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EDITED TRANSCRIPT

MFC.TO - Q3 2018 Manulife Financial Corp Earnings Call

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PRESENTATION

Operator

Please be advised that this conference call is being recorded. Good morning, and welcome to the Manulife Financial Third Quarter 2018 Financial Results Conference Call for Thursday, November 8, 2018.

Your host for today will be Ms. Adrienne O'Neill. Please go ahead, Ms. O'Neill.

Adrienne O'Neill - *Manulife Financial Corporation - Global Head of Investor Relations*

Thank you, and good morning. Welcome to Manulife's earnings conference call to discuss our third quarter 2018 results. Our earnings release, financial statements and related MD&A, statistical package and webcast slides for today's call are available on the Investor Relations section of our website at manulife.com.

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and operating results; and then Steve Finch, our Chief Actuary, will provide an actuarial update. After the prepared remarks, we will move to the question-and-answer portion of the call. We ask each participant to adhere to a limit of two questions. If you have additional questions, please re-queue and we will do our best to respond to all questions.

Before we start, please refer to Slide 2 for a caution on forward-looking statements and Slide 40 for a note on the use of non-GAAP financial measures in this presentation.

Note that certain material factors or assumptions are applied in making forward-looking statements and actual results may differ materially from what is stated. This slide also indicates where to find more information on these topics and the factors that could cause actual results to differ materially from those stated.

With that, I would like to turn the call over to Roy Gori, our President and Chief Executive Officer. Roy.

Roy Gori - *Manulife Financial Corporation - President & CEO*

Thank you, Adrienne. Good morning, everyone, and thank you for joining us today. Turning to Slide 5, yesterday, we announced our financial results for the third quarter of 2018. We delivered strong net income and core earnings of $1.6 billion and $1.5 billion, respectively, with both measures increasing significantly year-over-year.

The strong core earnings contributed to core ROE of 14.8% and our expense efficiency ratio dropping 7.6 percentage points to 49.5%. We delivered another quarter of positive net flows despite the uncertainty in investment markets, and new business value generation increased a strong 31% with solid growth across all segments.

We delivered strong momentum in our business and progress against our targets and as previously announced, the board approved a 14% increase to our dividend. This continues our track record of progressive dividend increases and is 1 quarter earlier than expected given our recent fourth quarter cadence.

We have implemented this with a discounted dividend reinvestment program, which will further award our long-term shareholders. Lastly, we have announced a share-buyback, which gives us the flexibility to repurchase shares as part of our capital management strategy.

Moving to Slide 6. We continue to execute on our five priorities and have made solid progress since our last call. With regards to our first priority optimizing our portfolio, we remain extremely focused on achieving our bold ambition of releasing $5 billion in capital by 2022.

In the third quarter, we sold ALDA assets, which released $600 million of capital. In addition, we recently announced three reinsurance agreements, which are expected to release over $1 billion in capital in the next 12 months.

Since the beginning of the year, we have released $1.6 billion through portfolio optimization activities. However, as we execute on our initiatives announced to date, we expect to achieve $3.4 billion or 2/3 of our 2022 goal. We are very pleased with our progress so far.

Moving to Slide 7. The second priority is to aggressively manage costs, and our 2022 ambition is to drive an expense efficiency ratio of less than 50%. We limited core expense growth to only 4%, which was substantially lower than pre-tax core earnings growth of 41%, which equated to a 7.6 point decline in our expense efficiency ratio.

In the third quarter, we have started to see early indicators from our previously announced voluntary retirement program in North America. This initiative was part of the $300 million in pre-tax run-rate expense saves we announced last quarter, and we are pleased that the take-up rate is in-line with our expectations.

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Our 2022 ambition is for these businesses to represent 2/3 of the earnings of the group, and in the third quarter, these businesses continued to perform well.

Asia delivered core earnings growth of 19% and a 29% growth in new business value. Core earnings in Global WAM grew 30%, and we continued our trend of positive net flows despite higher redemptions in our North American retail businesses and the redemption of two large institutional fixed income mandates in Canada.

We are seeing solid growth in behavioural insurance products across our geographies. We have more than doubled behavioural insurance sales in the U.S. and Asia. And in the U.S., we became the first life insurance company to fully embrace behavioural-based wellness insurance with the October 1st launch of Vitality Go on all life insurance policies at no additional cost. And we increased Vitality sales in Canada by 39% versus the prior year.

Our fourth priority talks of our ambition of being a global, digital and customer-centric leader. This will be achieved by putting customers first, and our 2022 ambition is to increase our Net Promoter Score by 30 points across all markets.

And while it is still early in our journey, we continue to delight our customers by further digitizing our business. In Canada, we marked our one millionth transaction processed through robotics.

We introduced e-claims in Vietnam, advancing our digital strategy by expanding and leveraging the successful launch of e-claims in Hong Kong earlier this year.

And our WAM business launched the first goals-based investment strategy for our Canadian retail customers that uses advanced analytics and dynamic liability-driven investment strategies.

With our fifth priority, developing a high-performing team, the foundation of success is the right corporate culture, and we have set a bold aspiration to become a top quartile employee engagement company.

On October 1, we launched our new corporate values, which were developed with the help of our employees in all geographies, ensuring we are on the right path as we transform our business to help our customers make decisions easier and lives better.

We are also proud to have won the Mercer Award for excellence in diversity and inclusion. And we appointed Pam Kimmet, a well-credentialed global leader as our new Chief Human Resources Officer to drive our strategy.

I would now like to take a few minutes to comment on the Mosten litigation and the recent Saskatchewan regulatory development. Let me say at the outset that this is not the appropriate forum to get into a back and forth on the litigation, which is still before the Saskatchewan court. We have provided supplementary information in the appendix for context, but otherwise, we have nothing new to say about this matter.

However, I will make a few general comments to underscore what has already been publicly disclosed. The Mosten case is not new. It has been before the Saskatchewan court since 2016 and is part of a broader action by the same principals against a number of life insurance companies in Canada.

The basis of Mosten's claim is that life insurers can be compelled to accept unlimited deposits. In effect, Mosten is attempting to use insurance policies to invest sizable sums that have no connection to the insurance coverage. We believe strongly that this claim is commercially absurd because it is contrary to the purpose of these insurance policies and is inconsistent with the regulatory constraints on insurance companies, which prohibit them from engaging in deposit-taking activities.

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And based on the actions the Government of Saskatchewan has taken, the Canadian Life and Health Insurance Association plans to request other provinces and territorial governments to take comparable regulatory steps.

As we have indicated, Manulife and the other life insurers involved in similar matters, plan to make submissions to the court in light of the new regulations asking it to dismiss the claims. We believe this should accelerate the resolution of the principal litigation matters in our favour.

We anticipate that Mosten and others who have an interest in undermining confidence in Manulife will continue to resist our position and may have an interest in spreading misinformation. However, we do not intend to litigate the case through our public disclosure.

We remain highly confident that we will ultimately prevail in this matter and that it will not have any material impact on our business operations or our ability to meet obligations to our customers, employees, vendors and other stakeholders.

Turning to Slide 12. As I mentioned, we recently announced three reinsurance transactions that are expected to release over $1 billion in capital. We have done this with an upfront gain, only a modest impact, to ongoing earnings, and have transacted with highly rated counterparties.

These transactions, along with our strong business momentum, earnings and capital position, have allowed us to announce several capital actions, which are designed to increase our flexibility and reward our long-term shareholders.

