duration and spreads out over many years as -- sure you'll know. So that -- even though these blocks of business are closed and we haven't been writing them for a long time, they still do have CSM associated with them.


Okay. All right. And just the last one I'll sneak in there. But I hear this not just from Sun Life, but other companies. It's an accounting change, there's no economic impact, et cetera. But -- and then your LICAT ratio is going to be higher under IFRS 17. So better capital ratio, whatever.

But if I take a step back and take a layman's view, I see your book value, your shareholders' equity going down by $4 billion to $5 billion on transition. It's moving into another category for regulatory capital purposes, but that's $4 billion to $5 billion that's no longer there for deployment.

So I'm wondering if you actually do think there's an economic impact here to shareholders? Because to me that seems like a fairly substantial one.

Manjit Singh - Sun Life - Executive VP & CFO

Gabriel, it's Manjit. As Kevin mentioned, the CSM, we think about it as a store of value. What's really happening in IFRS 17 is, we've taken profits that were previously recognized in retained earnings, and as Kevin mentioned, one of the key changes that comes with IFRS 17 is, we have to apply the new deferral principles, and we have to do that for our current in-force business.

So when we do that, we have to reclassify some of that retained earnings into CSM, but that's still there. And in fact, it's going to amortize back into retained earnings or replenish it over time. And the second thing that will happen, as we mentioned is that it will account for capital and it will be deployable capital. So that won't have any impact on sort of how we think about our capital options.


So you view it as deployable?

Manjit Singh - Sun Life - Executive VP & CFO

Yes, I do.

Operator

Our next question comes from David Motemaden with Evercore ISI.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

Just a question on that last point, just on the LICAT. I was wondering if you could size the positive impact to the LICAT ratio, and maybe just elaborate a bit more on how you're thinking about potentially returning that to shareholders?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thanks for that question, David. This is Kevin Morrissey. For the LICAT ratio impact, we are expecting a fairly modest increase. So you can think of that as maybe a few points, so nothing huge.
I just want to qualify that a bit with a couple of points because I do want to just reiterate the fact that the LICAT ratio is not final yet, right? So we do have a draft version, and it could change. So we don’t want to set anything in stone.

And I do want to highlight that OSFI has indicated that they’re looking to calibrate the guideline so that for overall, the industry LICAT ratio is neutral. So this will mean that some companies will be higher and some companies will be lower.

Based on what we see in terms of our risk profile and the applications of the guideline and that adjustment to make the guideline neutral, overall, across the industry, we are expecting to see kind of a net positive impact.

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

And then to the second part of your question, David -- it’s Manjit. We don’t really see any changes to the deployment priorities of core capital that we’ve talked to you about earlier.

So we’re focused on investing in our organic businesses, looking for M&A opportunities, and then if -- and of course, growing our dividend that I mentioned. We’re going to continue to grow our dividend in line with our medium-term outlook for earnings at 8% to 10%.

And then if we can’t do -- and then, of course, M&A. So there’s really no change in the capital deployment priorities that we’ve talked to you about earlier.

**David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst**

Okay. And then another question just on the CSM. So I guess, just on -- so I think it sounds like you guys are expecting mid-teens growth in the new insurance business CSM. I guess I’m a little surprised at how high that is, just because when I look at the value of new business growth, which I know is an embedded value principle, but also goes to just the concept of value of the in-force.

But if I look at the value of new business growth, it’s been, I would say, mid- to high single digits over the last several years. And obviously, I don’t think the last several years are as indicative of the earnings power and new business generation of the business.

But could you help me just understand the disconnect between those 2 metrics, just the value of new business growth over the last several years and the expectation for mid-teens growth in new insurance business CSM?

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

Okay. David, it’s Kevin Morrissey again. So the new business growth, as you can see on Slide 17, you can see our new business growth outlined there, and you can see the slide breaks down, both the gross and the net. And you can see the blue dots, those are the net reported gains.

And you can see that those have been growing over time, but there are gains and losses underneath that. So for the new business growth, that really is broken down into two pieces. You see a lot of the gains coming from Canada, North America in particular.

And then a lot of the losses, as you’ve seen in our disclosure, would have been coming out of Asia. And that’s where we have businesses that aren’t quite to scale yet.

So that’s in Vietnam, Indonesia, China, India, those are where we’re experiencing high growth, but we’re still trying to get up to our total cost structure. So it isn’t quite to scale yet.

The CSM is a bit different, right? Because the CSM is just the gain. So you’re thinking about the gains that are being deferred. And that business is continuing to grow, but it’s not growing kind of on a net basis.
So it's a bit different when you're comparing to pricing gains, which are net, and the CSM growth, which is related to new business, which is just the gains.

Operator
Our next question comes from Tom MacKinnon with BMO Capital Markets.

Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst
Just a question with respect to -- I think you said the low- to mid-teens growth in the new business CSM. Do you have any views on the growth in the overall CSM balance?

I think you said, it would be solid, but if you can put anything more specific on that and how it might compare to your 8% to 10% underlying earnings growth objective. And then I have a follow-up.

Natalie Brady - Sun Life - SVP of Strategic Finance Initiatives
Tom, it's Natalie. So in terms of the overall organic CSM growth, we are expecting it to be in the mid-single digits. In terms of the relationship to the EPS, this is one of a number of metrics that supports our overall 8% to 10% EPS growth.

