

# The Empire Life Insurance Company

Annual Report 2020



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# 2020 FINANCIAL HIGHLIGHTS

**136%**

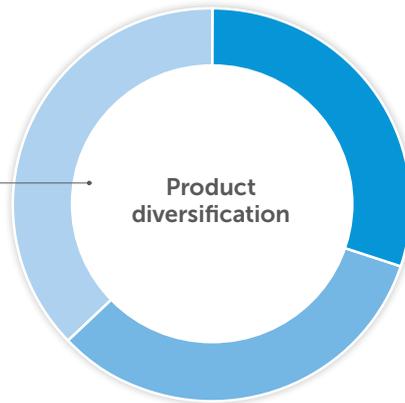
LICAT total ratio  
as at December 31, 2020

## Strength of our capital base

Our Life Insurance Capital Adequacy Test (LICAT) ratio is well above the minimum requirements set by the industry regulator. A high LICAT ratio demonstrates our long-term ability to pay claims and our prudent capital management.

## What is an LICAT ratio?

The LICAT is intended to measure the life insurer's solvency position by recognizing the long-term economics of the life insurance business. OSFI has established supervisory target levels of 70% for Core and 100% for Total capital.



## Product diversification

by premium and fee income for the 12 months ended December 31, 2020

Empire Life is well-diversified across three product lines:

Wealth Management

**30%**



Employee Benefits

**33%**



Individual Insurance

**37%**



## Financial ratings

These financial ratings give you an independent opinion of our financial strength as an insurer and our ability to meet policyholder obligations.

**A (Excellent)**

A.M. Best Company (As at June 24, 2020)

**Financial Strength Rating: A**

Issuer Rating: A

Subordinated Debt Rating: A (low)

DBRS (as at May 25, 2020.)

Common Shareholders'  
Net Income  
**2020 (in millions)**

**\$140**

Common Shareholders'  
Net Income  
**2019 (in millions): \$174**

Net Premium and Fee Income  
**2020 (in millions)**

**\$1,112**

Net Premium and Fee Income  
**2019 (in millions): \$1,172**

Total Assets Under Management  
**2020 (in millions)**

**\$18,836**

Total Assets Under Management  
**2019 (in millions): \$18,100**

**Note:** The selected financial information presented above is derived from the audited financial statements of The Empire Life Insurance Company and Management's Discussion and Analysis included in the Empire Life 2020 Annual Report.

## MESSAGE FROM THE CHAIRMAN OF THE BOARD

I've been reflecting on the word leadership and the importance of leadership in times of crisis. We have seen many examples of leadership this past year on the global stage, some good, some bad, some visionary, some focused on action. Great leaders plan for the unexpected, then respond quickly and effectively when the unexpected happens. They share a common purpose of helping the people they serve come through unprecedented times and challenges.

The leadership of Empire Life has done an exceptional job this past year. Through careful planning and strategic forethought, and decisive, compassionate response, the company has been able to continue operations, keep people safe, and help our customers at a time when they needed us most.

As an insurance company, our business is to manage risk and plan for the unexpected. For the past five years, the management team had increased capital as part of its strategy to ensure the financial strength of Empire Life in any event. This stronghold of capital has stood us well during the global pandemic and the company continues to be well-capitalized to meet all future obligations.

The company has also been making strategic and significant investments in its digital platforms and technology. Its industry-leading online applications have become a key competitive advantage in this new world of working and conducting business remotely.

When COVID-19 first began to emerge in Canada, the company prioritized the health and safety of its employees, advisors and customers and introduced important relief measures for customers to help them with the financial impact.

Management began regular online updates with employees to keep them informed. Our Board of Directors were regular guests on these calls and I personally enjoyed getting to hear, learn from, and meet the future leaders of the company. This past year has not been easy, juggling work and home demands, worrying about loved ones and staying safe. A shining light has been the employees of Empire Life. Throughout the pandemic, they have remained focused and dedicated, caring deeply about each other, our customers and the work.

I would also like to thank our Board of Directors for their leadership this past year. I have been impressed that our Board has been so actively engaged with management and employees, working as one team, with unity of purpose.

