S&P Global
Ratings

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Sun Life Financial Inc.

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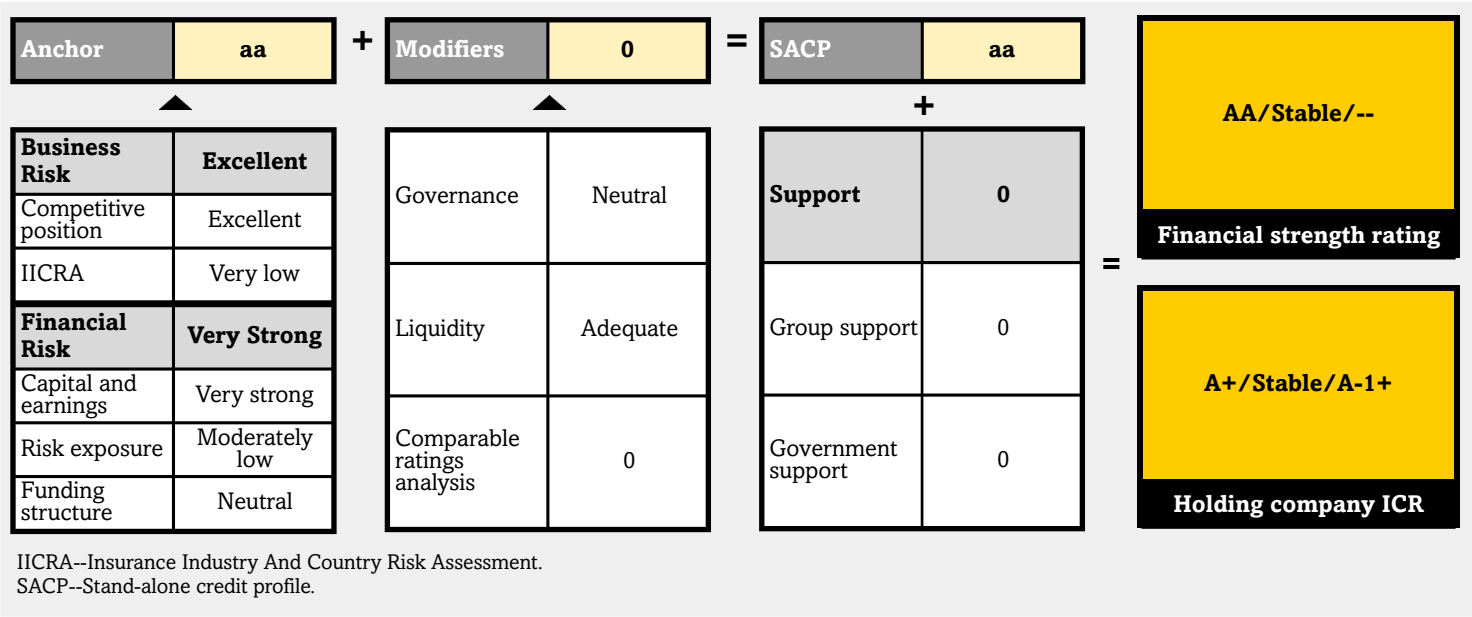


IICRA--Insurance Industry And Country Risk Assessment.
SACP--Stand-alone credit profile.

Credit Highlights

Overview

Strengths	Risks
Top positions in various global markets	Successful organic growth may strain capital adequacy under S&P Global Ratings' risk-adjusted model
Strong, stable operating performance optimizes risk and reward	Uncertain macroeconomic factors during the COVID-19 pandemic
Liability profile is relatively low risk with limited exposures to market-sensitive or long-duration liabilities	

S&P Global Ratings expects Sun Life to continue its four-pillar strategy of focusing on its Canadian group and individual life, U.S. group, Asia, and asset management businesses. Since Sun Life Financial Inc. announced its four-pillar strategy in 2012, it has grown across all four divisions. The company improved its reported return on equity (ROE), consistently near 10%-12% in recent years, with underlying ROE of 14.4% as of year-end 2020.

Sun Life's earnings are likely to remain sound based on the strong operating performance and low risk of its divisions. Each of Sun Life's divisions--U.S. group business, Canadian insurance (both individual and group), Asia, and asset management--continues to provide excellent risk-adjusted returns. The U.S. group and asset management businesses largely require very little capital (except for U.S. medical stop loss per S&P Global Rating's risk-based capital methodology) since both divisions are relatively low risk. Sun Life's Asian markets are higher growth and continue to perform well, and the company maintains its top market shares in the oligopolistic Canadian market.

