

The Empire Life Insurance Company

**Management's Discussion and Analysis
For the three months ended March 31, 2020**



MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of April 30, 2020

This document provides Management's Discussion and Analysis (MD&A) of the unaudited operating results and financial condition of The Empire Life Insurance Company (Empire Life or the Company) for the first quarter and year to date for 2020. This MD&A should be read in conjunction with Empire Life's unaudited Condensed Interim Consolidated Financial Statements for the three months ended March 31, 2020, as well as the MD&A and the audited Consolidated Financial Statements which form part of the Empire Life 2019 Annual Report dated February 26, 2020. Unless otherwise noted, both the unaudited Condensed Interim Consolidated Financial Statements and this MD&A are expressed in Canadian dollars. Some variances may not reconcile and analysis of components may not sum to the analysis for the grouped components due to rounding.

MD&A contains forward-looking information and involves numerous risks and uncertainties, including, but not limited to, those described in the "Risk Factors" section of the Annual Information Form which is available at www.sedar.com. No assurance can be given that results, performance or achievement expressed in or implied by any of the forward-looking information will occur, or, if they do, that any benefits may be derived from them. Actual results may differ materially from those expressed or implied by such forward-looking information. See the Forward-Looking Statements and Information section in this report.

The unaudited Condensed Interim Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS), which are generally accepted accounting principles as set out in the Handbook of the Chartered Professional Accountants of Canada. This MD&A makes reference to certain non-IFRS measures. These measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. They are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information and complement IFRS measures by providing further understanding of the Company's results of operations from management's perspective. Accordingly, they should not be considered in isolation nor as a substitute for analysis of the Company's financial information under IFRS. See Non-IFRS Measures section in this report. Note that certain comparative amounts have been reclassified and restated to conform with the presentation adopted in the current period.

Management's assessment of industry dynamics, risks and risk management, critical accounting estimates, strategy and outlook remains consistent with the disclosure in the 2019 Annual Report dated February 26, 2020.

Financial Analysis

Overview

(in millions of dollars except per share amounts)	First quarter	
	2020	2019
Common shareholders' net income (loss)	\$ (32)	\$ 43
Earnings per share - basic and diluted	\$ (32.05)	\$ 43.59
Return on common shareholders' equity (quarterly annualized) ¹	(8.0)%	11.2%

Empire Life reported first quarter common shareholders' net loss of \$32 million for 2020, compared to net income of \$43 million for the first quarter of 2019. The decrease in first quarter earnings was primarily a result of significant strengthening of policy liabilities supporting segregated fund benefit guarantees, partially offset by improved asset liability management trading gains and improved gains from increased yields on inforce assets and liabilities backing the life insurance and annuity lines.

The impact of novel coronavirus (or COVID-19) on Canadian and international business operations, supply chains, travel, consumer confidence and business forecasts, and domestic and international securities markets, is expected to continue through the first half of 2020, and potentially beyond. The Company continues to monitor developments in equity and fixed income markets generally, and in connection with the Company's investment portfolios in

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particular. While it is too early to predict the impact of COVID-19 related factors, during a time of increased uncertainty and volatility we expect that these events will have an impact on the Company's performance in the near term.

The following table provide a breakdown of the sources of earnings by line of business for the first quarter.

For the three months ended March 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Expected profit on in-force business	\$ 33	\$ 32	\$ 6	\$ 6	\$ 16	\$ 13			\$ 55	\$ 51
Impact of new business	(3)	(3)	(2)	(3)	(1)	5			(6)	(2)
Experience gains (losses)	(132)	—	(1)	3	5	1			(128)	4
Management actions and changes in assumptions	—	—	—	—	22	(1)			22	(1)
Earnings (losses) on operations before income taxes	(102)	28	3	6	41	18	—	—	(57)	52
Earnings on surplus	—	—	—	—	—	—	18	8	18	8
Income (loss) before income tax	(102)	28	3	6	41	18	18	8	(39)	60
Income taxes	(28)	7	1	1	11	3	4	2	(11)	14
Shareholders' net income (loss)	\$ (74)	\$ 21	\$ 2	\$ 4	\$ 30	\$ 15	\$ 14	\$ 6	\$ (28)	\$ 46
Dividends on preferred shares									(3)	(3)
Common shareholders' net income (loss)									\$ (32)	\$ 43

The expected profit on in-force business increased by 8% for the first quarter, driven primarily by modest increases in all three product lines over the last 12 months.

The impact of new business was similar to the first quarter of 2019. The impact of new business on the Individual Insurance line is positive when the present value of future profits from the new business exceeds the sum of the margins in the initial policy liabilities for that business plus the expenses incurred at the point of sale, and this amount was slightly less positive in the first quarter of 2020 compared to the first quarter of 2019.

