Corrected Transcript

14-Feb-2019

Sun Life Financial, Inc. (SLF)

Q4 2018 Earnings Call

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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 Q4 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.

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 fourth 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 fourth quarter and full year 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 on this morning's call.

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 earnings of CAD 718 million for the quarter, up 12% over Q4 of the prior year, with particular strength in the U.S. and Asia. We generated an underlying return on equity of 13.6% for the quarter and continue to deploy capital in a disciplined way, including the announcement of the GreenOak Real Estate transaction and the repurchase of 5 million common shares. We grew insurance sales by 19% over Q4 of the prior year and wealth sales were up 3%. The Value of New Business or VNB grew by 17% over prior year on sales growth, better product mix and pricing decisions.

Our results this quarter and for 2018 overall reflect strong execution on the drivers of profitable growth and on innovation. In Canada, we grew Q4 underlying net income by 6% over prior year. We launched Lumino Health, the first of its kind digital health network. Lumino takes many of the features that are available to our Canadian group plan members such as provider ratings, cost comparisons and health tips and makes them accessible to all Canadians.

We're also using digital innovations to help clients save and achieve lifetime financial security and in 2018, we presented almost 10 million digital nudges to our plan members through our digital coach Ella, informing them about savings opportunities or areas where they're leaving money on the table. And as one outcome, clients increased their additional in-plan deposits with us by 24% to over CAD 900 million last year. Clients are telling us that they like these nudges which help them to get more from their benefit plans and give them timely and relevant advice and actions that they can take.

Turning to the U.S., we grew underlying net income in the quarter by 27% over prior year. Full year 2018 sales were $1 billion, up 16% compared to 2017 and total business in-force grew by 4%. We're very pleased with the improved profitability and continue to change the business and improve it to better serve clients.

For example, we've broadened our successful Disability RMS business, which supports and shares risk with other insurers and health plans to include other lines of business, including a turnkey stop-loss offering. We've rebranded the business as FullscopeRMS and you'll be hearing more about this in the future.

In our asset management pillar, MFS ended the year with assets under management of $428 billion. Underlying net earnings were level with prior year reflecting the benefits of tax reform, offset by lower revenue from lower average AUM. Net outflows were $6.6 billion. MFS investment returns showed well in the quarter relative to market indices and competitors, outperforming in a period of heightened volatility and market declines, once again, reinforcing the value of active management. 78%, 79% and 94% of MFS's U.S. retail fund assets were in the top half of their Lipper categories based on three, five and 10-year periods respectively. In Sun Life Investment Management, assets under management ended the year at CAD 66 billion, an increase of 10% over the prior year.

In December, we announced an agreement to merge our North American real estate investment manager Bentall Kennedy with GreenOak Real Estate and take a majority stake of the combined entity. Since inception in 2010, GreenOak has raised billions of dollars of third-party equity and is a Top 10 global private equity real estate firm according to PERE 50.

GreenOak has successfully launched and managed a suite of products that have attracted top caliber global institutional investors, many of whom have invested in subsequent funds and new strategies as well. The transaction will increase the scale of Sun Life Investment Management to approximately CAD 80 billion in assets under management and continues to expand the menu of strategies that we can bring to clients.

Together Bentall Kennedy and GreenOak will offer a highly complementary suite of core and value-add real estate strategies along with a strong track record of performance, and a global footprint. In Asia, we grew underlying net income by 26% over the prior year. Insurance sales in our seven local markets were up 18% with growth across all distribution channels.

Sales in India benefited from our recently formed distribution arrangement with HDFC Bank, India's largest private sector bank. Insurance sales were down in our International high net worth segment, as we continue to adjust to changing product preferences with new product launches.

As another investment in digital innovation, in Hong Kong, we helped launch Bowtie Life Insurance Company, the first virtual insurer approved under the Hong Kong Insurance Authority's Fast Track process. Bowtie will offer health insurance products through its digital distribution channels starting in the first half of 2019.

Turning to slide 5. 2018 was a year where we continued to intensify our focus on clients and deliver on our key strategic priorities. There are hundreds of examples of how we're putting clients at the center of everything we do, new products and services, new experiences, and new processes. It's now part of the company's DNA. And we're bringing it to life by making it easier to do business with us, being more personal, proactive, and predictive and resolving client issues more effectively. We were pleased with the overall results for the year. Underlying earnings grew by 16%, driven by business growth, good expense management, U.S. tax reform, and the par seed capital income.

Our underlying ROE of 14.2% was strong and we generated these returns while maintaining strong capital ratios and CAD 2.5 billion of cash at the holding company. VNB was up 19% over the prior year, reflecting strong execution in product design, pricing and distribution. We increased our dividend per common share by 9% and repurchased 12.6 million common shares.

As we look ahead, we see strong demand continuing for what we do around the world. We have four strong pillars that taken together offer growth and diversification. Diversification, that's important because growth isn't always neatly synchronized across businesses and geographies. Sun Life offers a great balance between offense and defense. We have ample capital to invest in M&A opportunities. We have dry powder in our investment portfolio to take advantage of opportunities that emerge and we generate enough free cash flow after we fund strong organic growth and support a healthy common share dividend, enough free cash flow to allocate some of that capital to share buybacks. And we're guided by a great purpose, helping clients achieve lifetime financial security and live healthier lives.

At our Investor Day next month, we'll provide more detail about how we're executing on our purpose and the roadmap for delivering on our medium term financial objectives. 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.

Thanks Dean, and good morning everyone. Turning to slide 7, we take a look at the financial results from the fourth quarter of 2018. Continuing the momentum from the first three quarters of the year, we've rounded out the fourth quarter with strong earnings and strong return on equity. Reported net income of CAD 580 million was up from CAD 207 million in the prior year. Reported net income this quarter reflects the charge of CAD 153 million after tax, the market related impacts driven by the drop in the equity markets and interest rates in the quarter.

