MOODY'S
INVESTORS SERVICE

CREDIT OPINION
29 April 2021

Update

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RATINGS

Sun Life Assurance Company of Canada

Domicile	TORONTO, Ontario, Canada
Long Term Rating	Aa3
Type	Insurance Financial Strength - Dom Curr
Outlook	Stable

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

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Sun Life Assurance Company of Canada

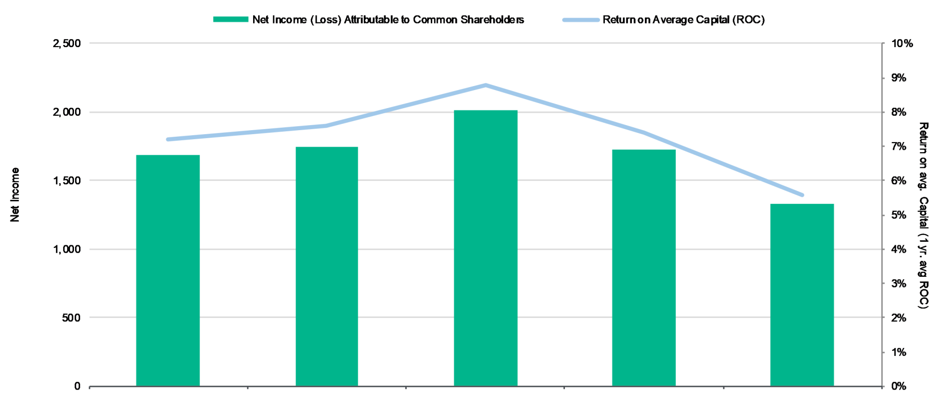
Update following rating affirmation

Summary

Our credit view of Sun Life Assurance Company of Canada (SLA, Aa3 IFS, stable) reflects its exceptional market position in Canada, good product risk and diversification, strong and predictable Canadian earnings, and solid capitalization. The sustainable profitability generated by SLA in Canada has been the central pillar supporting the company's high IFS rating. SLA holds the number one, two, or three market share positions in virtually all its market segments, which gives it the pricing power to maintain attractive margins. These strengths are tempered by a business mix which includes fixed annuities and segregated funds (i.e., variable annuities) that expose SLA to equity market and interest rate risks and could drive future earnings volatility. The group's acquisition activity has led to a high level of goodwill relative to its equity base, which strains its overall asset quality and financial flexibility to some extent. At SLA's parent, Sun Life Financial, Inc. (SLF, Baa1 (hyb)), there has been a strategic focus on building asset management capabilities.

In Moody's view, SLA's solid performance reinforces our opinion that its Canadian franchise remains strong. SLA entered the current pandemic-induced downturn on strong financial footing, though the extent of the economic costs will be unclear for some time. Despite reduced profitability, capital ratios are at or close to historical highs.

Exhibit 1
Net income and return on capital declines in 2020, but expect recovery in 2021



Sources: Moody's Investors Service and company filings

Credit strengths

» Excellent market position and brand in Canadian life insurance

» Stable profitability from its Canadian operation

» diversified business model

Credit challenges

» Navigating the uncertainty surrounding the health and economic implications from the coronavirus

» Meaningful exposure to secondary guarantees on segregated funds

» A business mix that includes a significant wealth management component, exposing the company to equity market and interest rate risks

» High total leverage compared to domestic and similarly rated peers

Outlook

The outlooks on SLF and its insurance subsidiary SLA are stable. Items to watch include significant expansion/acquisition of lower-rated, more volatile insurance operations outside of Canada, and maintenance of stable and sustainable consolidated profitability. The impact on SLA of the coronavirus and related economic disruption remains highly uncertain, depending on its severity and duration.