The share-buyback likely came as the biggest surprise to many of you given that historically, it has been low on our priority list for deploying capital. The decision to launch the buyback was based on recent market prices for our stock.

We intend to include share-buybacks as another element of our capital management and return playbook, especially when our share price is significantly below the underlying value of our business.

And to reward our long-term shareholders, we increased our dividend by 14%, only three quarters after our last increase, and implemented a discounted dividend reinvestment program. Phil will provide more details on these reinsurance transactions and capital actions in his presentation.

So in conclusion, I am very encouraged by our continued momentum in the third quarter. Net income and core earnings were strong, and we are executing well on our five priorities.

I would now like to ask Phil Witherington to review the highlights of our financial results. Phil.

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thank you, Roy, and good morning, everyone. Turning to Slide 14 and our financial performance for the third quarter of 2018. We achieved another quarter of strong core earnings and net income. We delivered solid top line growth and double-digit growth in new business value. And while we generated another quarter of positive net flows, they were down from the prior year.

I will highlight the key drivers of our third quarter performance with reference to the next few slides. Turning to Slide 15. We generated core earnings in the quarter of $1.5 billion, up 39% from the prior year on a constant exchange rate basis. Last year's earnings were impacted by 2 notable items totaling $130 million. However, even after adjusting for these items, core earnings grew by 23%.

This was driven by business growth in Asia and Global Wealth and Asset management combined with improved policyholder experience, the impact of lower U.S. tax rates and greater expense efficiency as we continue to improve operating leverage.

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equity gains in our surplus segment.

We have also benefited from higher fee income from strong equity market performance in the quarter. We delivered net income of $1.6 billion, driven by strong core earnings, investment related experience gains of $312 million outside of core earnings, and an update to our original estimate for the impact of lower U.S. tax rates.

This was partially offset by a $277 million charge from the direct impact of markets, our annual review of actuarial methods and assumptions and the upfront impact of our recently announced reinsurance transactions, which, while positive overall, resulted in a charge this quarter.

The $312 million investment related experience gains outside of core earnings were driven by higher-than-expected ALDA returns across most asset classes, the favourable impact of fixed income reinvestment activities and solid credit experience.

And the charge for the direct impact of markets was primarily driven by narrowing corporate spreads in the U.S. and several small items, including losses on the sale of available-for-sale bonds, widening swap spreads and the steepening of the yield curve in Japan.

Slide 16 shows our source of earnings analysis. Of note, expected profit on in-force business increased 4% from the prior year on a constant exchange rate basis, primarily due to in-force growth in Asia.

We also delivered strong growth in our Global Wealth and Asset Management business, which is reported as a separate line item.

Policyholder experience overall was positive this quarter, driven by Canada group insurance and U.S. life insurance. Long-Term Care policyholder experience was negative this quarter due to elevated claims, however, remains neutral, both on a year-to-date basis and on average since our last triennial review.

Core earnings also benefited from the impact of new business and earnings on surplus from higher-than-average gains on available-for-sale equities.

Turning to Slide 17. You can see that we delivered solid double-digit growth in core earnings in each of our operating segments, except for Canada, where growth was impacted by a one-time favourable tax settlement in the prior year. Excluding this notable item, Canada core earnings grew by 10%. The strong growth in core earnings drove a 4.2 percentage point increase in Core ROE to 14.8%.

On Slide 18, you can see that the core expenses of $1.8 billion grew by 4% from the prior year. The modest growth in expenses, coupled with a 41% increase in pre-tax core earnings, drove nearly an 8 percentage point improvement in our expense efficiency ratio to 49.5%. While we are pleased that we have managed our expense growth to half that of historic levels, it is still early in our expense efficiency journey and this ratio will fluctuate quarter-to-quarter as we invest funds in our strategic initiatives and execute on our expense efficiency actions.

And as mentioned earlier, core earnings benefited from several favourable smaller items that extended core earnings growth and lowered the expense efficiency ratio beyond the typical run-rate.

I want to emphasize that we will continue to be very focused on delivering bottom line benefits from our cost efficiency initiatives.

Slide 19 shows our APE sales and new business value generation. We delivered APE sales of $1.4 billion in the quarter, up 8% from the prior year, reflecting APE sales growth of 13% in Asia, where we have seen expansion in Japan, Hong Kong and Asia Other markets; and 14% growth in the United States following enhancements to indexed Universal Life products.

In Canada, the success of our newly launched Manulife Par product drove an 18% increase in individual insurance sales, although overall sales in Canada declined due to variability in large case group insurance market. We continued our focus on margins and delivered new business value of $452 million in the third quarter, up 31% versus the prior year, with all regions seeing double-digit growth.

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On Slide 20, you can see that we continue to deliver net inflows in our Wealth and Asset Management businesses. Net flows of $0.4 billion reflect positive net flows in Asia and the U.S.

The decline in net flows compared with the third quarter of 2017 was due to lower money market gross flows in mainland China, higher redemptions in our North American retail businesses and the redemption of two large institutional fixed income mandates totaling $1 billion in Canada.

The WAM Core EBITDA margin in the quarter increased by 1.7 percentage points, driven by higher fee income on higher average AUMA.

Turning to Slide 21. Total Company AUMA exceeded $1.1 trillion, driven by Global WAM, which saw a 7% growth in AUMA from the prior year to $644 billion.

Turning to Slide 22. The LICAT ratio for our primary operating company was 134% at the end of the quarter, which equates to $18.8 billion of capital above the supervisory target. This represents an increase of over $1 billion since the last quarter, reflecting our focus on capital efficiency and, as I will discuss with reference to the next slide, reflects very little benefit from our recently announced transactions.

We also reported a 20 basis point sequential decline in our financial leverage ratio to 29.2%.

Turning to Slide 23. We recently announced three transactions on our legacy business with highly rated counterparties. In the U.S., we reinsured substantially all of our individual and group pay-out annuity businesses amounting to CAD$12 billion worth of policy liabilities.

In Canada, we executed a similar transaction to that in the first quarter and reinsured the mortality and lapse risks on a portion of our legacy universal life business. In total, these blocks represent just under 10% of our legacy liabilities for life insurance and fixed products.

The transactions are expected to release $1.1 billion in capital by the end of 2019, which equates to roughly 2 LICAT percentage points. We also generated an upfront gain on the transactions and the expected ongoing earnings impact is a reduction of approximately $20 million post-tax per quarter.

Turning to Slide 24. We continued to make progress on the reduction of ALDA in our portfolios backing legacy businesses and released $600 million of capital in the quarter. As I have previously mentioned, while we recently announced three transactions on our legacy businesses that are expected to release over $1 billion in capital, only $35 million is reflected in our third quarter results.

In total, we have released $1.6 billion in capital so far in 2018. However, including the full amounts for the initiatives we have announced to date, namely the reinsurance transactions, the remaining ALDA dispositions and the sale of Signator, which closed last week, we have clear line of sight to bring this total to $3.4 billion, which represents 2/3 of our target.

Slide 25 outlines our financial targets and our year-to-date performance. Core EPS growth and Core ROE are both exceeding our medium-term targets, and cost efficiency and leverage are trending in the right direction.

And while there is more work to be done to achieve and maintain our medium-term financial operating targets, we are pleased with our position and momentum, which is why we felt comfortable with our recently announced capital actions.

Turning to Slide 26. We remain committed to reducing our leverage ratio to our medium-term target of 25% and expect to make meaningful progress on this in the next 12 months, irrespective of our recently announced capital actions. The capital actions will provide us with greater capital management flexibility to optimize shareholder value in a variety of market conditions.