Q4 2017 reported net income reflected a CAD 251 million charge, taken related to the enactment of the tax reform as well as negative CAD 57 million after-tax related to market impact. Underlying earnings were CAD 718 million or CAD 1.19 per share, which is up 13% from the same quarter last year. Underlying earnings grew across our businesses driven by the lower tax with the U.S., favorable expense experienced as a result of continued expense management as well as other experienced gains partially offset by unfavorable mortality and morbidity experience in the quarter.

Our underlying ROE of 13.6% was at the upper end of our target range for our medium term objective of 12% to 14%. We maintained a strong capital position with the LICAT ratio of 144% for Sun Life Financial, Inc. or SLF and 131% for Sun Life Assurance Company of Canada. The higher ratio of the SLF level largely reflects the excess cash of CAD 2.5 billion held by SLF Inc. Our leverage ratio of 21.2% remains below our long-term target of 25%, and there's another potential source of cash for capital deployment.

We also saw strong growth in our book value per share this quarter, up 9% over the prior year with CAD 35.84, reflecting the growth in income as well as the impact of currency translation on accumulated other comprehensive income, partially offset by the payment of common share dividend and share buyback. We repurchased approximately 12.6 million common shares for CAD 641 million in 2018 and 5 million shares for a total value of CAD 235 million in Q4. Our share buyback program reflects strong cash and capital generation in our businesses.

Our dividend payout ratio in the fourth quarter was 42% of underlying earnings within our medium term objective range of 40% to 50%.

Turning to slide 8, we provide details of the reported and underlying net income by business group for the quarter. In SLF Canada, underlying net income of CAD 245 million is up 6% from the prior year, reflecting favorable expense experienced as a result of continued expense management and lower incentive compensation costs as well as other experience. The underlying return on equity in Canada was strong at 14.1%.

In SLF U.S., underlying net income was up 27% from the fourth quarter of 2017, reflecting growth in the business, improved lapse experience in the In-force Management, and the benefit of lower income tax rate, partially offset by unfavorable mobility experience in Group Benefits and mortality experience in In-force Management.

Our Group Benefits after tax profit margin was 6.7% in the fourth quarter compared to 5% in the prior year, reflecting continued strong results in our stop-loss business. Underlying return on equity in SLF U.S. was also strong at 13.5% up from 10.9% in the prior year.

SLF Asset Management underlying earnings was CAD 227 million, up slightly from the prior year. The benefit of the over income tax rate in the U.S. was offset by impact of lower average net assets at MFS primarily as a result of equity market declines in Q4. MFS pre-tax net operating margin was 38%, down from 40% in the prior year primarily due to lower net assets in the quarter. Sun Life Investment Management generated underlying net income of CAD 6 million.

In SLF Asia, underlying net income grew by 26% over the last year reflecting favorable AFS [indiscernible] (13:08) in investment related experience partially offset by higher new business strains primarily due to lower sales in International. SLF Asia underlying return on equity of 10.9% was up 270 basis points from the prior year.

Turn to slide 9 we've provided details of our sources of earnings presentation. Expected profit of CAD 744 million was in line with the same period last year. With business growth offset by the impact of lower average net assets at MFS. Excluding the impact of currency and the results of SLF Asset Management, expected profit grew by 7% over the prior year from growth in each Canada, U.S. and Asia.

We had new business gains this quarter of CAD 17 million, down from CAD 29 million in the same period last year. The decline reflects higher levels of new business strain in SLF Asia as a result of lower sales in our International business segment. Experienced losses of $142 million for the quarter primarily reflects net unfavorable market impacts, mostly driven by equity market declines in the quarter. Mortality, morbidity and expenses also had an unfavorable impact which was partially offset by investment activity, contributions from credit and other experienced. Assumption changes were moderate at CAD 13 million in the quarter.

Other in our source of earnings which amounted to CAD 12 million increased the Fair Value Adjustment of MFS share-based awards, acquisition, integration and restructuring costs and the impact of hedges in SLF Canada that do not qualify for hedge accounting. Earnings on the surplus of CAD 111 million was CAD 17 million lower than the fourth quarter last year, reflecting lower levels of fair value gains on real estate. Our effective tax rate on reported net income for the quarter was 14.5%. On an underlying basis, our effective tax rate for the quarter was 16.8% and in line with our expected range of 15% to 20%.

Slide 10 shows sales results across our insurance and wealth businesses. Total insurance sales were up 19% or 16% on a constant currency basis compared to the fourth quarter of 2017. Sales in SLF U.S. were up 29% in U.S. dollars as a result of higher sales in both stop-loss and employee benefit. SLF Asia individual insurance sales were in line with the prior year, as sales growth in the Philippines, India and Hong Kong was offset by lower sales in International business segment.

SLF Canada insurance sales were down 4% on lower individual insurance sales, partially offset by slightly higher sales and Group Benefits. Total wealth sales of CAD 36.2 billion were up 3% from the prior year. On a constant currency basis, wealth sales were in line with last year.

SLF Canada wealth sales were up 53% mainly as a result of large case annuity sales in our Defined Benefits Solutions business in Group Retirement Services. SLGI also had a strong quarter with CAD 473 million of net sales and CAD 1.2 billion of gross sales. Sun Life Asset Management sales were in line with prior year on a constant currency basis. Higher mutual fund sales were offset by lower managed fund sales of MFS as well as lower fund sales of Sun Life Investment Management.

MFS net sales were negative at $6.6 billion. SLF Asia wealth sales were down 45% on a constant currency basis compared to the same quarter in the prior year, primarily from lower mutual fund sales in India as a result of market volatility and the Philippines on lower money markets sales. We continue to see strong sales in our Hong Kong MPF business, so we maintained our number four ranking in the industry for AUM and we're second in the industry for net sales. Strong sales growth, improved sales mix, and repricing in the quarter drove our Value of New Business or VNB measure up 17% to CAD 310 million.

Turn to slide 11. During the quarter we continued to demonstrate financial discipline and capital strength. Expected profit grew 7% across Canada, U.S. and Asia, excluding the impact of currency which was a slight positive. VNB grew 17% from higher sales and by driving a better mix of business and pricing changes. We generated an ROE at the top end of our medium term financial objective and for the full year added 150 basis points of ROE improvement.

