

The Empire Life Insurance Company Management's Discussion and Analysis

For the year ended December 31, 2019



MANAGEMENT'S DISCUSSION AND ANALYSIS

Dated as of February 26, 2020

This document provides Management's Discussion and Analysis (MD&A) of the operating results and financial condition of The Empire Life Insurance Company (Empire Life or the Company) for the years ended December 31, 2019 and 2018. This MD&A should be read in conjunction with the Company's December 31, 2019 consolidated financial statements, which form part of The Empire Life Insurance Company 2019 Annual Report dated February 26, 2020. Unless otherwise noted, both the 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 forward-looking information. See the Forward-Looking Statements and Information section in this report.

The consolidated financial statements have been prepared in compliance 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 to 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 the 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.

Financial Analysis Overview

(in millions of dollars except per share amounts)	Fourth quarter		Year	
	2019	2018	2019	2018
Common shareholders' net income	\$ 76	\$ 6	\$ 174	\$ 137
Earnings per share - basic and diluted	\$ 77.25	\$ 6.36	\$ 176.58	\$ 139.53
Return on common shareholders' equity (quarterly annualized) ¹	18.7%	1.7%	11.1%	9.4%

Empire Life reported fourth quarter common shareholders' net income of \$76 million for 2019, compared to \$6 million for 2018. In the fourth quarter of 2019, the Company enacted significant changes to its reinsurance program, which included an increase in the Company's individual life insurance retention level, along with a recapture of a significant amount of reinsured business. The net income impact of this reinsurance recapture initiative was \$78 million. Full year common shareholders' net income was \$174 million compared to \$137 million in 2018. The increase in earnings was primarily a result of the recapture initiative, partly offset by unfavourable assumption updates in the Wealth Management and Individual Insurance lines and a deterioration of long term disability (LTD) experience in the Employee Benefits line.

¹ See Non-IFRS Measures

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The following table provides a breakdown of the sources of earnings for the fourth quarter and year.

Sources of Earnings ¹ (in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
Expected profit on in-force business	\$ 47	\$ 51	\$ 190	\$ 194
Impact of new business	(7)	(12)	(28)	(16)
Experience gains (losses)	5	(26)	(6)	(3)
Management actions and changes in assumptions	48	(22)	37	(20)
Earnings on operations before income taxes	94	(9)	194	154
Earnings on surplus	16	15	54	37
Income before income tax	110	7	247	191
Income taxes	30	(3)	60	40
Shareholders' net income	79	10	187	151
Dividends on preferred shares	(3)	(3)	(13)	13
Common shareholders' net income	\$ 76	\$ 6	\$ 174	\$ 137

The expected profit on in-force business for the fourth quarter and for the year decreased by 8% and 2% respectively, due to lower than expected average assets under management in the Wealth Management line.

The impact of new business for the fourth quarter was primarily driven by lower new business strain in the Wealth Management and Employee Benefits lines partially offset by higher strain in the Individual Insurance line. Lower sales of fixed annuities in the fourth quarter of 2019 relative to the fourth quarter of 2018 were the primary contributor to lower strain in the Wealth Management line. For the year, the impact of new business was higher than 2018 primarily due to higher strain in the Employee Benefits line as block transfers from new specialty partners were added in the first and second quarters of 2019.

The experience gains for the fourth quarter of 2019 compared to losses in the fourth quarter of 2018 were mainly driven by lower investment losses in the Individual Insurance and Wealth Management lines. For the year, higher experience gains from strong growth in segregated fund assets were offset by higher experience losses in the Individual Insurance line from fixed income investments which contributed to higher overall experience losses in 2019 relative to 2018.

Management actions and changes in assumptions in the fourth quarter of 2019 were higher than 2018 due to the favourable impact of the reinsurance recapture initiative. For the year, this favourable impact was partly offset by updates to methodology and assumptions on policy liabilities and by deterioration in LTD claims experience in 2019 relative to 2018.

Earnings on surplus were higher for the year primarily due to realized gains on Available for sale (AFS) assets and lower interest expense as a result of a lower level of subordinated debt, partially offset by higher hedge costs.

¹ See Non-IFRS Measures

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Selected Financial Information

Income Statement Financial Information (in millions of dollars)	For the years ended December 31		
	2019	2018	2017
Revenue			
Net premium income	\$ 910	\$ 874	\$ 834
Fee income	262	264	257
Investment income	326	308	281
Realized gain on FVTPL investments	105	12	57
Realized gain on AFS investments including impairment write downs	22	(1)	6
Fair value change in FVTPL investments	490	(318)	239
Total revenue	2,115	1,138	1,675
Expenses			
Benefits and expenses	\$ 1,843	\$ 931	\$ 1,425
Income and other taxes	81	60	74
Total expenses	1,924	991	1,499
Net income (loss) after tax	191	148	176
Participating policyholders' portion	3	(3)	(5)
Shareholders' net income	\$ 187	\$ 151	\$ 181
Dividends on preferred shares	13	13	10
Common shareholders' net income	\$ 174	\$ 137	\$ 171
Return on common shareholders' equity	11.1%	9.4%	12.8%

Revenue volatility was driven primarily by the impact of market interest rate movements on the fair value change in fair value through profit or loss investments. The impact of these movements on net income is significantly reduced due to corresponding changes in insurance contract liabilities (included in Benefits and expenses in the above table).

Balance Sheet Financial Information (in millions of dollars)	As at December 31		
	2019	2018	2017
Assets			
Total cash and investments	\$ 9,293	\$ 8,278	\$ 8,559
Other assets	169	168	153
Segregated fund assets	8,499	7,823	8,682
Total assets	\$ 17,961	\$ 16,270	\$ 17,395
Liabilities			
Insurance contract liabilities	\$ 6,074	\$ 5,176	\$ 5,365
Reinsurance liabilities	698	789	651
Subordinated debt	399	399	698
Other liabilities	351	300	278
Segregated fund policy liabilities	8,499	7,823	8,682
Total liabilities	16,021	14,487	15,674
Total equity	1,940	1,783	1,721
Total liabilities and equity	\$ 17,961	\$ 16,270	\$ 17,395

