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# Sun Life Financial, Inc. (SLF)

Q3 2018 Earnings Call

# CORPORATE PARTICIPANTS

Gregory A. Dilworth
*Vice President-Investor Relations, Sun Life Financial, Inc.*

Dean A. Connor
*President & Chief Executive Officer, Sun Life Financial, Inc.*

Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

Kevin Morrissey
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*

Daniel Richard Fishbein
*President-US Business, Sun Life Financial, Inc.*

Randolph Brill Brown
*Chief Investment Officer, Sun Life Financial, Inc.*

Jacques Goulet
*President-Sun Life Financial Canada, Sun Life Financial, Inc.*

# OTHER PARTICIPANTS

Humphrey Hung Fai Lee
*Analyst, Dowling & Partners Securities LLC*

Meny Grauman
*Analyst, Cormark Securities, Inc.*

David Motemaden
*Analyst, Evercore Group LLC*

Sumit Malhotra
*Analyst, Scotia Capital, Inc.*

Doug Young
*Analyst, Desjardins Capital Markets*

Gabriel Dechaine
*Analyst, National Bank Financial, Inc.*

Scott Chan
*Analyst, Canaccord Genuity Corp.*

Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Paul Holden
*Analyst, CIBC World Markets, Inc.*

# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, ladies and gentlemen. My name is Chris, and I will be your conference operator today. At this time, I would like to welcome everyone to the Sun Life Financial Q3 2018 Financial Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

Greg Dilworth, Vice President of Investor Relations, you may begin your conference.

## Gregory A. Dilworth

*Vice President-Investor Relations, Sun Life Financial, Inc.*

Thank you, Chris, and good morning, everyone. Welcome to Sun Life Financial's earnings conference call for the third quarter of 2018. 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 presentation with an overview of our third quarter results by Dean Connor, President and Chief Executive Officer of Sun Life Financial. Following Dean's remarks, Kevin Strain, Executive Vice President and Chief Financial Officer, will 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.

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 this morning'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 Dean.

## Dean A. Connor

*President & Chief Executive Officer, Sun Life Financial, Inc.*

Thanks, Greg, and good morning, everyone. Turning to Slide 4, the company reported underlying net income of CAD 730 million or CAD 1.20 a share, up 14% over prior year, and underlying return on equity increased to 14%. Our Canadian, U.S. and asset management businesses each delivered double-digit earnings growth while Asia results were lower this quarter from higher levels of new business strain. Reported net income declined to CAD 567 million due to assumption changes and management actions.

Insurance and wealth sales were lower by 4% and 17% respectively over the prior year. Individual insurance sales grew 7% in Asia, led by growth in India from a new bancassurance relationship. Group Benefits sales were lower in both Canada and the U.S. And in wealth and asset management, we saw lower institutional sales in MFS and a reduction in sales activity in India and the Philippines due to market volatility.

Notwithstanding mixed sales performance, the Value of New Business or VNB, one of our key metrics, grew by 9% over the prior year, primarily reflecting an improved mix of business in Sun Life U.S. We continue to maintain significant capital flexibility with a LICAT ratio of 145% for Sun Life Financial. We repurchased and canceled 3.8 million shares in the third quarter. And last night, we announced a 5% increase in our common share dividend to

CAD 0.50 per share. Our capital position provides both a strong defense as well as a strong offense in terms of the ability to take advantage of opportunities and invest in business growth.

In the quarter, we advanced on our purpose, which is helping our clients achieve lifetime financial security and live healthier lives, by leveraging digital, data and analytics to make us more proactive and make it easier for clients to do business with us.

In Canada, we launched Lumino Health, the first of its kind digital health network. It takes the digital health platform that we've built for Sun Life plan members, a platform that provides cost, location and quality data on more than 150,000 healthcare providers across Canada and opened it up for all Canadians to use.

Lumino Health is a powerful digital platform that will help Canadians on their health journeys wherever they are, regardless of whether they're looking for healthcare providers, products, services, or simply want to know the latest health innovations that are out there. We think it will truly allow Canadians to live healthier lives, and it will make it easier for healthcare providers to connect with current and potential future patients.

We also announced the strategic relationship with Rise People Inc., Canada's first all-in-one integrated digital HR, payroll and benefits admin solution. Through this collaboration, we will develop new digital bundles that will simplify benefit plan delivery for small and mid-sized employers and help grow our Group Benefits business in this profitable segment of the market. In the U.S., the Group Benefits business after-tax profit margin grew to 6.4% on a trailing 12-month basis, up from 4.5% last year, reflecting the strong contribution of our stop-loss business where business in-force grew nearly 20% over the prior year.

We also marked an integration milestone from our 2016 employee benefits acquisition by moving the final product to the Sun Life U.S. Group Benefits portfolio. In Sun Life Asset Management, assets under management grew 6% to reach CAD 687 billion. Sun Life Investment Management, our alternatives manager, generated net inflows of approximately CAD 500 million. At MFS, assets under management grew to $485 billion, and the pre-tax net operating profit margin was 40% from a combination of higher asset levels and good expense management.

Net outflows for the quarter of $7.3 billion were improved from last quarter but continued to be impacted by client de-risking and rebalancing, particularly within institutions. 66%, 82%, and 88% of MFS's U.S. retail mutual fund assets ranked in the top half of their Lipper categories based on three-year, five-year, and 10-year performance, respectively.

In Asia, we saw strong momentum in India where individual insurance sales grew by 70% compared to the same period last year, primarily from the successful activation of our new bancassurance distribution arrangement with HDFC, one of India's largest banks. Sales in our Mandatory Provident Fund or MPF business in Hong Kong grew by 37% over the third quarter of last year, maintaining the top spot for industry net inflows for the second consecutive quarter. Our Hong Kong MPF business also earned the top ranking from Mercer's inaugural MPF Provider Satisfaction Rankings Report, reflecting both strong fund performance as well as client value-added services.

So, overall, we made great progress this quarter and for the first nine months of 2018, and continue to execute well against our medium-term objectives. Year-to-date, we grew underlying earnings by 17%. Our ROE is at the top end of our stated range of 12% to 14%. And we grew VNB by 20%. We're investing in our businesses, executing on growth, and are excited about the many innovations and improvements we're introducing for clients and advisors around the world.