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We intend to buy back shares opportunistically when we feel prices are significantly below the underlying value of our business and see the program as one of several tools to manage our capital on an ongoing basis.

Our robust capital position and continued strong business momentum also allowed us to increase our quarterly dividend by $0.03 to $0.25 per share. We were pleased to be in a position to announce a dividend increase one quarter ahead of our usual fourth quarter cadence.

We remain committed to our 30% to 40% dividend payout target and this increase puts us closer to the midpoint of the range.

Also, as part of our capital management strategy, we have introduced a discounted dividend reinvestment program to reward long-term shareholders who reinvest dividends and provide additional flexibility to fund growth, reduce leverage and incorporate share-buybacks into our ongoing capital management strategy.

I would now like to turn over the call to Steve Finch, who will provide an actuarial update. Steve.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Thank you, Phil. Good morning, everyone. On Slide 28, we summarize the impacts of our annual actuarial review. The 2018 annual review resulted in a pre-tax release of reserves of $174 million and a post-tax earnings charge of $51 million, which aligns with the estimate provided last quarter.

Of note, while we did release reserves overall, some of these releases relate to par blocks and, therefore, did not impact shareholder's earnings.

This year's review included lapse assumptions for U.S. Life Insurance, mortality assumptions for some of our U.S. and Canadian Insurance and Annuity businesses, certain investment return assumptions, as well as refinements to the projection of our tax and liability cash flows. Our actuarial valuation practices remain prudent and reserves and margins are appropriately aligned with the risks in each business.

Mortality and morbidity updates resulted in a $360 million charge to net income. The primary driver of the charge related to reserve strengthening for mortality assumptions in our Canadian Structured Settlement business and, to a lesser extent on term renewal business. On structured settlements, we saw emergence of a lower mortality on larger cases and on impaired or highly rated lives.

Lapse and Policyholder Behaviour updates resulted in a $226 million charge to net income. The charge was primarily driven by lapse assumption updates to our U.S. Universal Life No-Lapse Guarantee business to better reflect emerging experience, which showed a variation in lapses based on premium funding levels.

Of note, while a variation in lapse rates based on premium funding did already exist, our recent experience allowed us to better refine the assumption. Based on the updated assumptions, our experience for Q3 was in line with expectations. We also updated our lapse assumptions on several other U.S. Life Insurance products, which created a gain.

We have strengthened lapse assumptions significantly since 2010 for emerging experience as we have seen the guarantees embedded in our products are more valuable to our customers in a low interest rate environment. We are comfortable with our lapse assumptions in aggregate, which have been updated to reflect behaviour in a low interest rate environment, and we will continue to adjust for emerging experience as appropriate as the business ages.

We recorded a net favourable impact to net income from the review of investment assumptions of $143 million as benefits from updates to our bond default assumptions were partially offset by a charge from reviewing our oil and gas investment return assumptions.

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We review the tax deductibility of certain reserves, which was the largest driver, but also refine the projection of policyholder crediting rates for certain products. Both resulted in a reserve release.

New this quarter, we have started disclosing the impacts of the annual actuarial review within the reporting segments and the table at the bottom of this slide shows you the segmented view of the drivers I just mentioned.

Overall, our actuarial valuation practices continue to remain prudent and our reserves and margins are appropriately aligned with the risks in each of our businesses.

I want to conclude with a quick discussion of morbidity improvements in Long-Term Care as the subject is getting significant attention. As mentioned in previous calls, LTC reserve adequacy is best viewed in aggregate and morbidity improvement is only one aspect of the reserves. In fact, morbidity improvement represents only 5% of total LTC reserves or only 3% of our future expected claims payments.

I remain confident in our assumptions and that our LTC IFRS reserves are appropriate in aggregate. We have USD$10.3 billion in provisions for adverse deviations over and above our best estimate reserves, and our total IFRS reserves represent a 25% buffer to U.S. statutory reserves.

The USD$10.3 billion of margins is almost a 50% margin over best estimate assumptions. When U.S. peers unlock their U.S. GAAP assumptions, they establish 0% margin over best estimate. We believe our LTC reserves are amongst the most conservative in the industry.

We believe strongly that there is a positive correlation between morbidity improvement and mortality improvement, and we are comfortable with the current assumptions. The net of these assumptions in our reserves is largely offsetting.

Our morbidity improvement assumption on a padded basis is conservative at 0.45% for 25 years and is only on incidents. We have looked at some more recent data in our block and the findings give me no reason to change our assumption.

That said, morbidity improvement is just one of several areas of judgment. Another area of judgment is the amount we include in reserves for future premium increases, which at Investor Day was USD$800 million, representing only a fraction of the value of the premium increases we have filed for and expect to receive over time and we continue to make progress on achieving premium increases.

Finally, I would like to reiterate that since our last actuarial review of LTC in 2016, our policyholder experience has been roughly neutral overall. We continue to have confidence in our assumptions and confidence that the reserves remain prudent. We will revisit all of these assumptions as part of the full review in 2019.

Thank you. This concludes our prepared remarks. Operator, we will now open the call to questions.

QUESTIONS AND ANSWERS

Operator

And the first question is from Steve Theriault from Eight Capital.

Steve Theriault - *Eight Capital, Research Division - Principal & Co-Head of Research*

A couple for me. Maybe starting with capital. We are not used to seeing a DRIP discount, along with the buyback, and you did talk about in your opening remarks, but can you give us a little more context on how and if you intend to use the buyback? I guess, to put it simply, are you more

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Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Steve, for the question. This is Phil. So let me try and cover all of that. So firstly, the buybacks do allow us to return capital to shareholders quickly, and we do intend to use the buyback opportunistically when we see circumstances that the market value of our stock is trading significantly below the underlying value of our business. I am not going to put any financial parameters around that, but it's opportunistically when we see those circumstances prevail. I think when we look at the circumstances we have faced over recent weeks, we have been able to make substantial progress on portfolio optimization, which gives us line of sight to that $1 billion capital release. Combined with our existing strong capital position and a decline in our share price, it felt like the right time for us to launch the NCIB. In terms of the DRIP combined with the healthy dividend increase that we have announced, we see this as a way of rewarding long-term shareholders who seek to reinvest dividends. And it does provide us with greater flexibility to deploy capital, including making the share-buyback more of an ongoing program rather than a one-off event. So we see the DRIP and buyback as interacting, in that we do not intend to be buying back shares at the same price that we are issuing shares under the DRIP and, therefore, that creates overall value.

Roy Gori - *Manulife Financial Corporation - President & CEO*

I would just add to Phil's comments, Steve, and that is, is just the fact that the strong business momentum, the strong capital position that we are in and also, quite frankly, the great progress that we are making on our legacy portfolio optimization actions and then coupled with the good traction on expense management, have really given us the confidence to not only execute against the share-buyback in the timely fashion that we did but also to incorporate that more in our capital playbook going forward.

Steve Theriault - *Eight Capital, Research Division - Principal & Co-Head of Research*

Okay. And maybe that dovetails into my second question on expenses. You are already through your 2022 target. That is, obviously, very good progress. Phil, you mentioned volatility, but if you continue to show pre-tax core earnings growth somewhere around double-digit range, the only way I can figure that the efficiency ratio does not go lower is, of course, expense growth heads to that double-digit range too. So I guess, the question is why not be more aggressive with your expense target? Is it that core expense growth will approach those sorts of levels? It's a good problem to have I suppose given the progress you have made, but maybe a bit of an update.