Experience losses for the first quarter of 2020 declined compared to the first quarter of 2019 primarily due to a significant strengthening of policy liabilities supporting segregated fund benefit guarantees. This was partially offset by improved asset liability trading gains and improved gains from increased yields on inforce assets and liabilities backing the life insurance and annuity lines. In addition, there was less favourable claims experience in the Employee Benefits line.

Management actions and changes in assumptions were higher in the first quarter of 2020 relative to the same period in 2019, primarily due to management's ongoing activities to improve the matching of assets and liabilities in the Individual Insurance line.

Earnings on surplus increased for the first quarter of 2020 relative to 2019, primarily due to higher unrealized fair value gains on the Company's equity hedging program which more than offset unrealized fair value losses on preferred share investments in this segment.

Results by Major Product Line

The following table provides a summary of Empire Life results by major product line for the three months ended March 31 for 2020 and 2019. A discussion of results is provided in the Product Line section of the MD&A.

¹ See Non-IFRS Measures

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For the three months ended March 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Revenue										
Net premiums	\$ 27	\$ 54	\$ 91	\$ 88	\$ 97	\$ 96	\$ —	\$ —	\$ 216	\$ 238
Investment income	10	10	1	1	53	48	17	16	81	75
Fair value change in FVTPL investments	(55)	20	(3)	1	(334)	384	(7)	(2)	(399)	403
Realized gain (loss) on FVTPL investments	—	(1)	1	—	30	11	3	(1)	34	9
Realized gain (loss) on AFS investments including impairment write downs	(1)	—	(1)	—	(1)	—	8	—	5	—
Fee income	62	61	3	3	—	—	—	—	65	64
Total revenue	43	144	93	93	(155)	539	21	12	2	788
Expenses										
Net benefits and claims	50	65	63	61	41	39	—	—	154	164
Net change in insurance and investment contract liabilities	57	13	—	3	(270)	445	—	—	(213)	462
Policy dividends	—	—	—	—	7	7	—	—	7	7
Operating, commission and interest expenses	37	37	24	21	30	31	4	4	95	94
Income and other taxes	(28)	7	3	4	12	5	4	2	(9)	18
Total expenses	117	122	91	89	(180)	528	8	6	35	745
Net income (loss) after tax	\$ (74)	\$ 21	\$ 2	\$ 4	\$ 25	\$ 11	\$ 13	\$ 6	\$ (33)	\$ 43
Participating policyholders' portion									(5)	(3)
Dividends on preferred shares									3	3
Common shareholders' net income (loss)									\$ (32)	\$ 43

Total Revenue

Net premiums for the first quarter of 2020 decreased by 9%, primarily due to lower fixed annuity sales.

Assets valued at Fair Value Through Profit and Loss (FVTPL) declined in all segments during the quarter, reflecting volatility in both bond and equity markets during the quarter. The Capital and Surplus amount includes fair value losses on preferred share assets, partially offset by a gain from the Company's equity macro hedging program (discussed in the Risk Management section of the results). The TSX Composite Index declined by 21.6% for the first quarter and the yield on 30 year Government of Canada bonds declined by 46 basis points while credit spreads widened. Assets valued at FVTPL also includes the fair value change in assets backing index-linked products. Changes in the value of these assets are largely offset by changes in the related liabilities which are reflected in Net change in insurance and investment contract liabilities. The fair value change in assets backing other non-index linked policy liabilities in the Individual Insurance line is also partially offset by corresponding changes in the Net change in insurance and investment contract liabilities in the Expenses section of the results.

Fee income for the first quarter was consistent with the prior year, as the effect of lower asset values which underpin the volume of fee income did not decline until late in the first quarter of 2020.

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Total Expenses

A substantial portion of Total expenses is driven by the impact that equity market movements and market interest rate movements have on the Net change in insurance contract liabilities. This change in expenses is significantly offset by corresponding changes in the Fair value change in FVTPL investments, as noted in the Revenue section. The net change in insurance and investment contract liabilities includes a \$131 million strengthening of policy liabilities supporting segregated fund benefit guarantees.

Excluding the effect of Net change in investment and insurance contract liabilities, total expenses decreased by 12% for the first quarter of 2020 relative to the first quarter of 2019 primarily due to lower income taxes.

Net benefits and claims for the first quarter of 2020 were lower than 2019 primarily due to lower fixed annuity surrender benefits in the Wealth Management line. Net benefits and claims variability is dependent on the claims incurred. Generally, claims rise year over year due to growth of the insurance blocks. Variability in claims amounts does not, in isolation, impact net income as insurance contract liabilities are released when claims occur. The insurance contract liabilities released may be larger or smaller than the claims incurred depending on whether claims experience has been more or less than what was estimated for the insurance contract liabilities. Claims experience gains and losses are a combination of claims incurred compared to claims expected in product pricing and in insurance contract liabilities.