Factors that could lead to an upgrade

The following factors could lead to an upgrade of SLA and SLF:

» Maintenance of stable and sustainable consolidated profitability with a return on capital consistently above 12%

» Consolidated financial leverage at SLF below 20%

» Earnings and cashflow coverage above 10x and 7x, respectively

» SLA consistently maintains capital adequacy above 145% total LICAT ratio

Factors that could lead to a downgrade

The following factors could lead to a downgrade of SLA and SLF:

» Decline in return on capital below 8% on a sustained basis with increased earnings volatility

» Reduction of SLA's total LICAT ratio below 115% for a sustained period

» Consolidated financial leverage at SLF exceeding 30% for a sustained period

» Consolidated earnings and cash flow coverage below 8x and 5x, respectively, for a sustained period

» Significant expansion/acquisition of lower-rated, more volatile insurance operations outside of Canada or excessive reliance upon asset management earnings

Key indicators table

Exhibit 2

Sun Life Assurance Company of Canada [1][2]	2020	2019	2018	2017	2016
As Reported (Canadian Dollar Millions)					
Total Assets	322,625	293,430	268,012	265,923	255,896
Total Shareholders' Equity	21,708	18,188	17,967	16,939	16,690
Net Income (Loss) Attributable to Common Shareholders	1,318	1,719	2,005	1,546	1,671
Total Revenue	35,801	33,693	22,619	23,421	22,895
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	142.0%	109.9%	109.0%	121.9%	121.9%
Goodwill & Intangibles % Shareholders' Equity[3]	35.1%	34.3%	30.8%	31.6%	33.3%
Shareholders' Equity % Total Assets	5.0%	5.3%	5.7%	5.4%	5.5%
Return on Average Capital (ROC)	5.6%	7.4%	8.8%	7.6%	7.2%
Sharpe Ratio of ROC (5 yr.)	637.5%	1191.7%	1170.8%	1334.9%	1108.7%
Adjusted Financial Leverage[3]	23.0%	18.7%	18.3%	20.8%	22.8%
Total Leverage[3]	27.5%	30.4%	31.0%	33.4%	35.3%
Earnings Coverage[3]	8.0x	8.3x	8.8x	8.0x	9.2x
Cash Flow Coverage[3]	4.1x	6.4x	7.1x	8.4x	10.0x

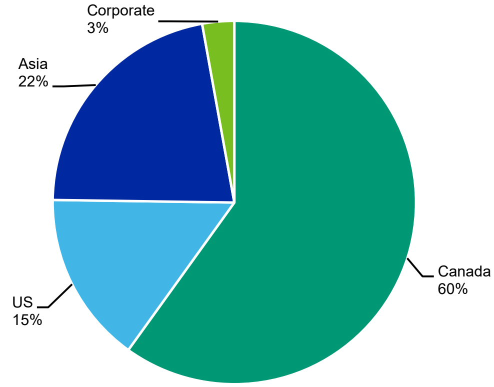
[1] Information based on IFRS financial statements as of the fiscal year ended 31 December. [2] Certain items may have been relabeled and/or reclassified for global consistency. [3] Information based on IFRS financial statements of Sun Life Financial, Inc. as of the fiscal year ended 31 December.
Sources: Moody's Investors Service and company filings

Profile

SLA is one of three leading life insurers offering a wide range of products and services in Canada. The US segment offers Group Benefits and In-force Management. Through joint ventures and subsidiaries SLA also operates in Hong Kong, the Philippines, Indonesia, India, China, Malaysia, Vietnam and most recently, Singapore. The product offerings in these geographies are oriented towards straightforward protection products distributed through independent agency channels and a growing bancassurance capability. SLA plans to grow these operations to become a more significant contributor to earnings. SLA's expanding presence in Asia adds growth and geographic diversity to its earnings base but the operating environment in some of these countries is weaker than Canada's and SLA does not enjoy the same market position it does in Canada.