Manjit Singh - Sun Life - Executive VP & CFO
And as we mentioned, Tom -- it's Manjit. That applies to the insurance businesses, but as you know, a majority of our earnings come from businesses that are noninsurance related, and there's no impact to the growth rate of those businesses.

Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst
Okay, that's great. And then just with respect to onerous contracts, and I believe this is -- and as mentioned, where your businesses are really not up to scale like Vietnam and mainly, in Indonesia, I think. There were two places you had mentioned.

And I assume then as we move to IFRS 17, you won't -- will those be having a negative -- no, those will be reflected immediately into your underlying earnings and will not have an impact on the CSM. Just if you can clarify that.

And then what are you doing to make sure these onerous contracts, where you're not up to scale, will eventually become non-onerous contracts? What are the steps taken here? And how will that impact growth, going forward?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP
Thanks for that question, Tom. This is Kevin Morrissey. So the first question is about the onerous contracts. Is that reflected in income immediately under IFRS 17? The answer is, yes. The second question is related to the CSM. So does that impact the CSM? There is no impact. So you're correct about that as well.

The last point about onerous contracts, I want to make two points about onerous contracts. The first is that there are some onerous contracts, and these are the losses at issue -- that are reported related to scale, right? And I know I did talk about the growing businesses, especially in Asia, where that's the case.
But there are also a few other points that are maybe particular, specific to IFRS 17 that I want to highlight. They're outlined on Slide 31. We didn't cover it in our speaking notes, but I did want to highlight that there are a number of components that result in IFRS 17 onerous contracts that provided maybe a bit of a different lens on the profitability.

And the first is that there are asset returns that we do expect in excess of the discount rate, and so that's an underlying source of profit that we don't have, currently. So you're very familiar with [CALM] methodology, I know. And that you have the embedded profits that are very explicit. In this case, you have the implicit embedded profit related to that discount rate. We also have the risk adjustment. So that's like the insurance PfADs, as you know, and that really doesn't change.

The other point that I want to highlight here is that there are reinsurance impacts that are particular to IFRS 17. I won't go into the details, but the result of having profitable reinsurance terms is not fully reflected at issue. So there is potentially additional value related kind of net of reinsurance on those contracts. So several sources of profitability that are not reflected in that onerous view, that are kind of in addition to, I'd say, some of the challenges related to scale.

Kevin Strain - Sun Life - President, CEO & Director

And Tom, it’s Kevin Strain. Do you want to follow up with Kevin Morrissey first and then I can answer the question about how we’re getting to scale in Asia?

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

Yes, that was really more the question. You want to see these things not have a negative impact on earnings. You want to -- or initially -- I understand there’s profit later, but you want to see them start to work their way into the CSM movement analysis.

And that’s -- and graduate from becoming an onerous contract into a non-onerous contract as a result of improving scale. So I think that’s -- it’s not really an IFRS 17-related question, but it certainly is a business-related question.

Kevin Strain - Sun Life - President, CEO & Director

Yes. And as you know, we’ve been growing quickly in Asia for the last 10 years. And part of our growth pattern was to drive towards getting to scale. We’ve been investing in distribution, which sometimes can be a drag and can create some of the strain as well.

But if you look at what we’ve done in Vietnam with the addition of both TPBank and ACB Bank, that’s been a great lift for sales. As you know, we did the CIMB Niaga bancassurance deal a few months ago. That won’t take effect for a few years, but that’s about driving us towards scale in Indonesia.

China and India are big markets that are growing quickly. We’ve been investing in distribution in both of those markets. And so the goal is to continue to execute on our strategy there, building strong distribution across agency, bancassurance, brokerage, digital and driving towards scale.

We still have a lot of discipline in terms of how we price it. So it typically links back to this issue around scale. I would say, in those markets, you can be profitable, and it’s about -- it really is about scale and those investments we’re making.
Tom MacKinnon - BMO Capital Markets Equity Research - MD & Analyst

And is there any kind of timeframe where you think, “Okay, a few more years, we’ll hit this scale -- threshold” such that the contracts won’t be onerous? I understand...

Kevin Strain - Sun Life - President, CEO & Director

Yes, it’s market by market. So if you look at our bigger markets like Hong Kong and the Philippines, we’re already there. I think Vietnam is on a really good track with ACB. In fact, it’s one of the leading bancassurance transactions now in the country.

So we’re heading in the right direction, Tom. There’s not a secret formula for when, but I think you should see improvement over time.

Operator

Our next question comes from Mario Mendonca with TD Securities.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

First, just a quick clarification on the closed block. I would have assumed that the establishment of the CSM on the closed block would have been offset by any liabilities currently held under IFRS 4 for the closed block.

Should I take it to mean that there were not liabilities or meaningful liabilities associated with the closed block because those earnings had already flowed -- those reserves already flowed through earnings. Is that the right way to interpret it?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thanks for that question. It’s Kevin Morrissey. That’s not quite right. The closed blocks do have substantial liability, still, on the balance sheet under IFRS 4. When we move to 17, it just redesigns the whole accounting methodology, right?