Product Line Results - Wealth Management

Key Operating Results

(in millions of dollars)	First quarter	
	2020	2019
Fixed Annuities		
Assets under management ¹	\$ 891	\$ 969
Gross sales ¹	27	53
Net sales ¹	(8)	5
Segregated Funds		
Assets under management ¹	7,051	8,392
Gross sales ¹	243	221
Net sales ¹	(81)	(84)
Fee income	61	60
Mutual Funds		
Assets under management ¹	112	152
Gross sales ¹	4	2
Net sales ¹	(6)	(7)
Fee income	—	1
Net Premiums	\$ 27	\$ 54
Benefits and Expenses	144	115
Net income (loss) after tax	\$ (74)	\$ 21

Fixed annuities assets under management decreased by 8% during the last 12 months. Gross sales in the first quarter were 49% lower compared to the first quarter of 2019.

Segregated fund assets under management are lower relative to the same period in 2019, reflecting the equity market volatility experienced late in the first quarter of this year, whereas the first quarter of 2019 saw segregated

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fund assets rebounding from the lows experienced in December 2018. For the first quarter of 2020, gross sales were 10% higher than the same period in 2019. On October 23, 2019, Empire Life launched six new Multi-Strategy GIF segregated funds, to offer customers a mix of investment management styles and greater diversification.

Segregated fund fee income was slightly higher compared to the first quarter of 2019. Fee income from segregated funds and mutual funds is calculated daily for most products. As the fluctuations in equity and fixed income markets occurred late in the quarter, there was a relatively modest impact on this revenue line for the first quarter.

Mutual fund assets under management decreased during the last 12 months due to lower mutual fund sales. Empire Life continues to explore various strategic alternatives with respect to its mutual fund business.

This line incurred a loss of \$74 million for the first quarter of 2020 compared to net income of \$21 million in the first quarter of 2019, primarily as a result of a significant increase in policy liabilities for segregated fund guarantees. These guarantees are only payable if fund values are below the guaranteed values when the insurable event occurs.

Product Line Results - Employee Benefits

Key Operating Results

(in millions of dollars)	First quarter	
	2020	2019
Selected financial information		
Annualized premium sales ¹	\$ 30	\$ 22
Net premiums	91	88
Net income (loss) after tax	\$ 2	\$ 4

Annualized premium sales increased in the first quarter compared to the same period in 2019. The Company continues to increase sales of its core products in the small to medium-sized business market. Empire Life continues to enter into strategic partnerships to expand market share.

Net premiums for the first quarter increased by 3% relative to the same period in 2019. The Company continues to focus on profitable sales in the employee benefits market where price competition continues for all major product lines.

Net income for the quarter decreased, primarily due to less favourable claims experience across all benefit types compared to the corresponding period in 2019.

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Product Line Results - Individual Insurance

Key Operating Results

(in millions of dollars)	First quarter	
	2020	2019
Shareholders'		
Shareholders' annualized premium sales ¹	\$ 5	\$ 5
Shareholders' net premiums	68	70
Net income (loss) after tax	30	15
Policyholders'		
Policyholders' annualized premium sales ¹	3	4
Policyholders' net premiums	30	27
Net income (loss) after tax	(5)	(3)
Net income (loss) after tax	\$ 25	\$ 11

Shareholders' annualized premium sales were flat for the quarter compared to the same period in 2019, while policyholders' annualized premium sales declined 16% for the first quarter. Shareholders' net premiums were also slightly lower in the quarter. Policyholders' net premiums increased in the first quarter of 2020 compared to the same period in 2019, reflecting recent strength in policyholders' new premium sales.

Shareholders' net income for this product line was \$30 million for the first quarter of 2020. Bond market yields rose during the quarter, as the increase in credit spreads more than offset the decline in Government of Canada long duration bond yields. While the increase in yields decreased the fair value gains on fixed income assets supporting insurance contract liabilities, these losses are more than offset by decreases in the corresponding insurance contract liabilities, primarily contributing to the increase in net income relative to the same quarter last year.

Results - Capital and Surplus

Key Operating Results

(in millions of dollars)	First quarter	
	2020	2019
Income from investments	\$ (11)	\$ 20
Gains (losses) on hedging instruments	33	(9)
Interest and other expenses	(4)	(4)
Earnings before income taxes	18	8
Income taxes	4	2
Net income (loss) after tax shareholders' portion	14	6
Net income (loss) after tax policyholders' portion	(1)	—
Net income (loss) after tax	\$ 13	\$ 6

In addition to the three major lines of business, Empire Life maintains distinct accounts for the investment income attributable to Shareholders' Capital and Surplus and to Policyholders' Surplus.