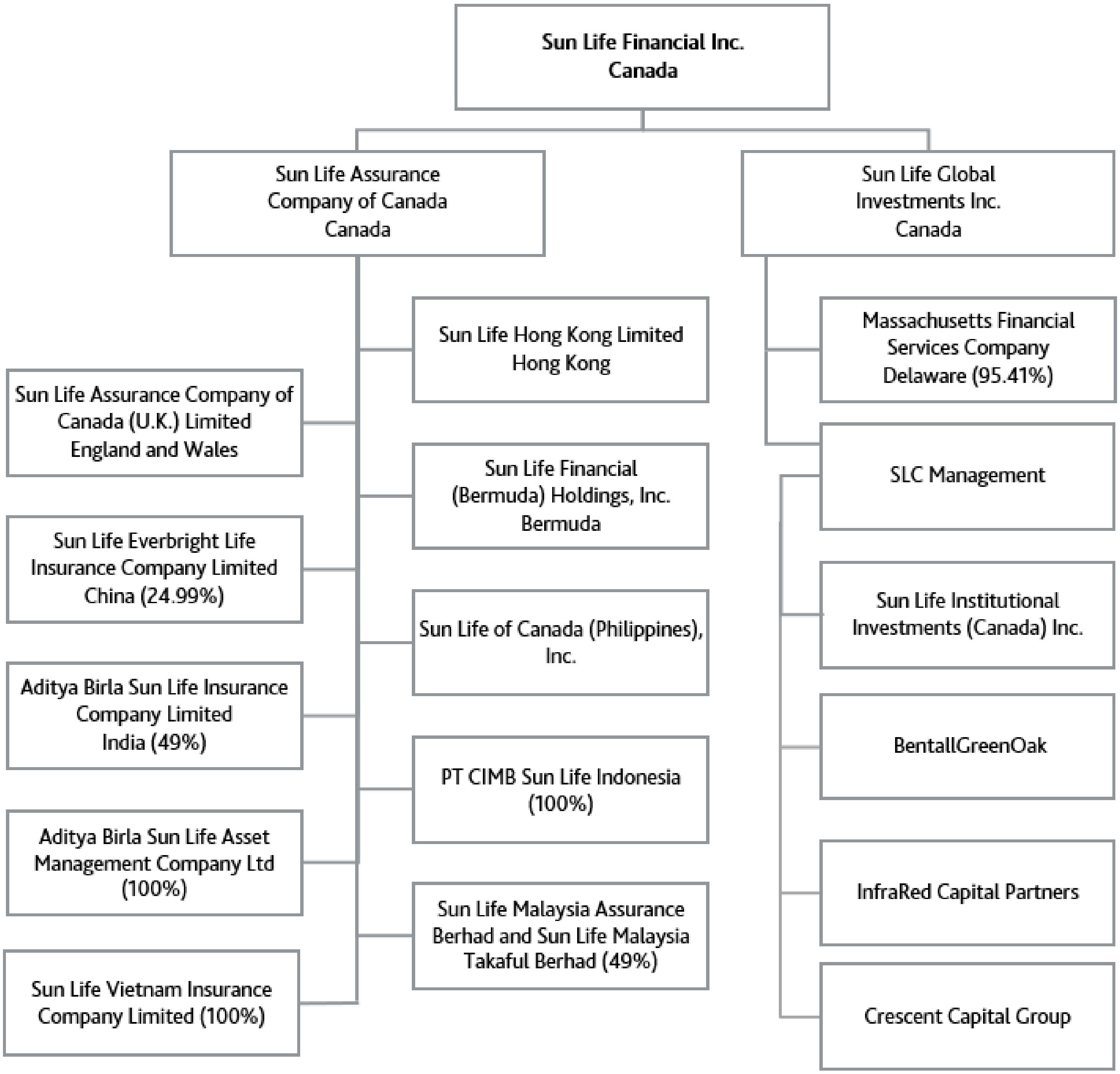
At SLA's parent, SLF, there has been a strategic focus on building asset management capabilities organically and through acquisition. Asset management generates low-risk recurring fee-based earnings, is a low capital intensity business and is very scalable. Management is notably repositioning the business mix of SLF towards asset management and could increase volatility of earnings under market conditions such as those seen in early 2020. The asset management operations of SLF could also be subject to net fund redemptions in weak economic conditions and the current trend away from actively managed investments towards passively managed investment alternatives. During 2020, SLF's U.S. based asset manager, Massachusetts Financial Services Company, experienced $13 billion of net inflows benefitting from elevated retail flows. While we view AUM growth as a net credit positive, increased reliance on earnings from asset management affiliates could shift SLF's credit profile up or down, depending on the size and credit quality of the asset manager relative to the insurance operations of the combined group.