We continue to be disciplined on expenses, keeping fourth quarter operating expenses excluding fair value adjustments and acquisition, integration, restructuring costs flat year-over-year. Including these adjustments operating expenses were down by 7% and our capital position is strong. Our LICAT ratio reflected this, where we ended the year with our ratio of 144% of SLF Inc. which [indiscernible] (00:17:49) into CAD 2.5 billion in cash available for deployment. Over the course of the year, we deployed capital in balanced and diversified ways including a return of capital to our shareholders, north of 60% of underlying earnings impacting in dividends and buybacks.

Our investment portfolio is well diversified across asset classes and also reflects high quality where 99% of our debt securities are investment grade. Our credit experience remained strong, generating CAD 23 million of income after tax in the quarter. And finally, our leverage ratio at 21.2% provides us with significant financial flexibility for the future.

As we enter 2019, our four pillar strategy, financial discipline and client focus give us a position of strength as we continue to deliver on strategic initiatives, execute well on acquisitions and leverage our robust capital position.

With that, I'll turn the call over to Greg to begin 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 re-queue with any additional question.

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 Steve Theriault of Eight Capital. Your line is open.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

Thanks very much. A couple of things from me, please. First, if we could turn to MFS expenses, so as you look at this year, expenses, I think the low watermark for expenses was Q4 relative to Qs 1, 2, 3. And last year, Q4 was the high watermark. And I won't be surprised to have you tell me that you reined in expenses on the back of the challenging markets. But going forward, I'd be interested because I would have expected normally Q4 would have been a seasonally high quarter for expenses given where asset levels end of the year, and we can see the January numbers for MFS. Is that sort of run rate of [ph] CAD 450 million (00:19:56) doable in 2019? How much flexibility is there on that expense run rate to whether lower AUM and support the margin and all that good stuff? Thanks.

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

A

Good morning, Steve. This is Mike Roberge. Yeah, the biggest factor if you look year-over-year in terms of the expense change would be the IFRS fair value adjustment on share-based comp. And so, much of that's related to the market, what happens to the share price. So all else being equal, we would expect that isn't something that's going to be recurring. So that's a piece of it.

The other piece of it, which is about half of it is lower formulaic comp and some things that we did and actions that we can take around comp, compensation as well as lower dealer trails on share classes that we sold to advisors. So the vast majority of it is the fair value adjustment, which is something that we would expect not to be recurring.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

And when you say half of it, that's the [ph] 450 versus 550 (00:20:55) year-on-year or the [ph] 450 versus 500 (00:20:58) quarter-on-quarter?

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

A

No, I am looking at the delta. No, the delta between the quarters. While year-over-year, Q4 to Q4.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

A bunch of quarters, sorry, or the year-on-year quarter?

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

A

Year-on-year. I was giving you year-on-year. But the same thing would be true if you actually look to Q3 to Q4 as well. The vast majority of it was the fair value adjustment.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

Okay. And then second thing from me. Just a question on Canada and on par, you know we're hearing a lot from one of your competitors who's re-entered the market. The disclosure doesn't allow us from what I can see any way just drill down too far, but it doesn't look from your individual insurance sales in Canada that you're getting a lift in par that some of your other competitors and competitors who've been out of the market, and competitors who've long been in the market were seeing. So, can we get a little color there and maybe you can give us the mix or the growth rate in par, and if there's a discrepancy versus what we're seeing elsewhere is it just are you seeding some natural share with the re-entry of a big competitor, just some color there would be helpful?

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

A

Yeah. Thanks Steve. This is Jacques, and thanks for your question. I can't quite comment on what the competitors are doing far as the popular products, particularly in the high net worth, [indiscernible] (22:16) channel and the third-party. As you pointed out we've been seeing more – we've been a consistent player if you like over the years there. And what we're hearing is that our product is attractive, it's competitive. Because of our consistent presence, we have a good partnership in the third-party channels and right now, we're not seeing a slowdown in our sales, so we feel pretty good overall.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

So you're not seeing the slowdown, could you...

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

A

No.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

...give us a sense of what part of it is relative to total insurance sales?

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

A

If you look, so in the third-party, it's mostly par. You can remember the tax changes that affected Q4 2016 and Q1 2017. If you factor that out, because this was a kind of a one-off event in the industry, our par sales have grown over 2018.

Stephen Gordon Theriault
Analyst, Eight Capital

Q

Okay. Thanks for that.

Operator: Your next question comes from Humphrey Lee of Dowling & Partners. Your line is open.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Good morning, and thank you for taking my questions. Looking in Asia, it's definitely nice to see a rebound in underlying net income sequentially, but the expected profits from inflows were lower quarter-over-quarter. And I was just wondering if you can provide some color on what happened in Asia this quarter and then is the fourth quarter level a new run rate for the expected profits?

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

A

Yeah. Humphrey, this is Claude Accum. The best way to look at expected profit is actually year-over-year or 12 months versus 12 months prior. But sequentially what you saw in Q3 to Q4 is some FX movement. And you saw some declines in the equity markets in Asia. A good part of the expected profit is [indiscernible] (00:24:16) on funds. But if you look at 12 months this year versus 12 months last year, that's a better robust barometer of expected growth, expected profit, it's up 20% in that space.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Got it. And then, shifting gears in U.S. Group Benefits your employee benefit sales looked very strong in the quarter with a huge pick up. I think kind of like the double digit sales in the fourth quarter for employee benefits is definitely a first for you guys since the transaction. I was just wondering if you can provide some colors in terms of what you saw in the quarter and what drove the strong performance?

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.

A

Sure. Thanks, Humphrey. This is Dan Fishbein. Just a quick reminder that the way we record sales in our results is the effective [ph] date 01/01 (00:25:07) sales are recorded when they are made, which is in the fourth quarter. So the fourth quarter is our biggest sales quarter of the year. We saw quite strong results across all of the businesses in the fourth quarter, up significantly over last year. That was certainly led by stop-loss. We've had very strong sales in the quarter and in the year, and that's continuing our momentum in that business.

