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PRESENTATION

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

Welcome to Sun Life's Earnings Call for the second quarter of 2022. My name is Yaniv Bitton, and I will be the host for the call today. Our earnings release and the slides for today's call are available on the Investor Relations section of our website at sunlife.com. We will begin today's call with opening remarks from Kevin Strain, President and Chief Executive Officer. Following Kevin, Dan Fishbein, President of Sun Life U.S., will provide an update on the DentaQuest acquisition. Manjit Singh, Executive Vice President and Chief Financial Officer, will then present the financial results for the quarter.

After the prepared remarks, we will move to the question-and-answer portion of the call. Other members of management will also be available to answer your questions this morning.

Turning to Slide 2. I draw your attention to the cautionary language regarding the use of forward-looking statements and non-IFRS financial measures, which form part of today's remarks. As noted in the slides, forward-looking statements may be rendered inaccurate by subsequent events.

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

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

Thanks, Yaniv, and good morning, everyone. Before getting to the quarter, I want to discuss the agreement we announced earlier this morning to sell our closed block of business in the U.K. to Phoenix Group for approximately $385 million. The economics of the transaction relate to our U.K. life and pension business, which has been running as a closed block since 2001. Phoenix is the U.K.'s largest long-term savings and retirement provider. They have the scale and expertise to run closed life and pension businesses, and we're confident they will deliver exceptional client service.

As part of the transaction, we will enter into a long-term strategic partnership with Phoenix to become a preferred asset management provider. MFS and SLC Management will continue to manage approximately $9 billion in the U.K. general account on behalf of Phoenix. They will also become material partners to Phoenix, supporting their goal to invest approximately USD 25 billion in North American public and private fixed income as well as alternative investments over the next 5 years. Phoenix had over GBP 310 billion in assets under administration as at December 31, 2021, with a strong track record of growth. In the last 5 years alone, their AUA has increased over 300% through both organic and inorganic growth. It's an exciting opportunity for us that is aligned to our strategy to focus on less capital-intensive businesses in markets with natural tailwinds. The transaction also supports growth in our asset management businesses.

On close, Sun Life will release capital held for the life and pension business. We estimate a LICAT benefit of 1% to 2% associated with the capital release. However, the final amount will be determined on close. Sun Life will continue to maintain our economic interest in the U.K. payout annuities business. This block of business has an attractive risk/reward profile with strong ROE and cash flows and has been optimally structured from a Sun Life capital perspective. We expect that this business will generate approximately $30 million of annual underlying net income after the transaction closes in the first half of 2023.

I want to take this opportunity to thank our team in the U.K. for their passion and dedication to Sun Life. An important part of our decision-making process included finding a company where our U.K. employees could continue to grow and develop their careers, and we believe we have done so with Phoenix.

Turning to Slide 5. We provide an overview of our second quarter financial highlights. Our diversified business mix continues to demonstrate resilience and strength. Reported net income of $785 million was down 13% year-over-year predominantly driven by market impacts. Underlying net income of $892 million was up modestly. Manjit will discuss the quarterly financials in more detail. Overall, we saw good growth across the business despite challenging conditions. Canada had a strong quarter as disability results improved. The U.S. was also strong as COVID mortality impacts moderated, and we added approximately USD 10 million in earnings in the U.S. for DentaQuest. This happened after the close on June 1.

These positives offset lower fee income at MFS, driven by equity markets and a relatively in-line quarter in Asia as COVID-related restrictions continued to impact the Hong Kong business. Capital also remained solid in the quarter with 128% LICAT for SLF and 124% for SLA.

Slide 6 highlights several strategic initiatives from the quarter that support our client impact strategy. This quarter, we expanded our commitment to sustainability as SLC Management's fixed income business signed up to the Net Zero Asset Managers initiative, joining previous commitments made by other SLC affiliates including BentallGreenOak ("BGO") and InfraRed. In Malaysia, we launched the first Shariah-compliant investment-linked Takaful ESG fund. The fund provides an affordable and accessible avenue for clients to embed ESG factors in their investments.

As part of distribution excellence, we renewed our bancassurance partnership in the Philippines with RCBC, one of the country's leading commercial banks. The partnership was renewed for an additional 10 years and will continue to provide RCBC clients with access to financial protection products.

We also saw another quarter of strong momentum at SLC Management with capital raising of $5.7 billion in the quarter. We're seeing good traction across all asset classes offered through our diverse alternative investment platform, including BGO, where investors are pivoting to debt secured by real estate to provide protection against current economic conditions. And our position as a trusted brand was recognized this past quarter by Corporate Knights magazine, which once again included Sun Life on its list of the Best 50 Corporate Citizens in Canada. We have appeared on the annual ranking for 17 years and the 2022 edition ranks us 21st overall, driven in part by strong scores on executive gender diversity, board racial diversity and sustainability linked to executive pay.