Capitalization will likely remain a strength for Sun Life over the next two years. Sun Life's strong growth in recent years has led to deteriorating capital adequacy in our modeling. Over the next few years, we expect Sun Life to maintain 'AA' capital adequacy given its limited exposure to tail risks in its highly diversified and relatively shorter-duration insurance liability portfolio.

Outlook: Stable

The outlook is stable, reflecting our expectation that the group will maintain its excellent business risk profile and very strong financial risk profile. We expect fixed-charge coverage above 8.0x, with financial leverage below 30%, in our base-case scenario. We also expect Sun Life to maintain its competitive position as a "big three" insurer in Canada with consistent earnings from the asset management and U.S. and Asia insurance segments.

Downside scenario

We could lower the ratings if Sun Life's:

- Competitive position deteriorates owing to a longer-term decline in operating performance relative to peers, particularly in its core insurance operations; or
- Market position or brand strength declines, particularly in its core Canadian market; or
- Capital weakens materially, and we expect the company not to recover to at least 'AA' capital adequacy over the ratings timeframe.

Upside scenario

While unlikely in the next two years, we could raise our ratings if capital redundancy at the 'AAA' level improves significantly and we believe management remains committed to maintaining capital at the 'AAA' level.

Key Assumptions

- Real Canadian GDP up by 5.5% in 2021, and growth of 2.4% in 2022
- Core Consumer Price Index (CPI) growth of 2.0% in 2021, and 1.9% in 2022
- Real consumer spending growth of 1.8% in 2021 and 2.4% in 2022Growth in exports of 7.2% in 2021 and growth of 5.8% in 2022
- Average 10-year U.S. Treasury note yield of 1.7% in 2021 and 2.2% in 2022

Sources:

- "Economic Outlook Canada Q2 2021: Consumer Spending Could Set The Pace of Recovery"; March 30, 2021
- "Economic Outlook U.S. Q2 2021: Let the Good Times Roll"; March 24, 2021

Key Metrics

	2022f	2021f	2020	2019	2018
Net income	>2,700	>2,700	2,509	2,717	2,616
Fixed-charge coverage (x)	>8.0	>8.0	13.75	12.82	11.25
Financial leverage (%)	<30	<30	26.4	24.8	24.0

Key Metrics (cont.)

	2022f	2021f	2020	2019	2018
S&P capital adequacy/redundancy	AA	AA	AA	AA	AAA
Return on revenue (%)	>7	>7	7.3	8.0	12.7
Return on assets (%)	>1	>1	1.0	1.1	1.3
Return on equity (%)	>10	>10	10.0	11.1	11.0

S&P Global Ratings believes high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects remains. Vaccine production is ramping up and rollouts are gathering pace globally. Widespread immunization, which will help pave the way to return to more normal social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Business Risk Profile: Excellent

Sun Life has an excellent competitive position supported by stable operating performance, broad geographic and business diversity, and leading market positions in group and individual businesses in Canada. It is within the top three Canadian life insurers, with a 20% market share in the individual insurance segment. The brand is well-recognized, and the company continues its Canadian strategy, as shown by high persistency among its group clients.

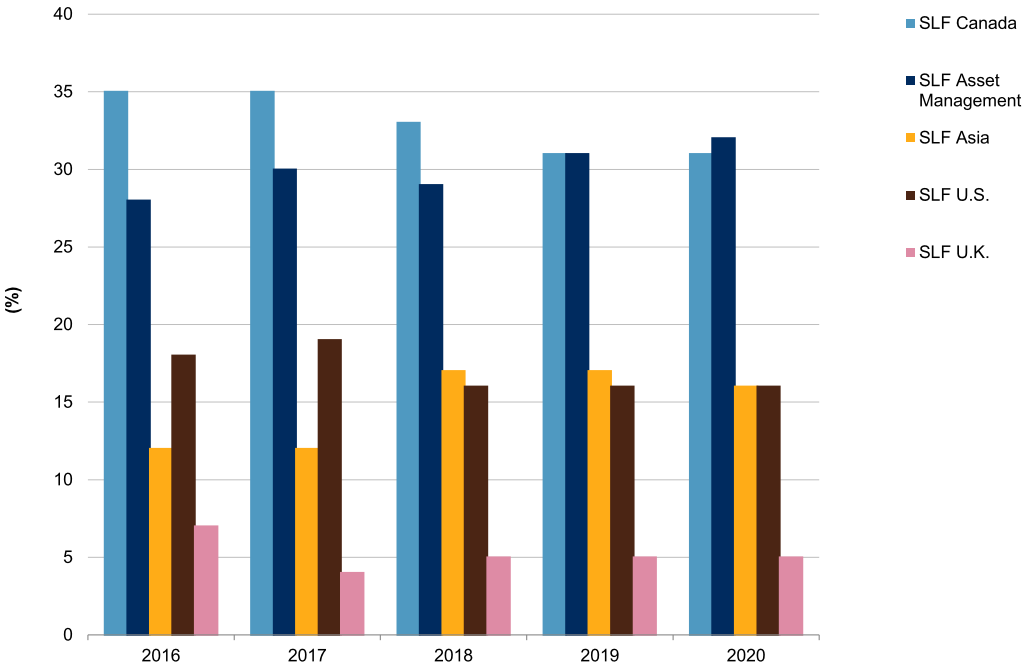
The company has been top ranked in group retirement services for 18 years and top ranked in group benefits for 11 years in the Canadian market. Other segments include:

- U.S. group benefits;
- Asset management, which includes its third-party asset management business and its flagship Massachusetts-based manager MFS Investment Management; and
- The Asia business, which sells life insurance in Hong Kong, the Philippines, Indonesia, and Malaysia, among others in the region.

In 2020, its regional segments SLF Canada, SLF U.S., and SLF Asia contributed 31%, 16%, and 16% of net underlying income, respectively; individual insurance, asset management, and group insurance contributed 25%, 32%, and 21%, respectively. The company also has broad distribution that includes a career sales force and third-party agents.

Chart 1

Sun Life -- Business Line Diversification (Underlying Net Income) (%)



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Sun Life's operating performance has been strong, with an ROE (on a net income basis, unadjusted for preferred shares) consistently between 10% and 12%.

While the macroeconomy has been challenging because of the COVID-19 pandemic, the impact to Sun Life's net income and other financial metrics was limited. Death claims increased in 2020 compared with the prior year owing to COVID-19, but the mortality impact was overall immaterial for the company. Sun Life had favorable morbidity in 2020 because many individuals did not use dental, extended health care, vision, or other benefits, especially during the first half of the year. Benefit utilization returned to normal later in the year where we expect it will remain. Nonetheless, the longer-term mortality and morbidity impact to the businesses as a result of the pandemic will still need to play out over time and we will closely monitor these trends.

The company benefits from geographic and risk diversification of the sources of earnings which is a strength to the rating. Sun Life's asset management business, despite headwinds in net flows owing to recent market trends (a shift to passive from active investing) showed strong net inflows of US $13.1 billion at MFS in 2020 following negative net flows for multiple years. It is too soon to tell whether strong net inflows will be a longer term trend for MFS given the headwind in the market. We will closely monitor if these trends will continue. SLC Management is the company's in-house manager for its general account and has recently bolstered its capabilities through acquisitions like Infrared in

2020 and Crescent Capital Group in 2021. The asset management business has consistently contributed more than 20% of EBIT over the past few years and we expect it to continue.

Financial Risk Profile: Very Strong

As of year-end 2019, Sun Life's capital had a strong redundancy at 'AA', according to our risk-based capital (RBC) model. The Life Insurance Capital Adequacy Test (LICAT), a new regulatory ratio introduced in 2018, did not affect the company's capital management strategy, and it had a LICAT ratio of 147% on a consolidated basis (including the holding company, which is regulated by the Office of the Superintendent of Financial Institutions) as of Dec. 31, 2020.

We expect capitalization to remain redundant at 'AA' over the next few years. From a LICAT perspective, based on Sun Life's disclosed sensitivities, we expect the ratio will be relatively stable.

Sun Life's overall risk exposure is moderately low, with products generally low risk and shorter duration than many peers. We believe it benefits from strong risk controls and continues to monitor risk adequately, especially the interest rate risk at the product, portfolio segment, business unit, legal entity, and enterprise levels. Sun Life uses a variety of metrics, techniques, instruments, and management actions, including extensive stress testing and stochastic analysis that compare very favorably with peers.

Sun Life also benefits from a diverse, highly rated, and well-managed investment portfolio with an average credit quality of 'A'. The credit impairments within its investment portfolio have been immaterial despite heightened asset risk amid a pandemic. However, we are not yet out of the woods and continue to monitor the performance of the company's investment portfolio. It has modest exposure to postretirement liabilities and foreign-exchange mismatches, but we believe its strong risk framework monitors these risks within tolerances.

Sun Life's funding structure remains neutral to the rating, with coverage exceeding 8x and leverage of less than 30%. We expect both metrics to remain stable.

Other Key Credit Considerations

Governance

In our view, Sun Life's governance practices are in line with public companies. It has clear performance and operational goals and strategies, which it lays out for the market and systematically tracks. The company has robust internal financial reporting and conservative risk tolerances that show a strong enterprise risk management program embedded throughout the organization.

The breadth and depth of management are strong, and the board regularly evaluates succession plans. Management has a record of converting strategic decisions into action and meeting its financial and operational goals.