What's driving the sales there is we are executing well with our relationships, with partnerships, with third-party administrators. We also have gotten good sales lift from a couple of captive relationships and a significant uptick in sales from our key broker and benefits consultant partners. We also had a significant increase in our group sales in Life & Disability, up year-over-year, also quite pleased that we had a 37% increase year-over-year in our Worksite Sales, which is very important to our future.

And then finally, in DRMS sales were up significantly as well. So it was really across all of our businesses that enabled us to get to that $1 billion level for the year.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

I guess on the group sales is where kind of I find it a little bit surprising because that from some of the comments, your peers' comments, like overall industry wide, sales were a little bit lighter because there's less business coming to market for bid, and there's definitely a little bit also better persistency across the industry, while sales were down a little bit or a little bit softer. So that's why I was a little bit surprised to see the strong sales results in the group business for you guys in the fourth quarter.

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.

A

Yeah, I can comment on that, Humphrey that, you know, first of all, there is that point of we record the [ph] 01/01 (00:26:56) sales in the fourth quarter and most of our competitors do not. So we may have a little bit of a timing comparison issue there. But in our group sales, we also saw a significant uptick year-over-year in our national accounts sales, which as you know is an area that we've really been focusing on building out a dedicated unit and team to focus on that. And that was a major contributor to the growth in that, as well as I mentioned good momentum in our Worksite Sales as well.

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. The investment in Bowtie Life kind of caught my attention. Just sort of a bigger picture question about your appetite to invest further in digital distribution across your regions. And more broadly how you – how significant do you think digital distribution can become over a reasonable period of time?

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

A

Meny, it's Dean. Thanks for the question. I think you're right to call it out as an important innovation. I think what we think is important is to experiment and to try new forms of distribution. And Bowtie is clearly in that category. We've had lots of practice at this in Canada where we have been distributing term life insurance digitally for a number of years and with lots of learnings from that and lots of learnings, as you know, through the group platform and digitally nudging and digitally selling extensions of coverage and additional coverage to our clients and plan members.

And another version of that or another way we're experimenting with that is in the United States, the acquisition of Maxwell Health, which is a really first rate digital platform to not just enroll people in their benefit plans, but to engage them in making decisions and adjusting those decisions as things change in their lives. We're in the process of rolling that out this year to Sun Life clients, and we're excited about that because that'll provide another form of digital connection to end users.

And then the last example I would give you is back in Asia, as you know we've been working with a number of telcos in different markets to distribute simple products, easily bought to mobile subscribers who can buy it on their handheld devices. And that's we've learned a lot and we've added quite a few clients through that. All of these digital experiments I would say are still early days. I think what's really important is that we're out there testing, learning, building, and in some cases we're seeing some meaningful traction.

Meny Grauman
Analyst, Cormark Securities, Inc.
Q

What share of business is distributed digitally now, even a ballpark figure, if you have it?

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

Oh, for the industry, it's very small globally, very small. And in the case of Sun Life, it's small as well. But I think you'll see in the future more growth in digital distribution. I think the biggest opportunity is where you've got the combination of digital distribution and advice, whether that's from an adviser or through other forms of advice combining to help people get the solutions they need. And it might start with a digital distribution call and end up with a call to the call center or a meeting with one of our advisors to actually get something done for that client. So, I think what will be challenging is to parse the role of digital between pure digital sales versus the lift in other sales. But I think we're excited about it. We're investing in it and we think it's got a big future for us.

Meny Grauman
Analyst, Cormark Securities, Inc.
Q

Thank you.

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

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets
Q

Thank you. Good morning. First question is for Kevin just looking at the experience gained in the quarter and specifically, the line that you've broken out now other which is attributed largely to project spending. Just want to make sure I understand how this works because you separated the project spend from what I guess is the run rate or core expenses at some point this year. When you book a gain related to the project spend is that as simple as your assumptions embed a forecast for what that spend will be in a given quarter and if you come in lower than that, you book a gain or is there something more significant at play in terms of that particular lend?

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

Sumit, this is Kevin Morrissey. Thanks for the question. In the other [indiscernible] (32:13) we have, as you've noted, we've included some of the project costs. And so those are in the shorter term projects and issues, and what we've included in that line would be the full cost of those projects [ph] chart (00:32:25). So that's not a variance versus a plan or budget number.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets
Q

So, in this quarter when that's listed as a gain, I think it's CAD 44 million after tax, so what is the driver of that, Kevin?

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

Yeah. So the – that's a good question because those underlying costs are in there. We did see a positive number that was higher than we would have – would be normally expected. It was – really it wasn't one big thing, but it was several smaller items, individually they weren't significant, but taken together they did add up in the quarter.

I'll give you a rough split of how that breaks out, about a third of that was related to policy administration updates in Canada. This is part of the normal review that resulted in true-up the claims. Importantly, there was no impact to clients there. About a third of it was a reinsurance review in the U.S. As part of the normal review, we take a look at both premiums and claims on that side that too resulting small liability adjustments and that was not an actuarial liability, so that's why it wasn't part of the ACMA line. And about a third of that was favorable joint venture experience and there were several smaller items, joint ventures in China, Malaysia, an example would be in IBNR or in course of the payment review liability a small release there in China.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets

Q

Okay. That's actually really good detail because I think the line has the footnote related to the project spend but it sounds like the gain in the quarter if I can call it that is actually related more to other factors.

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

A

That's, right. Yes.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets

Q

All right. Now to the actual business and my question is going to be for Dan. Dan, I don't want to front run the Investor Day too much, but obviously the uptick in your profit margins in the U.S. business has been one of the good news stories for the companies for a couple of years now. If I think back over the last few years and the factors that you had highlighted for this business there was obviously the synergies post Assurant. There were some of the claims, improvements that you are hoping to enact and looking to enact and stop loss and then the pricing increases, everything has gone very well as far as the business is concerned including the U.S. economy.

So I think a lot of that has now been baked in. My question here would be when you look at a profit margin approaching 7%, what are the next factors and maybe I'll save the number for next month unless you want to give it to me now, but what operationally is your team looking at in terms of the next drivers for further expansion and margins in the U.S. business?

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.