Income from investments in the first quarter of 2020 was lower than the prior year, primarily due to unrealized losses on preferred share assets valued at FVTPL in this line. Gains on the hedging program (discussed in the Risk Management section) in the first quarter, compared to a loss in the first quarter of 2019, primarily related to

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unrealized gains on the Company's hedging instruments as well as a realized gain from a hedging instrument that the Company sold during the quarter.

Shareholder Dividends

The declaration and payment of common shareholder dividends and the amounts thereof are at the discretion of the Board of Directors.

Common shareholder dividends are reviewed on a quarterly basis and depend upon various factors, including the results of operations, the economic environment and the financial condition of Empire Life, taking into account regulatory restrictions on the payment of shareholder dividends, as well as any other factors deemed relevant by the Board of Directors.

The following table provides details of the amounts and dates for Empire Life's per share preferred share dividends.

	Amount of Dividend per share	Payable Date	Record Date
Non-Cumulative Rate Reset Preferred Shares, Series 1 (TSX: EML.PR.A)	\$ 0.359375	July 17, 2020	June 17, 2020
Non-Cumulative Rate Reset Preferred Shares, Series 3	\$ 0.306250	July 17, 2020	June 17, 2020

Empire Life advises that the above-referenced dividends are eligible dividends for the purposes of the Income Tax Act, Canada and any similar provincial tax legislation.

Total Cash Flow

(in millions of dollars)	Year to date	
	2020	2019
Cash flow provided from (used for)		
Operating activities	\$ 22	\$ 96
Investing activities	(3)	(90)
Financing activities	(7)	(7)
Net change in cash and cash equivalents	\$ 12	\$ (1)

Cash flows from operating activities include insurance premiums, net investment income and fee income. These funds are primarily used to pay policy benefits, commissions, operating expenses and policyholder dividends. Cash flows from investing activities primarily relate to purchases and sales of investments supporting policy liabilities and the capital and surplus accounts. Cash flows related to financing activities include issuance and redemption of capital instruments and related dividend and interest payments.

For the year to date, cash and cash equivalents increased by \$12 million. Cash flows provided by operating activities decreased by \$74 million primarily due to lower net income for the period. Cash used for investing activities decreased by \$87 million compared the same period in 2019. Cash used for financing activities was consistent with 2019 levels.

For an analysis of liquidity for Empire Life, see note 10(e) and note 27(b) to the 2019 consolidated financial statements.

Financial Instruments

Empire Life's investment strategy includes the purchase of investment quality bonds to support, to a very large extent, insurance and annuity policy liabilities and the use of equity investments to support insurance policy liabilities. Cash flows arising from these financial instruments are intended to match the liquidity requirements of the

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underlying customer obligation. Investment strategies are subject to prescribed limits outlined in various corporate policies. Empire Life is subject to market risk on these financial instruments.

The Company is also subject to credit risk on these financial instruments which could result in a financial loss should the other party fail to discharge an obligation. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, short-term investments and mortgages. Market risk exposure is managed mainly through investment limits and oversight of its in-house investment managers and external investment firms by the Chief Investment Officer, Asset Management Committee and Investment Committee of the Board. The Investment Committee actively monitors the portfolio size and asset mix. Empire Life has a semi-static hedging program as part of its approach to managing this risk. Credit risk is managed by applying investment guidelines established by the Investment Committee of the Board of Directors. The investment guidelines establish minimum credit ratings for issuers of bonds, debentures and preferred share investments, and provide for concentration limits by issuers of such debt instruments. Management reviews credit quality relative to investment purchases and also monitors the credit quality of invested assets over time. Management reports regularly to the Investment Committee of the Board on the credit risk to which the portfolio is exposed.

The Company manages credit risk with respect to derivatives by applying limits and credit rating restrictions established by the Investment Committee in its investment guidelines, which set out permitted derivatives and permitted uses for derivatives, as well as limits to the use of these instruments. In particular, no leverage is permitted in the use of derivatives and strict counterparty credit restrictions are imposed. Additional information regarding financial instruments is included in notes 2(d), 3, 10(c), and 27 to the audited consolidated financial statements for the year ended December 31, 2019.

Sources of Capital

Empire Life has issued private and public securities to strengthen its capital position and fund new business growth. The securities outstanding are summarized in the following table.