Slide 7 provides highlights on our digital leadership. By focusing on digital priorities and continuing to develop our operating model, we are making great progress in our digital journey. In Canada, our digital coach, Ella, continues to help clients make better decisions, driving year-to-date increases in both wealth deposits and insurance coverage, which were up 14% and 64%, respectively, from prior year.

We're also making excellent progress in the U.S. with 76% of claims submitted digitally in the quarter. And in Asia, we saw a significant increase in digital submissions of new business applications, up 13% over the prior year. I'm also excited to welcome Chris Wei to Sun Life as our Executive Vice President and Chief Client and Innovation Officer, reporting to me. Chris joins our executive team in this new global cross-enterprise role, leading Sun Life's commitment to client experience excellence. Chris will be responsible for identifying and cultivating innovative solutions focused on achieving our purpose, including establishing measurable targets while maximizing our impact to foster a sustainable society and healthier planet. He will lead our sustainability, global marketing and corporate communications functions. Chris brings more than 25 years of global leadership experience in insurance and wealth management, and we're excited to have his depth of knowledge and experience on our team.

With that, I'll hand the call over to Dan to discuss the close of DentaQuest. We are excited to have DentaQuest join the Sun Life family.

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

Thanks, Kevin. I'm pleased to provide an update today on DentaQuest since closing the acquisition on June 1. With the addition of DentaQuest, Sun Life is now the second largest dental benefits provider in the U.S. by membership, and we now serve more than 50 million Americans across all of our benefits products. Combined, we expect to generate more than $7 billion in total annual U.S. benefits revenues as one of the largest providers of specialty benefits in the U.S. Over the past decade, we have transformed the U.S. business from a mostly retail individual life and annuities business to a high-performing market-leading benefits business.

The DentaQuest acquisition continues this evolution, changing the footprint of our business in the U.S. into a larger, more health care-focused organization now with more than 70% of our benefits revenue coming from health care. These changes have transitioned Sun Life U.S. from a capital-intensive to a capital-light business with strong cash flow generation, from businesses with long-term risk profiles to mostly short-term risk and fee-based businesses, from slow-growth markets to higher growth markets and from ROEs in the single digits to a return on tangible equity in the high teens.

The DentaQuest acquisition adds a large and growing business that aligns strongly with our risk and return profile and advances our business strategy to be a leader in health and benefits. Together, we will do even more to provide great oral health care to all and to help people live healthier lives. We welcomed 2,400 DentaQuest employees to the Sun Life family on June 1. The leadership team for the dental business is in place, consisting of a blend of DentaQuest and Sun Life leaders and is focused on growth strategies, revenue synergies and optimizing performance.

We're approaching integration with great care, and our goal is to realize the full potential of the transaction for all our stakeholders, including providing enhanced offerings for clients, delivering on our accretion and cost savings targets for shareholders, creating new opportunities for our employees and delivering a positive integration experience for all. We have a strong track record of successfully integrating group benefits businesses while minimizing disruption for our clients. Many of the leaders who managed the Assurant integration are involved in the DentaQuest integration.

We are focused on integration activities that will support our run rate cost savings target of USD 60 million by 2024. We're off to a strong start with a fully integrated leadership team, engaged employees and a detailed plan for the remaining steps. This quarter, we began reporting separately on the performance of our Dental business, which includes DentaQuest, both the government and commercial segments and the existing Sun Life U.S. dental and vision business. The second quarter includes 1 month of results for DentaQuest and 3 months of the legacy Sun Life dental and vision results.

I'm excited about the future at Sun Life U.S. We now have 4 strong businesses with market-leading positions in dental and stop-loss and a top 10 employee benefits business. Although recent results have been somewhat masked by COVID impacts, once this subsides, we remain confident in achieving our medium-term targets for the U.S., including 10% or more earnings growth for our benefits businesses.

At this time, I'd like to turn the call over to Manjit.

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

Thank you, Dan, and good morning, everyone. Slide 11 provides an overview of our second quarter results. The results reflect the strength of our business fundamentals and the benefits of our diversified business mix amidst a challenging operating environment. Reported net income in the quarter was $785 million, down 13%, primarily driven by lower equity markets. Underlying net income of $892 million and underlying earnings per share of $1.52 were up 1% from the prior year. Good insurance sales, moderating COVID impacts, strong credit results, one month of earnings from the DentaQuest acquisition and disciplined expense management helped to offset lower asset management results. Underlying return on equity was 14.9% in the quarter. Book value per share was up 6% over the prior year. And excluding the impacts in other comprehensive income, book value per share was up 10%. We continue to maintain a solid capital position with LICAT ratios of 128% at SLF and 124% at SLA. The decline in the SLF ratio from last quarter primarily reflects the closing of the DentaQuest acquisition and market impacts in the quarter.