Exhibit 3
SLA revenues dominated by Canada
fiscal year 2020



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

Exhibit 4
SLA organizational chart



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

Detailed credit considerations

Moody's rates SLA Aa3 for insurance financial strength, which is in line with the adjusted scorecard-indicated outcome in Moody's insurance financial strength scorecard.

Insurance financial strength rating

The key factors currently influencing the rating and outlook are:

Market position and brand: Favorable Canadian industry structure supports a high score

The Canadian life insurance market is an oligopoly with three dominant players - Sun Life Assurance Company of Canada, Great-West Life Assurance Company, and Manufacturers Life Insurance Company - who together hold about 75% of the industry's total direct premium. SLF captured approximately 18% of total net premium generated in Canada in 2020. This market structure, in and of itself, is a rather formidable entry barrier. In addition, federal government legislation currently bars entry by the Canadian life insurers' most significant external threat - the large Canadian banks.

SLA has very different market positions across its operating segments. In Canada, it has a Aa score on Moody's relative market share ratio. In Asia and the UK (which is in runoff), which are very small in relation to Canada, the scores are A and Ba, respectively. Weighting by total revenues - the best readily available method - we calculate a weighted relative market share ratio in the A range, which we believe accurately reflects SLA's blended market presence. SLA also operates in the US through a branch, and is subject to local regulatory supervision.

Overall, SLA's strong and sustainable market position in Canada will act as a buffer to any negative pressures stemming from offshore markets.

We have left the adjusted score at Aa, as indicated by the unadjusted scorecard result.

Distribution: Largest propriety sales force in Canada, take-up on digital offerings may increase

SLA has good diversity of distribution with three major distribution channels: (1) its captive sales force now branded as Sun Life, which is the largest proprietary sales force in Canada, although the pandemic has driven greater adoption of digitally assisted sales. SLA has made substantial investments in digital channels and processes and is well positioned in this regard. SLF has recently made increased use of artificial intelligence driven underwriting; (2) third party distributors, a category that includes national brokerage houses and independent managing general agencies; and (3) the institutional channel for sales of group life and health products. In the US, Group Benefits products are distributed by a network of over 31,000 independent brokers who are supported by 190 SLF sales representatives. In Asia, SLA has a multi-channel distribution strategy, including agency, bancassurance, brokerage and growing digital and telecom capabilities. In Q1 2020 the company reorganized its Asia business into two segments: 1) Local markets which includes the businesses of Philippines, Indonesia, India, China, Malaysia, Vietnam and Singapore, and 2) International Hubs, which combines the previous International and Hong Kong segments. Given its proprietary sales force and position in the Canadian oligopoly, Moody's regards SLA's distribution control as excellent. Because of strong distribution control, which promotes favorable policyholder persistency and in our view, more than offsets a lesser level of distribution diversity.

We have adjusted the score up to Aa from A.

Product focus and diversification: Low risk par reserves a strength but unhedged equity markets risk remains an issue

SLA offers a broad range of protection products. The COVID pandemic may cause a shift in the perception of risk potentially causing the perceived need for insurance products to increase. A sizable block of SLA's actuarial liabilities are participating reserves (approximately one-third) that are low-risk for the company - these products are priced based on mortality rates about twice what is normally experienced although they guarantee 3% to 5% interest on cash surrender values. The breadth of SLA's position in the Canadian market means that four lines of business provide 10% or more of premiums and deposits (individual life, health, segregated funds, and group pensions). However the potential volatility associated with the equity-related businesses of SLA remains a concern. SLA also operates in Hong Kong, the Philippines, Indonesia, India, China, Malaysia and Vietnam. The product offerings in these geographies are oriented towards straightforward protection products distributed through independent agency channels and a growing bancassurance capability. SLA plans to grow these operations to become a more significant contributor to earnings. In the US, SLA provides group insurance products and services, including life, long-term and short-term disability, absence management, medical stoploss, dental, vision and voluntary insurance such as accident and critical illness.