(In millions of dollars)	As at	
	March 31, 2020	December 31, 2019
Subordinated debentures	\$ 400	\$ 400
Equity		
Preferred shares	\$ 250	\$ 250
Common shares	\$ 1	\$ 1
Total Equity	\$ 251	\$ 251

Details of the Company's outstanding subordinated debt and preferred shares are as follows:

Subordinated Debentures				As at	
(in millions of dollars)	Date Issued	Earliest Redemption Date	Interest Rate	March 31, 2020	December 31, 2019
Subordinated debentures (1)	December 1, 2016	December 16, 2021	3.383%	\$ 200	\$ 200
Subordinated debentures (2)	September 1, 2017	March 15, 2023	3.664%	\$ 200	\$ 200

(1) Series 2016-1 Subordinated 3.383% Unsecured Debentures due 2026. From December 16, 2021, interest is payable at 1.95% over the 3-month Canadian Deposit Offering Rate (CDOR).

(2) Series 2017-1 Subordinated 3.664% Unsecured Debentures due 2028. From March 15, 2023, interest is payable at 1.53% over the 3-month CDOR.

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Preferred Shares (In millions of dollars)	Date Issued	Earliest Redemption Date	Yield	As at	
				March 31, 2020	December 31, 2019
Preferred shares	January 1, 2016	April 17, 2021	5.75% \$	150 \$	150
Preferred shares	November 1, 2017	January 17, 2023	4.90% \$	100 \$	100

Empire Life's debentures and preferred shares are rated by DBRS Limited (DBRS) and A.M. Best Company, Inc. (A.M. Best).

Empire Life's DBRS issuer rating is "A" (sixth highest of 20 categories), its subordinated debt rating is "A (low)" (seventh highest of 20 categories), its financial strength rating is "A" (sixth highest of 22 categories) and its Preferred Share rating is Pfd-2 (fifth highest of 18 categories). All ratings have a stable trend. According to DBRS, the assigned ratings reflect Empire Life's position as a consistently performing life insurer with a proven track record of generating stable earnings while maintaining a conservative risk profile.

A.M. Best ratings of Empire Life are "A Excellent" financial strength rating (third highest of 16 categories), "a" long-term issuer credit rating (sixth highest of 21 categories), "bbb+" Subordinated Debt rating (eighth highest of 21 categories), and "bbb" Preferred Share rating (ninth highest of 21 categories). All ratings have a stable trend. According to A.M. Best, the ratings reflect Empire Life's balance sheet strength, which A.M. Best categorizes as very strong, as well as its strong operating performance, neutral business profile and appropriate enterprise risk management.

Regulatory Capital

The Life Insurance Capital Adequacy Test (LICAT) is intended to improve the measurement of the life insurer's solvency position by recognizing the long-term economics of the life insurance business. Empire Life had a strong capital position under MCCR and continues to have a strong capital position under the LICAT framework. Empire Life is required to maintain a minimum Core Ratio of 55% and a Total Ratio of 90%. OSFI has established supervisory target levels of 70% for Core and 100% for Total capital.

As of March 31, 2020, the Total Ratio and Core Ratio reduced significantly from December 31, 2019 primarily due to the significant strengthening of policy liabilities and regulatory capital supporting segregated fund benefit guarantees.

LICAT (in millions of dollars)	Mar 31 2020	Dec 31 2019	Sep 30 2019	Jun 30 2019	Mar 31 2019
Available capital					
Tier 1	\$ 1,435	\$ 1,616	\$ 1,562	\$ 1,549	\$ 1,507
Tier 2	671	669	681	674	692
Total	\$ 2,106	\$ 2,285	\$ 2,243	\$ 2,223	\$ 2,200
Surplus allowance and eligible deposits	1,029	1,109	944	937	921
Base solvency buffer	2,371	2,191	2,133	2,115	2,083
LICAT total ratio	132%	155%	149%	149%	150%
LICAT core ratio	91%	109%	104%	104%	103%

¹ See Non-IFRS Measures

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Other Comprehensive Income

(in millions of dollars after tax)	First quarter	
	2020	2019
OCI, attributable to shareholders	\$ (18)	\$ 43
OCI, attributable to policyholders	(1)	4
Total other comprehensive income	\$ (19)	\$ 47

Other comprehensive income (OCI) decreased in the first quarter of 2020 primarily due to unrealized fair value losses on available for sale (AFS) investments partially offset by a gain on the remeasurement of the post-employment defined benefit plans. The loss on these components of other comprehensive income was primarily due to fluctuations in interest rates and credit spreads during the first quarter of 2020.

Remeasurement of defined benefit pension plans does not immediately impact LICAT as each quarter's remeasurement gain or loss is amortized over twelve quarters for LICAT purposes.