And with that, I'll now turn the call over to Kevin Strain, who will take us through the financials.

## Kevin D. Strain

*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

Well, thanks, Dean, and good morning to everyone on the call. Turning to Slide 6, we'd take a look at the financial results from the third quarter of 2018. Building on the momentum from the first half of the year, we saw strong underlying earnings and EPS growth as well as ROE results this quarter.

Reported net income of CAD 567 million was down from prior year, primarily due to updates from our third quarter actuarial methods and assumptions review and less stable market-related impacts. I will discuss our actuarial assumption changes more during my comments on the sources of earnings in a few minutes.

Underlying earnings, which exclude the impacts of market-related factors and assumption changes, were CAD 730 million or CAD 1.20 per share, both up 14% over the third quarter of 2017. Underlying earnings growth year-over-year was driven by strong business growth, the positive impact of U.S. tax reform and investment experience, partially offset by less favorable mortality experience and higher new business strain. Our underlying ROE at 14% was at the upper end of our target range for our medium-term objective of 12% to 14%.

We ended the quarter with a LICAT ratio of 145% for Sun Life Financial, Inc. and 130% for Sun Life Assurance Company of Canada. The higher ratio at the SLF level largely reflects the excess cash of CAD 2.7 billion held by SLF Inc. Our LICAT ratio dropped by 4 points in the quarter. Approximately 2 points of the decline was related to changes in interest rates, in line with our public sensitivity. The remainder was primarily related to assumption changes, which impacted the available capital, the surplus allowance and the base solvency buffer. The assumption changes also had the benefit of reducing our LICAT sensitivity to interest rate increases by more than 50%.

Our strong capital ratios are supported by a leverage ratio of 21.9%, which is below our target leverage ratio of 25%. We have repurchased and cancelled a total of 7.7 million shares or CAD 406 million worth for the first nine months of 2018 and 3.8 million shares or CAD 200 million for Q3. Our share buyback program continues to balance support for our EPS and ROE growth while maintaining a strong capital position.

During the quarter, we renewed the normal course issuer bid or NCIB program for another 12 months with a limit of up to 14 million shares. Our business generates more than CAD 700 million of cash and capital each year, which is roughly the size of our NCIB as renewed. Our third quarter dividend payout ratio was 40% of underlying earnings, within our medium-term objective range of 40% to 50%. As Dean noted earlier, along with our results this quarter, we also announced a 5% increase to our common share dividend to CAD 0.50 per share, a 9% increase on an annualized basis for 2018, reflective of our earnings growth and our strong capital position.

Turning to Slide 7, we provide details of underlying net income by business group for the quarter. In SLF Canada, underlying net income of CAD 251 million was up 13% from the prior year, reflecting favorable investment experience as well as business growth primarily related to the growth in fee income from our wealth businesses. The underlying return on equity for Canada was strong at 14.5%.

In SLF U.S., underlying net income was up 9% in U.S. dollars, reflecting the impact of investment activity, improved lapse experience in the In-force Management business, and the benefit of the lower income tax rate, partially offset by less favorable mortality experience in Group Benefits. Our Group Benefits after tax profit margin was 6.4% in the third quarter compared to 4.5% in the prior year, reflecting the continued strong results in our stop-loss business. Underlying return on equity in SLF U.S. was also strong at 15.7%.

SLF Asset Management had underlying earnings growth of 23% on higher average net assets at both MFS and Sun Life Investment Management, disciplined expense management, and a lower income tax rate in the U.S. MFS pre-tax net operating profit margin was 40%, in line with the prior year.

In Asia, underlying net income declined by 15% from last year. While SLF Asia's expected profit was up 16% year-over-year, new business strain increased by CAD 17 million, offsetting the growth in earnings. Our investment in growing businesses across the region and lower investment gains also contributed to the lower earnings versus prior year.

Turning to Slide 8, we provide details on the sources of earnings presentation. Expected profit of CAD 788 million increased by CAD 78 million or 11% over the same period last year. Excluding the impact of currency and the results of SLF Asset Management, expected profit grew by 14%, driven by business growth across Canada, the U.S. and Asia.

We had new business strain this quarter of CAD 8 million compared to CAD 21 million of new business gains in the same period last year. The decrease is primarily from higher levels of new business strain in SLF Asia on lower international sale and Hong Kong mix of business, and lower levels of gains in SLF Canada on lower GRS sales, primarily related to our defined benefit solutions business.

Experience items were largely favorable this quarter with positive net market impact, strong investment gains, and credit experience, favorable mortality experience and favorable morbidity results in a stop-loss business in SLF U.S. This positive experience was partially offset by unfavorable lapse and policyholder behavior experience.

The net impact of our third quarter review of actuarial methods and assumption changes resulted in a CAD 258 million pre-tax charge to net income. This quarter's review included the assessment of many assumptions across a large number of products, businesses and geographies. Updates to mortality and morbidity assumptions based on industry data and recent experience were positive contributors.

However, more than offsetting these impacts were updates to lapse and other policyholder behavior experienced primarily in SLF U.S., including changes to assumed lapse rates and premium persistency. Other in the source of earnings, which amounted to a negative CAD 40 million, includes the fair value adjustments of MFS share-based payment awards, acquisition and integration costs, and the impact of hedges in SLF Canada that do not qualify for hedge accounting.

Earnings on surplus of CAD 119 million were CAD 17 million higher than the third quarter of last year, reflecting increased levels of investment income and higher surplus assets. Our effective tax rate on reported net income for the quarter was 17.3%. On an underlying basis, our effective tax rate for the quarter was 19.1% and in line with our expected range of 15% to 20%.

Slide 9 shows sales results across our insurance and wealth businesses. Total insurance sales were down 4%, or 5% on a constant currency basis, compared to the third quarter of 2017. SLF Asia individual insurance sales grew 7% on a constant currency basis, led by double-digit growth in India and the Philippines. SLF Canada insurance sales were down 6%, mainly driven by fewer large case sales in Group Benefits. Sales in SLF U.S. were down 14% in U.S. dollars, as a result of a decrease in stop-loss partially offset by growth in employee benefit sales. Total wealth sales of CAD 29.8 billion were down 17% from prior year or 19% on a constant currency basis.