A

Sure. Thanks, Sumit. I think you described it very well. We're obviously at the top of the range that we set out at the last Investor Day one year to two years early even after adjusting for the impact of U.S. tax reform. So where do we go from here? So, first a couple of comments on where we are right now? We have been experiencing quite good results in our stop-loss business actually better than our pricing target. So, that's something we have to keep in mind, that should normalize to our pricing targets over time.

At the same time, we're not yet at our full targets for our group business particularly in Disability, but we definitely have more room there to improve the margins as we complete the work on pricing actions as that runs through the entire book as well as improved claims management and some continued expense management. You're right, of course, that we're now mostly done with the synergies from the Assurant transaction, although we still have some impact left to go as we convert the remainder of the business this year.

Our primary way of thinking about growth in margins going forward is there is still some room for just basic performance improvement. As I mentioned, we also have market growth. Sometimes I think we focus on the 3% to 4% growth that's typically attributed to the group's space. But a good portion of our business is in the healthcare space. It's about 45% with stop-loss and dental. And that's a business that grows at a considerably greater rate in terms of the market growth rate at least twice that of the more traditional ancillary business.

And then, when we layer on top of that, our work to close coverage gaps and get people more coverage even within our existing client base through tools like Maxwell which will expose people in a more direct ongoing and intimate way to our recommendations and information and dialogue about coverage. We think we can significantly increase the size of the business even within the current block. So when we add all that together, there's still quite a bit of opportunity for earnings growth. But as you said, we're not going to comment on a new target until Investor Day. We will have a new target, but we'll talk more about that in March.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets

Q

Look forward to that. My last one and I'll try to keep it quick is for Dean. Dean, you referenced it and I think we can all see on many different measures your capital and balance sheet flexibility is at the very high end of the sector. You've probably been, at least in my view, the most balanced when it comes to capital deployment via acquisitions, dividends, buybacks, investing in the business.

Some of your counterparts in this sector are increasing their share repurchase activity to levels or to percentages of the share count that that's higher than we normally see in this sector. I'm just wondering conceptually do you view in a given where valuations are right now, increasing the buyback as a preferred option or potential option for Sun Life and its shareholders, or are you more focused in deploying capital back into the business and adding scale via acquisitions. How does that balance work for you conceptually?

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

A

Well, Sumit, thanks for the question. And you're right to describe our approach as a balanced approach and both offense and defense and we're in the fortunate position of being able to do both. So CAD 2.5 billion of excess cash as Kevin described and strong LICAT ratio, the leverage ratio at 21.2% dry powder. So all of that gives us some good capacity as we explore M&A opportunities.

We've got as I mentioned some further dry powder on our balance sheet's liquidity that can be invested in investment opportunities, that's another form of offence that we think about and actively plan for and manage. Strong dividend payout with the yield that's now north of 4%. And on top of that, we can generate enough free cash flow to buy back CAD 700 million to CAD 800 million a year of stock which is the NCIB we announced last August, and are actively pursuing.

You would have noted that since we announced that [ph] CAD 14 million (00:39:52) program last August, up to December 31 we'd, so after 4.5 months we'd executed about 60% of that program. And that pace continues in Q1. So, I think we've got a good balance mix that is allocating capital in a smart way and a balanced way. But thinking about shareholders who want to own our stock for the next five years or longer, where we think this is a smart way to allocate capital. And of course, behind all of that is the commitment to remain disciplined as we think about M&A.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets
Q

And if I just bottom line all that, you've kept the NCIB at 2% of shares outstanding. Is that a level that you're happy with or what's the old joke, I've never met a CEO who's happy with the way the stock is trading. Is 2% of shares the right level or do you anticipate getting more aggressive on repurchases going forward?

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

Well, I'm not going to comment on what we might do in future NCIBs. We launched this one in August, we're obviously comfortable with it and we're executing actively on it.

Sumit Malhotra
Equity Research Analyst - Financial Services, Scotiabank Global Banking and Markets
Q

Thanks for your time.

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

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

Good morning. A couple, one on the business, the Asia segment, you've added that Offshore Insurance business to it and that's induced a bit more volatility on the – in the strain line in particular. Is that a reflection at all of the market conditions in Asia that are in a weaker and maybe fewer high net worth individuals looking for these type of products?

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

Hi, Gabriel. This is Claud Accum here.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

I can't hear you actually, Claude.

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

...is a great addition to Asia, we are very happy to have it in part of the portfolio. As I mentioned that business is very interesting, it's have very large cases, very sophisticated clients, sophisticated brokerage. The selling process is six months.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.
Q

You're really not coming through. I don't know if you're on a speaker phone or what.

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

Can you hear me now Gabriel?

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

A little bit better, yes.

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

A

Okay, the International business is a, is a great addition to the Asia portfolio we're very glad to have joined the portfolio. The dynamics of that business is it's very large cases, their sophisticated clients, sophisticated brokers and there's only four players in that market primarily. And the selling process is typically six months. So what happens in Q4 is with the uptick in interest rates, clients took a bit longer to take a decision to buy. And so we expect some of those sales to defer to 2019. But in the meantime our sales were down in International in Q4 and that's what you're seeing on that experience gain/loss line. It's down a bit. But the dynamics of that business is something we understand well and we think it will hit well in the portfolio going forward.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

So nothing unusual?

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

A

No, it's as it plays.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

All right. Thanks, Claude. My next that – I've got a couple I want to throw at you here. Is there any updated view on National Pharmacare potentially rolling out in the future? I know that government is looking a little bit uncertain these days. But that could have a risk – presented a risk to your group business. And then the – we haven't talked about legacy businesses for Sun Life in quite some time. I know you've got a run-off [ph] FGUL (00:43:39) business. Is there any movement on that front or are you exploring any opportunities there, is the market warming up at all for a potential disposition? Thanks.

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

A

Gabriel, first thanks for the question. I start asking you can you hear me well as I'm sitting right next to Claud [indiscernible] (00:43:57)

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

No. I can't. I don't think I'm the only one. I think you're maybe too far from the speaker.

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

A

Well, I'm actually quite close to it, but maybe it's not working well. Is it better now Gabriel?

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

A little bit. I'll strain my ears.