Now let's turn to our business group performance starting on Slide 13 with MFS. MFS reported net income of USD 228 million, up 19% from the prior year, reflecting fair value changes and outstanding share-based payment awards. Underlying net income was down 17%, driven by lower average net assets, in line with year-over-year declines in global equity markets. MFS generated a pre-tax net operating margin of 36%. Operating margin declined by 3 percentage points from the prior quarter due to lower average net assets, partially offset by lower variable compensation. AUM was down 13% from Q1 to USD 553 billion largely reflecting lower equity markets and USD 5.5 billion of net outflows. Net outflows in the quarter were driven by U.S. retail, reflecting significant industry-wide retail redemptions. In fact, Q2 reflected the highest level of U.S. retail industry redemptions in over 30 years. That said, MFS saw lower relative retail redemptions as a proportion of AUM compared to the industry. Institutional inflows were USD 1.5 billion in the quarter.

Turning to Slide 14. SLC Management delivered another solid quarter with reported net income of $5 million and underlying net income of $23 million. Underlying net income reflected strong growth in fee-related earnings, partially offset by real estate investment from mark-to-market losses. Fee-related earnings were up 13% from the prior year, reflecting strong capital raising activity and the deployment of capital into fee-earning AUM over the past 12 months. The fee-related earnings margin of 23% was down modestly due to continued investments in business growth.

Strong capital raising of $5.7 billion in the quarter reflects the diversification of our investments platform, with positive momentum across all investment strategies. Total AUM includes $21 billion that is not yet earning fees. Once invested, these assets can generate annualized fee revenue of more than $175 million.

On Slide 15, Canada's reported net income of $160 million was down from the prior year, mainly due to market-related impacts. Underlying net income of $344 million was up 19% from the prior year, underpinned by good business growth and favourable mortality, morbidity and credit experience. This quarter's results also include higher large case group benefit sales in Sun Life Health and solid growth in third-party insurance sales. Wealth sales were supported by higher large case mandates in Group Retirement and Defined Benefit Solutions, partially offset by lower industry-wide retail mutual fund sales.

Turning to Slide 16. U.S. reported income of USD 167 million was up 31% from the prior year, reflecting real estate gains. Underlying net income of USD 121 million was up from USD 93 million in the prior quarter, reflecting 1 month of earnings from DentaQuest and more normalized group life mortality. Group life mortality significantly improved in Q2, in line with improvements in the overall population. We also saw some moderation in the favourable stop-loss morbidity experience in the quarter, but inpatient utilization remains below pre-COVID levels.

Our U.S. business continues to demonstrate strong core fundamentals with solid growth in premiums and fee income, good client persistency and benefits from investments in PinnacleCare and DentaQuest.

Slide 17 outlines Asia's results for the quarter. Reported net income was $131 million, down 8% from the prior year in constant currency. Underlying net income of $148 million was down modestly on a constant currency basis. Second quarter results were impacted by lower sales in Hong Kong, driven by pandemic-related restrictions and lower equity market-related fee income. This is mostly offset by higher new business gains in our international high-net-worth business and while international sales were lower than the prior year, profitability of sales is up as we focus on selective origination in the high-net-worth market.

Outside of Hong Kong and International, insurance sales grew double digits in the rest of our markets as they emerge from pandemic restrictions. Asia wealth sales were lower than prior year, reflecting declines in global equity markets. Overall, we're pleased with our results this quarter. Sun Life's attractive mix of diversified businesses once again allowed us to deliver good performance in a challenging operating environment. The fundamentals of our business remain strong. And we are continuing to invest to drive future growth. And the investments we have made in recent transactions, including in SLC Management, DentaQuest and bancassurance in Asia are performing well and contributing to results.

With that, I'll turn the call back to Yaniv for Q&A.

QUESTIONS AND ANSWERS

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

Thank you, Manjit. (Operator Instructions). I will now ask the operator to poll the participants.

Operator

(Operator Instructions) The first question comes from Meny Grauman, Scotiabank.

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

Question about Asia. It looks like COVID -- North America is putting COVID behind, and we saw the improvement in the U.S., but in Asia, it looks like COVID-related restrictions continue to be a factor and this quarter, we saw it in Hong Kong. I'm wondering what the outlook looks like or what you're seeing so far in Q3, but then even beyond that, do you expect any material change in COVID-related restrictions? Or is this going to be a persistent issue over the foreseeable future?

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

Thank you very much for the question. Meny, it's Ingrid Johnson from Asia. I've actually just spent almost 4 weeks touring Asia and went to almost all of our markets other than India and China and it's exactly right. The rest of Asia is actually opening up really nicely, whereas Hong Kong is still facing some of the restrictive measures as it started with a zero-COVID policy.