¹ See Non-IFRS Measures

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Other Financial Information (in millions of dollars)	As at December 31		
	2019	2018	2017
Assets under management¹			
General fund assets ¹	\$ 9,462	\$ 8,447	\$ 8,713
Segregated fund assets ¹	8,499	7,823	8,682
Mutual fund assets ¹	139	145	184
Subordinated debt	399	399	698
Preferred shares	250	250	250
Available regulatory capital			
Tier 1	\$ 1,616	\$ 1,476	\$ 1,409
Tier 2	669	653	932
Total	2,285	2,129	2,341
Surplus allowance and eligible deposits	\$ 1,109	\$ 887	N/A
Base solvency buffer	\$ 2,191	\$ 2,029	N/A
Required regulatory capital	N/A	N/A	\$ 831
LICAT total ratio	155%	149%	N/A
LICAT core ratio	109%	103%	N/A
MCCSR ratio	N/A	N/A	282%
	For the years ended December 31		
	2019	2018	2017
Cash dividends per share			
Preferred shares series 1	\$ 1.4375	\$ 1.4375	\$ 1.4375
Preferred shares series 3	\$ 1.2250	\$ 1.2250	\$ 0.2584
Common shares	\$ 69.7632	\$ 40.6060	\$ —

Improvements to core and total capital were primarily driven by strong net income and strong growth in the Surplus allowance. The Surplus allowance reflects the value of conservative margins in the insurance contract liabilities. The Base solvency buffer increased due to overall growth in inforce business, as well as an increase related to the changes in the Company's reinsurance program.

Effective January 1, 2018, Minimum Continuing Capital and Surplus Requirements (MCCSR) was replaced by the Life Insurance Capital Adequacy Test (LICAT).

¹ See Non-IFRS Measures

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Results by Major Product Line

The following tables provide a summary of Empire Life results by major product line for the three months ended December 31 and year for 2019 and 2018. A discussion of results is provided in the Product Line section of the MD&A.

For the three months ended December 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Revenue										
Net premiums	\$ 35	\$ 53	\$ 93	\$ 86	\$ 101	\$ 99	\$ —	\$ —	\$ 229	\$ 237
Investment income	9	10	1	1	57	53	17	18	84	82
Fair value change in FVTPL investments	(6)	(18)	—	1	(194)	(70)	—	2	(200)	(86)
Realized gain (loss) on FVTPL investments	1	—	—	—	60	(6)	(2)	(1)	59	(7)
Realized gain (loss) on AFS investments including impairment write downs	—	—	—	—	—	—	10	(2)	10	(1)
Fee income	63	62	3	3	—	—	—	—	66	65
Total revenue	102	106	97	91	24	76	25	17	249	289
Expenses										
Net benefits and claims	51	45	69	60	37	36	—	—	157	141
Net change in insurance and investment contract liabilities	4	8	2	3	(147)	12	—	—	(141)	23
Policy dividends	—	—	—	—	8	9	—	—	8	9
Operating, commission and interest expenses	37	40	23	22	34	38	4	1	99	101
Policy dividends	2	3	3	3	27	(4)	8	3	40	5
Total expenses	94	96	97	88	(42)	91	12	4	162	278
Net income (loss) after tax	\$ 8	\$ 11	\$ —	\$ 3	\$ 66	\$ (15)	\$ 13	\$ 13	\$ 87	\$ 11
Participating policyholders' portion									8	1
Dividends on preferred shares									3	3
Common shareholders' net income									\$ 76	\$ 6

¹ See Non-IFRS Measures

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For the years ended December 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Revenue										
Net premiums	\$ 159	\$ 155	\$ 360	\$ 340	\$ 390	\$ 379	\$ —	\$ —	\$ 910	\$ 874
Investment income	40	39	5	4	215	199	66	66	326	308
Fair value change in FVTPL investments	18	(35)	4	(1)	473	(279)	(5)	(3)	490	(318)
Realized gain (loss) on FVTPL investments	1	1	—	—	111	15	(7)	(4)	105	12
Realized gain (loss) on AFS investments including impairment write downs	—	—	—	—	1	—	21	(2)	22	(1)
Fee income	249	253	13	11	—	—	—	—	262	264
Total revenue	467	412	382	354	1,190	314	76	58	2,115	1,138
Expenses										
Net benefits and claims	206	185	256	230	156	154	—	—	618	570
Net change in insurance and investment contract liabilities	18	(17)	18	1	773	(34)	—	—	808	(50)
Policy dividends	—	—	—	—	31	30	—	—	31	30
Operating, commission and interest expenses	144	147	91	82	134	132	16	20	386	381
Income and other taxes	24	24	11	17	31	12	16	7	81	60
Total expenses	393	339	375	330	1,125	295	32	27	1,924	991
Net income (loss) after tax	\$ 74	\$ 73	\$ 7	\$ 24	\$ 65	\$ 19	\$ 44	\$ 31	\$ 191	\$ 148
Participating policyholders' portion									3	(3)
Dividends on preferred shares									13	13
Common shareholders' net income									\$ 174	\$ 137

Total Revenue

Net premiums for the fourth quarter were lower relative to the same period in 2018 primarily due to lower sales of fixed annuity products in the Wealth Management line. For the full year, net premiums were higher relative to 2018 reflecting growth in all product lines.

Investment income for the year increased relative to 2018 primarily due to asset mix changes made in 2018 to incorporate higher yielding securities.

Assets classified as Fair value through profit or loss (FVTPL) experienced a larger net loss in the fourth quarter relative to the same quarter in 2018 primarily due to increases in market interest rates during the fourth quarter of 2019. For the year, assets classified as FVTPL experienced a gain primarily due to decreases in market interest rates from their December 2018 values. For the same period in 2018, market interest rates increased, contributing to the net loss in assets valued as FVTPL.

Fee income for the fourth quarter and the year increased by 2% and decreased by 1% respectively relative to the same period in 2018 primarily related to segregated fund management and guarantee fees from changes in assets under management. This is discussed in the Product Line Results - Wealth Management section later in this report.

Total Expenses

A substantial portion of the Net benefits and expenses changes are driven by the impact that market interest rate movements have on the net change in insurance contract liabilities. Net benefits and claims increased for the fourth quarter and the year by 11% and 8% respectively driven primarily by fixed annuities in the Wealth Management and higher health benefit claims in the Employee Benefits line. Net benefits and claims variability is dependent on claims incurred. Generally, claims rise year over year due to growth of the insurance blocks. Variability in claims amounts

¹ See Non-IFRS Measures

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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 in the insurance contract liabilities. Claims experience is a combination of claims incurred compared to claims expected in product pricing and in insurance contract liabilities.

Operating expenses, commissions and interest expenses decreased for the fourth quarter compared to 2018 primarily due to lower operating expenses in the Individual Insurance line. For the year, operating expenses, commissions and interest expenses were 1% higher than 2018 primarily due to higher operating expenses in the Employee Benefits line.

