

## Research

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### Sun Life Financial Inc.

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# Sun Life Financial Inc.

## Credit Highlights

Overview	
Strengths	Risks
Top positions in a variety of global markets	Successful organic growth that may strain capital adequacy under S&P Global Ratings' risk-adjusted model
Strong and stable operating performance that optimizes risk and reward	Uncertainty about macroeconomic factors during the COVID-19 pandemic
Liability profile that's relatively low risk with limited exposures to market-sensitive or very 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, the company has seen growth across all four divisions. The success of the strategy is shown in the company's improved return on equity (ROE), which has consistently been 10%-12% in the past few years, with underlying ROE at 14.2% as of year-end 2018.

***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 four pillars--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 require very little capital since they 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 over the past few years, including its Assurant acquisition, has led to some deterioration in its capital adequacy in our modeling. Over the next few years, we expect Sun Life to maintain 'AA' capital adequacy, which we believe supports the rating given the company's limited exposure to tail risks in its highly diversified and relatively shorter-duration insurance liability portfolio.

## Outlook

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 due to a longer-term decline in operating performance relative to peers', particularly in its fee-based asset-management business;
- Market position or brand strength declines, particularly in its core Canadian market;
- Capital weakens materially, and we expect the company not to recover to at least 'AA' capital adequacy over the ratings horizon.

### 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 down by 2% in 2020 and growth of 3.4% in 2021
- Core Consumer Price Index (CPI) growth of 2.0% in 2020 and 2.1% in 2021
- Real consumer spending growth of 2.3% in 2020 and 1.8% in 2021
- Decline in exports of 3.1% in 2020 and growth of 1.7% in 2021
- Average 10-year U.S. Treasury note yield of 1.2% in 2020 and 1.38% in 2021

S&P Global Ratings acknowledges a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak and its subsequent impact on economic forecasts. As the situation evolves, we will update our assumptions and estimates accordingly.

**Table 1**

Key Metrics						
	2021f	2020f	2019	2018	2017	2016
Net income	>2,000	>1,500	2,717	2,616	2,242	2,581
Fixed-charge coverage (x)	6x-10x	6x-10x	12.04	10.84	8.67	10.25
Financial leverage (%)	<30	<30	24.8	24.0	26.6	28.0
S&P capital adequacy/redundancy	>AA	>AA	AA	AAA	AAA	AAA

**Table 1**

<b>Key Metrics (cont.)</b>						
	<b>2021f</b>	<b>2020f</b>	<b>2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Return on revenue (%)	>8.0	>6.0	8.0	12.7	9.4	12
Return on assets (%)	>1.0	>0.5	1.1	1.3	1.1	1.4
Return on equity (%)	>10.0	>8.0	11.1	11.0	9.9	11.8

f--S&amp;P Global Ratings forecast.

## Business Risk Profile

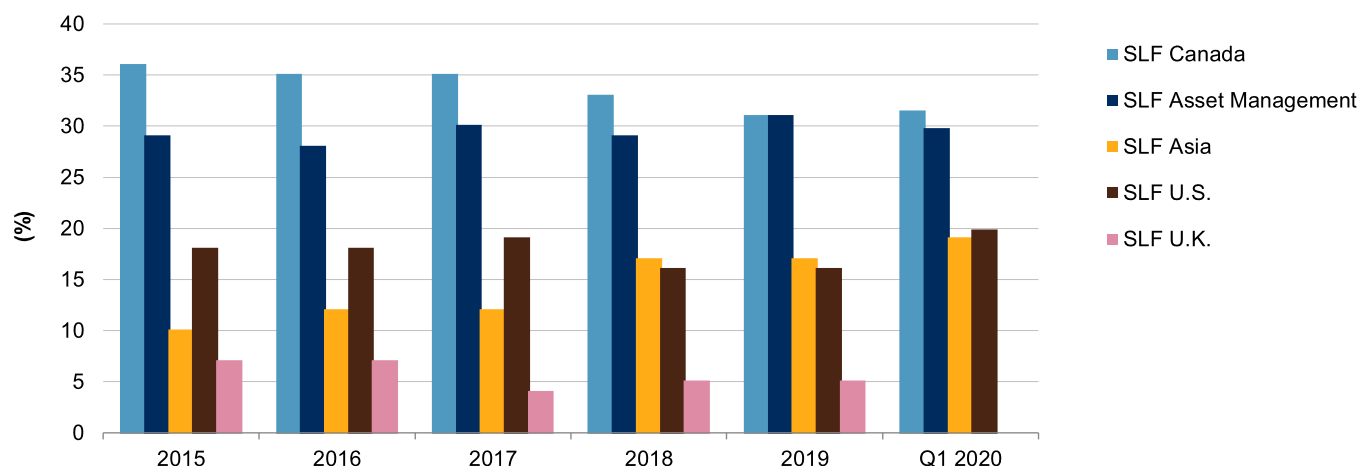
Sun Life has an excellent competitive position supported by stable operating performance, broad geographic and business diversity, and leading market positions in group and individual businesses in Canada. It has maintained a top three position among Canadian life insurers with an 18% market share. The brand remains well-recognized, and the company continues to execute well on its Canadian strategy, as shown by high persistency among its group clients.