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

A

Okay. Thanks. I'll take the Pharmacare question, the first one of the three on there. We don't know where the government is going and there are different signals coming at different points in time. The comment I will give you is that generally the system works well for most Canadians.

Clearly though it could be improved, our view Gabriel is that the best way to improve it is to strengthen the partnership or the cooperation between public and private. That should happen in three areas frankly. First is pricing. We think that Canadians should be able to pay the lowest price possible for their medicines. The second area is catastrophic coverage. We think that public and private could come together on things like high cost treatments. And the third one is, I would describe as the standard formulary, and so in other words, if you already have coverage for your employer, which millions and millions of Canadian have, you can continue on that, and if you're one of the few unfortunately who has either no coverage or insufficient coverage, you could be on the public system.

We don't know, as I said, where things are going as a company, we're actively engaged both in a direct manner and through the industry association with CLHIA. So there is a budget coming up from Minister Morneau, we might get some more signals there, but that's how I would describe the situation on Pharmacare in Canada.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

How big is the drug part of your group business in Canada?

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

A

It's an important, but it's not – I mean, if there was a change to Pharmacare, it would depend of course what features, does it go all the way to single payer or is there some in-between. I think it's a bit too early to speculate at this stage in terms of where it can go, but we have a very good and thriving GB business overall. So...

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

Okay. Thank you.

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

A

And Gabriel, it's Dean, just on your question on the legacy businesses, and you referenced the – I think, the U.S. UL book but in addition to that, of course we've got our UK closed block book. And together they make up around 10% of the underlying earnings of the company. On the one hand, as you would quickly note, these businesses are not front-and-center in our four-pillar strategy. Our approach to these has been to optimize them, so optimize them around the client service, around tax, capital, the reserves, the use of reinsurance, expenses and so on. And I think we've been making good progress on all those fronts across those blocks.

We think those businesses give us optionality for the future, so today, they generate good cash flow generally and earnings. And at some point in the future, there's some optionality there for us. In the meantime, as I said, job one is to run them as well as we can and keep improving the operation of them.

Gabriel Dechaine
Analyst, National Bank Financial, Inc.

Q

Thanks. I heard you well Dean.

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

A

Thanks, Gabriel.

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

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Yeah, thanks very much. Just a couple questions, one with respect to MFS margins. They were, in what have been a bit more of a difficult market, they were pretty good at 38% in the fourth quarter and they were 38% for all of 2018 and 38% for all of 2017. How should we be looking at the margin going forward? I know this is a function of equity markets, but if we had equity markets probably go up in the area of you know 6%-ish to 8% annually, how should we be thinking about the margins at MFS?

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

A

Good morning Tom, Mike Roberge. You know I maybe I'll start with how we've been able to maintain margin. Markets have helped over the last couple of years. We've been able to reinvest into parts of the business growing out fixed income, growing out our non-U.S. retail business. At the same time we've been really careful around discretionary expenditures across the organization and so we've been pretty vigilant to not grow head count substantially, invest in the business and been able to maintain margins. I think as you think about in on a go forward basis in a normal environment, as we've said over time, we think that margins in the mid to upper 30s are something that we can maintain over that period of time and I think we'd continue to say that that's the case.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)

Q

Okay. Thanks. And then a follow-up question with respect to Asia. I mean, we see that underlying earnings were up nicely year-over-year from CAD 111 million to CAD 140 million in the quarter. But if I look at page 25 of the supplement, the expected profit went up from CAD 111 million to CAD 117 million, so not much there. The earnings on the surplus year-over-year were up CAD 10 million, but the impact of new business was down CAD 15 million. So if we just look at the sum of those three numbers, Asia was flat year-over-year. So, how are we to determine – how should we be looking at Asia growing if those are what we believe to be the three biggest numbers that should drive underlying earnings growth in Asia?

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

A

Tom, it's Claude Accum here. Thank you for that question. So, if you look at Q4 of last to Q4 of this year, you're right to call out there was strong growth, up 26%, CAD 29 million. Expected profit was up, but it was only up 5%. And the other piece of it came up nicely were AFS surplus. That was quite strong, up CAD 10 million.

But coming back to expected profit, it is difficult to look at a single quarter, Q4 of last year to Q4 of this year. Because it's been a focus on the FX changes that has been happened. And it's only going to focus – it's going to give high priority or high weight to the market changes. The markets were down in Q4 of last year to Q4 of this year and that [indiscernible] (00:51:09) an expected profit. As I said before, a better way to look at it, Tom, is four quarters of expected profit this year versus four quarters of expected profit last year. And on that basis, some of those other quarter-to-quarter changes even out and you'll see that there's a 20% growth in expected profit 12 months over 12 month.

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

And Tom, it's Kevin Strain. The expectation of Asia providing 15% to 20% in terms of our medium term objective of 8% to 10% is still what we're looking at for Asia.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)
Q

All right. I mean just in order to kind of help us model that, I think if you would – if you're able to somehow be able to transcribe the SOE in terms of those three key drivers, maybe stripping out AFS gains or something like that out of the earnings on the surplus so that we can determine how to model the underlying earnings, I think that would help us going forward.

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

Yes. It's Kevin again. Claude mentioned that the fee income had an impact this quarter right? So you don't see that same impact for the full year. But it does have an impact on the current quarter. So it's a little bit tied to the equity markets because there's a lot of unit linked product.

Tom MacKinnon
Analyst, BMO Capital Markets (Canada)
Q

Okay. Thanks.

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

Doug Young
Analyst, Desjardins Capital Markets
Q

Hi. Good morning. Kevin, I think in the past you've mentioned expense gaps and I know you don't have an official expense target at Sun Life and whatnot. But I'm hoping maybe if you're willing to get into talking about the expense gaps maybe by region. And I know this quarter, I think it's on a year-over-year basis, you showed some expense improvements in Canada. What are you doing from a process perspective to drive down some of those expense gaps?