Sun Life Asset Management sales were down 18% on a constant currency basis, mainly from lower managed fund sales at MFS as well as lower fund sales at Sun Life Investment Management. MFS net sales were negative at $7.3 billion but better than last quarter and worse year-over-year. SLF Canada wealth sales were down 2%, as the third quarter of 2017 included higher large case sales in Group Retirement Services.

Individual wealth sales in Canada were up 15% on continued growth from our wealth manufactured products, including Sun Life Global Investment mutual funds. SLF Asia wealth sales were down 47% compared to the same quarter in the prior year, primarily from lower sales in India and the Philippines as a result of market volatility. We continued to see strong sales in our Hong Kong MPF business where we maintain our ranking of fourth in the industry based on assets under management.

While the growth in sales during the quarter was not what we would expect in terms of year-over-year growth, we did continue to see positive growth in our Value of New Business measure, which was up 9% to CAD 244 million. This growth was driven by improvements in business mix, which is an important component of our distribution strategies and driver of long-term profitability.

So, to conclude, in the third quarter, we delivered strong financial performance, with underlying EPS growth of 14%, an ROE at the top end of our range, VNB growth of 9%, and we maintain our capital strength with excess cash of $2.7 billion and our strong earnings supported our 5% dividend per share increase.

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

## Gregory A. Dilworth

*Vice President-Investor Relations, Sun Life Financial, Inc.*

Thanks, Kevin. To help ensure that all of our participants have an opportunity to ask questions on today's call, I would ask that each of you please limit yourself to one or two questions and then to re-queue with any additional questions.

With that, I'll now ask Chris to please poll the participants for questions.

# QUESTION AND ANSWER SECTION

**Operator**: [Operator Instructions] Your first question comes from Humphrey Lee of Dowling & Partners. Your line is open.

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Humphrey Hung Fai Lee
*Analyst, Dowling & Partners Securities LLC*

Q

Good morning, and thank you for taking my questions. Just a question on – in Asia, especially on the new business strain that you've talked about in Kevin's prepared remarks, you talked about low international sales and then also the mix of products in Hong Kong drove the high new business strain in the quarter. I was just wondering if you can provide a little more color in terms of like what type of product sales in Hong Kong that drove the lower new business strain – the higher new business strain result in the quarter?

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Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

A

Hi, Humphrey. It's Claude Accum here. In Hong Kong, what we saw was the broker market moved. So it was in the broker market. And they moved to a part of the product grid where we are less competitive. So we expect that to turn around as the business responds and repositions their product. And so we had slower sales in the broker channel, and that's what led to the higher strain that you saw emerge there in Hong Kong.

And on international, there were lower broker sales and less gain on sales this quarter due to an unfavorable mix. What we saw in international is the market moved more towards a multi-pay product due to the rising rates that we've seen in Asia this year. The business has responded. They've launched actually a great new product. It's an indexed UL product. And it performs quite well on the multi-pay illustration basis. So we expect those sales to come back in future quarters.

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Humphrey Hung Fai Lee
*Analyst, Dowling & Partners Securities LLC*

Q

Got it. And then shifting gears to MFS, like, obviously net flows remain a pressure, but margin and the expenses were good. What are you doing in terms of kind of streamlining expenses and how much benefits should we see from these kind of expense management actions going forward?

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Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

A

Good morning, Humphrey. It's Mike. Yeah. I mean, the flow environment has been challenging for the industry, and we've obviously not been immune from that. From an expense perspective, when you see it, controllable expenses, which should be those that we certainly have more discretion over, and this is going back over the last few years, we've been pretty cautious on given the organic environment for MFS. And so we'll continue to do that as we look forward, be really careful about the controllable expenses that we have.

We've guided to a margin in the mid-to-high 30%s and we've obviously been able to keep that in this environment. And – but – you're not – we're not looking – we're managing money for our clients over the long-term. We're not looking to take costs out of here, just to take costs out. But where we can control costs, where we can take out costs on the margin, we'll do that. But from here, it's going to be – the market environment is going to drive earnings certainly more than the – what we can do on the expense side.

Humphrey Hung Fai Lee
*Analyst, Dowling & Partners Securities LLC*

Q

I guess just to follow on that quickly. So, like, obviously this quarter, a 40% operating margin was good and in part because of expenses. How sensitive is that margin ratio compared to a kind of broader equity market performance?

Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

A

Well, first – let's talk about the quarter. If you go back over the last several years, what you'll see is the second half seasonably – you see the margin go up in the second half. And that's a function of stock-based compensation, which hits in the first half of the year, as well as just seasonality of some of the expenses. And they slow – which do tend to slow in some of the summer months. And so, part of that is seasonality in the quarter, but clearly markets are going to have a pretty big impact on profitability, what the margin looks like over the near-term.

Humphrey Hung Fai Lee
*Analyst, Dowling & Partners Securities LLC*

Q

Got it. Thank you for the color.

**Operator**: Your next question comes from Meny Grauman of Cormark Securities. Your line is open.

Meny Grauman
*Analyst, Cormark Securities, Inc.*

Q

Hi, good morning. A question on Asia, on the wealth side, you called out market volatility, particularly in India and the Philippines. Just wondering if you could just go into that in a little more detail in terms of what you saw during the quarter. And then if you could extend it and just talk about the trends that you're seeing so far in Q4, particularly in those markets and relative to market volatility there.

Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

A

Yeah. It's – Meny, it's Claude Accum. So wealth sales are more volatile, and they'll tend to follow the equity and bond markets. In gross sales this year, we actually had a great result. It's CAD 8 billion over nine months coming in. So – against current AUM. That's 0.9% of the current AUM, 40% annualized. So we think that's a good velocity of gross flows coming in. But it does follow the markets, or for example, in India, we had CAD 1 billion this quarter, CAD 4.8 billion in the first nine months. And we have one of the strongest AMC businesses in India. And it's one of the best performing in the Indian market.