So any of the profits under IFRS 17 that are still unrecognized, you still have to set up a CSM, despite the size of the current liabilities on the balance sheet. So that’s really just an adjustment of kind of that restatement of the liabilities that I had outlined on Slide 12.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

But if those liabilities were not on the balance sheet already, they have to have been somewhere. Presumably, they went through earnings?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

So the liabilities, we do have substantial liabilities on the balance sheet, but the pricing gains associated with them would have been in equity and that is where you have that transfer from the equity into the liability account.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

So when you say those pricing gains were in equity, I just want to be clear on this, they presumably got to equity through earnings?
Manjit Singh - Sun Life - Executive VP & CFO

Correct.

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

That's right, yes.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. Okay. Just a sort of a different type of question now. We're all going to have to decide for ourselves how to value these companies, and clearly, Sun Life is one where we've got to be careful because it is, as you demonstrated in this presentation, there's a lot of this business that doesn't fit in well into an IFRS 17 mode.

To really do a good job of that, I think we're going to need to understand the equity that is allocated to, let's say, 2 broad businesses, your insurance and then everything else. Is that some disclosure you think you might provide, going forward, so we can do a better job of understanding Sun Life?

I hate using sum of the parts because I think that can be silly sometimes, but are you going to provide us with the equity breakout, so we can do a better job of valuing Sun Life?

Manjit Singh - Sun Life - Executive VP & CFO

Mario, it's Manjit. So yes, I mean part of what we're going to be doing is, in terms of the new disclosures that we're going to be providing, is taking a look at information that will be helpful for people to understand, the new reporting that we're providing. And that would be an element that we would consider.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. That's going to be, I think, pretty important for understanding your company. And then the final question is, this disconnect between assets and liabilities and the discount rates. I think I understand what's going to cause the asset discount rates to move. That's going to be all the stuff we're used to seeing with markets.

What I don't understand is, what's going to cause the liability discount rates to move? Is it just going to be changes in the risk-free rate or like this illiquidity premium? What causes that to change?

The reason I ask is, I can see scenarios, where there's a huge divergence between the discount rate and assets and the discount rate on the liabilities. And it's just going to cause crazy volatility unless we really understand what's happening. Can you help me understand, what's going to cause discount rates on the liabilities to change?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes. Thanks for the question, Mario. It's Kevin Morrissey. The change in the liability discount rates, there's two components there: there's a risk-free rate and there's an illiquidity premium. So the volatility is going to come mainly from changes to the risk-free rates.

So when you calculate discount rates each quarter under IFRS 17, you have to reflect the current market observable rate, so in Canada, you can think about that as interest rates out for the first 30 years. And so that discount rate will be moving with those risk-free rates each quarter to the first 30 years.
The discount rate between 30 years and 70 years. There's an ultimate discount rate. That ultimate discount rate, there's guidance from the Canadian institute of actuaries around setting that.

And you can think of that as something that's going to be much longer term, that's out 70 years from now, and that will change periodically, but not regularly. But over time, I think you might see that move with the longer-term trends on interest rates.

The second component you mentioned, you're right. There is also an illiquidity premium. That illiquidity premium, it does vary by different products, but that's going to be stable. It doesn't change over time.

It's really driven by the liability characteristics. And so that doesn't really change over time unless you're changing the profile of the liability. So within current products that you're writing, that illiquidity premium will be quite stable.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. So then finally, would I be correct in saying that the volatility from interest rate changes is really going to come from changes in credit spreads of the assets you hold because the risk-free rate is going to affect the assets and liabilities similarly.

The illiquidity premium is not moving, but credit spreads could move. So is that right? That changes in credit spreads are going to become the big thing we're going to have to watch out for, going forward?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Mario, I think you're right that credit spreads will be a significant driver of that disconnect because there isn't that direct link that we have now under CALM under IFRS 4 between the liabilities and the assets, right?

So you have that balancing mechanism, which kind of buffers out a lot of that noise. So you definitely will see more volatility related to credit spreads.

We will also see some volatility related to interest rates because although you do have the changes in interest rates impacting assets, and as I mentioned, the liabilities, you won't necessarily have a one-for-one matching for the duration of those assets and liabilities.

So we'll still see some noise, especially for the long-term traditional insurance products for risk-free rate changes.

Mario Mendonca - TD Securities Equity Research - MD & Research Analyst

Okay. So finally, finally, I suppose that you're going to tell us when we see this big volatility, going forward, is, "Hey, as long as we hold these assets and liabilities to maturity, it doesn't matter." Is that the right answer when we see that strange volatility?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes, that's the way we're thinking about it, Mario. And that's why we're going to be separating out that component from underlying, and it will be identified and reported.

Operator

Our next question comes from Doug Young with Desjardins Capital Markets.
Doug Young - Desjardins Securities Inc., Research Division - Diversified Financials and Insurance Analyst

Just sticking with the interest rate sensitivity, I just wanted to understand because I do think some of the rates that are used to value things like the CSM, I think the rates are locked in. Maybe you can correct me, if I'm wrong. What causes there to be unlocking of some of these rates? And how does that move around with changes in interest rates? And how does that flow through the results?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Doug, it's Kevin again. So you're right, the CSM is locked in. And so that's kind of fixed when the CSM is set up, and that's something that isn't going to change over time, it is set. And as long as there is still CSM on the balance sheet, the changes that impact that will kind of move the balance up and down. To the extent on any product, a group of products where the CSM becomes extinguished, then you will see some volatility. If that happens, that would impact earnings, but we're expecting that to be very unlikely in most cases.