Product Line Results - Wealth Management

(in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
Fixed Annuities				
Assets under management ¹	\$ 958	\$ 944	\$ 958	944
Gross sales ¹	35	53	159	155
Net sales ¹	—	23	13	32
Segregated Funds				
Assets under management ¹	8,480	7,806	8,480	7,806
Gross sales ¹	243	244	856	908
Net sales ¹	(83)	(18)	(329)	(118)
Fee income	62	61	246	249
Mutual Funds				
Assets under management ¹	139	145	139	145
Gross sales ¹	2	2	8	16
Net sales ¹	(7)	(8)	(28)	(27)
Fee income	—	1	2	3
Net income after tax	\$ 8	\$ 11	\$ 74	73

Fixed annuities assets under management increased by 1% during the last 12 months. Gross sales in the fourth quarter were 34% lower as customers shifted away from fixed income products. For the year, gross sales were 3% higher compared to 2018, reflecting strong sales in this segment during the first three quarters of the year.

Segregated fund assets under management increased by 9% during the last 12 months primarily due an increase in stock markets during the first quarter after a significant decline in the fourth quarter of 2018. Gross sales in the fourth quarter were consistent with the fourth quarter of 2018 and lower for the full year primarily due to lower sales of traditional segregated fund products, partially offset by an increase in sales of the Guaranteed Minimum Withdrawal Benefit (GMWB) product. 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. The Company also launched a new Short Term High Income GIF and reopened the Global Dividend Growth GIF. On November 12, 2018, Empire Life launched a new No Load purchase option within the GIF and Class Plus 3.0 product lines, and added four global fund options 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 increased by 2% for the fourth quarter of 2019 and decreased by 1% for the full year primarily due to lower average assets under management relative to the same periods in 2018.

¹ See Non-IFRS Measures

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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.

Product Line Results - Employee Benefits

(in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
Selected financial information				
Annualized premium sales ¹	\$ 21	\$ 12	\$ 104	\$ 59
Net premiums	93	86	360	340
Net income (loss) after tax	\$ —	\$ 3	\$ 7	\$ 24

For the fourth quarter and year, annualized premium sales for Employee Benefits increased by 75% and 76% respectively, relative to 2018. This is primarily due to large block transfers from new strategic distribution partners in the first quarter of 2019, in addition to continued growth of the small to medium-sized business owner market. Over the last two years, Empire Life has entered into a number of strategic partnerships to expand market share.

Net premiums for the fourth quarter and year increased by 8% and 6% respectively compared to the same period 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 declined in the fourth quarter of 2019 and full year relative to 2018 primarily due to a deterioration of long-term disability experience as the experience gains observed in 2018 did not recur.

Product Line Results - Individual Insurance

(in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
Shareholders'				
Shareholders' annualized premium sales ¹	\$ 5	\$ 6	\$ 21	\$ 23
Shareholders' net premiums	69	69	274	278
Benefits and Expenses	(87)	59	916	173
Net income (loss) after tax	62	(16)	67	24
Policyholders'				
Policyholders' annualized premium sales ¹	5	5	18	16
Policyholders' net premiums	32	29	116	101
Benefits and Expenses	19	36	178	109
Net income (loss) after tax	4	1	(1)	(4)
Net income (loss) after tax	\$ 66	\$ (15)	\$ 65	\$ 19

Shareholders' annualized premium sales declined for the fourth quarter and the year compared to 2018 primarily due to lower sales of term life products. Policyholders' annualized premium sales were consistent with the fourth quarter of the prior year and 13% higher for the full year from increased sales of the Company's participating life products. Shareholders' total net premiums in the fourth quarter was consistent with the same quarter in 2018 and 1% lower for the full year. Policyholders' net premiums were 10% and 15% higher for the fourth quarter and full year respectively, compared to 2018 primarily due to the stronger sales of the Company's participating life products in 2019.

Shareholders' net income was higher for the fourth quarter and full year compared to 2018 primarily due to the impact of the reinsurance recapture initiative and mortality table update, partially offset by changes in net the net investment assumptions, as explained in more detail in the following table.

¹ See Non-IFRS Measures

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(in millions of dollars)	Year	
	2019	2018
Components of pre-tax income increase from update of policy liability assumptions		
Lapse/premium assumptions	\$ (27)	\$ (59)
Net investment assumptions	(120)	(3)
Mortality experience	12	28
Mortality table update	155	—
Reinsurance recapture	107	—
Other	(69)	(3)
Total gain (loss) from update of policy liability assumptions (excludes policyholders' portion)	\$ 57	\$ (38)

In 2019 the lapse/premium assumption change primarily related to updates of assumed lapse rates on renewable term policies. The refinement to lapse/premium assumptions for 2018 were primarily related to the adjustment of the lapse assumption on 10-year renewable term products and the enhancement of universal life lapse assumptions.

The primary drivers of the net investment assumptions change for 2019 were decreases to the initial reinvestment rate (IRR) and ultimate reinvestment rate (URR) used in the valuation of liabilities. Updates were also made to the equity investment return assumption, the planned level of equities matching policy liabilities, and to the maturity assumptions for preferred shares. However, these items had a less significant impact when compared with the IRR and URR updates. In 2018 the change due to net investment assumptions was minimal.

Updates to the mortality experience in 2019 were primarily related to revised projected assumptions for the individual life business. In 2018, mortality assumption changes included updates for mortality experience and a revised mortality improvement scale which is in line with the Canadian Institute of Actuaries promulgated mortality improvement scale.

In 2019 the individual insurance mortality tables were replaced by more recent industry tables. The updated tables provide a more appropriate mortality projection, specifically at older ages. Actual/expected ratios were updated based on a combination of Company and industry experience.

In 2019, the Company enacted significant changes to its reinsurance programs. Specifically, the reinsurers of the Company's individual life policies were notified that in 2020 the Company will increase its individual life retention from \$500,000 to \$1.5 million and the recapture provisions of all eligible reinsurance treaties would be enacted. The recapture resulted in a substantial net liability decrease on both the universal life and non-participating blocks of business as the present value of future reinsurance premiums was greater than the estimated future claims.

Several model enhancements were implemented in 2019. These enhancements include updates to return of premium assumptions on universal life policies, reinsurance model refinements, and refinements to the mortality projection. Other policy liability updates for 2018 were primarily related to refinements to the modelling of reinsurance treaties.

Results - Capital and Surplus

(in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
Net income (loss) after tax				
Net income (loss) after tax shareholders' portion	\$ 10	\$ 12	\$ 39	\$ 30
Net income (loss) after tax policyholders' portion	4	—	5	1
Net income (loss) after tax	\$ 13	\$ 13	\$ 44	\$ 31

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.

