

# The Empire Life Insurance Company

**Management's Discussion and Analysis  
For the six months ended June 30, 2019**



# MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of August 1, 2019

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 second quarter and year to date of 2019. This MD&A should be read in conjunction with Empire Life's unaudited Condensed Interim Consolidated Financial Statements for the six months ended June 30, 2019, as well as the MD&A and the audited Consolidated Financial Statements which form part of the Empire Life 2018 Annual Report dated February 27, 2019. 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](http://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 is 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 2018 Annual Report dated February 27, 2019.

## Financial Analysis Overview

(in millions of dollars except per share amounts)	Second quarter		Year to Date	
	2019	2018	2019	2018
Common shareholders' net income	\$ 20	\$ 57	\$ 63	\$ 96
Earnings per share - basic and diluted	\$ 20.45	\$ 58.14	\$ 64.04	\$ 97.44
Return on common shareholders' equity (quarterly annualized) <sup>1</sup>	5.1%	15.6%	8.2%	13.2%

Empire Life reported second quarter common shareholders' net income of \$20 million for 2019, compared to \$57 million for second quarter 2018. The decrease in earnings was primarily a result of unfavourable changes in bond yields, which contributed to an increase in insurance contract liabilities that more than offset the impact of fair value gains on fixed income investments in the Individual Insurance line. Lower earnings in the Wealth Management and Employee Benefits product lines were primarily driven by less favourable expense and claims experience relative to the second quarter of 2018. Year to date common shareholder's net income was \$63 million compared to \$96.0 million in 2018, primarily due to the above mentioned items.

<sup>1</sup> See Non-IFRS Measures

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The following tables provide a breakdown of the sources of earnings by line of business for the second quarter and year to date.

For the three months ended June 30 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Expected profit on in-force business	\$ 27	\$ 31	\$ 6	\$ 5	\$ 12	\$ 16			\$ 46	\$ 52
Impact of new business	(3)	(2)	(6)	(1)	2	2			(6)	(1)
Experience gains & losses	2	2	1	3	(16)	3			(13)	8
Management actions and changes in assumptions	–	–	–	–	(9)	10			(9)	10
Earnings on operations before income taxes	26	31	2	7	(10)	31	–	–	17	69
Earnings on surplus	–	–	–	–	–	–	12	11	12	11
Income before income tax	26	31	2	7	(10)	31	12	11	29	80
Income taxes	6	8	–	2	(4)	7	2	2	5	19
Shareholders' Net Income	\$ 20	\$ 23	\$ 1	\$ 5	\$ (7)	\$ 24	\$ 10	\$ 8	\$ 24	\$ 61
Dividends on preferred shares									(3)	(3)
Common shareholders' net income									\$ 20	\$ 57

For the six months ended June 30 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Expected profit on in-force business	\$ 58	\$ 59	\$ 12	\$ 11	\$ 26	\$ 32			\$ 97	\$ 102
Impact of new business	(6)	(4)	(9)	(4)	7	4			(8)	(4)
Experience gains & losses	1	1	4	12	(15)	(3)			(10)	10
Management actions and changes in assumptions	–	–	–	–	(10)	11			(10)	11
Earnings on operations before income taxes	54	56	7	19	8	44	–	–	70	119
Earnings on surplus	–	–	–	–	–	–	20	15	20	15
Income before income tax	54	56	7	19	8	44	20	15	90	134
Income taxes	13	14	2	5	–	9	4	3	19	31
Shareholders' Net Income	\$ 41	\$ 42	\$ 6	\$ 14	\$ 8	\$ 34	\$ 16	\$ 12	\$ 70	\$ 103
Dividends on preferred shares									(7)	(7)
Common shareholders' net income									\$ 63	\$ 96

The expected profit on in-force business for the second quarter decreased by 12% and 5% on a year to date basis, driven primarily by lower profit in the Individual Insurance product line and to a lesser extent by reduced margins on a lower asset base in the Wealth Management product line.