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

So if there's a change of interest rates and you were making a change of assumption that was going through on the CSM, you wouldn't necessarily unlock that rate, and therefore, there would not be an impact at that time. Is that the correct way to think about it then?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes, that's right.

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

Okay. And then the other would be, let's say, your asset yield and your discount rate, you have a spread of 100 basis points and those move essentially in tandem. So your spread doesn't change. What we're seeing outside of the mark-to-market impact, that spread, that is going through I would assume underlying earnings, and that wouldn't necessarily change in that scenario. Is that the correct way to kind of think about it?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes, that's right, Doug. There will be the spread. As long as that net difference is consistent, we wouldn't expect that to change. And you're right, that would be in underlying earnings.

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

Okay. And then just from questions I'm getting. Obviously, I think the big confusion is, you talked about 20% of your earnings as being materially impacted by IFRS 17, 80% isn't. Yet your shareholder equity is dropping 15% to 20%. I think there's a bit of a disconnect and a confusion around that. And so maybe there's kind of a few things I'm just trying to understand, like how much of -- you talked about your nontraditional insurance business that moderately gets impacted like par and all of that.

How much of this impact is coming from that bucket versus the 20% bucket that's traditional, that really is what we were focused on when people were thinking about what the impact would be? Is it more the first than the second? Or just trying to understand that.
Manjit Singh - Sun Life - Executive VP & CFO

So Doug, it's Manjit. So as Kevin mentioned in his comments, we do have a fairly sizable and profitable insurance business, notwithstanding that we have a lot of other businesses that are outside of insurance, as you mentioned. And so that size of that business is about $146 billion. And as Kevin noted, some of the changes that we walked through have an impact on how those liabilities are measured. About 2% to 4%, so relatively modest impact.

But if you apply that against the size of our current business, that's what really results in the impact that you're seeing to equity. As we talked about that, that impact is really sitting in CSM that will amortize back into income, and will continue to qualify as capital.

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

Okay. But I guess maybe thinking it another way, there is the VUL impact, and then there is 1/3 that's related to the change of the discount rate and removal of the market premium for NFI. And I think I kind of understand both of them. Are those 2 items relatively new, like something that really kind of popped up in the last year or 2? Or is that something that's always been something that really had to be considered ever since this discussion happened many, many moons ago?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes, Doug, it's Kevin Morrissey. This is something that has been around for a while. So it's not something new, and it isn't a surprise.

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

Okay. And then just lastly, unallocated expenses. I know that's going from liability to the CSM, so not hitting book value. But can you size what the unallocated expense component in the CSM is? Just because it seems like not everybody is choosing to move in this direction. And so to compare apples-to-apples, it just would be interesting to understand what that is in your CSM.

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Doug, it's Kevin Morrissey again. Thanks for the question. So for the nonattributable expenses, the methodology outlined under the IFRS 17 standard is fairly broad-based, and there's a lot of judgment. So I think you're right that if you look at different companies, they're going to be applying that different ways. So we're not disclosing the amount of that at this time.

But I do want to kind of context that. So I think the relative amount probably isn't that important because as we've noted, it really is kind of an out and an in. And when you look at how much it impacts the CSM and then the CSM will be amortized, which will cover those costs. Kind of net-net, we're not looking at any material impact to earnings.

Operator

Our next question comes from Meny Grauman with Scotiabank.

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

Just a question on the risk adjustment. In your view, how important it is as an indicator for future earnings? How intertwined do we view the risk adjustment and the CSM?
Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

For the question on the risk adjustments, it’s Kevin Morrissey. So risk adjustments are important. Just like the insurance PfADs are important today, it’s going to be a steady source of profit. One of the interesting things that you’ll see in the new IFRS 17 disclosures, is you’ll see the amount of the risk adjustments, so you don’t see the PfADs today, so that will help you.

You also see the confidence interval that we set for those risk adjustments. So it’s an important part. You asked about that relative to the CSM. I think it’s really both. The CSM amortization and the risk adjustments, and in addition to that, the other sources of profits that we mentioned like the NFI returns, non-fixed income returns above the discount rate. So it’s really all of those taken together that are important.

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

And then just in terms of -- is there any potential that IFRS 17 can proactively change your business mix or product structure in Asia, specifically? Like I know you keep emphasizing this is an accounting change. Is there any sense that this will actually have an impact in terms of the kind of products you choose to sell or how they’re actually designed?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

It’s Kevin again. I think that the key for us is that this isn’t really changing our overall view of the profitability. We don’t see any significant strategy changes coming out of this. I do expect that the markets will probably evolve over time somewhat. And this is something that we’ve been considering in our product pricing for a while now. So recent products that we’ve launched, we’ve done a full review under IFRS 17 as well as the current basis. So the short answer is, no, we’re not expecting to see any significant changes. You may see, again, some modest changes in the market as they kind of reflect the dynamics and how they’re a bit different perhaps under IFRS 17.

Operator

Our next question comes from Darko Mihelic with RBC Capital Markets.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

And thanks for doing this, by the way. This has been very helpful. A few questions. I have some practical ones and there’s some theoretical ones, which probably is a big rabbit hole for me and Kevin. But I’ll just stick with the practical for now, maybe re-queue. The first question is, when I look at Slide 7, there’s obviously no numbers here. I don’t think you guys are prepared to talk about numbers yet in terms of earnings impact per segment. But the question is like, will you resegment a little bit?