Net income from the shareholders' portion of capital & surplus was lower than the fourth quarter of 2018 primarily due to a loss on hedging instruments in this portfolio relative to gains recorded in December 2018 from equity market

¹ See Non-IFRS Measures

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volatility, partially offset by higher realized gains on AFS assets. For the year, shareholders' net income was higher than 2018 primarily due to higher realized gains on AFS assets, positive fair value changes in FVTPL assets and lower interest expenses relative to 2018, partially offset by higher losses on hedging instruments. The interest expense for 2018 was higher prior to the redemption of \$300 million 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 will 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 \$113.435853 per common share on February 26, 2020 to all common shareholders of record March 16, 2020 payable April 8, 2020. This dividend includes a regular quarterly dividend of \$22.0724 and an additional dividend of \$91.363453 per common share, which was enabled by the strong capital position of the Company at December 31, 2019.

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

	Amount of Dividend per share	Payable Date	Record Date
Common shares	\$ 113.435853	April 8, 2020	March 16, 2020
Non-Cumulative Rate Reset Preferred Shares, Series 1 (TSX: EML.PR.A)	\$ 0.359375	April 17, 2020	March 18, 2020
Non-Cumulative Rate Reset Preferred Shares, Series 3	\$ 0.306250	April 17, 2020	March 18, 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	
	2019	2018
Cash flow provided from (used for)		
Operating activities	\$ 368	\$ 346
Investing activities	(337)	(68)
Financing activities	(96)	(367)
Net change in cash and cash equivalents	\$ (65)	\$ (89)

Net change in cash and cash equivalents decreased by \$65 million, made up of the following items:

- The increase in cash provided from operating activities in 2019 relative to 2018 was primarily due to lower cash outflows related to changes in working capital levels.
- The increase in cash used for investing activities in 2019 relative to 2018 was primarily due to management actions to deploy excess cash into higher yield investments in order to enhance investment income.
- The decrease in cash used for financing activities in 2019 relative to 2018 was due to the redemption of \$300 million subordinated debentures on May 31, 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 common

¹ See Non-IFRS Measures

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stocks or exchange-traded funds (ETFs) 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 issuer of such debt instruments. Management reviews credit quality relative to investment purchases and also monitor 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.

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 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	
	December 31, 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 preferred shares and subordinated debt are as follows:

Preferred Shares				As at	
(in millions of dollars)	Date Issued	Earliest Redemption Date	Yield	December 31, 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

				As at	
(in millions of dollars)	Date Issued	Earliest Redemption Date	Yield	December 31, 2019	December 31, 2018
Subordinated debentures ^(a)	December 2016	December 16, 2021	3.383%	\$ 200	\$ 200
Subordinated debentures ^(b)	September 2017	March 15, 2023	3.664%	\$ 200	\$ 200

^(a) 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).

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

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", its subordinated debt rating is "A (low)", its financial strength

¹ See Non-IFRS Measures

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rating is “A” and its Preferred Share rating is Pfd-2. 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, “a” long-term issuer credit rating, “bbb+” Subordinated Debt rating, and “bbb” Preferred Share rating. 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. The Company 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.

LICAT	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31
(in millions of dollars)	2019	2019	2019	2019	2018
Available capital					
Tier 1	\$ 1,616	\$ 1,562	\$ 1,549	\$ 1,507	\$ 1,476
Tier 2	669	681	674	692	653
Total	\$ 2,285	\$ 2,243	\$ 2,223	\$ 2,200	\$ 2,129
Surplus allowance and eligible deposits	1,109	944	937	921	887
Base solvency buffer	2,191	2,133	2,115	2,083	2,029
LICAT total ratio	155%	149%	149%	150%	149%
LICAT core ratio	109%	104%	104%	103%	103%

Other Comprehensive Income

(in millions of dollars)	Fourth quarter		Year	
	2019	2018	2019	2018
OCI, attributable to shareholders	\$ (16)	\$ (7)	\$ 48	\$ (28)
OCI, attributable to policyholders	(4)	(3)	1	(4)
Total other comprehensive income	\$ (20)	\$ (10)	\$ 49	\$ (32)

Other comprehensive income (OCI) decreased in the fourth quarter primarily due to unrealized fair value losses on AFS investments compared to a small gain in the fourth quarter of 2018 partially offset by a gain on remeasurement of post-employment benefit liabilities. For the year, OCI increased relative to 2018 primarily due to unrealized fair value gains on AFS assets in 2019 relative to unrealized fair value losses on AFS assets in 2018, and a lower loss on remeasurement of the liability component of post-employment DB plans relative to 2018.

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.

Industry Dynamics and Management’s Strategy

Empire Life’s operations are organized by product line with each line of business having responsibility for product development, product pricing, marketing, distribution and customer service within their particular markets. This structure recognizes that there are distinct marketplace dynamics in each of the three major product lines. Management believes this structure enables each line of business to develop strategies to achieve the enterprise-wide objectives of business growth and expense management while recognizing the unique business environment in which each operates. The lines of business are supported by corporate units that provide administrative and

¹ See Non-IFRS Measures

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technology services to the lines of business, manage invested assets, and oversee enterprise risk management policies.

Based on general fund and segregated fund assets, Empire Life is among the 10 largest life insurance companies in Canada. Empire Life has approximately 7% market share of segregated funds, 1% market share for employee benefits and 2% market share for new life insurance premiums. To be priced competitively in the marketplace while simultaneously providing acceptable long-term financial contribution to shareholders, Empire Life, as a mid-sized company, must find a way to continue to be cost competitive with the larger companies that have some natural economy of scale advantages. In order to improve its unit expenses, management's enterprise-wide strategic focus has been on achieving profitable growth in its selected markets and on expense management. Empire Life has focused exclusively on the Canadian marketplace and, within it, on particular market segments where management feels there are opportunities to build solid, long-term relationships with its distribution partners by offering competitive products and more personal service. By focusing on particular market segments and by being seen by these independent advisors as a viable alternative to broadly focused competitors, management believes these solid relationships will enable profitable growth. In 2019, the Company acquired a minority interest in The Gryphin Advantage Inc. as part of its continuing commitment to ensuring consumers have the availability of independent advice in the marketplace.

The Wealth Management product line at Empire Life is comprised of segregated fund products, guaranteed interest products and mutual funds. These products compete against products offered by a variety of financial institutions. A key element of any competitive strategy in this market is providing a competitive rate of return to clients. The value-oriented equity investment strategy used by Empire Life has focused on developing long-term performance in the fund marketplace. Management will continue to improve competitiveness by focusing on long-term performance, providing low cost products to customers along with broadened distribution reach. Empire Life continued to achieve strong growth in assets under management from its segregated fund business as a result of net new sales and equity market appreciation. Empire Life is continuing to monitor and manage GMWB risk exposure and the competitive landscape for this product.