The impact of new business strain was greater in 2019 compared to 2018 mainly driven by the Employee Benefits product line and to a lesser extent in the Wealth Management product line. The impact of new business for the Individual Insurance product line was positive for each of the 2019 and 2018 periods. The impact of new business 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.

Experience gains for the second quarter of 2019 and year to date declined from 2018 primarily due to decreases in bond yields which contributed to an increase in policy liabilities that more than offset fair value gains on fixed income investments in the Individual Insurance product line, and less favourable claims experience in the Employee Benefits product line.

Management actions and changes in assumptions declined in the second quarter and year to date due to changes in the fixed income investment portfolio as part of management's ongoing activities to improve the matching of assets and liabilities in the Individual Insurance product line. Enhanced matching generates improved profitability when bond yields are higher, and reduced profitability when bond yields are relatively low.

<sup>1</sup> See Non-IFRS Measures

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Earnings on surplus increased for the quarter and year to date primarily due to higher income from invested assets in 2019, and lower interest expenses, partly offset by higher costs for Empire Life's hedging program.

## Results by Major Product Line

The following tables provide a summary of Empire Life results by major product line for the three months ended June 30 and year to date for 2019 and 2018. A discussion of results is provided in the Product Line section of the MD&A.

For the three months ended June 30 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
<b>Revenue</b>										
Net premiums	\$ 40	\$ 29	\$ 88	\$ 84	\$ 97	\$ 93	\$ -	\$ -	\$ 225	\$ 205
Investment income	10	10	1	1	55	55	16	17	83	83
Fair value change in FVTPL investments	3	(2)	3	-	202	23	(4)	(2)	205	19
Realized gain (loss) on FVTPL investments	1	-	-	-	19	12	(1)	-	18	12
Realized gain (loss) on AFS investments including impairment write downs	-	-	-	-	-	-	5	1	6	1
Fee income	63	63	3	3	-	-	-	-	66	66
<b>Total revenue</b>	<b>118</b>	<b>101</b>	<b>96</b>	<b>87</b>	<b>373</b>	<b>183</b>	<b>17</b>	<b>17</b>	<b>603</b>	<b>388</b>
<b>Expenses</b>										
Net benefits and claims	47	43	65	58	42	47	-	-	153	147
Net change in insurance and investment contract liabilities	6	(6)	5	-	299	66	-	-	310	60
Policy dividends	-	-	-	-	8	8	-	-	8	8
Operating, commission and interest expenses	38	33	23	19	32	33	4	6	97	91
Income and other taxes	6	8	3	4	(1)	9	3	2	11	23
<b>Total expenses</b>	<b>98</b>	<b>77</b>	<b>95</b>	<b>82</b>	<b>380</b>	<b>162</b>	<b>7</b>	<b>8</b>	<b>580</b>	<b>330</b>
<b>Net income (loss) after tax</b>	<b>\$ 20</b>	<b>\$ 23</b>	<b>\$ 1</b>	<b>\$ 5</b>	<b>\$ (8)</b>	<b>\$ 20</b>	<b>\$ 10</b>	<b>\$ 9</b>	<b>\$ 24</b>	<b>\$ 57</b>
Participating policyholders' portion									-	(3)
Dividends on preferred shares									3	3
<b>Common shareholders' net income</b>									<b>\$ 20</b>	<b>\$ 57</b>