However, the sales patterns are down in India. As you have observed, in India, there's about a 15% decline in certain market indices. And so those sales are down, but the overall level we're quite comfortable within India. In the Philippines, we had a great international – sorry, institutional money market sale last year. That didn't repeat this year. So if you take that out of Philippines, the wealth sales are actually up 100%. And so – but both the India and Philippine markets will follow the equity market and bond market cycle. So you'll see some volatility there.

Meny Grauman
*Analyst, Cormark Securities, Inc.*

Q

And then just on the asset management space, there's been a lot of M&A activity. Just wondering, you talked about it on the investor day, but just wanted to check into see if you've changed your views in terms of the attractiveness of M&A specifically in the context of MFS.

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Dean A. Connor
*President & Chief Executive Officer, Sun Life Financial, Inc.*

A

Meny, it's Dean Connor here. You're right that we have talked previously about acquisitions in the asset management space, being focused first and foremost on Sun Life Investment Management, our Alternatives Manager. And we've indicated that we continue to look for opportunities to add new capabilities and to strengthen and grow those platforms. We've gone, as you know, from zero to over CAD 60 billion of AUM in a relatively short period of time. But we see lots of opportunity to grow that, both organically and through acquisitions.

You've seen us talk less about M&A in terms of MFS. We think we've got a platform that's at scale with nearly $500 billion of assets under management. You're right to call out consolidation in the industry. I think, Mike, I'll let you comment on that. But I think we see that as an opportunity in terms of – at a time when there's lots of clients being transitioned and lots of people being transitioned an opportunity for a really strong manager like MFS to grow organically.

So, Mike, do you want to say a few words on that?

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Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

A

Yeah, sure. Meny, I mean, our view of some of the deals that have been done more recently with Invesco and Oppenheimer and Janus Henderson last year and the like is, those deals which are trying to put the organizations together we think are very difficult to do. The transactions, which are buying capabilities that you don't have and putting them under a broader umbrella, you can – which is the strategy for SLGI, we think makes sense broadly in the industry.

And the challenge that putting and consolidating a people business is you've got to keep the people, you've got to convince the clients to say, and we think it creates opportunity for us because what it allows us to do is go in and talk to those clients that own some of those managers that are going through that transition and talking about our capabilities. And we find that advisors and other gatekeepers are open to those conversations.

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Meny Grauman
*Analyst, Cormark Securities, Inc.*

Q

Thank you.

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**Operator**: Your next question comes from David Motemaden of Evercore ISI. Your line is open.

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David Motemaden
*Analyst, Evercore Group LLC*

Q

Hi, thanks. Just a question for Mike on MFS. Just wondering if you could just give us a sense of the pipeline and outlook for flows heading into 4Q. And also, I noticed that the investment performance on a three-year basis dipped a little bit to 66% from around 80% in previous quarters. Just wondering how you're thinking about that and visibility into continued solid performance falling off and sort of what that means for new business and retention levels.

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Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

A

Hey, good morning. I mean, I guess from a forward-look, we don't comment on pipeline and what we're seeing real-time. But what I would say is if you look at industry, 3Q – and just you look at the retail business in 3Q, mutual fund sales were about negative CAD 23 billion. If you ex out Vanguard, which obviously is primarily passive, that's about CAD 40 billion negative hit to the industry in 3Q. and you're not seeing very different environment in 4Q.

So just to give you some sense of what the industry is seeing, 4Q does not look dissimilar to 3Q. And you can go out and see those numbers. From a performance perspective, listen, we pay on and evaluate on long-term performance. For long-term performance, you look at five-year and 10-year performance continue to be strong. You will see the one year and three-year numbers move around quite a bit. they move around month-to-month here as funds come in and out of that. It's nothing that we're concerned about. And it's not having any impact on our ability to position product with new prospects.

David Motemaden
*Analyst, Evercore Group LLC*

Q

Okay. Great. And then just a question for Dean and maybe Kevin. Just how are you thinking about balancing buybacks versus M&A now, just given both I guess prices in the market in terms of potential targets? And in terms of sizing it, are you considering something that would be more of a bolt-on or more transformational and sort of how you're thinking about how it could impact the level of repurchases going forward?

Dean A. Connor
*President & Chief Executive Officer, Sun Life Financial, Inc.*

A

Thanks, David. It's Dean here. So, as you know, our non-course issuer bid, our buyback program, roughly CAD 800 million is roughly equivalent to the kind of free cash flow that we're generating after funding the next 12 months of organic sales and after the dividend. And that allows us to retain a CAD 2.7 billion of cash at the holding company and – which is a fair bit of firepower, as well as a very low leverage rate, which – well below our 25% long-term target. So I think we had – we think we have a lot of capability in the balance sheet to put towards acquisitions while maintaining the buyback program.

In terms of sizing them, I think our first sort is around that – is this aligned with our four-pillar strategy as we look at potential acquisitions? What can we bring to it beyond a checkbook? What does it bring to us in terms of new capabilities? How do we make the combined business grow faster than it's already growing? And does it hit our economic hurdle targets in terms of lifetime ROE in deploying shareholder capital? So those are the things we think about as we look at acquisitions.

And we look at those – whether it's a small transaction or a large one, we look at them all through that same lens. I won't comment specifically as to the size of transactions we're looking at because I think that the characteristics I just described a second ago are actually more important. They're the first sort.

David Motemaden
*Analyst, Evercore Group LLC*

Q

Great. Thanks for the color.

**Operator**: Your next question comes from Sumit Malhotra of Scotia Capital. Your line is open.

**Sumit Malhotra**
*Analyst, Scotia Capital, Inc.*
Q

Thanks. Good afternoon. First question is for Kevin Morrissey, please. And just looking at the management or the assumptions actuarial review in the quarter, there hasn't really been a major financial event for Sun Life for a number of years. And I don't want to say this quarter was major. But it did catch me by surprise to see the magnitude of the lapse strengthening, particularly since you had taken a couple of such actions in the second half of 2017, in which I thought you had adequately strengthened your reserves so that this was no longer an issue. Just hoping to get an update from you on what you saw in the business that led you to have to enact another round of reserve strengthening.