Within the broader employee benefits marketplace in Canada, Empire Life continues to focus on the small group employer market with fewer than 200 employees representing the majority of Canadian companies. This niche strategy coupled with an ongoing focus on balancing growth and profit has enabled Empire Life to be cost competitive within this market segment and is expected to enable this product line to grow its market share while generating acceptable returns.

Individual Insurance products are very long-term in nature and consequently can be subject to new business strain. New business strain occurs when the provision for adverse deviation included in the actuarial policy liabilities exceeds the profit margin in the product pricing. At current reinsurance price levels in the Canadian market place, a company may reduce new business strain and improve profitability in the short term by opting to increase the amount of insurance risk reinsured to third parties. Mortality trends continue to be favourable for life insurance products. Rather than give up the future earnings that would emerge if the trend in mortality improvement witnessed in recent decades continues, Empire Life continues to utilize lower than average levels of reinsurance with the resultant negative impact on short-term earnings. Low long-term interest rates continue to have an unfavourable impact on this product line. In the past few years, industry prices for longer term life insurance products have increased. Empire Life has also increased prices for these products and has focused its growth efforts on shorter term products, such as 10 year renewable term life insurance. Because of the reasonable long-term returns of this product line, management continues to focus on steady growth, technology development and process improvement in order to continue to have a cost structure that allows us to compete while generating an acceptable long-term financial contribution. Empire Life is continuously reviewing its Individual Insurance product mix to improve profitability, reduce interest rate risk, reduce required regulatory capital, develop web-based products and processes, and improve the customer and advisor experience.

Risk Management

Empire Life is a financial institution offering wealth management, employee benefits and individual insurance products. The Company is exposed to a number of risks as a result of its business activities. The goal of the Company's risk management process is to ensure that the operations that expose it to risk are consistent with its

¹ See Non-IFRS Measures

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strategy, business objectives and risk philosophy, while maintaining an appropriate risk/reward balance and enhancing stakeholder value. When making decisions about risk taking and risk management, Empire Life considers:

- The need to meet the expectations of its customers, shareholders and creditors and to protect the commitments that have been made to them;
- The need to be adequately compensated for the capital it deploys to support business activities and strategic objectives;
- The need to protect its brand; and
- The need to maintain (or improve) its targeted financial strength rating.

Empire Life's risk appetite defines the aggregate level of risk the Company is willing to take to achieve its business strategies. The risk appetite supports the pursuit of shareholder value but does not compromise the Company's ability to pay claims and fulfil policyholder commitments.

Empire Life's risk management framework is structured based on a number of guiding principles:

- Due to the long term nature of the majority of its commitments, the Company accepts capital market risk provided it is managed within specific risk tolerances and limits. The Company takes a low-risk, value-oriented approach to managing its investments - it accepts credit and alternative asset risk provided it is rewarded through appropriately enhanced returns;
- The Company manages liquidity across the business to provide a high level of confidence that all obligations (to customers, creditors and shareholders) will be met when they fall due;
- The Company accepts insurance risks provided they are properly priced and managed in order to deliver value to its customers and shareholders;
- The Company is forward-looking in its business planning and takes a prudent approach to capital management. It strives to have a high level of confidence that capital is sufficient to support planned future activities;
- Management is active in industry committees and, through a network of oversight functions, monitors the landscape so that the Company is appropriately positioned to manage regulatory, tax, accounting and actuarial changes;
- The Company accepts that operational risks are a part of doing business and knows that risk management is a key part of decision-making. It protects its business and customers by engaging in cost-effective risk mitigation; and
- The Company expects ethical conduct by all of its employees and it acts with integrity at all times.

The Board of Directors oversees and monitors Empire Life's risk management framework, processes and practices, and reviews and approves the Company's Enterprise Risk Management Framework and overall risk appetite. Senior management shares responsibility and accountability for risk management across the organization. This enables a cross-functional perspective on risk management, enhanced by the frequency of contact across the management team. The Company has an Asset Management Committee with responsibility for overseeing the management of corporate policies established by both the Investment Committee and Risk and Capital Committee of the Board, with specific focus on market, credit and liquidity risk including asset/liability management as well as capital management. The Product Management Review Committee is responsible for overseeing management of corporate policy established by the Risk and Capital Committee of the Board, with specific focus on insurance. Activities not delegated to one of these two committees remain under the oversight of senior management. More information related to governance can be found under the Corporate Governance over Risk Management section of Empire Life's 2019 Annual Report. Risk management policy development is centralized under the leadership of the Chief Risk Officer and applies to all business units. The Chief Risk Officer is a member of the Asset Management Committee and Product Management Review Committee and has Board reporting responsibility with respect to risk and capital management. All risk management policies and procedures are regularly reviewed for relevance and changes in the risk environment. Accountability, application, day-to-day management and procedural elements are the responsibility of area management, supported by business unit compliance officers and the risk management department. There is senior management representation and oversight on various interdisciplinary risk control committees. The Company formally establishes and documents its values and risk tolerances through several company-wide policies including a code of business conduct, corporate disclosure principles, enterprise risk management, capital management and whistleblower policies. The Company's strategic risk management policies (including those related to product design and pricing, investment and capital management) are also approved by its Board, or a Board committee.

¹ See Non-IFRS Measures

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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. Empire Life has a semi-static hedging program. The hedging program may employ derivatives 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 and 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. During the fourth quarter and for the year, Empire Life experienced a loss of \$2 million and \$11 million after tax respectively on its hedging program primarily due to rising Canadian stock indices. This compares to a hedging program gain of \$6 million and \$2 million respectively for the comparable periods in 2018 primarily due to a decline in Canadian stock prices in December 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 December 31, 2019, Empire Life had \$8.5 billion of segregated fund assets and liabilities. Of this amount, approximately \$8.2 billion have guarantees. The following table provides a percentage breakdown by type of guarantee.

	Dec 31 2019	Dec 31 2018
Percentage of Segregated Fund Liabilities with:		
75% maturity guarantee and a 75% death benefit guarantee	4%	3%
75% maturity guarantee and a 100% death benefit guarantee	46%	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

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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 December 31, 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 table.