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the six months ended June 30 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
<b>Revenue</b>										
Net premiums	\$ 94	\$ 61	\$ 177	\$ 169	\$ 193	\$ 186	\$ –	\$ –	\$ 463	\$ 416
Investment income	20	19	2	2	103	97	32	32	158	151
Fair value change in FVTPL investments	23	(7)	5	–	585	(52)	(6)	(3)	608	(62)
Realized gain (loss) on FVTPL investments	–	–	–	–	30	16	(3)	–	27	16
Realized gain (loss) on AFS investments including impairment write downs	–	–	–	–	–	–	5	(1)	6	(1)
Fee income	124	126	6	5	–	–	–	–	130	132
<b>Total revenue</b>	<b>261</b>	<b>200</b>	<b>190</b>	<b>176</b>	<b>911</b>	<b>248</b>	<b>29</b>	<b>28</b>	<b>1,391</b>	<b>652</b>
<b>Expenses</b>										
Net benefits and claims	112	95	125	117	81	81	–	–	318	293
Net change in insurance and investment contract liabilities	20	(23)	8	(3)	744	48	–	–	772	22
Policy dividends	–	–	–	–	16	15	–	–	16	15
Operating, commission and interest expenses	75	71	44	39	63	61	8	12	191	183
Income and other taxes	13	14	6	10	5	13	4	3	29	40
<b>Total expenses</b>	<b>220</b>	<b>157</b>	<b>184</b>	<b>162</b>	<b>908</b>	<b>219</b>	<b>12</b>	<b>15</b>	<b>1,324</b>	<b>553</b>
<b>Net income (loss) after tax</b>	<b>\$ 41</b>	<b>\$ 42</b>	<b>\$ 6</b>	<b>\$ 14</b>	<b>\$ 4</b>	<b>\$ 29</b>	<b>\$ 17</b>	<b>\$ 13</b>	<b>\$ 67</b>	<b>\$ 98</b>
Participating policyholders' portion									(3)	(5)
Dividends on preferred shares									7	7
Common shareholders' net income									\$ 63	\$ 96

## Total Revenue

Net premiums for the second quarter of 2019 increased by 10% and by 11% for the year to date primarily due to growth in fixed annuity premiums in the Wealth Management line.

Investment income was flat in the second quarter and increased by 5% on a year to date basis, primarily as a result of asset mix changes made during 2018 which added higher yielding securities.

Fair Value Through Profit or Loss (FVTPL) investments experienced an increase in the quarter and on a year to date basis reflecting the significant decline in long-term interest rates throughout 2019 versus an increase in long-term interest rates for the same period in 2018. This change in revenue is more than 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 second quarter of 2019 was flat relative to the second quarter of 2018 and slightly lower on a year to date basis, primarily due to a decline in segregated fund management and guarantee fees from lower average assets under management. This is discussed in the Product Line Results – Wealth Management section later in this report.

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Total Expenses

A substantial portion of Total expenses are driven by the impact that 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. Net of changes in investment and insurance contract liabilities, total expenses for the second quarter were stable and increased by 4% on a year to date basis compared to 2018.

Net benefits and claims for the second quarter of 2019 were higher than 2018 and year to date primarily due to an increase in fixed annuity surrenders in the Wealth Management product line and less favourable claims experience in the Employee Benefits product 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)	Second quarter		Year to Date	
	2019	2018	2019	2018
<b>Fixed Annuities</b>				
Assets under management <sup>1</sup>	\$ 967	\$ 951	\$ 967	\$ 951
Gross sales <sup>1</sup>	40	29	94	61
Net sales <sup>1</sup>	8	4	12	(3)
<b>Segregated Funds</b>				
Assets under management <sup>1</sup>	8,323	8,579	8,323	8,579
Gross sales <sup>1</sup>	189	202	410	470
Net sales <sup>1</sup>	(108)	(16)	(192)	(52)
Fee income	62	62	122	124
<b>Mutual Funds</b>				
Assets under management <sup>1</sup>	147	171	147	171
Gross sales <sup>1</sup>	2	3	5	9
Net sales <sup>1</sup>	(6)	(7)	(13)	(15)
Fee income	1	1	1	1
<b>Net Premiums</b>	\$ 40	\$ 29	\$ 94	\$ 61
<b>Benefits and Expenses</b>	92	70	207	143
<b>Net income after tax</b>	\$ 20	\$ 23	\$ 41	\$ 42

Fixed annuities assets under management increased by 2% during the last 12 months. Gross sales in the second quarter were 38% higher, and 54% higher on a year to date basis compared to 2018, reflecting a shift in the market to guaranteed wealth products that often occurs after challenging and volatile equity markets.