**Kevin Morrissey**
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*
A

Okay. Thanks, Sumit. It's Kevin here. As you saw, we did take significant strengthening this quarter. It was the first time since we had kind of net overall strengthening since 2015. So you're right to highlight we've had a pretty good track record. Most of the strengthening, as you will have observed, was in the U.S. closed block of universal life business. In-force Management block, that was about CAD 400 million of the CAD 450 million of strengthening. We've had some recurring lapse losses there for the last four quarters ranging from CAD 10 million to CAD 15 million after tax.

We did take the opportunity this quarter to do some significant strengthening, both on the lapse and premium persistency. And so I'd say that the change this year was probably a bit different. In that, we focus the review both on looking at the past experience but also looking at anticipated future trends. So going forward, we do expect that the experience will continue to fluctuate, but we anticipate seeing the future lapse losses to be centered around zero now.

**Sumit Malhotra**
*Analyst, Scotia Capital, Inc.*
Q

And sorry, Kevin. To be clear, you said 2015. I wasn't – from my notes here anyway, it looked like a large part of last year's actuarial review focused on lapse as well. There was CAD 100 million strengthening that we saw in the year-ago quarter. Is that not correct?

**Kevin Morrissey**
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*
A

That is correct. Yes. Last year, we had – in Q3 last year, we had an overall gain of CAD 100 million. We had strengthening in the lapse category of CAD 100 and mortality was CAD 200 million. So overall, the reference that I had was to the last overall strengthening that was in 2015.

**Sumit Malhotra**
*Analyst, Scotia Capital, Inc.*
Q

Yes.

**Kevin Morrissey**
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*
A

Yeah.

Sumit Malhotra
*Analyst, Scotia Capital, Inc.*

Q

Yeah. And then as far as lapse is concerned though, I think your earlier point is you feel you're now at the stage where this should not be much of a financial impact in the interim. Is that fair?

Kevin Morrissey
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*

A

I think that is fair. So last year, as you highlighted, we had strengthening and it was – some of it was in the U.S., but it was across different geographies as well. You would have seen some of it last year in Canada. The experience has demonstrated that we've addressed that situation. Our ongoing experience in Canada has now been favorable. So that's good news.

This year, I do feel confident that we've been able to take quick firm action this quarter in the U.S. in dealing with not just the past experience but positioning us very well in the future. We did some back-testing on the results year-to-date in the U.S. based on the new valuation basis. And I'm pleased to see that that was a small net gain close to zero. Although I can't predict the future, I am confident that we have addressed the past experience and we are well-positioned looking forward.

Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

Sumit, it's Kevin Strain. I might add to that. We look at reported earnings versus underlying earnings over a long period of time, and we're quite proud of the fact that these two numbers roughly run in line with each other. And that's something we look at very closely. When I look at the CAD 166 million of impact of ACMA for the year, it impacted our LICAT by about 1 point and it had no impact on our excess cash position, which actually went up to CAD 2.7 billion. So just to put the whole impact in perspective, I think over a long period of time, we really look closely at reported income versus underlying, and the overall impact of that CAD 166 million is about 1 point on LICAT.

Sumit Malhotra
*Analyst, Scotia Capital, Inc.*

Q

Listen, I hear you, and I will speak from my position here. I think changes in policyholder experience or actuarial assumptions always capture more attention because it gets to the core of the actual insurance business. So the fact that you had taken lapse strengthenings a year ago and they reemerge today I think is certainly what caught me by surprise. And that's why I started with that one. But I appreciate your comments on the bigger financial impact.

Maybe one more for Dean, and I'll wrap it up here. We've talked a lot about the potential capital deployment options. And I think with you guys, it's been a little bit more cut-and-dried. You're returning something like CAD 0.60 of every dollar of earnings to shareholders via dividends and buybacks. And you've obviously talked about the areas of interest acquisition perspective. What about some organic possibilities, Dean? I feel like in the past, we had talked about the potential for Sun Life to maybe remove some of the reinsurance that it had utilized and boost your overall returns because you had the capital flexibility to do that. Is that something that would be a meaningful use of capital, or is that something smaller that we wouldn't really notice on a normal course basis?

Dean A. Connor
*President & Chief Executive Officer, Sun Life Financial, Inc.*

A

Thanks, Sumit. So Dean here. You're right to call out reinsurance as one of the opportunities for deploying capital that we've talked about in the past. And indeed, we've acted on that. At the start of this year, we brought back in some Group Benefits reinsurance that we had put out there. We – some of this you don't see, but raising the retention levels on the amount of mortality risk that we retain on our balance sheet, as the business has grown, we have the ability and we're doing that. We're raising the amount that we're retaining, which has the result of using less reinsurance. And of course, that requires more capital. And so we're happy to put up to support the growth and to capture a bigger share of the profits from that. So it is part of our toolkit. It is part of the – and we've been acting on it. We tend to have been smaller transactions more laser-focused that we think of adding some nice value to the business.

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Sumit Malhotra
*Analyst, Scotia Capital, Inc.*

Q

So something like that is going to help the margins in Dan's business as you remove some of the reinsurance and capture more of the profitability, and theoretically some of the – some additional portion of the risk for your own business?

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Dean A. Connor
*President & Chief Executive Officer, Sun Life Financial, Inc.*

A

Yeah. I think – I think that's right. It's not just the U.S. business, but there's other parts of the company as well, that we're looking at that as well. And it's one of the things that is helping to drive the growth in expected profit. As Kevin noted, up 11% in the quarter versus prior. It's one of the things that's helping to drive that growth in expected profit.

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Sumit Malhotra
*Analyst, Scotia Capital, Inc.*

Q

Thanks for your time.

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**Operator**: Your next question is from Doug Young of Desjardins Capital. Your line is open.