Roy Gori - *Manulife Financial Corporation - President & CEO*

Thanks, Steve. Let me start, and Phil may want to supplement my comments. We are, obviously, delighted with the progress that we are making on expense management and to deliver against our efficiency target in the quarter was tremendous. We are not yet ready to declare victory, would be my short answer. And we still have a lot to do and we believe that there's still a lot of value that we can generate on the expense management front. Having said that, our results for the quarter did benefit from certain items that we perhaps will not expect to see continue in future quarters. And it will bounce around a little bit. We, again, continue to manage our expenses really very tightly. But at the same time, we want to make sure that we are also investing in the growth parts of our business that are going to provide future earnings. So I would say that we are committed to the target that we have. We would like to deliver our goal of being under 50% efficiency sooner than what we have committed, but we also want to provide some caution against the fact that we will need to continue to invest in the parts of our business that are going to give us long-term value and growth.

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Roy. And I would just supplement that absolutely, we are not ready to declare long-term victory at this stage in our expense efficiency program. We did lay out at Investor Day a number of initiatives that give line of sight to $300 million of run-rate saves and those run-rate saves, we

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is really the discipline that we are applying to our expense base at the moment. So I think this is something that is really new to the company, that we are being extremely disciplined in how we deploy the financial resources that we have to deliver those bottom line benefits that we laid out.

Operator

The next question is from Meny Grauman from Cormark Securities.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

A question on capital optimization. You are 2/3 into the $5 billion target and you are managing to do this without a big hit to run-rate earnings and, in fact, an upfront gain on the recent announcement. I am wondering as you look to the next, call it, $1.5 billion, do you expect to have that same sort of favourable earnings impact? Or how much tougher is it going to be to deliver that same kind of profile as you get to the end of that 2022 target?

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

Meny, it's Naveed Irshad here. If you recall at Investor Day, we talked about our road map for getting to the $5 billion of capital release, not relying on block transactions. And to the extent we achieved any of those block transactions, that would sort of accelerate hitting the target or allow us to overachieve. So I think we are sort of moving into that glide path. Also talked about the concept of slicing and dicing the various blocks of business, which would probably be most financially optimal for us. And so what we have done is sort of go block by block, and so we executed on these transactions. We have a number of other transactions that we are actively working on in the pipeline. And so hope to have a steady stream of these transactions closing in upcoming quarters. We are certainly looking at the relationship of earnings forgone to capital release in each transactions; that is really a lens we look at. We also look at certain risk reduction and other sorts of metrics. I am sort of cautiously optimistic that you will see more of these transactions over the upcoming quarters, and we are well on the glide path to overachieving the objective.

Meny Grauman - *Cormark Securities Inc., Research Division - MD & Head of Institutional Equity Research*

And then just if I can ask on LTC. Steve, you are pretty fulsome in your prepared remarks, but just sort of a detail in the MD&A. It talks about unfavourable experience in LTC in the quarter. So just wanted to have a little bit more detail on that. And also, you talk about how it's consistent with the prior year period. So just wondering, is there something about Q3, in particular, that creates this kind of issue? I am just wondering about that comment specifically.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Sure, Meny. So we did see unfavourable experience in LTC this quarter. For context, it was comparable to Q3 last year, and we have typically seen Q3 can be adverse. It is also neutral year-to-date. So we recorded a gain in Q1 of this year and the experience in Q3 essentially reversed that gain. We tend to look at it over the longer term as opposed to any one quarter because the results do bounce around quarter-to-quarter and this was within the range of what we have seen both on the positive side and the negative side. So we tend to focus on results since the last review, which has been roughly neutral. In terms of what happened this quarter, if we drill into the results, it was a mix of termination experience. So we saw relative to previous quarters, relatively lower terminations of higher cost benefits, so lifetime benefits and females. We also looked back over a number of quarters and that is not a trend, so it emerged in our Q3 results.

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Your next question is from Humphrey Lee from Dowling & Partners.

Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

In Asia, new business value continued to grow at a very good pace, but I would say this quarter, you hit a new level relative to recent quarters. Like, obviously, Japan was a factor with the new product, but Hong Kong and Other Asia was also strong in 3Q. I was just wondering what was driving the strong NBV growth in the quarter?

Anil Wadhwani - *Manulife Financial Corporation - CEO & President of Manulife Asia*

Humphrey, this is Anil. Thanks for the question. So if you look at our new business value, as you rightly pointed out, we saw a resurgence of momentum in Japan. We had some challenges on account of some excessive competitor activity in the first half, which we held our ground and actually, protected value and our margins. But we saw a resurgence on account of the launch of new product, which really kind of drove both the APE sales as well as the new business value. In terms of Hong Kong specific, we have been very, very focused on growing our drivers. So if I could draw your attention to the agency growth, if you look at the YTD agent count, our Hong Kong agent count has been growing at an accelerated pace of 13%. Our active agent count has been growing at double digits. So that has started to kind of translate to both the APE sales that we are seeing in Hong Kong, which has been pretty consistent throughout the year, as well as the gains that you are seeing on new business value. With respect to Asia Other, Asia Other is our fastest growing segment. So on a YTD basis, our sales are growing at 15%. Our new business value is growing on a YTD basis at 31%, and that's not surprising because Asia Other comprises of markets like China, Indonesia, Vietnam, Singapore. Our DBS relationship, as you know, has been tracking very well, 20% plus on a YTD basis. So there are a lot of compelling factors, including some of the secular trends that we are seeing in Other Asia and a combination of these factors is really kind of driving the growth that you are seeing on a consistent basis on new business value.

Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

And then maybe a question for Naveed. So in your early comment, you talked about there is a good pipeline of transactions that you are looking at. Should we think about like it is more kind of in tune of what we have seen so far. And then also, just looking at the counterparties of the three transactions that you pick, very highly reputable, highly rated counterparties, is that the M.O. that you would follow going forward for some of these other transactions?

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

Yes, so Humphrey, thanks for the question. So obviously, the strength of the counterparty is a key consideration in any transaction. I would not rule out doing transactions with other counterparties. Obviously, there is economic risk that we sort of quantify in doing that. For some of the other blocks of business, that is, let's say, Long-Term Care, for example, you are seeing a lot of private equity money get into the space, and we may have to look at other considerations in making transactions, not that we would not rule out any such transaction. It just happened to be that on these specific blocks that we transacted on, highly rated counterparties put forth very attractive offers.

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

And this is Phil. If I could just add, if we look at the process that we have been following over the course of the year, we have shifted from bilateral discussions around transactions to competitive bid processes and our experience has been that, that much better lines us up for success. And so that is something that we would absolutely continue to do as we execute further transactions in the coming quarters.

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Yes, so for all three of the transactions we announced, we had an auction process. Obviously, we went to market, and we had multiple bids from a range of bidders, highly rated counterparties and private equity-related counterparties. So we had some options in terms of value and sort of counterparty risk and we examined the trade-off very carefully and made our decision.

Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

If I can sneak in one more. I recall there is some discussion about Michigan, which is your primary state of domicile. There is some potential legislature on allowing insurance company to separating block of business into different entities. Do you have any update on that? And I guess, like, that would potentially affect how you pursue further block transactions down the pipeline.

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

Yes, there is some activity in Michigan on that front, but no new formal developments. We are monitoring those developments closely. To the extent there is such a legislation in place, we would certainly actively look at that option. So there is activity but no sort of finality there.