Segregated fund assets under management are lower relative to the same period in 2018, partially reflecting the equity market volatility over the last 12 months as segregated fund assets declined near the end of 2018 and have partially rebounded in 2019. For the second quarter of 2019, gross sales were 6% lower than the same period in 2018 and 13% lower on a year to date basis. On November 12, 2018, Empire Life launched a new no load purchase option within the Guaranteed Investment Funds (GIF) and Class Plus 3.0 product lines, and added four global fund options

<sup>1</sup> See Non-IFRS Measures

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to Class Plus 3.0. The no load option gives clients full access to their investments without any surrender charges. On May 28, 2018, Empire Life introduced seven new global funds, a fee for service option and a preferred pricing program to provide clients with more global and lower cost investment options within the GIF product line of segregated funds.

Segregated fund fee income was stable in the second quarter and is slightly lower on a year to date basis, reflecting the decrease in average assets under management in 2019 relative to the same period in 2018.

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.

During the second quarter, net income for this product line decreased by \$3 million and decreased by \$1 million on a year to date basis, driven primarily by increases in operating expenses.

## Product Line Results – Employee Benefits

### Key Operating Results

(in millions of dollars)	Second quarter		Year to Date	
	2019	2018	2019	2018
<b>Selected financial information</b>				
Annualized premium sales <sup>1</sup>	\$ 26	\$ 10	\$ 48	\$ 36
Net premiums	88	84	177	169
<b>Net income (loss) after tax</b>	<b>\$ 1</b>	<b>\$ 5</b>	<b>\$ 6</b>	<b>\$ 14</b>

Annualized premium sales were 160% higher in the second quarter and 33% higher on a year to date basis compared to the prior year, primarily due to a large block transfer from a new strategic distribution partner. In addition, 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 second quarter and year to date 2019 increased by 5% relative to the same periods in 2018. Empire Life 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 and year to date decreased primarily due to less favourable claims experience across all benefit types compared to more favourable experience for health and long-term disability benefits for the corresponding period in 2018.

## Product Line Results – Individual Insurance

### Key Operating Results

(in millions of dollars)	Second quarter		Year to Date	
	2019	2018	2019	2018
<b>Shareholders'</b>				
Shareholders' annualized premium sales <sup>1</sup>	\$ 6	\$ 7	\$ 11	\$ 11
Shareholders' net premiums	68	68	138	140
Net income (loss) after tax	(7)	24	8	34
<b>Policyholders'</b>				
Policyholders' annualized premium sales <sup>1</sup>	4	4	8	7
Policyholders' net premiums	29	24	55	46
Net income (loss) after tax	(1)	(4)	(4)	(5)
<b>Net income (loss) after tax</b>	<b>\$ (8)</b>	<b>\$ 20</b>	<b>\$ 4</b>	<b>\$ 29</b>

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the second quarter of 2019 shareholders' annualized premium sales declined slightly and were stable on a year to date basis compared to 2018, while policyholders' annualized premium sales were level for the second quarter and increased slightly on a year to date basis. Shareholders' total net premiums were stable in the second quarter and slightly lower on a year to date basis, while policyholders' net premiums increased in the second quarter of 2019 and year to date compared to the same period in 2018, reflecting recent strength in policyholders' new premium sales. In November 2018, Empire Life introduced Guaranteed Life Protect, which offers customers guaranteed, lifetime coverage with no health or lifestyle questions asked.

Shareholders' net income for this product line declined to a net loss for the second quarter of 2019 and lower overall net income on a year to date basis. Bond market yields declined on a quarter and year to date basis. While the decline in yields increased the fair value gains on fixed income assets supporting insurance contract liabilities, these gains were more than offset by increases in the corresponding insurance contract liabilities, primarily contributing to the decline in net income relative to the same quarter and year to date period last year.