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Doug Young
*Analyst, Desjardins Capital Markets*

Q

Good morning. Maybe I can just start with Dan. Looking at the Group Benefit business, I know the last 12-month margin was 6.4%. I'm hoping you can just let us know what the margin was in the quarter. It looks like there may have been a slight pullback sequentially, and maybe that's due to mortality experience as was mentioned. But just want to get some color on that. And as well, just color on the stop-loss sales. It looks like it was down in the quarter. I'm not sure Q3 is a huge quarter for that particular business, but just maybe a little bit of color. I'll start there.

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Daniel Richard Fishbein
*President-US Business, Sun Life Financial, Inc.*

A

Yeah. Thanks, Doug. It's Dan. First of all, on the margin question, of course, as you know, we're using a trailing 12-month method right now. And we had a very strong, an unusually strong standalone quarter Q3 of 2017. And we replaced that with a strong but not quite as strong margin quarter this quarter. The standalone numbers in Q3 was 7.4%. So I think the sequential drop you see there is really just replacing one quarter with another quarter, but 7.4% is one of the highest numbers we've seen in a standalone quarter.

In terms of the stop-loss sales, as you noted, the third quarter is not a big quarter for stop-loss sales, just the way the calendarization works out on effective date. Fourth quarter is by far the biggest quarter because that's when we make the sales for 01/01, which is when most of the business [ph] reviews or turns over (39:17). If you look at our sales results from last year, you'll note that the third quarter represented less than 15% of the full-year sales. So I think what we saw in the third quarter is not that significant. It's more the nature of the lumpiness of group businesses. What I can say is we finished the third quarter with inventory, as we go into the fourth quarter of sales opportunity that was higher than where we were with inventory at the same point last year.

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**Doug Young**
*Analyst, Desjardins Capital Markets*

Q

And so just to clarify, so Q3 this year was 7.4% margin. Is that – sorry – yeah. Is that correct?

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**Daniel Richard Fishbein**
*President-US Business, Sun Life Financial, Inc.*

A

Yes, that's correct.

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**Doug Young**
*Analyst, Desjardins Capital Markets*

Q

Okay. And then just – it sounds like – I don't think you've shut Assurant systems down, but it sounds like everything new is going on to the Sun Life system. Has the 100% of the cost synergies come through or is there still a little bit left on that front?

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**Daniel Richard Fishbein**
*President-US Business, Sun Life Financial, Inc.*

A

Yeah. So we've transitioned to a single suite of system, but we're still in the conversion process. At the end of the third quarter, we had converted approximately one-third of the legacy business. We'll have 50% or so converted by the end of the year. And our target is 90% by July of 2019. So we are still utilizing some of the legacy systems.

In terms of hardware, we moved all of the systems to our data centers. So a lot of the transition services agreements and payments there have been completed. So we're moving along as scheduled on our conversion, and that's going well. In terms of the synergies, the vast majority of the synergies have been achieved as of the end of the third quarter. We do have a way – a bit of a ways to go, but it's a small number. But of course, some of that has been phasing in, including during this year. So when we annualize that next year, there's a pickup from that as well.

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**Doug Young**
*Analyst, Desjardins Capital Markets*

Q

Okay. And then just maybe one for Dean. I would say, if I went back many years, you did a very good job de-risking the U.S. business. There is this import business that's left there. It's a closed block obviously. But it has created some volatility. And this quarter being an example with the ACMA review. And I don't – I know you don't need the capital. I know you've got a low – very low debt-to-cap ratio. But how do you measure that with potential opportunities to dispose of it? I mean, we all talk about M&A, but what about dispositions of certain businesses that maybe don't fit your criteria.

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**Dean A. Connor**
*President & Chief Executive Officer, Sun Life Financial, Inc.*

A

Yeah. Thanks, Doug. It's Dean here. You're right to point out that we in the past have shut down businesses. We sold businesses that didn't fit our strategy. And we've been – we've been active at managing the portfolio of businesses across Sun Life. We have, as you know, two closed blocks, the U.S. In-force Management and the U.K. They together make up around 10% of our underlying earnings. They are – they're not, as you know, explicitly part of our four-pillar strategy. They both generate good cash flow. They both generate decent double-digit ROEs.

Our first priority is to optimize those businesses. So we think about that in terms of the clients, the tax, capital structures, reserves, the use of reinsurance, administration cost, and so on. Lot of levers to pull to optimize those businesses. And I think they – together they give us optionality for the future. As you know noted, we don't need the cash at this red-hot moment, but those are businesses that could change in the future. So our current focus is to optimize them along the dimensions that I just noted, and that's what we're working hard on.

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**Doug Young** Q
*Analyst, Desjardins Capital Markets*

Appreciate the color. Thank you.

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**Operator**: Your next question comes from Gabriel Dechaine of National Bank Financial. Your line is open.

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**Gabriel Dechaine** Q
*Analyst, National Bank Financial, Inc.*

Good morning. Yeah. I also want to talk about the actuarial, the ACMA stuff. But the lapse I think has been well covered so far. I want to look at the mortality and morbidity release. And just a simple question. You are – the way your book is positioned is you're positioned for longevity risk. And if people are actually dying sooner or not seeing their lifespans expand as quickly as they used to, that's actually good for you. As a trend that we've been seeing several countries, by releasing that much mortality reserve, are you still going to be favorably positioned for that trend at the end of the year?

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**Kevin Morrissey** A
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*

Yeah. Thanks for the question, Gabriel. It's Kevin Morrissey here. On the mortality gain that we recognized this quarter, that was related to our underlying base mortality assumptions. We've had favorable experience across a number of geographies. So that turned out to be positive.

With respect to the mortality improvement, you noted correctly that Sun Life has more exposure to longevity versus mortality. So our last review of our mortality improvement assumptions were done last year. We're kind of on a two-year cycle for that. And as you noted, there has been a bit of slowing of mortality improvement. So that's an assumption that we'll be looking at updating next year. And so far, based on that experience, I would say that the outlook would be favorable.

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**Gabriel Dechaine** Q
*Analyst, National Bank Financial, Inc.*

So this year, you didn't look at the longevity? That would be...

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**Kevin Morrissey** A
*Senior Vice President & Chief Actuary, Sun Life Financial, Inc.*

There was – there was no change to the mortality improvement component of longevity. Just the underlying base assumption table. That's right.