And then secondly, in line with Mario’s question about equity, will you give us granular CSM per business unit? Obviously, there isn’t any for asset management, but you know what I mean. Will you provide a fairly granular view of CSM per business segment?

Manjit Singh - Sun Life - Executive VP & CFO

So Darko, it’s Manjit. I’ll start, then I’ll let Natalie comment on the CSM piece. We’re not anticipating at this point, Darko, to redo any of our current reporting. I think that aligns with how we view our businesses and manage our businesses. As we talked about through the piece, there will be additional disclosure and metrics we provide, that will be helpful within those -- within our current business pillars, but we’re not planning to change any of our current business pillars.
Natalie Brady - Sun Life - SVP of Strategic Finance Initiatives

It’s Natalie Brady. What we would say is, on our disclosures post-IFRS 17, they’re going to look very similar to today. So we do provide each of the pillars in our disclosures and that would continue. So that would include a view of the CSM for the Asia pillar.

Manjit Singh - Sun Life - Executive VP & CFO

And there will be fairly granular reporting on CSM that’s required by the standard, and that will be, I think, helpful for you, Darko.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

And how granular will the information be for the risk adjustment by year?

Natalie Brady - Sun Life - SVP of Strategic Finance Initiatives

So similar the risk adjustment is a required disclosure in the new world, and so we would be providing that as well by pillar.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

And then just a theoretical question for Kevin. When I think of IFRS 17, I think of accounting and actuarial kind of everything being impacted and changing systems and so on. A few questions come to mind, but first, I'm very interested in some of the guardrails that are out there. So it's my understanding that the URR is sort of capped and stuck until a certain time. And then for now, it's just 15 basis points, most that can be moved. So the question is, are we waiting for more information on like, is it going to be promulgated? How is that going to come around? And the sensitivity around that, is there anything you can provide to us today with respect to just information on the URR and how sensitive your company is to it?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thanks for that question, Darko. It’s Kevin. I mean it is an interesting question, and there are IFRS 17 guardrails. So maybe just a slight clarification. It's now moving from the URR to the UDR, the ultimate discount rate because there are no reinvestment rates under IFRS 17. But for the UDR, the CIA has come out with a guidance note and this is intended to serve that purpose exactly what you described, Darko, which is the guardrails. And what it does is, it establishes a minimum liability.

So you can think of that as a minimum liability test, where based on certain assumptions, companies need to test against their specific assumptions to make sure that the liability they’re holding is at least at the liability based on that test. So that CIA guidance is out there. It is intended to narrow the range of practice. The CIA has decided to not promulgate the rates. So that does not look like it is coming. However, I think it will be the guidance that has been provided will be sufficient to kind of get all the companies appropriately aligned under IFRS 17.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

And any initial view on the sensitivity?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Yes. The sensitivity is something that we’ve been looking at. I guess the first point I’ll make, Darko, is that you're probably aware, we're looking at dual reporting this year, and we’re looking at our IFRS 17 results each quarter after our IFRS 4. We're currently in the midst of doing our Q1, so that's not done yet. So we're still looking at more analysis on the sensitivities, and we do expect more of that to come in the future.
We do expect, as I mentioned, the reported income to be more volatile under IFRS 17, and that's largely because of that disconnect in the discount rates, which we've spoken about earlier. Under capital, I think it's really important that we're not seeing an increase in the volatility under capital. For both interest and equity, they look to be very comparable to what we're seeing today under IFRS 4. So we're very pleased to see that as a result of this transition, our low capital volatility will remain.

Operator
Our next question comes from Paul Holden with CIBC.

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

I want to go back to the discussion on capital deployment. You had said earlier, at least a couple of times, that it doesn't change capital deployment priorities. I'm just kind of wondering why and maybe the simple answer is because it already had because you knew this change was coming. The reason I ask this question is, if I think about the timing of earnings we can argue that's just accounting. But when I think about acquisitions and the importance people place on earnings accretion within the first few years, I think the accounting is important. So just wondering, why you make that comment that it doesn't impact capital deployment priorities? And again, maybe it is because it already has.

Manjit Singh - Sun Life - Executive VP & CFO

Paul, it's Manjit. So as we mentioned, we're not sort of seeing any impacts on our capital ratio. In fact, if things hold to where they are today, we would expect to see a moderate increase in our LICAT ratio. And then secondly, a part of the piece that you're seeing with the transfer from equity to CSM, that continues to count as capital. So there really isn't sort of a change in the deployable capital.

Now to your point about if we're looking at a particular transaction, that might factor in terms of how we think about that transaction, how earnings emerge from that transaction. But in terms of how we deploy our current capital, there wouldn't be an impact on that.

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

Okay. I think I understand. And then second question, I guess similar vein is on investment allocation because clearly, there are some implications in terms of how the accounting works for investment returns or asset returns. Is there any planned changes in investment allocation with more or less towards equity and/or real estate?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Thanks, Paul, it's Kevin Morrissey. I'll take that one. We are not planning to make any fundamental changes to our asset strategies. However, we will be resegmenting the assets backing our insurance contract liabilities. So we have to reflect the reallocation of equity to the insurance contracts. So we do have a bit of work to do there. We may take some investing -- some investment ALM activities to address some of the changes to our accounting exposures, but these would be within our current establishment of investment ALM strategies.