However, under the new Chief Executive that is being evaluated. That's very uncertain and you're correct, we do see that implication flow through into our sales and principally also with the borders closed and the virtually zero MCV sales versus in 2016, it was at a tight $9 billion, and there was a high weighting of our competitors on that being able to write that business. So we are seeing increased competition domestically in Hong Kong. Two quarters of contraction of GDP. There's no doubt that this needs to change. We're not sure when, but we're preparing and making sure we build a really great business that's positioned to take advantage as the restrictions ease.

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

If the zero policy -- zero-COVID policy continues, are there any changes you can make to that business? Or anything you're contemplating to adjust to that ongoing reality?

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

Importantly, we've also faced the market volatility that's being felt globally. So we're #2 in terms of our MPF flows, we still have a very strong position overall with a third position. So we're very strong in the wealth business and that we will continue. And the business is very well positioned also with our BowTie insurer that has got good momentum. So we feel that we're well positioned to Sun Life with our global positioning that we want to strengthen our offerings in Hong Kong. So we're cautiously optimistic, and we do believe that Hong Kong will emerge at some point, and we will be well positioned to take advantage of that. And we actually remain committed to our medium-term objective of 15%.

Operator

The next question comes from Tom MacKinnon, BMO.

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

With respect to DentaQuest, is it possible that you might be able to share with us the underlying earnings that DentaQuest contributed in the one month that you had it in the second quarter. And I have a follow-up.

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

Sure, Tom. This is Dan Fishbein. In U.S. dollars, the underlying earnings for DentaQuest in the one month was $10 million.

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

Okay. That's great. And then the follow-up is with respect to corporate. Just wondering how that might trend -- an underlying earnings loss of $35 million, significantly higher year-over-year. I assume that's from increased debt. Just wondering how that might trend going forward until you sell the -- until the close of the U.K. block? And then when the close of the U.K. block happens, I think the -- you would lose another $40 million in annual earnings, and would that be in that corporate block as well? So just a little bit of colour there.

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

Tom, it's Manjit. Yes, the corporate earnings, as you know, include a number of factors, so they do move around a little bit quarter-to-quarter. This quarter, we did benefit from favourable expense experience, largely in the corporate segment. So that's what's reflected in this quarter's results. And then to your point, going forward, once the clock transaction closes, we would -- you would see a decline in that number for the business that we sold. And we mentioned in our slides, that would be about the $40 million you outlined and that's the $40 million on an annual basis.

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

That's right. And I think you had mentioned before that after dividends and investment in the business that you generate excess capital of about $1 billion annually, does that change at all with this divestiture?

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

No, I don't think that changes materially after the divestiture. As we said, the $40 million is a relatively small number. And as you know, as part of the transaction, we are freeing up capital and obviously, we'll use that capital to generate additional earnings.

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

And Tom, it's Kevin. Of course, we've also entered a strategic management partnership with Phoenix, and we expect that we will get a good chunk of the $25 billion they're planning to deploy over the next 5 years into the North American sort of asset management space, and that will provide an income stream that will make up some of the lost revenue. So deploying the capital we get back and also the asset management agreement are in combination, I think, a good support to the earnings.

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

Okay. And how much do you expect to get on that $25 billion?

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

It's going to emerge over the next 5 years. And you might even say it would emerge sort of pieces over the 5 years. You can look -- Steve talked about in his slides what we expect from the alternatives. This will be a mixture of public fixed income to alternative asset management. So it's hard to say exactly what the time line will be. There's a process and a fiduciary responsibility they have for bringing them on.

But you will see that earnings emerge, and we expect that will make up a good chunk of what we've lost. And in fact, the other piece is you have to remember, this is a closed block. For the life and pension business that we sold, we expect that, that was going to decline quite significantly over the next 5 to 7 years, whereas the paid annuity business that we're keeping, we expect to be fairly stable from an earnings perspective and cash flow perspective.

Operator

The next question comes from Scott Chan with Canaccord Genuity.

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

My question is actually a follow-up to Tom on DentaQuest. I know it's one month, but Dan, is there any seasonal impact on that business or like a $120 million annual run rate is kind of what we're looking for?

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

Yes. I would caution that one month is not necessarily a trend. And so multiplying one month by 12 is always a little tricky. What I can say is we're still confident in the accretion projections that we made when we announced the transaction, and certainly, the results in June would support that. We did see a little higher margins in June than perhaps we expected and a little lower revenues, but the higher margins more than made up for the small variance in revenues. But overall, I think the comment we would make is at least this first month gives us confidence in our prior projections.

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

And if I take that first month and just annualize it and just do a quick math, it seems like the earnings power is substantially lower than when you announced the deal and could be some risk to that EPS accretion targets? Or is that not the case?

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

No, that's not the case. The accretion target we announced would actually translate to a number a little bit lower than the June number.

Operator

The next question comes from Doug Young with Desjardins Capital Markets.