Risk Management

Caution Related to Sensitivities

In the sections that follow, Empire Life provides sensitivities and risk exposure measures for certain risks. These include sensitivities due to specific changes in market prices and interest rates, based on market prices, interest rates, assets, liabilities and business mix in place as at the calculation dates. The sensitivities are calculated independently for each risk factor, assuming that all other risk variables remain constant. Actual results can differ materially from these estimates for a variety of reasons, including the interaction among these factors when more than one factor changes; changes in actuarial and investment return and future investment activity assumptions; actual experience differing from the assumptions; changes in business mix, effective tax rates and other market factors; and the general limitations of Empire Life's internal models used for purposes of these calculations. Changes due to new sales or maturities, asset purchases/sales, or other management actions could also result in material changes to these reported sensitivities. For these reasons, the sensitivities should only be viewed as directional estimates of the underlying sensitivities for the respective factors based on the assumptions outlined, and should not be viewed as predictors for Empire Life's future net income, OCI, and capital sensitivities. Given the nature of these calculations, Empire Life cannot provide assurance that actual impact will be consistent with the estimates provided. Changes in risk variables in excess of the ranges illustrated may result in other than proportionate impacts.

Market Risk

Empire Life has equity market risk related to its segregated fund products and from equity assets backing life insurance liabilities. The Company has a semi-static hedging program. The hedging program may employ derivative positions including put options and futures. The extent of derivatives used is monitored and managed on an ongoing basis, giving consideration to equity risk and the level of available capital.

There is income statement volatility from this hedging program. Based on current equity market levels, Empire Life has required capital for LICAT purposes but does not have policy liabilities on the statement of financial position related to segregated fund guarantees. Therefore, a by-product of hedging LICAT exposure is net income volatility, as the gains or losses from hedging instruments are not necessarily offset by changes in policy liabilities related to segregated fund guarantee risk. The equity risk hedging program provides some relief in adverse scenarios, but may incur losses in positive scenarios. During the first quarter, Empire Life experienced a gain of \$24 million after tax on its hedging program, primarily due to volatile Canadian equity markets. This compares to a hedge cost of \$6 million after tax for the comparable period in 2019.

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Empire Life's LICAT ratio is also sensitive to stock market volatility, due primarily to liability and capital requirements related to segregated fund guarantees. As of March 31, 2020, Empire Life had \$7.1 billion of segregated fund assets and liabilities. Of this amount, approximately \$6.8 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	Mar 31 2020	Dec 31 2019
Percentage of Segregated Fund Liabilities with:		
75% maturity guarantee and a 75% death benefit guarantee	5%	4%
75% maturity guarantee and a 100% death benefit guarantee	45%	46%
100% maturity and death benefit guarantee (with a minimum of 15 years between deposit and maturity date)	7%	7%
Guaranteed minimum withdrawal benefit (GMWB)	43%	43%

All Empire Life segregated fund guarantees are policy-based (not deposit-based), thereby generally lowering Empire Life's stock market sensitivity relative to products with deposit-based guarantees. Policy-based guarantees consider all of the deposits in the customer's policy (whether the fund value is below or above the guaranteed amount) to arrive at an overall net guarantee payment, whereas deposit-based guarantees consider only the deposits where the fund value is below the guaranteed amount and ignore all the deposits in the customer's policy where the fund value is above the guaranteed amount. Therefore, policy-based guarantees generally pay less than deposit-based guarantees. For segregated fund guarantee insurance contract liabilities, the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period-end stock markets are high relative to market levels at the time that segregated fund policies are issued, the sensitivity is reduced. If period-end stock markets are low relative to market levels at the time that segregated fund policies are issued, the sensitivity is increased.

The segregated fund regulatory capital and liability framework includes the use of "zero floors" (i.e., negative liability amounts are not permitted so zero is used instead, as described below) and other regulatory constraints, and this often makes the sensitivity impacts non-linear. The liabilities are the greater of: (i) the average of the amounts determined by averaging the results from adverse economic scenarios; and (ii) zero.

Empire Life also has equity market risk related to its equity assets backing life insurance liabilities. Based on stock market levels as at March 31, 2020 and December 31, 2019, the sensitivity of Empire Life shareholders' net income and LICAT ratio resulting from stock market increases and decreases is provided in the following table.

Sensitivity to equity risk: Impact on net income (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
As at March 31, 2020					
Segregated fund guarantees	\$ 40	\$ (6)	\$ (121)	\$ (229)	\$ (354)
Other equity risk	4	—	(27)	(89)	(153)
Equity hedge	(15)	(9)	13	30	51
Total	\$ 29	\$ (15)	\$ (135)	\$ (288)	\$ (456)
As at December 31, 2019					
Segregated fund guarantees	\$ —	\$ —	\$ (10)	\$ (76)	\$ (229)
Other equity risk	33	15	(12)	(20)	(65)
Equity hedge	(2)	(1)	4	16	38
Total	\$ 31	\$ 14	\$ (18)	\$ (80)	\$ (256)