So in particular, you asked about the NFI, real estate and equity. We don't have anything specific planned for that. Those are 2 asset classes that have done very well for us in the past. We still have a lot of confidence in those asset classes, and they really kind of underpin a critical part of our investment strategy. So I would say just kind of more of the same, not a significant change in direction.

Operator
Our next question comes from Nigel D'Souza with Veritas.
I had a question for you on your expectation for mid-single-digit reduction to underlying income -- net income in 2022. This year we've also seen some mobility restrictions and lockdowns in Asia that's impacted insurance sales for those jurisdictions. Just wondering if you have a sense of what the expected reduction would have been, if we didn't have those mobility restrictions and lockdowns in Asia and the insurance sales mix was more normalized.

Manjit Singh - Sun Life - Executive VP & CFO
Nigel, it's Manjit. And what we tried to do is to give you a sense for the impact of the changes from IFRS 4 to IFRS 17. So that was just done based upon our current business and the conditions within that business. So it's just to give you a sense of that, it's not to kind of really think about different scenarios because obviously, just like they do in IFRS 4 different business conditions would have a different impact on the business.

Nigel R. D'Souza - Veritas Investment Research Corporation - Investment Analyst
Okay. So what would be helpful is, do you have the expected impact comparatively in 2023? If you reported under IFRS 4, what would your underlying net income be relative to IFRS 17?

Manjit Singh - Sun Life - Executive VP & CFO
Sorry, into 2023, you said? or...

Nigel R. D'Souza - Veritas Investment Research Corporation - Investment Analyst
On transition to IFRS 17 in 2023, I assume your underlying net income would be higher. Do you have a sense of sizing that? How much higher would it have been?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP
Nigel, it's Kevin Morrissey. We're not looking at IFRS 4 in 2023. I mean that has ended. So what we’ve really focused on is the comparative year, so 2022. That’s where we've given the guidance that we expect kind of a low single-digit, mid-single-digit decrease in that comparative year. And from there, we're just looking forward to IFRS 17, and we are seeing the growth pick up, and it does accelerate under IFRS 17.

Nigel R. D'Souza - Veritas Investment Research Corporation - Investment Analyst
Okay. And just a final point on that. Would it be fair to assume that the impact would be similar mid-single digit for 2023 underlying net income? Or is that not fair to characterize?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP
I think it’s not fair. I'm not going to speculate about it because there's so many moving pieces, and we have spent a lot of time analyzing what we expect to have happen. And there are a lot of pieces, so I just don't want to speculate on kind of a future year. That's really done, we think. So we're looking forward to the future under 17.
**Manjit Singh - Sun Life - Executive VP & CFO**

Yes. And as we've said, Nigel, that once we reset to IFRS 17, we continue to expect to resume our 8% to 10% growth going forward.

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**Nigel R. D'Souza - Veritas Investment Research Corporation - Investment Analyst**

Okay. Got it. And if I could ask a bit more of a technical question. From understanding the new business value gains calculation is essentially a net present value calculation that includes your cost of capital consideration into that. But under IFRS 17, the CSM does not take into account the cost of capital. So is it fair to say that you're less likely to classify, an insurance policy as onerous because of taking out the cost of capital component? Any colour there would be helpful.

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

Nigel, it's Kevin Morrissey again. So for the new business gains, you're right, it is a net present value of all the future cash flows, but it does not include the cost of capital. When we look at VNB or value of new business, that is a net present value calculation, which does include the cost of capital. So that's a bit of a different metric. So you are right that, that's not -- the cost of capital isn't under the CSM, but it's also not included in the pricing gains currently.

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**Operator**

Our next question is from the line of Gabriel Dechaine with National Bank Financial.

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

Just a quick follow-up. I don't know if we talked about the ACMA impact. I know you did it in the presentation there, but just to come up with a very simple, stupid example here, how it's going to look under the new system. Let's say, you had a ACMA change that would cost you $1 billion plus or minus, doesn't really matter the direction, under the current accounting standard. And it was a 10-year time line for the assumption. So the current accounting would be a $1 billion gain or charge, under the IFRS 17, you'd spread it out $100 million amortized over. Is that correct? And not through retained earnings, it would be an adjustment through CSM?

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

Gabriel, it's Kevin Morrissey. Maybe I'll break that down a bit in terms of that example. So if there was a $1 billion ACMA under IFRS 17, the duration isn't really important because it's a present valuing of all the future years, whatever that is. So under IFRS 17, you do have that same present valuing effect, so that has not changed. What is changing is where you're reflecting it. So if it's an assumption related to insurance like policyholder behaviour, where you've seen us strengthen in the past.

Currently, where that impacts net income, you're still going to see that impact net income. Where you've seen changes related to, for example, reinvestment risks that have impacted net income, that ACMA now goes through CSM. So it's really the location of the changes of whether it's through income or CSM, and I think both of those are going to be important, and you'll be able to have a clear view on both of those pieces.