Operator

The next question is from Gabriel Dechaine from National Bank Financial.

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

Along with the buyback news, which was pre-announced, you did talk in this presentation about making meaningful progress on deleveraging. Can you give us some line of sight on what you expect to achieve over the next 12 months? How do you balance the two opposite kind of strategy?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Gabriel. This is Phil. I think I should start by saying that we are in a strong capital position and that does give us flexibility to make progress on leverage. The biggest timing constraint on leverage reduction is the extent to which our issued bonds are maturing. And I would note that we have a maturing issuance in the fourth quarter, $250 million, and we have $1.5 billion of issuances maturing in 2019. So that does give us the flexibility to be able to act on leverage. It does not mean that we will be totally out of the debt markets. It is really important that we remain in the debt markets to provide flexibility in our management of capital. But I do feel as if we are in an ideal position to be able to make that meaningful progress in the year ahead.

Roy Gori - *Manulife Financial Corporation - President & CEO*

I would just add, Gabriel, that the decision on buybacks was certainly aided by our confidence in the progress that we are making on leverage and getting that to below the target that we have articulated. So that was certainly a factor that gave us confidence to make the call that we did.

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

Okay, great. So if I understand it correctly, you are going to be a net redeemer next year?

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I cannot predict the future, but we certainly have the flexibility to do that, all other things being equal, yes.

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

Got you. I just want to dive into the ALDA and the investment gains overall. It was a really, really strong quarter for core investment gains and the amounts above that. Can you give me a bit more detail on what drove that? There was some mention of ALDA gains, good credit experience. There used to be detail on that slide there that we do not have any more. And yes, let's go with that.

Scott Hartz - *Manulife Financial Corporation - Head of General Account Investments*

Gabriel, Scott Hartz here. Yes, thank you for recognizing strong investment gain quarter and there will be volatility in those numbers as we have seen in the past. What we did see was fixed income reinvestment and credit continued to remain strong. Those tend to be the more stable portions. Maybe not quite as strong as prior quarters but still strong. And what really drove the good result this quarter was the returns on our alternatives. Year-to-date, those had been slightly negative, so a little bit below our assumed returns, and that turned around. And now, year-to-date, we are above our assumed returns. So about 2/3 of the result in the third quarter was due to ALDA and it was not from any particular category. All the 6 categories had very strong results in Q3.

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

Is that, like, when you are selling real estate, that you are recognizing gains or anything like that? Or because you...

Scott Hartz - *Manulife Financial Corporation - Head of General Account Investments*

Well, that was a tailwind for sure. As we have been selling down some of the ALDA, we have been able to achieve sale prices above our price values so that was part of the driver but not all of it. It was also just the good results from new appraised values as well.

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

Okay, and then just to sneak one in then. The LTC experience, you do not quantify that number. Why don't you? I mean I could guess why not, but could you tell us what it was this year or this quarter because I do not know what it was last year for comparative purposes?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Gabriel. This is Phil again. So we do not really want to get into quantifying experience by block of business. But it genuinely is neutral year-to-date and neutral since the last actuarial triennial detailed review as Steve had laid out. So it's not something we see as a trend. And experience, whether it's LTC or other blocks of business, we will see it bounce around from quarter-to-quarter. And believe me, if there is a trend emerging, we will not hide that. We will make sure that we address it as soon as it's feasibly possible.

Operator

The next question is from Sumit Malhotra from Scotia Capital.

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I wanted to follow up or start with last week's press release to begin with. The $1 billion in capital relief that was communicated, I think the largest portion of it related to your line here that you will have further refinement of the U.S. asset portfolio. I took it that was referring largely to the ALDA holdings. And if I contrast this with what we heard in December when you had the announcement, there was some losses realized as you repositioned the portfolio. So I think my question here is, is that $470 million a net number? Or is there a potential charge that the company will have to take as it makes the move to reposition the ALDA portfolio?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Thanks, Sumit. It's Steve here. I can answer that. So the upfront net income impact of the transaction reflects ALDA asset repositioning. So there's no further charge to take here. It's the comments really that we do not get the capital benefit until the asset leaves the balance sheet. The other thing I would say is, we are very confident in achieving that repositioning as we have made very strong progress on the ALDA initiative that we announced at the end of last year. And just to completely clarify because you made one comment that I wanted to clarify as well. We have not realized losses on the sale of the ALDA portfolio. In fact, it's been very consistent with our carrying values.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

Sorry, I may not then have phrased it that well. I think what I meant was you had the charge related more to the differential and investment returns that was going to be realized when you move from ALDA to more traditional fixed income. Is that the better way to say it?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Correct, yes. Yes, and that impact is reflected already in the impact of the current quarter.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

It's in that number, okay. I got you there. And then this one is likely more for Phil. So Phil, again it's been referenced a couple of times, the trade-off, if you will, between filing for a buyback and then also putting the discount on the DRIP. I guess I will put it this way. When we've seen companies in this space introduce the discount, the take up from your shareholders is relatively fast. So when we think about the impact on numbers going forward, last week's press release talked about $80 million of earnings that would be foregone as a result of the reinsurance. What is your expectation in regards to the share count from here? Is there going to be a more noticeable increase? Or do you expect that the NCIB will keep you at a more neutral level?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Sumit. So we do fully expect to execute on the NCIB, and it is up to 40 million shares. My expectation is that if we look at the NCIB and the DRIP, over a medium-term period, we will see those items being roughly offsetting. But it's hard for me to predict with any precision what that would mean for the share count over a 6 to 12 month period.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

And maybe more to the point, on your comments on leverage, you had communicated the $250 million redemption before. In talking about meaningful improvement in the leverage ratio over the course of the next year, is it fair to say you are not contemplating any benefit resulting from these two actions, in particular, i.e., the discounted DRIP is going to add to equity, and that's one of the factors? Is that the right way to think about it? That's not a factor in your guidance?

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That is correct. Irrespective of the capital actions that we announced last week, we will make, and we would have made, progress on the leverage ratio. So we are not dependent on increasing equity through the DRIP in order to achieve our leverage ratio target.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

Last one for me is probably for Paul, maybe for Phil. The Global Wealth and Asset Management core earnings expense trends looked very good here as well. The one geography that stood out to me was the U.S. We do not usually see 50% sequential increases in earnings power in a wealth manager. You did mention there were some additional gains on an aggregate company level this quarter in core earnings. Was any of that in the U.S. Global WAM segment? Or Was there some other factors at play?

Paul Lorentz - *Manulife Financial Corporation - Head of Global Wealth & Asset Management*

Yes, it's Paul here. The earnings in Q3 does have the improvement that we talked about with higher fee income on the AUM and margin expansion because of the expense management. There is in the U.S. a tax credit in Q3 that if you normalize for, I think you would get a tax rate consistent with Q2. And that is probably the piece that you are seeing there is why the jump up higher than expected, and that's something that happened in the quarter and I believe happened in the third quarter of last year as well.

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

And maybe I supplement as well because I think your question was more broadly as well in terms of the run-rate for core earnings and how much of that was elevated by WAM. There are no items in core earnings that I would highlight this quarter as being notable. However, there are a number of factors in any particular period that can jump around. And what we have seen in the third quarter is that many of those factors have been positive and favourable to us. So if we step back and look at, in aggregate, what the impact of those favourable items may be to the future run-rate, we felt that the level of elevation was in the order of $100 million.