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

Dan, on the U.S. group insurance business, underlying earnings were down year-over-year, and I know there's puts and takes in here, but ultimately, I'm just hoping you can flesh out some of those puts and takes when we look at that. And I know the LTM margin was 4.7%. I know you're targeting 7% plus. I know the dental and vision business has been stripped out, so it's not really comparable. I'm just wondering, is there a new target for the margin for that U.S. group insurance business you can share with us?

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

Okay. So a few questions there. The first one on the group earnings or the group benefits earnings compared to the same quarter of last year. Your observation is, obviously, correct. And the biggest driver there is that in the second quarter of last year, we had really outsized stop-loss results. And we continue to have very strong stop-loss results this quarter, just not as outsized as they were in that quarter last year. We also, compared to the prior quarter last year, we had a very strong quarter in long-term disability, and it was certainly less strong in this quarter. So those are the primary drivers there.

In terms of the margin, remember that we report a rolling 12 months or rolling 4 quarters metric. So partly what you're seeing here is looking back several quarters. The current quarter was actually quite strong, although, again, compared to a very strong quarter last year. So we actually swapped out a very strong quarter for a not quite as very strong quarter this year. But that's a 4-quarter metric that will, obviously, improve over time.

In terms of the margin target, we -- dental was, obviously, a very, very small part of that in the past. It would be a very big part of that now if we included DentaQuest, and margin we've concluded is not really the best way to think about the dental business, especially in comparison or in combination with the other group businesses. Dental businesses competitively have relatively low margins, and that's because they have very high ROEs because they require much less capital than other group businesses. So we're going to report dental separately and likely use other metrics for that. But for the remaining group business, our margin target remains the same as it has been, which is 7% or more.

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

And just a follow-up. When you think about getting from 4.7% back up to 7%, is it more on the group life -- group benefit life and health business? Or is it on the stop-loss? Like where do you see -- is stop-loss still above that 7% coming down and the group life and health moving up? Or has there been a change in that shift?

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

No. Stop-loss is still above and group is still below. While COVID incidence certainly has improved dramatically, there still are COVID impacts in the business. You see some of that -- a little of that in long-term disability. Certainly, there's -- especially over the past 4 quarters, there's still quite a bit in mortality there. But we would see stop-loss may even drift down a little bit as some of the favourability from delays in care gradually moderate. But on the other hand, we would expect group life and group disability to go back up as the COVID impacts fade away.

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

Okay. And just second, Kevin, on the sale of the U.K. I guess the question was why retain the annuity business. I think you covered a little bit about that. But is this also a play on you want to keep longevity to offset the build-out of the life insurance business? And when you think about deploying capital, can you remind us what are you focused on? And from an acquisition perspective, what are you focused on?

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

Yes. Thanks, Doug. So it is a bit about we like the risk profile of the business, but we've optimized that business for our book. And under IFRS-17, you actually see a slight growing pattern over the next 10 years to that earnings. And the earnings almost come back 100% or maybe even more than 100% in cash flow, and it's got a very good ROE. So we like the risk profile. We like the structure of it. And it helps all of our 3 medium-term objectives. Of course, when we're thinking more broadly about M&A, that's what we're looking at.

We're looking at adding -- does the acquisition or disposition add to our strategy? Does it fit in with our strategy on an acquisition? Is it adding either capabilities or is it adding scale? Is it helping our 3 medium-term objectives? So is it accretive? Is it helping our earnings growth? Is it supporting the ROE objective that we've put out? And are we getting cash flow out of it? And then importantly, can we execute on the transaction.

So we've deployed capital against all of those over the past little while. You've heard Dan now talk about DentaQuest, but you've seen the benefits of adding the SLC businesses and the bancassurance in Asia. So it's really about those things. Are we adding to our strategy? Are we meeting our medium-term objectives and can we execute on the integration?

Operator

The next question comes from Gabriel Dechaine, National Bank Financial.

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

Just a follow-up on that U.K. What's the underlying earnings of the retained business? Just it's hard to...

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

It would be approximately the $30 million that I talked about, Gabe, during the -- during my opening remarks.

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

$30 million, but it's also a potential trends on the mortality side or look at the other way, continue -- you could still have much more material reserve releases in the future. Is that not correct?

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

I'll maybe ask Kevin to speak to the reserve releases, but it's -- and the $30 million is under an IFRS-17 basis.

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

Gabe, it's Kevin Morrissey. Yes, our experience has been quite good over the long-term on this block of business. It's one of the reasons why we retained it. We have very sophisticated methods of managing the investment risk and there's very little kind of net residual risk there, and we like kind of the profile, as Kevin mentioned, of the business and the cash flows coming out of that. So yes, there is certainly some potential upside on that business as well.

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

While I got you, Kevin, one of your -- well, the big U.S. life insurers booked a big reserve charge for lapse risk in the no-lapse guarantee business line that they're -- I don't think selling anymore. You've got it on your runoff block. Is there -- are you confident in those reserve levels? I believe you would have been more proactive over the years on identifying or reserving for those lapsetrends?