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

So insurance risk, ACMA, mortality lapse, that still goes through the income statement, but then investment-related stuff will be through CSM?
Our next question comes from David Motemaden with Evercore ISI.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

So just a question on Slide 26. It feels like at least on the 40% of business that is more impacted by IFRS 17, it feels like the CSM amortization is going to be a big earnings driver. What are your expectations in terms of CSM amortization growth every year? Is that going to be similar to the mid-single-digit range of growth in the balance? Or how should we think about that?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

David, it's Kevin Morrissey. Thanks for that question. So the CSM growth, you're right that, that is going to be a big part of our income going forward. And that's one of the reasons why we've said that under IFRS 17, we see the underlying earnings being stable, more predictable. So you'll see the CSM in the exhibits under IFRS 17. You also see the amortization, which I think you'll love because the exhibits will show you the runoff of that, so you'll see how that's going to be impacting earnings over time. The size of that, we do expect that to grow in the mid-single digits, you're right.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

Got it. Okay. And then I guess that would imply, at least on the other 60% of earnings that's not as impacted by IFRS 17, the expectation is, you'll grow earnings there in the 10%-plus range?

Manjit Singh - Sun Life - Executive VP & CFO

Yes. I think David, as we said, overall, our mix of businesses, we expect to generate 8% to 10% overall.

David Motemaden - Evercore ISI Institutional Equities, Research Division - MD & Fundamental Research Analyst

Got it. Okay. And then just on Slide 27 on the CSM, I'm just really looking at the insurance experience gains/losses. It also feels like this is going to be pretty important going forward, sort of a leading indicator in terms of assumption changes. If we look back over the last 5 years or 10 years, if you've looked at this new framework sort of back-tested it. Would that experience gains/losses - would that have been a positive or a net negative to the balance over the last 5 years, 10 years?

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

David, it's Kevin Morrissey. Thanks for that question. So you're right, the insurance gains and losses will be an important source. That would be very similar to what we see under IFRS 4. So if you look backwards, we had a number of experience losses related to policyholder behaviour. A lot of that coming from the In-force Management business in the U.S. As you will recall, over the last few years, we've done some significant strengthening on those assumptions.

And over the last several quarters, we've seen neutral to positive results. So we're quite comfortable that we've dealt with that historical issue. And going forward, we expect to see that fairly in line with, I think, where we are now in terms of our IFRS 4 experience, which I think our expectations would be essentially net neutral with, I'd say, small volatility from period to period.
Our next question comes from Tom MacKinnon with BMO Capital.

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

Just more of a high-level question. I'm not sure if Manjit or Kevin would want to address this. But what do you say to people who say, well, they just focus on book value and the book value, which is strictly an accounting thing and not a capital thing goes down, so that's a negative. I mean the CSM is high-quality Tier 1 capital, yet it's not included in the book value. But the book value also includes goodwill, which is not Tier 1 capital. So -- and the CSM is certainly deployable capital. So what do you say to those who just focus on book value and say, oh, your book value is going to go down 15% or 20%. So I'm done with Sun Life.

Manjit Singh - Sun Life - Executive VP & CFO

Yes. Thank you for the question, Tom. It's Manjit. I think you make some very good points. And as we've talked about through the presentation, we really look at CSM as a store of value, and that's very much like retained earnings. Those earnings that we have in there are really deferred profits that will come into income over time. And as Kevin mentioned, you'll see that in our CSM continuity and they're going to be predictable and stable. And number 2 is that, like you said, for capital purposes, the CSM, which we've transferred from equity is going to continue to count for capital.

So even though we see a difference in the GAAP book value of our capital, we don't see any changes in the regulatory capital. So in many ways because of that, it continues to be a store of value, continues to count as capital, it is very much like the current retained earnings that we see today.

Kevin Strain - Sun Life - President, CEO & Director

Tom, I may just add, like as Manjit said -- it's Kevin. It's deployable capital, and I think that, that's really important. And I think you articulated well comparing it to goodwill and other elements. I think it's also important that the CSM is growing. I mean that talks about how our business is structured and what we expect from the business. So as I look at this and step back, it's an accounting change, and it moved where those prior profits were, and they were before they were in equity and now they're in the CSM.

I don't see a lot of difference in terms of how the business performed or how to think about the business from that perspective. So I think you raised some really good elements there, but I think it's also important that we see that growing, which talks back to the strength of the underlying business continuing to grow.

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

Operator, it's -- sorry, Tom. I was just going to cut in, it's Yaniv here. We have time for just one more question on today's call, but maybe I'll let you ask your follow-up and then we'll go to the next question.

Kevin Strain - Sun Life - President, CEO & Director

Go ahead, Tom.

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

I think we lost Tom. So maybe we'll go to the next question.
Operator

Our next question comes from Darko Mihelic with RBC Capital Markets.

Darko Mihelic - RBC Capital Markets, Research Division - MD & Equity Analyst

It's going to be a theoretical one, but I'm kind of very interested in the answer. Ever since I started following lifecos and when IFRS 17 was very first floated, the concept was, oh, this is bad. It's going to be volatile. It's going to be scary. You're not going to like it. It had been deferred for many years because a lot of jurisdictions freaked out over how bad it was going to be. And now in 2023, I've got Manulife and now you telling me it's going to be stable. This is fantastic.

So maybe Kevin or maybe Manjit, maybe one of you can just let me know, what has been the 1 or 2 big changes to IFRS 17 since then and now that suddenly results in everything being excellent and final. And you can tell from the way I'm asking it. The reason why I'm asking is a little skeptical, right, on everything I've heard was going to be bad, but now it's not so bad, and it's actually pretty good. So maybe you can just let me know on 1 or 2 big things that has changed your understanding of IFRS 17 such that we should all be very comfortable now with earnings and capital stability.