The company has been top ranked in group retirement services for 17 years and top ranked in group benefits for 10 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 2019, its regional segments SLF Canada, SLF U.S., and SLF Asia contributed 13%, 16%, and 17% of net underlying income, respectively; individual insurance, asset management, and group insurance contributed 24%, 31%, and 19%, respectively. The company also has a broad distribution platform that includes both a career sales force and third-party agents.

## 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 macroeconomic environment as a result of the COVID-19 pandemic is dampening earnings, we expect the geographic and risk diversification of the sources of earnings to remain a strength to the rating. Sun Life's asset management business, despite headwinds in net flows as a result of recent market trends (a shift to passive from active investing), has consistently contributed more than 20% of EBIT over the past few years. Active management strategies may experience a resurgence of flows in a weaker market environment, potentially serving as an offset to declines in assets under management, and we will continue to monitor these trends.

## Financial Risk Profile

As of year-end 2018, 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 143% on a consolidated basis (including the holding company, which is regulated by the Office of the Superintendent of Financial Institutions) as of Dec. 31, 2019.

In recent years, the company's capital has had 'AAA' redundancy, according to our model, but its capital buffer at 'AAA' has been declining over the years, largely as a result of successful organic and inorganic growth in its U.S. group businesses. We expect capitalization to remain redundant at the 'AA' level over the next few years. From a LICAT perspective, based on Sun Life's disclosed sensitivities, we expect the ratio will increase slightly with the decline in rates.

Sun Life's overall risk exposure is moderately low, with products that are generally low risk and shorter duration than

many peers. We believe it benefits from strong risk controls and it continues to monitor its 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'. It has modest exposure to postretirement liabilities and foreign-exchange mismatches, but we believe its strong risk framework monitors these risks well and 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 of these 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 that's embedded in the organization at all levels.

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

### Liquidity

Sun Life has adequate liquidity, with a liquidity ratio of 210% as of year-end 2018. Because of Sun Life's nonlife (accident and health and notably the stop-loss) business, the proportion of stressed liabilities is higher than for some other life companies, as we charge the net claim reserves 100%, in addition to an 'A' confidence-level charge for reserves and premiums. A recapture of ceded accident and health business in 2018 caused a year-over-year decline in the liquidity ratio.

## 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: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Appendix

Table 2

Sun Life Credit Metrics History							
Ratio/metric	Q1 2020	2019	2018	2017	2016	2015	2014
S&P Global Ratings capital adequacy*	AA	AA	AAA	AAA	AAA	AAA	AAA
Total invested assets	268,307	277,044	253,676	251,053	237,909	227,537	207,250
Total shareholder equity	25,268	24,508	24,570	22,971	22,368	21,418	18,872
Gross premiums written	5,739	22,688	20,981	19,838	19,427	16,824	15,499
Net premiums written	5,146	20,288	18,642	15,281	15,048	10,395	9,996
Net premiums earned	5,146	20,288	18,642	15,281	15,048	10,395	9,996
Reinsurance utilization (%)	10.33	10.55	11.15	22.97	22.54	38.21	35.51
EBIT	784	3,336	3,518	2,847	3,516	3206	2,700
Net income (attributable to all shareholders)	415	2717	2616	2,242	2581	2285	1873
Return on revenue (%)	11.50	8.00	12.68	9.44	11.99	16.13	11.04
Return on assets (excluding investment gains/losses) (%)	1.07	1.13	1.29	1.07	1.39	1.35	1.37
Return on shareholders' equity (reported) (%)	6.67	11.07	11.01	9.89	11.79	11.34	10.34
Life: Net expense ratio (%)	46.27	45.98	47.01	55.87	53.06	64.07	59.6
EBITDA fixed-charge coverage (x)	10.55	12.82	11.25	9.06	10.58	9.96	5.11
EBIT fixed-charge coverage (x)	9.36	11.46	10.55	8.43	9.99	9.44	4.85
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	N.A	12.04	10.84	8.67	10.25	9.74	4.6
Financial obligations / EBITDA adjusted	2.19	2.07	1.93	2.53	2.16	1.95	1.99
Financial leverage including pension deficit as debt (%)	24.19	24.81	23.99	26.64	28.03	25.05	26.39
Net investment yield (%)	(0.77)	8.46	1.62	5.75	5.74	2.74	9.75
Net investment yield including investment gains/(losses) (%)	N.A	8.34	1.96	5.31	5.21	3.79	10.51

\*Forecast data reflects S&P Global Ratings' base-case assumptions. N.A.--Not available.

### Ratings Detail (As Of May 20, 2020)\*

#### Sun Life Financial Inc.

Financial Strength Rating

Local Currency

NR/--/--

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/--

**Ratings Detail (As Of May 20, 2020)\*(cont.)****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/--

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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