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

Yes. That's right, Gabriel. As you know, we've been very keen to focus on that experience and make updates in the assumption reviews annually to make sure that we're -- got that right up to the most recent experience. So last year, we did strengthen. We've been monitoring that since then. Happy to report that since that change last year, the experience has been fully in line with that last update. So certainly looking good over the last several quarters, and we don't anticipate any further changes to the lapse assumption on that block.

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

Perfect. And last quick one on SLC, the $20 billion that's not yet been deployed and the revenue potential attached to that. What's the -- forgive me if this has been asked already, but the time line you expect to deploy the capital -- or yes, the investment capital?

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

Gabriel, it's Steve Peacher. Thanks for the question. Yes, that $20 billion -- $21 billion reflects the nature of the alternative investment business. So across our real estate, alternative credit and infrastructure businesses, we raised closed-end funds and the capital gets committed by institutions and it gets -- and we draw on it as it gets deployed. In some cases, we earn fees just on the commitments. But in many cases, in most cases, we don't earn fees until it's deployed.

In general, those commitments you'd have a 3-year investment window in the product. So some of those commitments would be toward the end of the investment period, some would be money we just raised. So I would expect on average that money to get raised over the next year, year and a half.

Now I would say that at the same time, because in some cases, these funds are the sixth in a series or the seventh in a series, you also have funds that are at the end of their life and that are in disposition mode. And so you're always raising new funds, you're investing, some are rolling off. But I would say, to your question, that $20 billion should get invested on average over the next year, year and a half.

Operator

The next question comes from Mario Mendonca with TD Securities.

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

Can I just ask a little about experience, policyholder experience, like the more underlying experience? There's a pretty big shift from Q1 to Q2. And what I'm trying to get a better appreciation for is the extent to which that move from, say, negative mortality of 90 and morbidity of 18 and also on other lines, how that moved from a charge in Q1 to a meaningful gain in Q2?

And the way I want to approach this is, if you can help me think through what portion of that is just truly actually just different results? And how much of it really just reflects different underlying expectations in Q2 relative to Q1. I think you appreciate where I'm going with this. How much of it is actual and how much of it is really a change, that the expectations were different for Q2?

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

I might actually step in Mario, it's Kevin. I think Dan should talk about the U.S. mortality experience because that was a significant part of the change. And then we should have Jacques talk about the disability experience in Canada, because that was also a big piece. And Dan, you might want to touch on disability as well. And then if we still have some open items to wrap up, Mario, I think either Manjit or Kevin or I can come back at the end.

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

Sure. This is Dan. Yes, there was a very big change, as you can see in mortality, particularly in the group life business during the first quarter. We actually -- just a quick comment on the in-force management business, the legacy individual life business. We had a couple of large claims there. So that actually went a little bit the other way, at least compared to the quarter -- the prior quarter and the prior year as well as sequentially, but that's just the nature of the volatility in that business.

But the really big change was a great lessening in the COVID mortality from Q1 to Q2. Our COVID mortality experience actually declined by 90% from the first quarter to the second quarter. So that's the biggest driver from the U.S. that you're seeing there. It was not a change in expectations. That blends in very slowly between first quarter and second quarter, there would be very little change there. It was actually a very big change in the mortality experience.

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

Jacques?

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

Mario, this is Jacques. The material change in Canada is in morbidity, that is driven mostly by group disability experience in Sun Life Health. I've talked about this before, but there are a few key components there. One is the incidence or the volume of cases we get. And the other one is how long or short the durations are before people go back to work. We have positive experience in both incidence and duration.

Keep in mind also, Mario, that starting in 2019, we started putting price increases through the block, and that's also impacting. So at this stage, it's hard to say because we have one data point of Q2 being a good experience quarter. I would be cautious to declare this a new trend. There's a lot of things that influence incidence, for example. So a strong area of focus as we've had in a number of quarters now, as you know, and we're continuing that. We're watching it closely, but that's the main driver in Canada.

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

It's Kevin again. I would say that both of these items have been headwinds for us in the comparative quarters that you're talking about, Mario, and so you can see that this in a way, is us taking management actions in the case of Jacques and then a big change in the COVID death rates in the case of the U.S. business that you're seeing. And we talked about COVID mortality, in particular, a lot in Q4 and Q1. And those were disproportionate negative impacts, and we're sort of getting to a place where the COVID deaths now are, I think, roughly in the 300 to 400 a day in the U.S., and they had been running at a close to 3,000 a day. And I think Jacques answered the morbidity question.

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

Yes. I think I understand now that actual changes and management actions were the driver, not any big change in expectations. Perhaps a final sort of line of questioning in this respect. The expense side turned real positive this quarter, the 44. Was that a management action or a change that resulted in that gain? I would imagine that's less about expenses as well -- or sorry, less about expectations as well?