We have left the adjusted score at A, as indicated by the unadjusted scorecard result.

Asset quality: Portfolio dominated by high quality bonds and mortgages

As a result of pandemic-induced market developments, SLA has increased provisions for adverse deviation for fixed income asset credit spreads and losses on seed investments. Increased high risk assets (up to 142% in 2020 from 109% in 2019) were driven by negative credit migration, higher ETF holdings, and a new preferred share subsidiary ownership structure which consolidates at the holding company. SLF's investment portfolio breaks out as follows: 50% in bonds, 28% in mortgages and corporate loans, 8% in cash and other short term investments, 4% in equities, 4% in real estate, 1% in derivatives and 5% in policy loans and other invested assets at December 31, 2020. The company's projected credit losses under a base case and severe stress scenario are consistent with companies scoring at the Baa-level. As a result of the global pandemic there is heightened uncertainty regarding future real estate valuations over the near term.

We also note a good portion of the company's goodwill & intangibles is attached to its very profitable Canadian and Asset Management franchises, which provide the vast majority of SLF's earnings (note: SLF is SLA's parent holding company, the level at which goodwill & intangibles are measured). The proportion of private placements in invested assets (excluding derivatives) increased by 8% to 20% between 2010 and 2020. While increased private placement reliance modestly increases liquidity risk, this is commonly offset by the benefit of protective covenants.

We have left the adjusted score at Baa, as indicated by the unadjusted scorecard result.

Capital adequacy: Capital remains resilient

SLF's and SLA's Life Insurance Capital Adequacy Test (LICAT) ratios were 147% and 127% respectively as of December 31, 2020, well in excess of supervisory target levels. Although SLA's capital as a percent of total assets places the company in the Baa category, it has historically maintained its Canadian regulatory capital ratio well above required minimums. Further, capital levels exhibit good stability over time, reflecting low sensitivity to interest rates and stable earnings from asset management businesses. At current levels, SLA's LICAT ratio represents approximately CAD6.1 billion of excess capital above the supervisory minimum. SLF's ratio differs from the operating entity due to CAD3.1 billion of cash and liquid assets at the holding company.

We view this to be an Aa level of capital strength, and adjust as such.

Profitability: Maintenance of stable profitability anticipated once pandemic effects recede

In 2020 SLF reported net income of CAD2.4 billion, an 8% decrease from 2019 on higher experience losses and negative ACMA impacts. SLA achieved a 7.3% five-year average return on capital (2016-2020). This historical performance is below the lower end of our expectations for the Aa category (8% to 12%). Low interest rates and market volatility will pressure insurance and asset management earnings, however the company is consolidating its real estate footprint and simplifying its organizational structure to improve efficiency. Part of parent SLF's U.S. business is written out of SLA's U.S. branch, which has been the predominant piece of the SLF U.S. segment reported in the SLA financial statements prior to the Assurant acquisition, which added critical mass to the U.S. segment. The other business units include International Hubs, which was combined with the Hong Kong business in Q1 2020 and offers products to high net worth clients in international markets, and in-force management.

We are leaving the profitability factor at Aa on the expectation of improved levels of profitability going forward.