¹ See Non-IFRS Measures

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Sensitivity to equity risk: Impact on LICAT	Increase		Decrease		
	20 %	10 %	10 %	20 %	30 %
As at March 31, 2020					
Segregated fund guarantees	5 %	— %	(7)%	(13)%	(20)%
Other equity risk	(1)%	(1)%	(1)%	(2)%	(4)%
Equity hedge	(2)%	(1)%	1 %	2 %	2 %
Total	2 %	(2)%	(7)%	(13)%	(22)%
As at December 31, 2019					
Segregated fund guarantees	3 %	— %	(6)%	(16)%	(22)%
Other equity risk	(1)%	(1)%	— %	1 %	1 %
Equity hedge	(3)%	(2)%	1 %	3 %	3 %
Total	(1)%	(2)%	(4)%	(12)%	(18)%

Empire Life's equity market sensitivity in a 20% and 30% stock market decline increased primarily as a result of the significant decline in equity markets during the first quarter of 2020. The segregated fund guarantee liability was strengthened during the quarter as the value of withdrawal and guarantee benefits increase there is a decline in equity markets. This increases net income sensitivity as any changes to the liability when it is above the zero floor will flow through net income.

Empire Life also has a reinsurance agreement to cede a portion of Empire Life's segregated fund death benefit exposure. All Empire Life segregated fund policyholders with death benefit guarantees of at least \$2 million are included in this agreement. Empire Life does not reinsure any other insurer's segregated fund products.

The amount at risk related to segregated fund maturity guarantees and segregated fund death benefit guarantees, and the resulting policy liabilities and LICAT base solvency buffer for Empire Life's segregated funds is provided in the following table.

Segregated Funds (in millions of dollars)	Withdrawal Benefit > Fund Value		Maturity Guarantee > Fund Value		Death Benefit > Fund Value		Policy Liabilities	LICAT Capital
	Fund Value	Amount At Risk	Fund Value	Amount At Risk	Fund Value	Amount At Risk		
March 31, 2020	\$ 2,611	\$ 1,331	\$ 374	\$ 53	\$ 3,845	\$ 338	\$ 131	\$ 691
December 31, 2019	\$ 2,701	\$ 882	\$ 51	\$ 2	\$ 650	\$ 6	\$ —	\$ 465

The first six columns of the above table show all segregated fund policies where the future withdrawal benefit, future maturity guarantee, or future death benefit guarantee is greater than the fund value. The amount at risk represents the excess of the future withdrawal benefit, future maturity guarantee or future death benefit guarantee amount over the fund value for these policies. The withdrawal benefit amounts in the above table relate to GMWB products. The GMWB withdrawal benefit amount at risk represents the amount that could be paid by Empire Life to GMWB policyholders if the net return on each GMWB policyholder's assets is zero for the remainder of each GMWB policyholder's life, based on life expectancy. As at March 30, 2020, the aggregate amount at risk for all three categories of risk was \$1.7 billion. At December 31, 2019, the aggregate amount at risk for these three categories of risk was \$890 million. For these three categories of risk, the amount at risk is not currently payable. Payment is contingent on future outcomes, including fund performance, deaths, deposits, withdrawals and maturity dates.

The level of policy liabilities and required regulatory capital in the above table is calculated based on the probability that Empire Life will ultimately have to make payment to the segregated fund policyholders for any fund value deficiency that may exist on future payments to GMWB policyholders, or upon future maturity of the segregated fund policies, or upon future death of the segregated fund policyholders.

¹ See Non-IFRS Measures

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In addition, Empire Life considers the sensitivity of its LICAT ratio to changes in market interest rates. The impact of an immediate 50 basis point decrease in interest rates and a 50 basis point decrease in assumed initial reinvestment rate (IRR) for non-participating insurance business and segregated fund guarantees for March 31, 2020 and December 31, 2019, is shown in the table below. This assumes no change in the ultimate reinvestment rate (URR). The AFS bonds provide a natural economic offset to the interest rate risk attributable to Empire Life's product liabilities.

Sensitivity to market interest rates LICAT	Impact of 50 bps Decrease
March 31, 2020 LICAT total ratio	(2)%
December 31, 2019 LICAT total ratio	1 %

Quarterly Results

The following table summarizes various financial results on a quarterly basis for the most recent eight quarters:

	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30
(in millions of dollars, except per share amounts)	2020	2019	2019	2019	2019	2018	2018	2018
Revenue	\$ 2	\$ 249	\$ 475	\$ 603	\$ 788	\$ 289	\$ 197	\$ 388
Common shareholder's net income	\$ (32)	\$ 76	\$ 35	\$ 20	\$ 43	\$ 6	\$ 35	\$ 57
Earnings per share - basic and diluted	\$ (32.05)	\$ 77.25	\$ 35.29	\$ 20.45	\$ 43.59	\$ 6.36	\$ 35.73	\$ 58.14