## Results – Capital and Surplus

### Key Operating Results

(in millions of dollars)	Second quarter		Year to Date	
	2019	2018	2019	2018
Income from investments	\$ 18	\$ 18	\$ 38	\$ 29
Gains (losses) on hedging instruments	(2)	(1)	(10)	(2)
Interest and other expenses	(4)	(6)	(8)	(12)
Earnings before income taxes	12	11	20	15
Income taxes	2	2	4	3
Net income (loss) after tax shareholders' portion	10	8	16	12
Net income (loss) after tax policyholders' portion	1	-	1	1
Net income (loss) after tax	\$ 10	\$ 9	\$ 17	\$ 13

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 second quarter of 2019 was consistent with 2018 levels. For the year to date higher yields on invested assets was the primary contributor to the increase over 2018. Losses on the hedging program (discussed in the Risk Management section) in the second quarter was generally in line with the same period in 2018. The higher losses experienced in the first quarter of 2019 accounted for the year to date variance compared with 2018. The decrease in interest expense was due to Empire Life's redemption of \$300 million of subordinated debentures in May 2018.

### 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 Board of Directors declared a dividend of \$17.4408 per common share on August 1, 2019 to all common shareholders of record August 19, 2019 payable September 12, 2019.

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

<sup>1</sup> See Non-IFRS Measures



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	Amount of Dividend per share	Payable Date	Record Date
Common shares	\$ 17.440800	September 12, 2019	August 19, 2019
Non-Cumulative Rate Reset Preferred Shares, Series 1 (TSX: EML.PR.A)	\$ 0.359375	October 17, 2019	September 17, 2019
Non-Cumulative Rate Reset Preferred Shares, Series 3	\$ 0.306250	October 17, 2019	September 17, 2019

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	
	2019	2018
<b>Cash flow provided from (used for)</b>		
Operating activities	\$ 175	\$ 140
Investing activities	(140)	136
Financing activities	(48)	(330)
Net change in cash and cash equivalents	\$ (13)	\$ (53)

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 decreased by \$13 million. Cash flows provided by operating activities increased by \$35 million primarily due to higher cash inflows related to changes in working capital levels. The increase in cash used for investing activities and lower cash used for financing activities in 2019 was primarily driven by lower sales of securities relative to 2018 when a portion of the investment portfolio was sold to fund the redemption of \$300 million of subordinated debentures in May 2018.

For an analysis of liquidity for Empire Life, see note 10(e) and note 28(b) to the 2018 consolidated financial statements.

## Financial Instruments

Empire Life buys investment quality bonds to support, to a very large extent, the liabilities under the insurance and annuity policies of Empire Life. Empire Life's investment strategy also includes the use of publicly-listed "large cap" common stocks to support the liabilities under its insurance policies. Cash flows arising from these financial instruments are intended to match the liquidity requirements of Empire Life's policies, within the limits prescribed by Empire Life. Empire Life is subject to market risk on these financial instruments.

Empire Life 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. Empire Life manages market risk exposure 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. Empire Life manages credit risk by applying its 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 Empire Life's Board on the credit risk to which the portfolio is exposed.

<sup>1</sup> See Non-IFRS Measures

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Empire Life 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 28 to the audited consolidated financial statements for the year ended December 31, 2018.

## 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	
	June 30, 2019	December 31, 2018
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	June 30, 2019	December 31, 2018
Subordinated debentures (1)	December 2016	December 16, 2021	3.383%	\$ 200	\$ 200
Subordinated debentures (2)	September 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 CDOR.

Preferred Shares				As at	
(In millions of dollars)	Date Issued	Earliest Redemption Date	Yield	June 30, 2019	December 31, 2018
Preferred shares	January 2016	April 17, 2021	5.75%	\$ 150	\$ 150
Preferred shares	November 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.

<sup>1</sup> See Non-IFRS Measures

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## 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 June 30, 2019, the Total Ratio and Core Ratio remained relatively unchanged from December 31, 2018.