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**Gabriel Dechaine**
*Analyst, National Bank Financial, Inc.*

Q

Got you. Okay. That's good to know. Then on MFS, I'm just curious about the outlook for profit growth next year. And Dean and Kevin and others, you've given some kind of indication of how you see your segments growing vis-à-vis the 8% to 10% growth target. And we're seeing phenomenal growth from MFS this year bottom line, in large part because of the lower taxes. If I look at it on a pre-tax basis, adjusting for that MFS stock-based comp thing, we're pretty darn close to flat growth over the past two quarters. So how does that affect your outlook for profit growth in MFS next year when we don't have that tax tailwind?

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**Kevin D. Strain**
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

It's – Gabriel, it's Kevin. I may take a crack at it and let Mike add some detail. It's – as you know, we still are committed to our medium-term objective of 8% to 10% growth. MFS has been an important part of that. We expect MFS to grow roughly in line with the market growth. And that's what we've been talking to people about. There is some margin compression there, but they've also been managing their expenses. And it's – we can't predict what the market growth will be. So we see it growing sort of alongside of that.

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**Gabriel Dechaine**
*Analyst, National Bank Financial, Inc.*

Q

So, is it safe to assume – assuming we don't see some – a huge rebound in equity markets, but you could fall below that target range at MFS?

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**Michael W. Roberge**
*Chief Executive Officer and President, MFS Investment Management*

A

So MFS – yeah. If you think about markets growing at 5% or 6%, you can imagine MFS trying to maybe being slightly below that because of margin compression, but it depends on how the markets are growing. So the more important pieces in terms of growth, we're expecting 6% to 8% from Canada, 10-plus% from the U.S., and 15% to 20% from Asia. Plus, don't forget we have this excess cash that we can deploy to help drive growth. And we've been – and the buyback has been an important piece of our EPS growth as well. So there's a number of pieces that offset the slower growth at MFS from being really tied to the market growth.

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**Gabriel Dechaine**
*Analyst, National Bank Financial, Inc.*

Q

All right. And then just the last one if I can sneak it in. The real estate gains were, in the other notable items, were relatively low this quarter. Not a huge needle-moving figure. I'm just wondering what you're observing in the real estate valuations and in particular markets where you're a bit more cautious on future gains or maybe some more challenges there?

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**Randolph Brill Brown**
*Chief Investment Officer, Sun Life Financial, Inc.*

A

Sure. Gabriel, it's Randy Brown. So we have seen terrific real estate gains over the last number of years.

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Gabriel Dechaine
*Analyst, National Bank Financial, Inc.*

Q

Right.

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Randolph Brill Brown
*Chief Investment Officer, Sun Life Financial, Inc.*

A

And we've benefited from that. This quarter, as you noted, was slower. We're not seeing any particular pockets of weakness. I think it's just a cap rate compression. We've started to hit with Canadian rates rising and U.S. rates rising and cap rates having fallen, you've started to approach we think a lower bound on that.

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Gabriel Dechaine
*Analyst, National Bank Financial, Inc.*

Q

Okay. Thank you.

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**Operator**: Your next question comes from Scott Chan of Canaccord Genuity. Your line is open.

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Scott Chan
*Analyst, Canaccord Genuity Corp.*

Q

Good morning. I want to go back to expected profit. And if I look on a consolidated basis, it was up 8% sequentially and almost 10% year-over-year. And if I look by the segments, it was all up nicely. Perhaps just more color on the sequential increase and how do we think about that heading forward?

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Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

I think if you look at expected – it's Kevin Strain, Scott. If you look at expected profit, we're seeing strong business growth from each of the business groups. And I think that's a focus of ours is looking at the sales growth in Asia. Retention levels are driving the growth and expected profit. In the U.S., continued growth in the stop-loss and the Group Benefits business, and in Canada, the growth level.

So, on an expected profit basis, a key factor for the long-term growth of the company is the continued business growth. And so I sort of view expected profit a little bit in combination with the new business strain – new business gains as being driven by business growth. And so maybe – yeah. I don't know if you have a particular BG you want to ask questions of or just sort of in general?

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Scott Chan
*Analyst, Canaccord Genuity Corp.*

Q

No. That's helpful. Just in general. And maybe just one more on Canada and the Group Retirement Service business, I noticed that sales were down in the quarter year-over-year, but if I look at your net income contribution, it's like triple sequential now and year-over-year. Can you just help me maybe reconcile what helped boost that net income in that subsegment this quarter?

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Jacques Goulet
*President-Sun Life Financial Canada, Sun Life Financial, Inc.*

A

Yes. Thanks, Scott. This is Jacques here. We've good business management in our Group Retirement Business. And we've grown both our fee business over a number of years and something with our defined benefit solutions business. So it's just a business management, lot of effort around driving up margin through things like pricing, for example. So that's a good result. Yeah.

Scott Chan
*Analyst, Canaccord Genuity Corp.*

Q

Okay. Thank you very much.

**Operator**: Your next question comes from Tom MacKinnon of BMO Capital. Your line is open.

Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Q

Good morning. Just want to talk a little bit about Asia. The sort of the story there was before you were investing for growth, as the in-force block continued to grow, then you started to reap some of those benefits of investing for growth. Now we had a year-over-year decline in underlying earnings in Asia and the expense spend still remain relatively elevated, and expected profit went up nicely. But you had other things that hurt largely higher strain and lower earnings on surplus.

To what extent are these just sort of unique to the quarter or is there anything systemic here that we should be thinking about in terms of Asia strain and Asia earnings on surplus? I mean, was it just related to the dip in your wealth sales in the quarter with respect to the strain, or was there anything unique in earnings on surplus that would cause us to take pause with respect to earnings on surplus in Asia?

Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

A

Hi, Tom. It's Claude Accum here. When I look at Asia, I continue to see the Asia business group is generating 15% to 20% growth on all key metrics. When you look at the underlying fundamentals, this is seven countries in which we operate. And these are underpenetrated insurance markets, favorable demographics. The GDP growth is above G7 norms. And so I think that all translates into very robust and strong growth. That growth is not going to emerge in a straight line each quarter. But the underlying growth is robust.