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

Yes, Mario. It's Manjit. Yes, I think there's a couple of elements in there. The one element is around management actions. As you know, we've always had a very keen focus on expense discipline. We're keeping that focus. All of our businesses are focused on driving a productivity inside of their businesses. And that's resulting in sort of slightly lower expenses than we thought. And the second element is, obviously, given the moves that we've seen in the markets, some of our share-based compensation expense plans, there's downward impacts of that. So it's a combination of those 2 things.

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

Okay. And then maybe just one final thing. If we could go to the contract service margin, I think the company is guiding -- just I'm doing this by memory, I think it was $4.5 billion or -- is that right? Is it $4.5 billion or $5 billion in contract service margin?

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

The $4.5 billion was the adjustment to our shareholders' equity on 1/1/22.

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

I'm sorry. And did you say that most of that related to establishing the contract service margin? Would I be correct in saying the contract service margin should be you're guiding us to maybe $4.5 billion? Or am I not -- am I reading too much into that?

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

Yes. I think there's 2 elements to the contract service margin. One is the adjustment to the equity, which I spoke about in our call on May 31, we said about 2/3 of the shareholders' equity adjustment we gave you would be a part of the contract service margin. There's also another element which result -- which is related to the change in how we present the liabilities, and that information we haven't provided yet.

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

Okay. So the contract service margin could in fact be less than $4.5 billion. Is that true?

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

Well, we haven't sort of said that, but I would say it's going to be more than the $4.5 billion.

Operator

The next question comes from David Motemaden with Evercore ISI.

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

I had a question just on the U.K. business, on the bit that was retained. Could you just describe, I guess, why you are retaining that? Is that something you could consider, exploring something similar with a transaction on in the past? Or is there something about it that made it -- that Phoenix didn't want to keep maybe just some colour on why you didn't sell the annuity business as opposed to retaining the annuity business would be helpful.

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

David, this business has been optimized to our business and our sort of capital structure. If you -- as Kevin said, we like the risk profile, it fits well in. And as I said earlier, we like the earnings and cash flow and ROE that are coming off of it. So it was one overall that as we were doing the transaction, we decided we'd rather keep than sell. The -- it didn't impact us getting an effective asset management agreement, and we also got, we believe, a very good price from Phoenix on the parts we sold. So we were actually quite pleased to be able to keep this and that was us driving it more than Phoenix.

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

Yes. And the other thing I would add, if we look at the returns on this business, given Kevin's comments about how we structured it, it's 20% plus. So we're very happy with the returns we're getting on that business.

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

Okay. Great. And then maybe just taking a step back, and I think in the past, it didn't sound like you guys were in a rush or had really focused on trying to do something more strategic in the U.S. on that in-force management business. Has that changed?

Does this transaction that you did with Phoenix on the U.K. - was that more of a one-off to get the asset management agreement? Or is this something - a broader initiative that you guys are starting to think about in terms of just getting maybe potentially offloading or doing something more strategic with the in-force management business?

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

David, it's Kevin again. If you looked at the life and pension business that we sold, again, that block closed in 2001, and we were expecting income to start to decline and cash flow to decline. And at some point, you start to lack scale. In the IFM business in the U.S., we like the earnings profile. We like the ROE coming out, and we like the cash flow coming out of that business. It also supports our asset management business, right?

So it gives us asset management to provide to SLC. And so we think that's a positive. So at this point in time, I would say that the IFM business is a bit like the payout business in the U.S. We like the profile of it. We like the earnings and the cash flow coming out and the ROE. And so that's how we're thinking about that. If you watch, there's a number of asset management companies that are buying these closed blocks for the cash flow. And so that's strategic for us to provide that cash flow back to SLC as well.

Operator

The next question comes from Paul Holden with CIBC.

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

I want to go back to the U.S. group business because there's just been a lot of moving pieces over the last year, year and a half. And you mentioned targeting sort of a 10% organic growth rate in that business. Is there anything today that would suggest to us that the growth rate could be higher than 10%, just given the extent to which you're growing stop-loss, the price increases you've been pushing through? Or maybe there's factors that would suggest don't get too excited, maybe it's going to be a little bit less than 10% in the near term? Maybe you can talk through some of those dynamics for us.

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

Sure. Well, I'm always excited about the future so -- I'm an optimist. So you may have noticed that even without the addition of DentaQuest and PinnacleCare, the premium and fee revenue of the U.S. rose by 10% in the past year. So we're clearly generating significant organic growth, and that should translate into earnings growth as well. Now DentaQuest has been a growth engine over its history. It's had times of very rapid growth. A little bit of a caution there. It's something new for us all. Their business is very lumpy. Contracts are very large, smaller in number, but very, very large.

So there will be times with DentaQuest where they show dramatic growth from just adding 2 or 3 big contracts, and then there may be pauses in between some of those contracts. But we think there's a lot of potential in the DentaQuest business on multiple fronts to continue to win new government contracts in Medicaid, to expand significantly in Medicare Advantage, which is really a relatively new area for them, and to put their capabilities and our legacy capabilities together to make a first-class commercial dental business as well.