LICAT (in millions of dollars)	Jun 30 2019	Mar 31 2019	Dec 31 2018	Sep 30 2018	Jun 30 2018
<b>Available capital</b>					
Tier 1	\$ 1,549	\$ 1,507	\$ 1,476	\$ 1,526	\$ 1,513
Tier 2	674	692	653	608	614
Total	\$ 2,223	\$ 2,200	\$ 2,129	\$ 2,134	\$ 2,127
<b>Surplus allowance and eligible deposits</b>	<b>937</b>	<b>921</b>	<b>887</b>	<b>1,001</b>	<b>1,005</b>
<b>Base solvency buffer</b>	<b>2,115</b>	<b>2,083</b>	<b>2,029</b>	<b>1,908</b>	<b>1,949</b>
<b>LICAT total ratio</b>	<b>149%</b>	<b>150%</b>	<b>149%</b>	<b>164%</b>	<b>161%</b>
<b>LICAT core ratio</b>	<b>104%</b>	<b>103%</b>	<b>103%</b>	<b>117%</b>	<b>114%</b>

## Other Comprehensive Income

(in millions of dollars after tax)	Second quarter		Year to Date	
	2019	2018	2019	2018
OCI, attributable to shareholders	\$ 16	\$ 3	\$ 60	\$ (7)
OCI, attributable to policyholders	-	1	4	(1)
Total other comprehensive income	\$ 17	\$ 3	\$ 64	\$ (8)

Other comprehensive income (OCI) increased in the second quarter and year to date in 2019 primarily due to unrealized fair value gains on available for sale (AFS) investments, offset by a loss on the remeasurement of the liability component of post-employment defined benefit plans. The gain and loss on each of these components of other comprehensive income was primarily due to a combination of decreases in interest rates and favourable equity markets for the second quarter and year to date.

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

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 second quarter and year to date of 2019, the Company's hedge costs were \$1.3 million and \$7.3 million after tax respectively. This compares to a hedge cost of \$1 million and \$1 million for the same periods in 2018.

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 June 30, 2019, Empire Life had \$8.3 billion of segregated fund assets and liabilities. Of this amount, approximately \$8.0 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	Jun 30 2019	Dec 31 2018
<b>Percentage of Segregated Fund Liabilities with:</b>		
75% maturity guarantee and a 75% death benefit guarantee	3%	3%
75% maturity guarantee and a 100% death benefit guarantee	47%	47%
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, which 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 June 30, 2019 and December 31, 2018, the sensitivity of Empire Life shareholders' net income and LICAT ratio resulting from stock market increases and decreases is provided in the following tables.

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Sensitivity to Equity Risk: Impact on Net Income (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
<b>as at June 30, 2019</b>					
Segregated Fund Guarantees	\$ nil	\$ nil	\$ (9)	\$ (81)	\$ (219)
Other Equity Risk	33	15	(12)	(20)	(66)
Equity Hedge	(2)	(2)	5	16	39
<b>Total</b>	<b>\$ 31</b>	<b>\$ 14</b>	<b>\$ (17)</b>	<b>\$ (85)</b>	<b>\$ (246)</b>

as at December 31, 2018

Segregated Fund Guarantees	\$ 3	\$ 3	\$ (11)	\$ (129)	\$ (269)
Other Equity Risk	38	18	(15)	(46)	(118)
Equity Hedge	(6)	(4)	9	26	50
<b>Total</b>	<b>\$ 35</b>	<b>\$ 16</b>	<b>\$ (16)</b>	<b>\$ (150)</b>	<b>\$ (337)</b>

Sensitivity to Equity Risk: Impact on LICAT	Increase		Decrease		
	20%	10%	10%	20%	30%
<b>as at June 30, 2019</b>					
Segregated Fund Guarantees	3 %	- %	(6)%	(14)%	(20)%
Other Equity Risk	- %	- %	- %	- %	(1)%
Equity Hedge	(1)%	(1)%	1 %	3 %	4 %
<b>Total</b>	<b>1 %</b>	<b>(1)%</b>	<b>(5)%</b>	<b>(11)%</b>	<b>(17)%</b>

as at December 31, 2018

Segregated Fund Guarantees	3 %	- %	(10)%	(16)%	(22)%
Other Equity Risk	- %	(1)%	- %	- %	(2)%
Equity Hedge	(2)%	(1)%	1 %	2 %	3 %
<b>Total</b>	<b>1 %</b>	<b>(1)%</b>	<b>(9)%</b>	<b>(14)%</b>	<b>(21)%</b>