Paul Lorentz - *Manulife Financial Corporation - Head of Global Wealth & Asset Management*

Yes. And the only other thing I would add is the other way to look at it. You may want to look at the core EBITDA growth year-over-year, which neutralizes for both the tax change from last year and this one-time adjustment and that will give you a better idea of year-to-date growth year-over-year from an EBITDA earnings perspective.

Sumit Malhotra - *Scotiabank Global Banking and Markets, Research Division - MD of Canadian Financial Services*

So even there though, Paul, your margin improvement is pretty strong. I mean, over 29% I think for the first time we have seen. So the business itself did well, and I think expenses helped, but the tax piece is maybe the delta I was looking for, for the U.S. segment.

Paul Lorentz - *Manulife Financial Corporation - Head of Global Wealth & Asset Management*

Yes.

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Yes, I would just add to that and with the comment around just the diversity of our business, one of the things that we are really benefiting from in our Global WAM franchise is the fact that we have a very well-diversified franchise globally. And where we see possible challenges in certain markets, we see other parts of our business stepping up, and that is also helping improve the margin for our business where we see some real challenges as it relates to passive being a more predominant factor in North America. So again, we are really, I think, starting to really benefit from the diversity of our franchise and the global footprint which we are starting to drive greater scale from.

Operator

The next question is from Linda Sun-Mattison from Sanford Bernstein.

Linda Sun-Mattison - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

I have a question just for following the WAM. I am looking at the numbers for Asia, and we have got consecutive positive net flows. And I think in the prepared comment, you mentioned that money market fund in China actually was a decline in this quarter, if I heard it correctly. So for me, I am wondering, if I look next 12 to 24 months, what is a kind of sustainable run-rate in net flows in Asia? And where do you expect this could come from? So I am thinking about institutional, retail, or your pension fund, essentially the Hong Kong MPF fund.

Paul Lorentz - *Manulife Financial Corporation - Head of Global Wealth & Asset Management*

Yes, it's Paul here. I will start and then Anil can add additional context. But it is hard to predict going forward and I think a lot of what have happened this year has been because of the volatility in the markets and the trade discussions. That tends to impact the retail channels more than the other ones. So on the institutional perspective, it tends to be longer investors, a longer time horizon and I think those are more predictable as well as what the retirement platforms' individuals are saving within the context, so they might shift assets to be more conservative but it stays within the retirement platform, which again, I think speaks to Roy's comment earlier about the real benefits of the diversification not only by geography but by channel that we have. So I think if there was going to be variability, it really is going to depend on the retail side of things, and that is dependent on how markets do and what happens with the ultimate volatility in the markets.

Roy Gori - *Manulife Financial Corporation - President & CEO*

Anil, do you want to add anything?

Anil Wadhwani - *Manulife Financial Corporation - CEO & President of Manulife Asia*

Yes, so just a couple of comments, Linda. This is Anil. So firstly, Asia did experience positive net flows and, I guess, if you were to just kind of compare our net flows with some of the top-tier players who recently announced their results, we are exceedingly positively placed, right. And this is despite, some of the market volatility that we have seen. Now, from a market volatility perspective, if you look at the retirement flows, they are pretty agnostic. They are pretty statutory in nature so they are not necessarily going to kind of see the up and down that you would normally associate in response to market volatility. Interestingly, we are seeing interest from our institutional clients, given the fact that they are seeing some selective valuation metrics opportunities in Asia. And even on the retail side, we are seeing interest in the current market conditions, on some of the equity funds, which are a lot more resilient to market volatility. So for example, the U.S. bank equity fund, or the Greater China equity fund, we are still seeing at the retail level, a fair amount of interest. So the point being that even when markets are volatile, there will be selective opportunities that we can talk to, both our institutional as well as our retail clients.

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So what I am trying to get is from what your remarks, are you kind of gaining market share in Asia, either in the retail, institutional or you think it's volatile, it's hard to say?

Anil Wadhwani - *Manulife Financial Corporation - CEO & President of Manulife Asia*

Yes, I mean, if you look at purely from quarter three perspective, Linda, as I said, we feel pretty good about it. We seem to have outperformed some of our top-tier competitors, who recently announced their results. I am not going to get into the specifics, but we feel that we are gaining against some of our key competitors.

Paul Lorentz - *Manulife Financial Corporation - Head of Global Wealth & Asset Management*

And I would extend that beyond Asia to more of a global view as well.

Linda Sun-Mattison - *Sanford C. Bernstein & Co., LLC., Research Division - Senior Analyst*

Yes. And maybe I have a question more for Roy and Phil. You have got the kind of 13% ROE target and the core earning growth target. Now, given the accelerated pace of legacy group transactions and also I think probably better than targeted growth in Asia, where your NBV margin's higher, if I do my math, I think this number should be up. But can you give us a kind of outlook on where do you think your target should be on both ROE and core earnings growth?

Roy Gori - *Manulife Financial Corporation - President & CEO*

Yes, thank you, Linda. And what I would say at the outset is that we are, obviously, really very pleased with our progress on return on equity and our earnings growth. But I guess, as I said earlier, I would not really want to declare a victory at this point. I think we want to consistently deliver against each of our targets in a sustainable way before we are ready to start talking about increasing our goals. But we are really very encouraged with the progress that we are making. We are delighted that we are getting and making that progress across all of our business segments. And that certainly has given us the confidence to take the actions that we did last week. But when we are consistently delivering against those targets, I think that will be the right time for us to reassess whether the targets that we have got are appropriate or whether we want to look to increasing them. But certainly, buoyed by the confidence of the progress that we are making in the business.

Operator

And your next question is from Doug Young from Desjardin Capital Markets.

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

Just wanted to go back to the investment gains. Can you quantify what the credit gain was in the quarter?

Scott Hartz - *Manulife Financial Corporation - Head of General Account Investments*

Yes, it's Scott Hartz here. The credit gain has been very consistent, it's in the order of $50 million. We are in a period in the markets where we would expect credit gains, given how benign the credit environment is, but that's just been a very consistent number now for a while.

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And I want to follow on to that thought process because you did lower your bond default assumptions as a part of the actuarial review, which should, I guess, technically reduce your future credit gains that are coming through. But I still want to understand the process behind doing so because, obviously, credit conditions are benign, as you have indicated. Hard to see how they got much better, but arguably, I mean they really only have one way to go, I would imagine. So I just wanted to understand what gave you comfort in bringing down that bond default assumption.

Scott Hartz - *Manulife Financial Corporation - Head of General Account Investments*

Yes, it's Scott. I will start and turn it over to Steve who's the one that goes through it in the basis change. But it is a long-term view of where credit results have been, and we are a little cautious. And your point is right that credit results cannot get much better than what they are and this will bring them down a little bit. But as we look over like a 30-year time history, and we looked at really Moody's results and our own results and really calibrated it to Moody's results, our own results have been better than that. So we do still think there's room and would expect, over the cycle, to outperform on credit. But to your point, it can't get much better than this and in recessions, we will certainly have losses coming out of this.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Nothing to add.

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

Okay. And then, Steve, I guess, I think where the confusion on Long-Term Care insurance, I mean, I guess, maybe from my perspective is, I think last quarter, you said your claims experience was neutral in that it was neutral roughly year-to-date, but more neutral since the last review. And then you indicated this quarter that Long-Term Care insurance was adverse, yet it's still neutral since the last review. So I am just trying to understand the difference. Is this just so it's adverse, but it's so immaterial that it's a rounding error? That's, I guess, where my confusion is.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Got it. Yes, so a little clarity. And we focus on the long-term here because, as I said, we do see variability quarter-to-quarter, so it's really the longer-term trend that we focus on. And when we are talking about neutral, just so you understand what we mean, we are talking about a quarterly average impact to net income of low single digits. So that's what we are really calling neutral.