Liquidity and asset/liability management: ALM is robust but not without risk

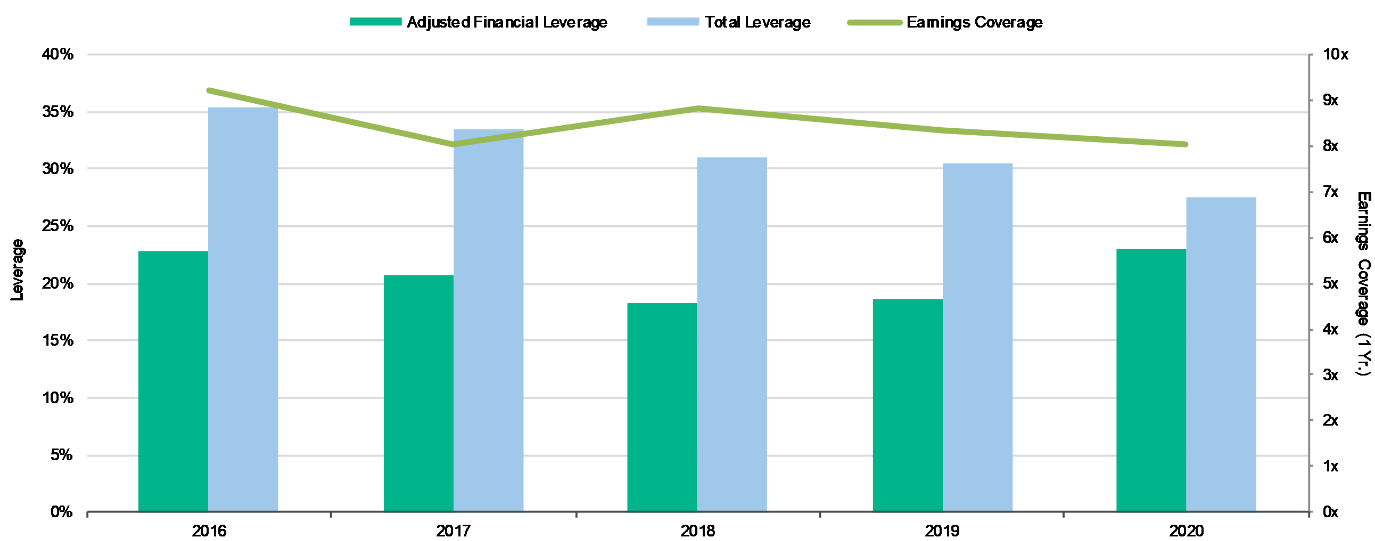
Applying the liquidity stress test approach to SLA, we arrive at a liquidity score in the Aaa range for SLA, calculated on a raw basis. Moody's believes liquidity at SLA (and the larger SLF group) remains robust and that the company uses sophisticated ALM and hedging strategies to keep any asset-liability mismatches within reasonable tolerances. Specifically, the hedging strategies utilize derivative instruments to manage the interest rate sensitivity of the duration gap between assets and liabilities, to mitigate the interest and equity related exposure of guarantees on insurance and annuity contracts and segregated funds, and to reduce currency exposure. That said, variable margin requirements associated with hedging activities add a level of complexity to liquidity management, and as a result, we have adjusted the raw score down to the Aa range

Financial flexibility: Return to historical earnings coverage levels driven by improved profit stability

SLA's financial flexibility is analyzed at the consolidated SLF level. On comparative IFRS basis, financial leverage metrics have improved in recent years due to strong earnings, however SLF issued CAD1.75 billion of subordinated issuances during 2020 to pre-fund upcoming maturities and bolster capital levels, which contributed to the increase in leverage to 23% from 18.7% in 2019. During 2019 the company restructured its captive reinsurance arrangements related to closed blocks of individual universal life insurance with no-lapse guarantee benefits. This structure provided financing of US statutory reserve requirements in excess of those required under IFRS. As such, we have adjusted our treatment of operating debt for SLF, the restated 2019 financial leverage amount would be 21% under the new approach. Total leverage was high at 35.3% in 2016, but has trended lower, ending 2020 at 27.5%.

In 2020, equity benefited from CAD2.4 billion in net income. SLF's one-year earnings coverage ratio stood at 8.0x at year-end 2020. Consolidated interest expense at the holdco was CAD355 million for 2020. SLF's more normalized earnings levels observed from 2015 to 2020 restored a healthier level of financial flexibility that we expect to continue over the medium term. SLF's moderate total leverage ratio implies the company could have less marginal debt capacity in a stress period than similarly rated peers. As a result, we have adjusted to the raw score of Aa down to a level of A.