Forward-Looking Statements and Information

Certain statements in this MD&A about Empire Life's current and future plans, expectations and intentions, results, market share growth and profitability, strategic objectives or any other future events or developments constitute forward-looking statements and information within the meaning of applicable securities laws. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements and information. Although management believes that the expectations and assumptions on which such forward-looking statements and information are based are reasonable, undue reliance should not be placed on the forward-looking statements and information because there can be no assurance that they will prove to be correct. By their nature, such forward-looking statements and information are subject to various risks and uncertainties, which could cause the actual results and expectations to differ materially from the anticipated results or expectations expressed. These risks and uncertainties include, but are not limited to, market risk including equity risk, hedging risk, interest rate risk, foreign exchange rate risk; liquidity risk; credit risk including counterparty risk; insurance risk including mortality risk, policyholder behaviour risk, expense risk, morbidity risk, product design and pricing risk, underwriting and claims risk, reinsurance risk; operational risk, including legal and regulatory compliance risk, model risk, human resources risk, third-party risk, technology, information security and business continuity risk; and business risk, including risk with respect to competition, risk with respect to financial strength, capital adequacy risk, risk with respect to distribution channels, risk with respect to changes to applicable income tax legislation, risk with respect to litigation, risk with respect to reputation, risk with respect to risk management policies, risk with respect to intellectual property, risk with respect to significant ownership of common shares. Please see the section titled "Risk Factors" in Empire Life's Annual Information Form available at www.sedar.com for more details on these risks.

Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements and information include that the general economy remains stable; assumptions on interest rates, mortality rates and policy liabilities; and capital markets continue to provide access to capital. These factors are not intended to represent a complete list of the factors that could affect Empire Life; however, these

¹ See Non-IFRS Measures

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factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein.

To the extent any forward-looking information in this MD&A constitutes future-oriented financial information or financial outlooks within the meaning of securities laws, such information is being provided to demonstrate potential benefits and readers are cautioned that this information may not be appropriate for any other purpose. Future-oriented financial information and financial outlooks are, without limitation, based on the assumptions and subject to the risks set out above.

The forward-looking information contained herein is expressly qualified in its entirety by this cautionary statement. When relying on Empire Life's forward-looking statements and information to make decisions, investors and others should carefully consider the foregoing factors, assumptions and other uncertainties and potential events. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date hereof or the date indicated, and to not use such forward-looking information for anything other than its intended purpose. Empire Life undertakes no obligation to update publicly or revise any forward-looking statements and information, whether as a result of new information, future events or otherwise after the date of this document, except as required by law.

Non-IFRS Measures

Empire Life uses non-IFRS measures including return on common shareholders' equity, source of earnings, assets under management, annualized premium sales, gross and net sales for mutual funds, segregated funds and fixed annuities to provide investors with supplemental measures of its operating performance and to highlight trends in its core business that may not otherwise be apparent when relying solely on IFRS financial measures. Empire Life also believes that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers. Empire Life's management also uses non-IFRS measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and to determine components of management compensation. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

Return on common shareholders' equity is a profitability measure that presents the net income available to common shareholders as a percentage of the average capital deployed to earn the income.

Sources of earnings breaks down Empire Life's earnings into several categories which are useful to assess the performance of the business. These categories include expected profit from in-force business, impact of new business, experience gains and losses, management actions and changes in assumptions, and earnings on surplus. The sources of earnings components are reconciled to net income. See the Overview section earlier in this report.

Annualized premium sales is used as a method of measuring sales volume. It is equal to the premium expected to be received in the first twelve months for all new individual insurance and employee benefit policies sold during the period. Mutual fund gross and net sales and segregated fund gross and net sales are also used as measures of sales volume.

Assets under management is a non-IFRS measure of the assets managed by Empire Life, which includes general fund assets, mutual fund assets and segregated fund assets. It represents the total assets of Empire Life and the assets its customers invest in.

The following table provides a reconciliation of assets under management to total assets in Empire Life's financial statements.

¹ See Non-IFRS Measures

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Reconciliation of Assets Under Management

As at	March 31, 2020	December 31, 2019
(in millions of dollars)		
Assets Under Management		
General fund assets	\$ 9,162	\$ 9,462
Segregated fund assets	7,065	8,499
Total assets per financial statements	16,227	17,961
Mutual fund assets	112	139
Assets under management	\$ 16,339	\$ 18,100

The above table includes the following amounts held by Empire Life's defined benefit (DB) pension plans.

As at	March 31, 2020	December 31, 2019
(in millions of dollars)		
DB plan assets		
Segregated fund assets	\$ 169	\$ 203
Mutual fund assets	12	14

¹ See Non-IFRS Measures