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

Okay, that puts it in perspective. And then maybe I sneak one. Just the $3.4 billion of capital relief that's in the works right now, from everything that you have done. If I do the math, that implies another $600 million to $700 million of ALDA has been already done in Q4. Is that right? Because if I do the math of what you have done, it's about $2.6 billion, $2.7 billion. $3.4 billion, is that the difference there that you have already done further work in Q4 around ALDA?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

So Doug, this is Phil. The progress we have made on the execution of ALDA in the quarter is a capital release of about $600 million. Year-to-date, that's $1.3 billion, and you may recall, we had a target of $2 billion. So we are very much on track to deliver that $2 billion target over the 12 to 18 month period that we had set ourselves.

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I am just trying to understand the $3.4 billion because if I look at ALDA, it's $1.3 billion, the UL was $240 million, Signator is $100 million and the recent capital option is $1,100 million. So it's $2.7 billion, but so you mentioned $3.4 billion. You have got stuff in the hopper for $3.4 billion. Or am I reading that incorrectly?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

So far, we have delivered $1.6 billion of capital efficiencies, cumulative year-to-date in the third quarter. The remaining components: in the fourth quarter we have the completion of Signator, which is about $125 million; and the impacts from the three reinsurance transactions that we announced last week. That brings us to a total of $3.5 billion.

Roy Gori - *Manulife Financial Corporation - President & CEO*

So let me just put it slightly differently. So if you think about the ALDA action that we announced in Q4 of last year, that would result in about $2 billion worth of capital freed up. The transaction that we announced last week would be another $1 billion. We have got the reinsurance transactions that we announced earlier this year and then Signator, that's effectively the bulk of how we get to the $3.4 billion.

Operator

Your next question is from David Motemaden from Evercore ISI.

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

Just a question for Steve. There's been a bit of focus in the industry on Long-Term Care, about how, I guess, the baseline morbidity assumption is more important on whether improvement is embedded in reserves. Just wanted to get a sense for how you guys feel you stack up on baseline morbidity assumptions.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Sure, David. I agree with that point. In my prepared remarks, the morbidity improvement itself I noted is only 3% of the present value of future claims costs. So it's the baseline assumptions for all the assumptions, frankly, are what matters. And really there, what I will tell you about is our process. We monitor our experience on a quarterly basis as well as doing deep dives every three years and reflecting all the experience that's available to us in our own book of business as well as any industry information that we can get our hands on. And I think that process should give people comfort that we have been updating our assumptions every three years and then reporting in aggregate how our overall experience is performing relative to those assumptions. And we are going to do the same thing for 2019, a very, very thorough review of our assumptions and experience. And the last point I would make is the reminder that under Canadian practice, we have to have a professional third-party peer review of those assumptions that reports to the Audit Committee.

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

Great. And I know you said experience has been neutral since the last review, but is it possible to get a sense for how some of the major assumptions have fared in terms of morbidity, mortality, approved rate increases? Just any sort of color you can give on some of the underlying assumptions?

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Yes. So in terms of the underlying assumptions, what we have said and it continues to be the case, is that our claims costs have been trending higher than the assumptions. However, we have seen higher levels of lapse and those two have been largely offsetting. In terms of the premium increase process, I think the disclosure at Investor Day is quite helpful on that point. It disclosed the progress that we have made both historically and on their current rate filing. And at that time, we disclosed that we had USD$800 million embedded in our reserves for rate increases that we had filed but not yet received. The outstanding amounts that we expect to achieve over time are several multiples of that amount. So we feel quite confident in the premium increase assumption that's embedded in the reserves, and we have made progress since Investor Day.

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

Got it. Great. And then just I think there were some comments earlier that there's been some activity on some of the, I guess, legacy blocks that you are looking to potentially reinsure. Is there any change in the interest level on Long-Term Care? I know it's just been a quarter since we last spoke about it, but just wondering if there's been any more incremental interest on it.

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

It's Naveed Irshad here. Yes, you saw the transaction that took place in Q3, so obviously, that was quite encouraging. We certainly have seen more interest in this space. A lot of private equity firms are looking at it quite actively. I think the interest rate environment, the fact that a lot of companies in the U.S. have become sort of more realistic about their assumptions has sort of triggered that activity. So it's certainly an avenue we are exploring.

Operator

Your next question is from Mario Mendonca from TD Securities.

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

Phil, just a quick question here first. You referred to $100 million in favourable but perhaps unusual items this quarter. Did I hear that correctly?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Not quite. So we said favourable, Mario, but we did not make reference to them being unusual. So there's nothing that I would call out as being one of the notable items that I would specifically exclude. But there are a number of different things that bounce around from quarter-to-quarter that have gone in our favour, available-for-sale, equity gains, policyholder experience, for example, equity markets have been higher in the third quarter, which has helped WAM fee income. So various items that, if we compare to what a typical run-rate would be if we look at the past few quarters, in aggregate are about $100 million higher.

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

Okay. And of that $100 million, how much would you say is sort of tax gains related?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Very small proportion of that $100 million. The only tax item that's gone into core would be the point that Paul made earlier with regards to WAM in the U.S. So the larger tax movement that's visible this quarter in our results has been posted through noncore, and that's simply a true-up to the U.S. tax reform estimate of $1.4 billion that we announced in the fourth quarter of last year.

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Right. So the core amount would be some small portion of $100 million is what you are telling us?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Correct.

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

Okay. Now, just sort of something entirely different. So Asia, I am struggling with how to interpret what's happening with new business relative to expected profit. So new business now reached 94% of expected profit. That's not something I have ever seen before in any insurance company. And so help me understand how to interpret this. Is the message here that the margins are just that healthy, they are that strong in this business? Or instead, should I look at this and say, there's some vulnerability because of changes in the regulatory environment, delays in product approvals? How do you look at this internally? Are you comfortable that new business has now reached almost 100% of your expected profit?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

So Mario this is Phil. I will start and then hand over to Steve Finch. So yes, we are comfortable with the contribution from new business. We do note that in the quarter, there has been a notable increase in the gains that we recognize from new business. New business gains are something that will bounce around from quarter-to-quarter. There are a number of factors in the third quarter that have worked in our favor when it comes to new business gains. There were some important product launches, so we had the Par product in Canada as well as an important product launch in Japan that both proved to be very successful. There are a number of repricing initiatives that we had worked through over the course of the last twelve months, and that's had a favorable impact. So it's something we are comfortable with, but I would expect it to move around from quarter-to-quarter. Steve?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

Sure, yes. And we have mentioned in the past that new business gains, as Phil said, can tend to bounce around. So looking at one quarter movement, I would not take that as a trend. We saw the comparatives from 2017 to 2016, we also saw some sizable changes at that time as well, but we certainly do not view this as the new run-rate. In terms of earnings on in-force, we do expect in Asia to also see a healthy growth in earnings on in-force on that business. In fact, when we look across the company, Asia would have the highest expected growth in earnings on in-force. In the current period, there is a headwind in terms of quarter to prior year quarter comparative, and that's the impact that at the end of last year and completed in Q1 was the final hedging on our Japan variable annuity business, so that's a bit of a headwind in the growth in earnings on in-force.