Sensitivity to equity risk: Impact on net income (in millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
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)

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
Total	\$ 35	\$ 16	\$ (16)	\$ (150)	\$ (337)

Sensitivity to equity risk: Impact on LICAT	Increase		Decrease		
	20 %	10 %	10 %	20 %	30 %
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)%

as at December 31, 2018

Segregated fund guarantees	3 %	— %	(10)%	(16)%	(22)%
Other equity risk	— %	(1)%	— %	— %	(2)%
Equity hedge	(2)%	(1)%	1 %	2 %	3 %
Total	1 %	(1)%	(9)%	(14)%	(21)%

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 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 a 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,

¹ See Non-IFRS Measures

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figures presented for the impact of equity risk on LICAT as at December 31, 2018 are restated to conform with the updated methodology.

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		
December 31, 2019	\$ 2,701	\$ 882	\$ 51	\$ 2	\$ 650	\$ 6	—	465
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 December 31, 2019, the aggregate amount at risk for all three categories of risk was \$890 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 December 31, 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
December 31, 2019 LICAT total ratio	1 %
December 31, 2018 LICAT total ratio	(5)%

Operational Risk

Operational risk relates to the uncertainty arising from larger than expected losses or damages as a result of inadequate or failed internal processes, people and systems, or from external events. Operational risk is naturally present in all of Empire Life's business activities and encompasses a broad range of risks, including legal disputes, regulatory compliance failures, technology failures, business interruption, information security and privacy breaches, human resources management failures, processing errors, modelling errors, theft and fraud, and damage to physical assets. If not managed effectively, operational risk can impact Empire Life's ability to manage other risks. The following is a further description of some operational risks and their associated risk management strategies.

(1) Legal and Regulatory Compliance Risk

Empire Life is governed by the Insurance Companies Act and supervised by OSFI and is also subject to various requirements imposed by legislation and regulation in each of the provinces and territories of Canada applicable to

¹ See Non-IFRS Measures

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insurance companies and companies providing other financial services. Material changes in the regulatory framework could have an adverse effect on Empire Life. Failure to comply with regulatory requirements or public expectations could adversely impact Empire Life's reputation and ability to conduct business. Empire Life is subject to litigation from time to time, in the normal course of business, and currently has a number of outstanding lawsuits. There can be no assurance that the present or any future litigation will not have a material adverse effect on Empire Life.

Empire Life's corporate compliance department, headed by the Chief Compliance Officer, oversees the regulatory compliance framework. This framework promotes risk-based management of regulatory compliance risk and includes Company-wide policies, operating guidelines, programs to promote awareness of laws and regulations impacting Empire Life, ongoing monitoring of emerging legal issues and regulatory changes and employee education programs that include anti-money laundering and anti-terrorist financing, privacy and information security risk management as well as reporting breaches and Empire Life's code of business conduct. The framework is supported by a network of business unit compliance officers as well as the corporate legal services department. The Chief Compliance Officer reports regularly to the Conduct Review Committee of the Board on the state of compliance, key compliance risks and emerging regulatory trends. The General Counsel reports regularly to the Audit Committee of the Board on litigation activity.

(2) *Model Risk*

Empire Life uses models to support many business functions including investment analysis, product development and pricing, valuation of policy liabilities, financial planning, asset/liability management, capital management, project management and risk management. The risk of inappropriate use or interpretation of Empire Life's models or their output, or the use of deficient models, data or assumptions could result in financial losses or inappropriate business decisions. Empire Life has developed management and mitigation processes related to model use and oversight of models to limit financial, operational and strategic impacts from an error or misinterpretation of model results. Senior management has overall responsibility and accountability for models in use to support activities within their business area. The Chief Risk Officer reports regularly to the Risk and Capital Committee of the Board on model use and related oversight activities.

(3) *Human Resources Risk*

Competition for qualified employees, including executives, is intense both in the financial services industry and non-financial industries. If Empire Life is unable to retain and attract qualified employees and executives, the results of its operations and financial condition, including its competitive position, could be adversely affected. To mitigate this risk, Empire Life has a number of human resources policies, processes and practices in place. Management reports regularly to the Human Resources Committee of the Board on succession planning and employee development programs as well as compensation practices and programs, all of which are designed to attract, motivate and retain high-performing and high-potential employees.

(4) *Third-Party Risk*

Empire Life obtains many different types of services from a number of third-party service providers and has outsourced certain business functions or processes to third parties. Should these third parties fail to deliver services in compliance with contractual or other service arrangements, Empire Life's business may be adversely impacted. To mitigate this risk, Empire Life has established contracting guidelines as well as a Company-wide outsourcing risk management policy that provides guidance when considering, entering into or managing existing outsourcing arrangements commensurate with the risks associated with the service provider and the nature of the arrangement. Annually, management reports to the Conduct Review Committee of the Board on outsourcing activities including details on those arrangements deemed to be most material to Empire Life.

(5) *Technology, Information Security and Business Continuity Risk*

Empire Life relies on technology in virtually all aspects of its business and operations including the creation and support of new products and services, and the nature of life insurance business necessitates a substantial investment in technology. Operational integrity, data integrity and security of information and systems infrastructure are all relied upon for normal business operations. Disruptions due to system failure, information security breaches, privacy breaches, cyber-attacks, human errors, natural disasters, criminal activity, fraud or the loss of certain software licensing agreements could have a material adverse impact on Empire Life.

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Empire Life has an enterprise-wide business continuity and disaster recovery program overseen by the Business Continuity Planning Team and senior management. The program includes policies, plans and procedures designed so that, to the extent practically possible, key business functions can continue and normal operations can resume effectively and efficiently should a major disruption occur. Each business unit is accountable for preparing and maintaining detailed business continuity plans and processes. Empire Life establishes and regularly tests business continuity and disaster recovery plans and maintains off-site system facilities and other related services and failover capability designed to minimize downtime and accelerate system recovery.

Information security breaches, including various forms of cyber-attack, could occur and may result in inappropriate disclosure or use of personal or confidential information. To mitigate this risk, Empire Life has an information security program overseen by the VP Enterprise Services and Security, who reports at least annually to the Risk and Capital Committee of the Board. This program consists of a number of standards, procedures and guidelines focused on management of cybersecurity risk and maintenance of the security and integrity of the data entrusted to Empire Life. An incident management process is in place for monitoring and managing security events.

Privacy breaches could occur and may result in unauthorized disclosure or use of private and confidential information. To manage this risk, Empire Life has a privacy program overseen by the Chief Privacy Officer. The program includes policies and standards, ongoing monitoring of emerging privacy legislation and a network of business unit privacy officers. Processes have been established to provide guidance to employees on the handling of personal information and the reporting of privacy incidents and issues to appropriate management for response and resolution. The Chief Privacy Officer reports regularly to the Conduct Review Committee of the Board on privacy and data security risks and emerging trends.