Liquidity

Based on our assessment, Sun Life has adequate liquidity, with a liquidity ratio of 208% as of year-end 2019. In our liquidity analysis, we exclude holding company cash more than C$500 million as we believe the excess will be deployed to fund opportunistic acquisitions. Including the full C$2.3 billion of holding company cash as of year-end

2019 would not change our liquidity assessment. Because of Sun Life's nonlife (accident and health and notably the stop-loss) business, the proportion of stressed liabilities is higher than that of other life companies, as we charge the net claim reserves 100%, in addition to an 'A' confidence-level charge for reserves and premiums.

Accounting considerations

The company reports audited financial data prepared in accordance with International Financial Reporting Standards (IFRS) and will be required to implement IFRS 17, effective January 2023. Sun Life has established a transition program for IFRS 17 and will manage the associated risks regarding implementation. An accounting change should not change the fundamental risk of insurance operations and the ultimate impact is still unclear. We do expect additional disclosures around reported equity and liability valuation assumptions, such as those used for the contractual service margin and risk adjustment, for example, which could be considered in our analysis once the standard is implemented.

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Sun Life Credit Metrics History

Ratio/Metric	2020	2019	2018	2017	2016	2015
S&P Global Ratings capital adequacy*	**AA**	**AA**	**AAA**	**AAA**	**AAA**	**AAA**
Total invested assets	301,673	277,044	253,676	251,053	237,909	227,537
Total shareholder equity	25,862	24,508	24,570	22,971	22,368	21,418
Gross premiums written	26,190	22,688	20,981	19,838	19,427	16,824
Net premiums written	23,738	20,288	18,642	15,281	15,048	10,395
Net premiums earned	23,738	20,288	18,642	15,281	15,048	10,395
Reinsurance utilization (%)	9.36	10.55	11.15	22.97	22.54	38.21
EBIT	3,359	3,336	3,518	2,847	3,516	3206
Net income (attributable to all shareholders)	2,509	2717	2616	2,242	2581	2285
Return on revenue (%)	7.27	8.00	12.68	9.44	11.99	16.13
Return on assets (excluding investment gains/losses) (%)	1.03	1.13	1.29	1.07	1.39	1.35
Return on shareholders' equity (reported) (%)	9.96	11.07	11.01	9.89	11.79	11.34
Life: Net expense ratio (%)	41.65	45.98	47.01	55.87	53.06	64.07
EBITDA fixed-charge coverage (x)	13.75	12.82	11.25	9.06	10.58	9.96
EBIT fixed-charge coverage (x)	12.18	11.46	10.55	8.43	9.99	9.44
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	12.98	12.04	10.84	8.67	10.25	9.74
Financial obligations / EBITDA adjusted	2.38	2.07	1.93	2.53	2.16	1.95
Financial leverage including pension deficit as debt (%)	26.40	24.81	23.99	26.64	28.03	25.05

Sun Life Credit Metrics History (cont.)

Ratio/Metric	2020	2019	2018	2017	2016	2015
S&P Global Ratings capital adequacy*	**AA**	**AA**	**AAA**	**AAA**	**AAA**	**AAA**
Net investment yield (%)	7.57	8.46	1.62	5.75	5.74	2.74
Net investment yield including investment gains/(losses) (%)	7.63	8.34	1.96	5.31	5.21	3.79

Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	**Very Strong**	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	**aa**	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

Note: Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

Ratings Detail (As Of April 27, 2021)*

Sun Life Financial Inc.	
Issuer Credit Rating	A+/Stable/A-1+
Preferred Stock *Canada National Scale Preferred Share*	P-1(Low)
Preferred Stock	A-
Senior Unsecured	A+
Subordinated	A
Related Entities	
Sun Life and Health Insurance Co. (U.S.)	
Financial Strength Rating	
Local Currency	AA/Stable/--
Issuer Credit Rating	
Local Currency	AA/Stable/--
Sun Life Assurance Co. of Canada	
Financial Strength Rating	
Local Currency	AA/Stable/--
Issuer Credit Rating	AA/Stable/A-1+
Subordinated	AA-
Sun Life Assurance Co. of Canada (U.S. branch)	
Financial Strength Rating	
Local Currency	AA/Stable/--

Ratings Detail (As Of April 27, 2021)*(cont.)	
Issuer Credit Rating	
Local Currency	AA/Stable/--
Sun Life Capital Trust	
Preferred Stock	
Canada National Scale Preferred Share	P-1
Preferred Stock	A+
Sun Life Hong Kong Ltd.	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Issuer Credit Rating	
Local Currency	AA-/Stable/--
Domicile	Canada

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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