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

You can see there's two things we're doing on the expense gap. One is obviously managing our expenses very closely and you can see that in the Canadian results, in the corporate expense line, in the U.S. expense line, in the MFS expenses we talked about earlier, and also in Asia. When you think about Asia, we are growing rapidly and we talked about that growth. So you'll see expenses grow a little bit more quickly in Asia than the rest of the company. But you're seeing the good level of expense growth I talked about in my opening remarks around operating expenses before the fair value adjustments and some of the restructuring costs being flat year-over-year.

So I think we're doing two things. We're growing our business. That comes through in the VNB numbers and in the sales numbers, the growing allowables, and we're trying to be very focused on holding our expenses across the businesses. And we also reflect the current market conditions. So as we see the market conditions becoming more challenging, we focus on expenses and holding the expenses in. So that's, I'd say it's looking both at growth because we don't want to stop the growth and the growth providing allowables can provide really good reductions in expense gaps over the medium term. But we're being – we're watching the expenses very closely and that comes through in the expense numbers.

Doug Young Q
Analyst, Desjardins Capital Markets

Any thought of giving more detail on those or maybe that's something you're thinking about for the Investor Day? Just curious.

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

Yeah, we can think about that for the expense – for the Investor Day. And look at ways so that we can help you to think about expenses versus allowable growth and how we kind of see it by business group.

Doug Young Q
Analyst, Desjardins Capital Markets

And just I don't – I know one metric isn't always the best way to judge things. I just – in terms of trying to kind of keep track of how you are progressing on expenses, I guess it's not as crystal clear. And then Dan, just going back to the stop-loss, you've done a lot of pricing adjustments on that business going back a few years. Am I correct – in one of your other comments that your results in stop-loss is better than your pricing, or you're getting pricing gains or whatnot. Are you in a position where you think you're going to reflect that in terms of drop in pricing or just thinking of that in an competitive environment? And any thoughts around medical cost inflation because I think that's what got you into trouble previously? Thanks.

Daniel Richard Fishbein A
President-US Business, Sun Life Financial U.S.

Yeah. Thanks for the question. I wouldn't really say that medical cost inflation was a driver in the past, although, there's a fair amount of cyclicality in this business and there tend to be times when there are competitors pricing very aggressively and that's probably a bigger driver. So we did see as you know two years and three years ago, somewhat decreased margins in our stop-loss business although still quite good margins, and probably the best in the industry at that time.

We adjusted to that cycle faster than any of the competitors, and that's really enabled us to drive very good results now. But we're also seeing the market what we're calling a flight to quality. A lot of the brokers who manage this business have been moving business to us and in some cases, back to us because they're tired of chasing a low rate, and then having to move the business a year or two later.

We've also built out our sales force. That sales force is working very effectively with a variety of channel partners. So the end result is that we're getting our target pricing, in some cases, actually a little better than our target pricing. So, we've been fortunate and that our results right now are even better than what we target. But we're not planning on using any of that, the lower prices and grab more market share using the price. We're getting plenty of market share just through the value that we're bringing to the marketplace.

Doug Young
Analyst, Desjardins Capital Markets
Q

Perfect. Thanks for the color.

Operator: Your next question comes from Paul Holden of CIBC. Your line is open.

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Thank you. I actually want to ask a follow up to the comments you just made on pricing cyclicality. Where would you say we are in the pricing cycle now and has competitive dynamics around that pricing cycle maybe changed because of that broker behavior you highlighted?

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.
A

In the – Paul are you referring specifically to stop-loss?

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Stop-loss, that's right, Yes.

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.
A

Yeah. Okay. Yeah, I think we're seeing more rational pricing now than we saw two and three years ago. I think we're always on – we're always vigilant for any change in that environment, because the market has stabilized and margins are healthy probably for more than just us. So, there always could be some change there, but we're not – right now, we continue to see a rational pricing environment in stop-loss.

And as I said, we're also finding that other value is becoming important expertise, stability, raised our ability also to help manage costs. We're increasingly getting involved on the clinical side, helping to manage the exposure as opposed to just reimburse the exposure and some of our partnership, for example, with captive partners like Pareto Health and with TBAs like Collective Health is bringing additional differentiated value to the market. So it's a combination of a rational pricing environment that has not started to fire at this point, and are bringing some true differentiation to the market.

Paul Holden
Analyst, CIBC World Markets, Inc.
Q

Okay. And then, maybe sort of similar question in terms of U.S. employee benefit plans where we're at in terms of the pricing cycle there in your opinion?

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.

A

Yeah. I mean, so the part of the answer there of course is our own work that we've been doing to re-price that business. And as you know that is a business unlike stop-loss that's typically written on a three-year cycle or with three-year rate. So, it's a longer period of time to go through that and we continue to go through that and make good progress on our book. In terms of the external environment, we would describe the marketplace that's continuing to be rational. We're not seeing predatory or aggressive pricing, but it seems like a relatively rational pricing environment across the board there.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Okay. Good. And then, final question is going back to the discussion around Canada individual insurance sales. So you commented that the par product was stable and doing fine. But then that's just maybe you've given up some market share in another product given that your two major competitors saw a pretty significant year-over-year growth and sales and Sun Life was down, so maybe you can comment there?

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

A

Paul, I'm going to start it in by asking if you can hear me.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

If you could speak a little bit louder, that'll be helpful.

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

A

I'll do more than that, I'll move around the room. How about that now?

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Little bit better.

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

A

Okay. So, yeah, individual sales, there is a few drivers there that I can talk to. The first one Paul is we did have some changes at the product level in Q3 of 2017 that were taking effect at 1/1/ 2018 and one of the things that did is drive up some volume in Q4 2017. And so that's one of the factors driving the impact.

The other one I would say is the continued focus as you know we've had on upgrading quality in the CSF channel and the impact that has on the number of advisors. And the third one, I'll come back to is the third-party channel, it's a high net worth channel. Sales can be quite large and it can be lumpy and if you miss on a few it can have an impact. So that's really the – a driver I would say as the – what you're looking at on Q4 last year to Q4 this year.

Now generally if you go back and I'm going say six quarters or seven quarters, you'll find that we've added number one or number two in sales both across life and health. The feedback we get from both our own channel and the third-party channel is that our products are attractive and competitive. So taking all that into account and if you add in there the fact that generally Canadians remain underinsured. We actually think that that creates good growth opportunities for us over medium term.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Okay. So if I got the message correct, you're happy with where your competitive position sits and no changes planned.