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

Okay. And then just one final question on leverage. What's special about 25%; getting to a 25% leverage ratio? Is there anything from a ratings perspective that would necessitate getting down to 25%?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Mario, it's Phil. There is nothing from a ratings perspective that forces us to get to 25%. In fact, at our current leverage ratio of 29.2%, we do not have any issues with that from a ratings point of view. In fact, we have capacity. The 25% really is when we step back and look at our overall capital position and capital management strategy, we would like to have as much financial flexibility as possible. And at 25% leverage, we see significant

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Roy Gori - *Manulife Financial Corporation - President & CEO*

I will just reinforce that point, Mario. We are very pleased with our progress on leverage and, quite frankly, the leverage ratio with where it is today is, in my mind, a source of strength. But as Phil highlights, having the flexibility strategically that a 25% leverage ratio would give us is certainly an element of strength that we would like to move towards.

Operator

The next question is from Paul Holden from CIBC.

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

So one follow-up question on the deleveraging. By my numbers, it looks like you can get to that 25% target or very close to by end of 2019. So my question is, how should we think about the earnings impact of deleveraging? I'm assuming there's probably some kind of positive spread differential on deleveraging. And do you have the flexibility to maybe target some higher cost leverage items versus necessarily just going by the cadence of debt maturities?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Thanks, Paul. This is Phil. So I think you raise an important point there, which is how quickly we do it, how quickly we were able to lower the leverage ratio. We will selectively refinance, so it doesn't mean that we will not refinance any of our maturing issuances. We will do it based on what makes sense economically rather than do anything economically irrational in order simply to get the ratio down. So I think it may take slightly longer than you have proposed there at end of 2019. It will be that controlled process. In terms of the impact on earnings, I see it as being something that, in the scheme of things, is modest. So not something that I would expect to materially impact our ability to generate core earnings.

Operator

Your next question is from Darko Mihelic's from RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets, LLC, Research Division - Financials Analyst*

I just have a question with respect to the annuities reinsurance deals in the U.S. When I look at the U.S. business, I see that in this quarter, you earned $124 million from annuities. So I wonder if similar to the question on Long-Term Care loss, I mean I wonder if you can talk about the blocks that are left behind that are generating those earnings. And how these transactions will affect the variability of those earnings that are coming from those other blocks and whether or not there's any interest in those other blocks that are left behind.

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

Darko, it's Naveed here. So the remaining blocks, I think we outlined this at Investor Day. So we have all of our variable annuity business in the U.S., which actually generate the bulk of that, the earnings. We also have a large structured settlement block in the U.S. that's still there. So those are sort of the two main remaining blocks. So the $20 million of quarterly earnings that are foregone, specifically, a majority of that is coming from the 2 payout annuity blocks that we have reinsured.

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No, understood. But, I guess, the questions is, I mean, we can all view this as sort of like you sold the easiest blocks to sell. So I guess, the question is, is there any interest in these other blocks? And is there a lot of variability with the earnings from these remaining blocks?

Naveed Irshad - *Manulife Financial Corporation - Head of North American Legacy Business*

I would say, yes. It's probably a fair assessment to say, like, we started with the ones that are the most marketable and we can transact quickly. So you have seen sort of us move very quickly on that. On the other two blocks, there is a market. You have seen transactions in the marketplace on both structured settlements and variable annuity so there is an established market there. So I think it's something we are certainly looking at. In terms of the variability of earnings, I do not think there's any difference here. Maybe, Steve, you want to comment.

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

I would just comment that when you are talking about those blocks, people think about the variable annuities and what variability of earnings we are getting there. And our hedging programs are operating very effectively. They have been tested somewhat over the last month or two, and they're performing very well, exactly as expected.

Darko Mihelic - *RBC Capital Markets, LLC, Research Division - Financials Analyst*

Okay. And just one quick housekeeping item with respect to the $20 million of earnings that you have given up as a result of these transactions. Can I just assume it's all expected profit or is there a small amount from earnings on surplus?

Steve Finch - *Manulife Financial Corporation - Chief Actuary*

It would be a combination. It would be a combination of the two.

Roy Gori - *Manulife Financial Corporation - President & CEO*

And just for clarity, Darko, that $20 million, does not include any benefits from the redeployment of capital.

Darko Mihelic - *RBC Capital Markets, LLC, Research Division - Financials Analyst*

But it's fair to say you would not really redeploy capital back into the U.S.?

Roy Gori - *Manulife Financial Corporation - President & CEO*

Well, we look at our capital deployment as a function of our strategic prioritization. But again, when you look at it from a total company perspective, the benefit of that capital relief and how we actually use that will be a factor that will be effectively a tailwind to our earnings as well.

Operator

The next question is from Tom MacKinnon from BMO Capital Markets.

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Just with reference to the $100 million I think that was mentioned, sort of, beyond a typical run-rate. I think one of the elements in there was new business gains. And I am just wondering if you can tell us what specifically happened in this quarter that would not happen ongoing that would help new business gains in this quarter. Because the way I look at it, if you keep keeping your expenses under control, you keep selling good, profitable new business, you will continue to get some pretty good new business gains here and especially more in a rising interest rate environment. So what was it that makes you think that they were a little stretched perhaps this quarter?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

Yes, Tom. This is Phil. Good question. The reason we highlighted new business gains is that it is something that can move around from quarter-to-quarter, and we have seen that over recent quarters. In the third quarter, we had seen higher new business gains because of some very specific product launches and the two that I called out, Canadian Par, that's been an important launch; and the new product in Japan has also been an important contributor. It's our expectation that our sales momentum continues. But equally, sales can jump around from quarter-to-quarter. The sales performance in the third quarter is actually much stronger than earlier in the year, so we are very pleased with that, and we will strive for that to continue. But we just wanted to highlight that when you step back and look in aggregate at a number of these favorable items, it's quite possible that there may be an ongoing aggregate run-rate impact of about $100 million if they do not all continue as favourably as the Q3 trend.

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

But as far as new business gains, if you continue the momentum in the Canadian Par product and then the new Japan product, why wouldn't we expect the new business gains to be similar?

Phil Witherington - *Manulife Financial Corporation - Chief Financial Officer*

So that's a fair point, Tom, yes. If we see the same sales momentum, it will continue. I may hand over to Anil to provide his perspective as well.

Anil Wadhwani - *Manulife Financial Corporation - CEO & President of Manulife Asia*

So Tom, this is Anil. So obviously, our intent is to, obviously, ensure that we do not make this a one-quarter event. But there is going to be a customer reaction, right, to some of the new product launches. And to the extent that they are irrational responses, we just have to kind of give a very balanced view or take a very balanced view of that. But I can tell you, we are already kind of beefing up our value propositions. More importantly, in Japan specifically, we are also kind of making the processes a lot more simpler so that our distributors could offer our value propositions to customers far more easily. So clearly, we are taking proactive measures to ensure that we kind of sustain it, but we can also expect some of the competitor reaction in quarter four and quarter one of next year.

Roy Gori - *Manulife Financial Corporation - President & CEO*

But in general, I would just add, Tom, that we are very optimistic about the sales momentum that we have achieved in the quarter and that we believe we can continue to achieve. We have got, again, a very diversified business across various markets in Asia and again, we have made great progress in North America, both in Canada and the U.S. So we do feel very optimistic about that converting into new business value and new business gains.

Operator

Thank you. There are no further questions registered at this time. I would like to turn the meeting back over to Ms. O'Neill.

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Thank you, Operator. We will be available after the call for any follow-up questions. Have a nice morning, everyone.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time, and thank you for your participation.

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