Empire Life's equity market sensitivity for segregated fund guarantees in a 20% and 30% stock market decline decreased primarily as a result of improved equity markets during the first half of 2019. The segregated fund guarantee liability became positive at December 31, 2018 after an equity market decline in the fourth quarter. This increased net income sensitivity as any changes to the liability when it is above the zero floor will flow through net income.

In 2019, the Company updated the methodology for calculating equity risk sensitivities. The new method refines the assumptions used in calculating the baseline LICAT equity requirements as at the reporting date. In the table above, figures presented for the impact of equity risk on LICAT as at December 31, 2018 are restated to conform with the updated methodology.

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 June 30, 2019 for Empire Life's segregated funds is provided in the following table.

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Segregated Funds	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		
(in millions of dollars)								
June 30, 2019	\$ 2,671	\$ 838	\$ 127	\$ 4	\$ 1,777	\$ 24	nil	\$ 448
December 31, 2018	\$ 2,689	\$ 1,057	\$ 301	\$ 24	\$ 3,789	\$ 165	4	\$ 433

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 June 30, 2019, the aggregate amount at risk for all three categories of risk was \$866 million. At December 31, 2018, the aggregate amount at risk for these three categories of risk was \$1,246 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.

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 June 30, 2019 and December 31, 2018, 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
June 30, 2019 LICAT total ratio	(2)%
December 31, 2018 LICAT total ratio	(5)%

## Quarterly Results

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

	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30
(in millions of dollars, except per share amounts)	2019	2019	2018	2018	2018	2018	2017	2017
Revenue	\$ 603	\$ 788	\$ 289	\$ 197	\$ 388	\$ 264	\$ 627	\$ 135
Common shareholder's net income	\$ 20	\$ 43	\$ 6	\$ 35	\$ 57	\$ 39	\$ 48	\$ 39
Earnings per share - basic and diluted	\$ 20.45	\$ 43.59	\$ 6.36	\$ 35.73	\$ 58.14	\$ 39.30	\$ 49.03	\$ 39.67

## 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

<sup>1</sup> See Non-IFRS Measures



# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 risks including equity risks, hedging risks, interest rate risks, foreign exchange rate risks; liquidity risks; credit risks including counterparty risks; insurance risks including mortality risks, policyholder behaviour risks, expense risks, morbidity risks, product design and pricing risks, underwriting and claims risks, reinsurance risks; operational risks, including legal and regulatory compliance risks, model risks, human resources risks, third-party risks, technology, information security and business continuity risks; and business risks, including risks with respect to competition, risks with respect to financial strength, capital adequacy risks, risks with respect to distribution channels, risks with respect to changes to applicable income tax legislation, risks with respect to litigation, risks with respect to reputation, risks with respect to risk management policies, risks with respect to intellectual property, risks 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](http://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 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. Quarterly and year to date returns are calculated on an annualized basis.

**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

<sup>1</sup> See Non-IFRS Measures

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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.

## Reconciliation of Assets Under Management

<b>As at</b>	<b>June 30, 2019</b>	December 31, 2018
(in millions of dollars)		
<b>Assets Under Management</b>		
General fund assets	\$ 9,336	\$ 8,447
Segregated fund assets	8,341	7,823
Total assets per financial statements	17,677	16,270
Mutual fund assets	147	145
Assets under management	\$ 17,824	\$ 16,415

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

<b>As at</b>	<b>June 30, 2019</b>	December 31, 2018
(in millions of dollars)		
DB plan assets		
Segregated fund assets	\$ 196	\$ 182
Mutual fund assets	13	12

<sup>1</sup> See Non-IFRS Measures