Kevin Morrissey - Sun Life - Chief Actuary & Senior VP

Okay. Darko, it's Kevin Morrissey. I'll take that very interesting question. You're right IFRS 17 has been going on for an awfully long time. And I think that certainly, my understanding of it and kind of the implications of it have evolved over time. And in that regard, the standard itself has evolved over time, over decades. So I think there was probably some hesitancy and I think that's probably natural for some of the change.

You asked what are 1 or 2 of the big things that have changed maybe that are helping us feel comfortable about it. We're certainly feeling good about it now. The first, I'd point to is the difference between the underlying net income volatility and the reported net income volatility. So the underlying net income is actually going to be larger than it was before. It's going to be more stable than it is. It is going to be more transparent for you and predictable because you'll see the future: how much things that we have for CSM amortization, PfADs, runoffs balances. You don't have any of that now under IFRS 4. So I think that's good.

We still will have more volatility under the reported earnings. So that is something that I think we probably may be overestimated how bad that would be, and we are seeing -- although we're seeing some increase in that, it is not as scary maybe as we thought it was at once.

Second item that I'd point to is LICAT, and I think this is a really important one. We really had no idea of what the changes would be under LICAT. As you know, that's a very deep technical document in terms of the guidance for doing that capital calculation. So there's a lot of uncertainty around where that would land.

Now that we have a close to final guideline, we've done our testing in terms of the transition impact, which is positive for us and our sensitivities, which remain low. That gives us a lot of comfort. So I'd say, those 2 would be the 2 biggest that stand out for me.

Kevin Strain - Sun Life - President, CEO & Director

Darko, it's Kevin Strain. I would say that in the early days because I was CFO at the time, and I've met with the Standards Board and those types of things. It wasn't very clear. It was very clear how the asset side would work, it wasn't very clear how the liability side would work and what the discount rate was going to be and how big a disconnect there would be between movements in the asset side and the liability side.

And over time, I think we've been able to work through a solution that it's not the same as IFRS 4, but it's probably not as big a disconnect as we thought it would have been under IFRS 17 4 or 5 years ago or more. So I think there was a piece of coming together here. The second thing is, when
we were looking at it before, I mean this has been a massive change. We've invested some of the company's very best resources on looking at it. You've heard 3 of them today, but there's a massive team behind this.

I think over that time, we've got to understand the new standard well. We've got to understand where the disclosure is going as well. It's one of the reasons we wanted to talk to the investor base about that today. So -- and then as Kevin mentioned, the LICAT rules weren't around when we first started talking about this. And I think the alignment now to LICAT and how the CSM will be treated for LICAT and the fact that CSM is Tier 1. So there's a bunch of things that evolved and we learned, and we've built a lot of capabilities in the organization, so that it goes from a place where we now feel pretty confident we understand how IFRS 17 works and works with our business.

So it's a process. It was a tough process. It's been a lot of work, and the team's worked really hard at it. But -- and this is the first step of understanding it. I don't think that any of our investor base is going to totally understand it at this point in time, right? This is a step towards gaining the understanding. And what I can tell you is that we feel pretty confident that it will disclose our business in a way that will be understandable.

And as Manjit said earlier, we're not changing our business profile. We're not changing our pillars. We're still driving towards the strategies we've been talking about. We're still looking at dividend growth that Manjit talked about. We talked about deploying capital. So we're just in a place that we think that, yes, it's different, but that's what it is, it's different.

Operator

And that's all the time we have for questions. I'd like to turn the call back to Mr. Bitton for any closing remarks.

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

I would like to thank all of our participants today. I will now ask Manjit to provide some final comments before we end the call. Should you wish to listen to the rebroadcast, it will be available on our website later this afternoon.

Manjit Singh - Sun Life - Executive VP & CFO

Thanks, Yaniv. I'd like to thank everyone for joining us this morning, and we hope you found today's IFRS 17 session helpful. Before we conclude, let me just summarize some of the key takeaways from today. First, IFRS 17 is a reporting change. It does not impact our business strategies or the underlying fundamentals of our businesses. Second, IFRS 17 will result in a transfer from shareholders' equity to insurance liabilities at transition, primarily reflecting the establishment of the CSM. The CSM will amortize back into income over time, and it will qualify as regulatory capital.

Next, there will be a reduction in the 2022 underlying earnings as we restate the basis of presentation from IFRS 4 to IFRS 17. However, we expect to generate year-over-year underlying [earnings] (added by company after the call) growth from 2022 IFRS 4 earnings to 2023 IFRS 17 earnings. Fourth, our underlying ROE objective increases to 18%-plus after transition to IFRS 17, and we will maintain our current objectives for underlying EPS growth and the dividend payout ratio, and we also expect to grow our dividends in line with our EPS MTO of 8% to 10%.

Fifth, we believe the new financial reporting along with our supplemental disclosures we provide will help to give more clarity on the sources of profits and key insurance business drivers. And finally, while work is ongoing, we are well prepared for the transition to IFRS 17. We will provide additional updates to reflect finalization of key guidelines, emerging industry practice as well as changes in the operating environment.

That concludes our call for today, and I wish all of you a good day. Thank you.

Operator

This concludes today's call. Thank you for your participation. You may now disconnect.