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

A

No.

Paul Holden
Analyst, CIBC World Markets, Inc.

Q

Okay. Good. That's all I had. Thank you.

Operator: Your next question comes from Mario Mendonca of TD Securities. Your line is open.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Good morning. Just a quick question going back to MFS for a moment. The – I try to make the adjustments to the expenses looking at the fair value and it still does look like expenses were down substantially, and I tried to do the math, and I think I got it right. It's about a CAD 47 million reduction in expenses adjusting for the fair value. Could you help us think through where that CAD 47 million comes from? Like how much of that would be variable reduction, variable cost versus actions you've taken to reduce expenses?

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

A

And Mario, are you asking year-over-year or quarter-on-quarter?

Mario Mendonca
Analyst, TD Securities Inc.

Q

Year-over-year.

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

A

Yeah. If you look at, again year-over-year, a little over half of that number is going to be the fair value adjustment. The next largest item is going to be compensation, so it's going to be variable compensation that flexes with the profitability, in addition to some other things that we do around compensation where we can adjust compensation, and that's head count and that's the level that we pay out of overall compensation. And then the last piece of it was lower dealer trails on share class sales to advisors. And so that number breaks down about – that number breaks down about, CAD 57 million of it was fair value, CAD 29 million of it was compensation, CAD 17 million of it was dealer trails.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Okay. So essentially, the ex the variable – ex the fair value adjustment, it looks like pretty much all of the decline was variable in nature, not a sort of fixed cost that you pulled out – somehow pulled out of the system?

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

A

Yeah. Most of it was variable. Most of it was variable with some things that we can do on the margin on the labor side and labor costs side, but most of it is variable.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Okay. So maybe you could move on then to, this might be for Kevin or one of the Kevins. And it relates to mortality and morbidity in the U.S., and I don't want to make too much fuss about one quarter, one quarter really doesn't mean much, but how are you looking at the deterioration, mortality and morbidity in the quarter? It was surprising, it's not something we see often. Is there any particular block of business or cohort that you're seeing that troubles you?

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

A

Hi, Mario. This is Kevin Morrissey. I'll take that one and I'll let Kevin comment too, if he wants to add to that. So when we look at the quarter in particular on the mortality side, you saw most of the negative experience there in the U.S. In-force Management block of business that was related to some – just a few are fairly large plans that were reinsured and I would say that that was something that was not something unusual in terms of – as a normal volatility of the mortality experience.

When I look at kind of the year-to-date earnings for mortality kind of across the business, I'm not seeing anything there that jumps out as a concern that it was a small negative for the year. On the morbidity side, when we look at the quarter, most of that was related to the U.S. group business and in particular it was the LTD termination rates were unfavorable. So, that was something that Dan has talked about in terms of profitability and the work that continues in terms of three-year cycle of repricing. And I think that's something that kind of shows up with the full year as well of that is something that we're looking to address going forward.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Okay. Just so we're clear and in terms of any reserve adjustments there wouldn't be anything, any major reserves tied to morbidity if I've got that right, morbidity on the group side, there, you don't book a lot of reserves against that, is that a fair statement?

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

A

Yes, that's right Mario.

Mario Mendonca
Analyst, TD Securities Inc.

Q

And then on the mortality there's nothing that would make you want to make an adjustment there?

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

A

No, there's nothing that looks of a concern there and as you probably noticed in our assumption messaging that gives you a mortality continues to be quite favorable and overall has been positive for the company.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Thank you very much. Yeah.

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

A

Yeah, it's Kevin, it's Kevin Strain, Mario. I just might say that the mortality in general, we've seen strong results and we have expectations but that's an area we know how to manage well and we like that risk category. The specifics just to be clear on the U.S. side, there's a small number of large cases that, that don't have reinsurance related to them and those – there's some volatility around that. But it's a small number of cases and we saw some of that volatility in this quarter.

Mario Mendonca
Analyst, TD Securities Inc.

Q

Got it. Thank you.

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

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Thanks. Good morning. Just a quick follow-up on the stop-loss business. Is there a seasonality in terms of sales within that product? Because I just noticed in Q4 it's materially different than other quarters.

Daniel Richard Fishbein
President-US Business, Sun Life Financial U.S.

A

Yeah. There certainly is. This is Dan. So in the fourth quarter, we book our sales that are effective dated [ph] 01/01 (01:07:44) , because we book the sales when they're made. So, for stop-loss, that's by far the biggest quarter of the year typically.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Okay. That's helpful and just turning back to MFS, Mike. And looking to net flows, I think it was kind of decent quarter-over-quarter considering the macro backdrop. Your relative funding performances improved and it's great and there's a lot of industry headwinds. If you can kind of point to a couple of factors to us, to watch to – actually see if – to see if that kind of trend on the net outflows side could improve whether it's like a product category or whatnot?

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

A

Yeah, good morning, Scott. Thanks for the question. Yeah, I think the number of things that we're working on that we're looking to execute again against first in U.S. retail is broadening out our exposure at all the big dealers in the U.S. Last year, irrespective of how tough the environment was, we actually grew sales with 8 of our top 10 dealers last year, what was a pretty tough environment for active.

And so, broadening our opportunity on the U.S. side – on the non-U.S. side, we think there is an opportunity to as platforms open up and distribution opportunities open up outside of the U.S. to improve flows on the non-U.S. side and we've talked a lot on the institutional side. The big opportunity for us is fixed income is our ability to partition ourselves the big fixing income and fixing income player institutionally. We are known outside of the U.S. primarily as an equity manager, we need to make that change and sell product solutions and fixed income to existing and new clients around the world. And so we're working in all three of those things, we're making progress against them and we're hopeful that we'll begin to see a continued improvement in all of those.

Scott Chan
Analyst, Canaccord Genuity Corp.

Q

Thank you. That's helpful. Thanks a lot.

Operator: That was our final question. I will now return the call to our presenters for closing comments.

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

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

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