And you can observe that by looking at it either by the [ph] country pieces (53:18) segmented or year-to-date metrics. Right? If you start at the top, the first question is, are you able to generate that level of growth on the top line? If you look on a nine-month basis, Asia actually generated 19% growth in insurance sales over prior year. So I think that's within the 15% to 20% above that thesis.

And then if you look on a three-month basis, we did see some slowing down on sales in Q3. But that was – if you look at it by the pieces, you'll see the – there's a lot of robustness in the pieces. So the Philippines was quite strong. It was up 20%. A significant expansion or distribution in the Philippines. We see that as good momentum and continuing. India was up 73%, Tom. We added a great new bancassurance agreement in India. And so that's on a great growth story.

And then you asked where we had some slowdown on the top line. And we talked about the slowdown before. We saw some slowdown on broker sales in Hong Kong. We think that turns around as we reposition the product and then we had some slowdown in international sales. And we've launched a new product in international.

And so those that are specific to this quarter show up, as you've observed, in new business strain, but as we take that corrective action, it reverses out. And, if I look at it whether it translates into a strong bottom-line growth, the number I focus the most on, Tom, is the expected profit. And we're seeing some very nice lift in the expected profit, as you called out.

It's actually up 18% on a constant currency basis. So – and so we think its top-line growth that's translating into bottom-line growth in a nice way, consistent with the thesis for Asia.

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Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

I think, Tom – it's Kevin Strain. It's – Asia can change quickly, and there's a lot of competitors, and they can change their pricing or features quickly. And one of the things that's really good about our business there is we can change quickly along with them. And so I think Claude and the team are adjusting to the changes they saw this quarter.

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Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Q

Is there – and what about the earnings on the surplus? Was there anything unique there? It seemed to dip – it seemed to be running closer to in the 40s and – or up to 40% and then it was 26% in the quarter. So, is there anything unique there?

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Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

A

Yeah, Tom. When I look at that, it mainly comes down to one country. It's the Philippines. And there's a collection of issues in the Philippines specific to this quarter. They took some accounting adjustments. And in the Philippines, specifically interest rates are up a lot there. So they just slowed down some of the interest gains they can recognize in the Philippines surplus segment. And there was one other small factor. So a collection of different issues in the Philippines.

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Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Q

Does the Philippines generally account for a good chunk of the earnings on surplus that you get in Asia?

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Claude A. Accum
*President, Sun Life Financial Asia, Sun Life Financial, Inc.*

A

I don't have that exact number in front of me. I'll come back to you on that.

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Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

The Philippines is certainly one of our larger businesses from a profit and also the amount of capital that's deployed there. So it would be one of the – one of the larger countries of seven.

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Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Q

And given that rates have gone up there, should we expect the earnings on surplus in Asia to be a little bit more measured going forward?

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Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

I don't know if I would judge it by – based on this quarter because it is really related to some things that happened last year as much as anything.

Tom MacKinnon
*Analyst, BMO Capital Markets (Canada)*

Q

Okay. Thanks very much.

**Operator**: Your next question is from Paul Holden with CIBC. Your line is open.

Paul Holden
*Analyst, CIBC World Markets, Inc.*

Q

Thank you. So first question is related to MFS. So what we've heard for some time now is that a market correction would potentially be beneficial for MFS, both in terms of relative performance and perhaps on the other end net sales. So maybe October was a mini test of that, but just really a mini test of that, but curious to hear how relative performance held up in that month in particular.

Michael W. Roberge
*Chief Executive Officer and President, MFS Investment Management*

A

Yeah. I mean, I think that's – excuse me – performance is pretty hard to judge over a very short period of time. We talk about a correction. We're talking about a traditional economic cycle rolling over credit cycle beginning to rear its head in a real drawdown in the marketplace. And in that environment, our view is if in fact the industry and we manage risk well in an environment like that, we would think that some of the unabated move into passive will be reconsidered by investors. And so until we get into that economic cycle, a major drawdown, it's going to be very hard for us to judge over the short-term.

Paul Holden
*Analyst, CIBC World Markets, Inc.*

Q

Okay. Got it. And then, second question, given that Sun Life in aggregate has a good amount exposure to wealth and asset management, I believe roughly 50% of combined earnings, give or take. What are your thoughts around expense management again at the group level if we are to go into that kind of drawdown scenario, hearing from one of the large Canadian asset managers this morning that they are getting tighter around expense control? So just wondering what your philosophy would be.

Kevin D. Strain
*Chief Financial Officer & Executive Vice President, Sun Life Financial, Inc.*

A

It's Kevin Strain. I'll start with that question and call in kind of – if we can put it out to Mike and Steve if you want more information. I clearly – expenses are something we look at really closely and we do a lot to manage expenses across our entire business. And you've seen that year-to-date our operating expense growth is 3.1%, for example.

You heard Mike talk earlier about the really good work they did this quarter on controlling their expenses and expense reductions. And I know when I'm at MFS, they have a lot of focus on that. And I think they'll continue to have a lot of focus on that. SLIM, we're in the category of building it out. Right? In sort of like Asia, as you're investing into that business and building it out, you may see expense growth that doesn't look quite in line with the revenue growth, but I think that's part of building a new business overall.

But I would say in terms of expense management, we're very focused on that and would be very aware of changes in the equity market, the impact they have on profit, and that impacts the impact of the size of the envelope we have to spend. And we would adjust accordingly.

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Paul Holden
*Analyst, CIBC World Markets, Inc.*

Q

Got it. Thanks for your time.

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**Operator**: At this time, there are no more questions in queue. I will turn the call back over to the presenters.

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Gregory A. Dilworth
*Vice President-Investor Relations, Sun Life Financial, Inc.*

Great. Thanks, Chris. I'd like to thank all of our participants on the call today. And if there are any additional questions, we will be available after the call. And should you wish to listen to the broadcast, it will be available on our website later this afternoon. Thanks, everyone, and have a good day.

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**Operator**: This concludes today's conference call. You may now disconnect.