Exhibit 5
Financial Flexibility: Declining leverage and stable coverage



Sources: Moody's Investors Service and company filings

Liquidity analysis - solid holdco coverage

The firm's liquidity policies require each operating subsidiary to keep sufficient liquidity to meet expected liabilities in both a one month and one-year stress test. The holding company targets CAD500 million in excess cash and has access to $1.4 billion in fully committed credit facilities as at December 31, 2020. SLF ended 2020 with CAD3.1 billion of cash and liquid assets at the holding company, up from CAD2.3 billion at year-end 2019 primarily attributable to strong earnings and a moratorium on dividend increases and share buybacks imposed by the regulator. There is dividend capacity available to the holding company from its Canadian life insurance and US investment management franchises. SLF's unrestricted subsidiary dividend capacity totaled approximately CAD2.1 billion at year-end 2020. Moody's calculates SLA's dividend capacity on the basis of the company maintaining its LICAT ratio above 130%.[1]

These sources, in total, exceed the 2020 major uses of cash at the holding company, which include CAD1,360 million in common and preferred share dividends paid and CAD205 million of interest expense paid. In 2020, there were no dividend increases and the company's payout ratio was 54%, up from 48% 2019. Subsequent to year end, SLF called CAD350 million of subordinated debt. Scheduled maturities within the next five years include CAD300 million of Series E senior debentures due in 2021 and CAD2,150 million of subordinated debt with first par call dates up to 2026. The company has no commercial paper outstanding.

ESG considerations

Environmental

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

Social

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

Governance

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

Support and structural considerations

SLF's preferred stock rating Baa1(hyb) is rated two notches below its implied senior unsecured debt rating, which in turn is rated two notches from the SLA's Aa3 IFS rating.

Rating methodology and scorecard factors

Exhibit 6
Sun Life Assurance Company of Canada

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								Aa	Aa
Market Position and Brand (15%)								Aa	Aa
-Relative Market Share Ratio		X							
Distribution (10%)								A	Aa
-Distribution Control		X							
-Diversity of Distribution			X						
Product Focus and Diversification (10%)								A	A
-Product Risk			X						
-Life Insurance Product Diversification		X							
Financial Profile								A	A
Asset Quality (10%)								Baa	Baa
-High Risk Assets % Shareholders' Equity				142.0%					
-Goodwill & Intangibles % Shareholders' Equity[3]			35.1%						
Capital Adequacy (15%)								Baa	Aa
-Shareholders' Equity % Total Assets				5.0%					
Profitability (15%)								Aa	Aa
-Return on Capital (5 yr. avg.)			7.3%						
-Sharpe Ratio of ROC (5 yr.)	637.5%								
Liquidity and Asset/Liability Management (10%)								Aaa	Aa
-Liquid Assets % Liquid Liabilities	X								
Financial Flexibility (15%)								Aa	A
-Adjusted Financial Leverage[3]		23.0%							
-Total Leverage[3]		27.5%							
-Earnings Coverage (5 yr. avg.)[3]		8.5x							
-Cash Flow Coverage (5 yr. avg.)[3]	7.2x								
Operating Environment								Aaa - A	Aaa - A
Preliminary Standalone Outcome								A1	Aa3

[1] Information based on IFRS financial statements as of fiscal year ended December 31, 2020. [2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis. [3] Information based on IFRS financial statements of Sun Life Financial, Inc. as of fiscal year ended December 31, 2020.
Source: Moody's Investors Service

Moody's related publications

Outlook

Insurance – Canada: 2020 Outlook

Sector in-depth

Q4 2020 Earnings — Strong earnings cap off challenging year

Issuer profile

Sun Life Financial, Inc. Key Facts and Statistics - FYE Dec 2019

Sun Life Assurance Company of Canada, Inc. Key Facts and Statistics - FYE Dec 2019

Methodology

Life Insurers

Ratings

Exhibit 7

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

Source: Moody's Investors Service

Endnotes

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

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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