Business and Strategic Risk

Business and strategic risk relates to the uncertainty in future earnings and capital related to the potential inability to implement appropriate business plans and strategies, make decisions, allocate resources, manage distribution or adapt to changes in business environment, such as the competitive landscape, regulatory and tax changes or changes in accounting and actuarial standards. Empire Life regularly reviews and adapts its business strategies and plans in consideration of changes in the external business environment, economic, political and regulatory environment. Empire Life's financial performance is dependent upon its ability to implement and execute business strategies and plans for growth.

Empire Life's business strategies and plans are designed to align with risk appetite, capital position and financial performance objectives. Empire Life periodically reassesses risk appetite taking into consideration the economic, regulatory and competitive environments in which it operates. The current environment requires Empire Life to adapt rapidly to new opportunities and challenges and to refine its strategies accordingly. If Empire Life fails to revise its strategies on a timely basis or adapt to the changing environment, it may not be able to achieve its growth objectives.

Empire Life's business strategies and plans are dependent on the successful execution of organizational and strategic initiatives designed to support the growth of its business. The ability to effectively manage these changes and prioritize initiatives directly affects Empire Life's ability to execute these strategies. Identifying and implementing the right set of initiatives is critical to achieving Empire Life's business plan targets. Failure to implement these initiatives could also lead to cost structure challenges.

Successful execution of Empire Life's business strategies and plans depends on a number of factors including its ability to (i) generate sufficient earnings to maintain an adequate level of capital; (ii) generate sustained investment performance; (iii) meet regulatory requirements; (iv) manage risk exposures effectively; (v) attract and retain customers and distributors; (vi) have the right set of products; and (vii) reduce operating expenses while maintaining the ability to hire, retain and motivate key personnel. Empire Life's business and strategic plans are reviewed and discussed by its senior management team and are subject to approval by the Board of Directors, which also receives regular updates on implementation progress against key business plan objectives. The Board and its subcommittees receive regular updates on key risks.

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In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact Empire Life is included in Empire Life's Annual Information Form available at www.sedar.com. Additional disclosures of Empire Life's sensitivity to risks are included in note 27 to the 2019 consolidated financial statements.

Disclosure Controls and Procedures

Empire Life's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by Empire Life under Canadian securities laws is recorded, processed, summarized and reported within the specified time periods, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management on a timely basis to allow appropriate decisions regarding public disclosure. Under the supervision of management, an evaluation was carried out on the effectiveness of Empire Life's disclosure controls and procedures as of December 31, 2019. Based on that evaluation, management concluded that Empire Life's disclosure controls and procedures were effective as at December 31, 2019.

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS. Under the supervision of management, an evaluation of Empire Life's internal control over financial reporting was carried out as at December 31, 2019. Based on that evaluation, management concluded that Empire Life's internal control over financial reporting was effective as at December 31, 2019. No changes were made in Empire Life's internal control over financial reporting during the year ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, Empire Life's internal control over financial reporting.

Critical Accounting Estimates

Empire Life's significant accounting policies are described in note 2 to the consolidated financial statements. Certain of these policies require management to make estimates and assumptions about matters that are inherently uncertain. The most critical of these accounting estimates for Empire Life are the valuation of policy liabilities, financial instrument classification, pension and other employee future benefits and the determination of allowances for impaired investments.

Policy Liabilities

The determination of policy liabilities requires best estimate assumptions that cover the remaining life of the policies for mortality, morbidity, investment returns, persistency, expenses, inflation and taxes and include consideration of related reinsurance effects. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviation from best estimates is included in each assumption. These margins allow for possible deterioration in future experience and provide for greater confidence that policy liabilities are adequate to pay future benefits. The resulting provisions for adverse deviations have the effect of increasing policy liabilities and decreasing the income that otherwise would have been recognized at policy inception. A range of allowable margins is prescribed by the Canadian Institute of Actuaries. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in earnings in the year of the change. Empire Life's sensitivities to risks related to policy liabilities are included in note 27 to the consolidated financial statements.

Financial Instrument Classification

Management judgment is used to classify financial instruments as fair value through profit or loss, available for sale or loans and receivables. Most financial assets supporting insurance contract liabilities and investment contract liabilities are designated as FVTPL. Most financial assets supporting capital and surplus and participating accounts are classified as AFS. Loans and receivables support both contract liabilities and capital and surplus. The designation of a financial instrument as FVTPL or AFS dictates whether unrealized fair value changes are reported in net income or other comprehensive income. Additional information regarding financial instrument classification is included in notes 2(d), 3(a), 3(b), and 10(c).

Pension and Other Employee Future Benefits

Pension and other employee future benefits expense is calculated by independent actuaries using assumptions determined by management. The assumptions made affect the pension and other employee future benefits expense included in net income. If actual experience differs from the assumptions used, the resulting experience gain or loss is

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recorded in OCI. Additional information regarding pension and other employee future benefits is included in notes 2(k), and 12.

Provision for Impaired Investments

Empire Life maintains a prudent policy in setting the provision for impaired investments. When there is no longer reasonable assurance of full collection of loan principal and loan interest related to a mortgage or policy contract loan, management establishes a specific provision for loan impairment and charges the corresponding reduction in carrying value to income in the period the impairment is identified. In determining the estimated realizable value of the investment, management considers a number of events and conditions. These include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability of the borrower, repayment history and an assessment of the impact of current economic conditions. Changes in these circumstances may cause subsequent changes in the estimated realizable amount of the investment and changes in the specific provision for impairment.

Available for sale securities are subject to a regular review for losses that are significant or prolonged. Objective evidence of impairment exists if there has been a significant or prolonged decline in the fair value of the investment below its cost or if there is a significant adverse change in the technological, market, economic or legal environment in which the issuer operates or the issuer is experiencing financial difficulties.

Outlook

The Canadian economy performed largely as expected in 2019 with GDP growth estimated at 1.6% for the full year, the Canadian dollar weakened slightly to 1.32 (annual average) per U.S. dollar and annual unemployment was stable at 5.6%, the lowest it has been since the 1970's. Consumer spending has slowed down gradually throughout the year and business investment in machinery and equipment has slowed significantly after a strong first quarter in 2018. A number of uncertainties will continue in 2020 which may negatively impact the Canadian economy including slower global demand, on-going trade tensions, geopolitical concerns (e.g. North Korea, Iran, Brexit, Italy), and central bank monetary policy.

The Bank of Canada left the overnight rate unchanged in 2019, sitting at 1.75%. The Canadian Federal Bond yield curve shifted down with the 5-year rate decreasing from 1.88% to 1.68% in 2019 and the 30-year rate decreasing from 2.18% to 1.76% in 2019. Corporate and provincial bond spreads tightened during 2019. Interest rates have generally been lower than typical levels for several years.