So that business can grow at a very good pace. Stop-loss also, as you've seen for several years, has been growing at a very good pace. We're the industry leader there. And as we come out of COVID, we have lots of optimism for what we can do in the group business. As you've probably noticed, after several years of that business being relatively flat, the past year and a half, it has really started to grow organically. So we're confident in the 10% number. And certainly, I always think there's upside.

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

Okay. That's a great answer. And I think things have been pretty quiet for Mike Roberge. I'll ask a question on MFS. So we saw positive institutional flows this quarter. I wonder if that's just the rebalancing impact. You've talked about that in the past, usually it worked the opposite way with higher equity markets. So wondering if it's just institutional clients taking or really, I guess, rebalancing portfolios, adding more equity or if there was something more to it?

Michael Roberge - *Sun Life - Chairman of MFS Investment Management*

This is Mike. I think the institutional flows do tend to be somewhat lumpy, and there were just a number of wins that funded in the quarter. Some of that would have been rebalancing. But I think it was just activity at the client level where we lined up well with those particular opportunities, and they happen to fund in that particular quarter. So that's really what drove. That's sort of the colour behind the institutional flows.

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

Okay. And then just quick follow-up. I mean, is there any sense you can give us given the current pipeline today and where things might land in the future?

Michael Roberge - *Sun Life - Chairman of MFS Investment Management*

Yes. I mean we don't comment on what pipeline looks like and what we think the future looks like. All I would say is we expect institutional flows quarter-to-quarter to be relatively lumpy based on what clients are doing and the size of the mandates that they're putting out. So I'm not comfortable giving a forecast.

Operator

Next question comes from Nigel D'Souza with Veritas Investment Research.

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

I wanted to follow up on experience and specifically on the expense side. As mentioned earlier, the delta year-over-year on expenses is pretty significant. And I'm wondering if you could flesh out the impact there on variable versus fixed costs. You mentioned share-based comp, is that what's driving the majority of it? On the fixed side, could you touch on the outlook in an inflationary environment. Do you expect to keep costs below your assumptions? Or should we expect over the medium-term, an unfavourable revision to your expense outlook or less favourable expense experience as inflation weighs on your results?

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

Nigel, it's Manjit. So in terms of the composition of the expense experience in the quarter, I would say about 2/3 of that was related to variable compensation that I spoke about earlier. I mean in terms of inflation, obviously, we're feeling some of the general impacts that you're seeing in the overall market, but not at the sort of the headline levels that you sort of see in the media - 9% or 10%. It's more in pockets, certain areas like technology and data specialists, we're seeing more pressure on that side. But as I spoke about earlier, we also are having opportunities to drive expenses lower by productivity initiatives. We've done that for many years, and we're continuing to focus on that. So overall, we feel we can manage our expenses -- continue to manage our expenses ahead of our revenue growth.

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

Okay. That's helpful. And if I could finish off with the impact of investment activity component of your experience this quarter. I mean, that continues to be favourable. Just trying to get a sense of how does that correlate with interest rate volatility or spread volatility? Should we expect that favourable experience to continue until spreads and interest rates stabilize? Or what's the right way to think about that line item?

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

Kevin, do you want to take that, Kevin Morrissey?

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

Sure. Nigel, it's Kevin Morrissey. The investing activity, as you know, is very strong again this quarter. We had gains of about $36 million. There's a number of different factors that impact that in addition to the flows and the market environment. I'd say that we positioned our portfolio to have a certain amount of reserve to take advantage of favourable market conditions, and you're seeing some of that coming through in the quarter. It also has to do with kind of the deals that we're doing and the flows of those vis-a-vis the size of our new business in each quarter depending on how much we're backing against new business and how much we're backing against in-force. So I'd say that our outlook continues to be favourable relative to our $10 million to $20 million per quarter guidance.

Operator

We have no further questions at this time, and I will turn things over to Mr. Bitton for closing remarks.

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

I would like to thank all of our participants today. Should you wish to listen to the rebroadcast, it will be available on our website later this afternoon.

I will now turn the call over to Kevin Strain for closing remarks.

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

Thanks, Yaniv. We remain focused on our purpose and our strategy, our diversified mix of business, strong risk management, balance sheet strength and capital position are helping us managing through what's clearly challenging times. You can see steps across each pillar and across all elements of our strategy that continue to move the business forward.

The close of DentaQuest, our strategic partnership with Phoenix, reviewing our distribution relationships with -- renewing our distribution relationships with RCBC and gaining traction on sustainability and digital leadership were all steps we took in the quarter to continue delivering for our clients, our employees and our shareholders.

I want to thank everybody for joining the call and wish you all a great rest of the summer.