Global equity markets performed well in 2019 with the MSCI up over 27% for the year. The S&P 500 stock index was up 28.9% and the S&P/TSX composite index was up 19.1% for the year. Stock market conditions impact the in-force profit margins and new business growth for the segregated fund and mutual fund portions of Empire Life's Wealth Management product line.

Looking forward to 2020, the global economy is expected to have moderate growth. The Canadian economy is expected to continue to grow at a slower pace than in 2019 with forecast GDP of 1.6% slightly below the estimated 2% in 2019. The western provinces are expected to continue to grow, with British Columbia benefiting from the natural gas projects. Provinces in central Canada are expected to experience slower growth with oil production cuts and pull back on capital spending plans. The Atlantic Provinces are expected to grow at a more moderate pace. Short-term interest rates are expected to continue to rise in the U.S. as well as in Canada but at a much slower pace and likely in the second half of the year. Overall the Canadian economy is well positioned to support continued growth of all Empire Life's product lines.

The individual insurance market continues to grow modestly even with the challenge of the persistent low long-term interest rate environment that followed the financial crisis. Empire Life has decreased its emphasis on long-term life insurance products in favor of shorter term products, such as 10 year renewable term life insurance. Long-term interest rates, product mix and product pricing are expected to continue to be challenges for Empire Life's Individual Insurance product line. The segregated fund product line saw a decline in net sales while experience positive market returns in 2019; fees will likely be impacted by competition going forward. Empire Life will continue to develop low cost efficient products delivered digitally to satisfy consumer needs. Within the employee benefits product line, although highly concentrated Empire Life will continue to penetrate its niche market to grow the business.

¹ See Non-IFRS Measures

MANAGEMENT'S DISCUSSION AND ANALYSIS

As noted under the Regulatory Capital section, OSFI implemented its Life Insurance Capital Adequacy Test (LICAT) Guidelines on January 1, 2018. This new Guideline established a new risk based regulatory capital framework for life insurance companies and replaced the previous MCCSR Guideline. LICAT is intended to improve the quality of capital available and provide a better alignment of risk measures with the long-term economics of the insurance business. This new Guideline was developed in consultation with the Life Insurance Industry and OSFI. OSFI is also reviewing the overall approach for determining capital requirements for segregated fund guarantee risks. Changes to the capital required for products with guaranteed income may ultimately impact the industry's ability to offer these products at reasonable prices to the consumer. OSFI has indicated that the effective date for the Guideline for segregated fund guarantee will be implemented at the same time as IFRS 17. OSFI is continuing to review the application of Non-Viable Contingent Capital (NVCC) for life insurance companies. If NVCC applied, new preferred shares and subordinated debentures issued after the transition date would have to be compliant with the new regime to qualify as capital.

The International Accounting Standards Board (IASB) issued IFRS 17, Accounting Standards for Insurance Contracts, in May 2017. IFRS 17 will include fundamental changes from the CALM method (equivalent to IFRS 4 Insurance Contracts) that Empire Life currently applies for the valuation of insurance contracts and revenue recognition. The IASB has also granted a temporary exemption from the application of IFRS 9 Financial Instruments to allow insurance companies the ability to implement both IFRS 17 and IFRS 9 concurrently. IFRS 9 applies to the measurement of financial assets, the expected credit loss model and hedge accounting. For insurance contracts and financial instruments accounting, the goal is global consistency under IFRS as opposed to the differing approaches in each country that exist today. Preparing for the adoption of IFRS 17 and IFRS 9 is a significant initiative for Empire Life and for the industry. Empire Life is currently assessing the impact that IFRS 17 and IFRS 9 will have on Empire Life's consolidated financial statements as well as developing a plan to implement the changes required to be ready to report under the new standards when they take effect.

The Canadian Securities Administrators (CSA) has increased disclosure requirements for mutual fund companies, including point of sale requirements and customer relationship model initiatives. Mutual fund fees continue to be an area of interest for Canadian securities regulators. The CSA commissioned independent third-party research that will assess the impact of commissions and embedded (trailer) fees on mutual fund flows. This research will support CSA policy decisions concerning Canada's current mutual fund fee structure. Empire Life continues to monitor these developments and assess the possible impact to the insurance industry at some future date.

The industry is also improving the oversight of Managing General Agents (MGAs) and their advisors. Life insurance companies, including Empire Life, commonly contract with MGAs as a key component of the distribution chain for insurance and wealth management products. In 2013, the Canadian Life and Health Insurance Association (CLHIA) developed a new Insurer-MGA Relationship guideline (effective January 1, 2015). The Guideline describes desired outcomes and related practices in five general areas, including, perform due diligence prior to entering into a contract with an MGA, clearly set out roles and responsibilities in the contract, commit to a culture of treating customers fairly, monitor the performance of the MGA and retain ultimate responsibility. The industry is also considering establishing a licensing regime for all distribution firms. The licensing of distribution firms would clarify the accountability for the distribution partners to adhere to the insurer's code of conduct and provide on-going monitoring of the advisors activities.

Quarterly Results

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

	Dec 31	Sep 30	Jun 30	Mar 31	Dec 31	Sep 30	Jun 30	Mar 31
(in millions of dollars, except per share amounts)	2019	2019	2019	2019	2018	2018	2018	2018
Revenue	\$ 249	\$ 475	\$ 603	\$ 788	\$ 289	\$ 197	\$ 388	\$ 264
Common shareholder's net income	\$ 76	\$ 35	\$ 20	\$ 43	\$ 6	\$ 35	\$ 57	\$ 39
Earnings per share - basic and diluted	\$ 77.25	\$ 35.29	\$ 20.45	\$ 43.59	\$ 6.36	\$ 35.73	\$ 58.14	\$ 39.30

Forward-Looking Statements and Information

¹ See Non-IFRS Measures

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 and strategic, 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 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.

¹ See Non-IFRS Measures

MANAGEMENT'S DISCUSSION AND ANALYSIS

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.

Reconciliation of Assets Under Management

As at (in millions of dollars)	December 31, 2019	December 31, 2018
Assets Under Management		
General fund assets	\$ 9,462	\$ 8,447
Segregated fund assets	8,499	7,823
Total assets per financial statements	17,961	16,270
Mutual fund assets	139	145
Assets under management	\$ 18,100	\$ 16,415

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

As at (in millions of dollars)	December 31, 2019	December 31, 2018
DB plan assets		
Segregated fund assets	\$ 203	\$ 182
Mutual fund assets	14	12

¹ See Non-IFRS Measures