Leadership also means driving change when there needs to be change. Empire Life has always had a very positive, open and welcoming culture. As a Board, we support the important work the company has undertaken to promote diversity and inclusion. Our vision is to create a culture of respect and equity, where we embrace and value our differences and where people can be their true selves, feel they belong and have equal opportunities. The creation of a new corporate statement and mandate showing our commitment to this work is an important first step.

It was our former Prime Minister, the Right Honourable John N. Turner who said, "In any democracy, there is always a tug-of-war between policies to achieve equality, and policies to promote excellence. I am certain that Canada can achieve both equality and excellence."

In September, 2020, we lost a dear friend and mentor when Mr. Turner passed away. Mr. Turner served on the Board of Directors of Empire Life from 1990 to 2020. He was a remarkable man and trusted advisor. His intelligence, experience and business knowledge will be sorely missed.

A true leader recognizes they serve the people they lead. I am proud to serve the people of Empire Life, our Board, customers, advisors and other stakeholders, and look forward to the privilege of leading this great company for many more years ahead.



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**Duncan N. R. Jackman**

*Chairman of the Board*

February 24, 2021

# MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Resilience. In many ways, that single word has been at the foundation of our company's success over its 98-year history, but never has the need for resilience been more evident than throughout 2020.

## **Our people**

After sharing observations and highlights of the previous year, my annual report message usually closes with words of thanks and acknowledgement to our employees. I would like to recognize them at the beginning of my commentary this year. Without their resilience, their hard work in the face of uncertainty, and their commitment to each other and our stakeholders, there would be little else to report in this message and our results would have been very different. The impacts of the coronavirus pandemic have been, and continue to be, far-reaching. Lives have been lost and the health and well-being of individuals and families have been profoundly changed. Small businesses have been devastated and those that have survived continue to struggle to stay afloat.

Connection and a sense of belonging were important parts of our culture before the pandemic and have shown themselves to be more important than ever over the past year. I am particularly pleased with the work being done throughout all levels of the organization to build a strong foundation for a formal diversity and inclusion program.

I know I speak not only for myself, but also for our Board of Directors and senior management when I say how proud we are of every member of the Empire Life team for the resilience they have demonstrated and their unfaltering dedication to our customers and business partners in what has undoubtedly been an unexpected and extraordinary year.

## **Customer focus and support**

We have taken a number of measures to ensure continued service to our customers while protecting the health and safety of our employees, essential service providers and the general public. Within a very short time, we were able to shift to having almost all our employees across the country work from home and yet remain "open for business". The technology and digital capabilities we had invested time and resources in over the preceding years allowed us to increase our use of virtual meetings and work-from-home arrangements, resulting in peace of mind for our employees and uninterrupted responsiveness to the needs and expectations of our customers and business partners.

We introduced a number of relief measures for individual customers who have life insurance or critical illness policies with us and for small businesses and plan members who have group benefits coverage with us.

As the pandemic wears on, mental health resilience has become more important than ever. Our Group Solutions team stepped up last spring with the addition of Mental Health Navigator to all group plans with extended health benefits, providing plan members and their families with access to valuable guidance and resources. This was later augmented by the introduction of telemedicine services to give those plan members 24/7 access to safe, simple, fast and easy medical consultation and care.

## **Financial focus and strength**

We went into 2020 with a very strong capital position and we maintained that strength throughout the year, despite market turmoil from interest rate declines, widened credit spreads and a dramatic drop in equity markets, impacting our balance sheet early in the year.

As part of our regular business operations, we plan for significant adverse events that could result in a substantial drop in the markets and other impacts to our business. Over the past five years, we have taken a number of steps to increase our capital as part of our strategy to ensure the financial strength of our organization in any event. We continue to manage our assets prudently in a challenging low interest rate environment.

We strengthened policy liability reserves to support segregated fund guarantees and other lines of business. While market volatility is a source of anxiety for many investors, Ian Hardacre, our Chief Investment Officer, repeatedly reminds us of the importance of staying calm and riding out market fluctuations over time. Our investment management team has a long history of staying true to its disciplined focus, looking beyond short-term returns and embracing longer-term results with the investment time horizon measured in years, not weeks or months. This disciplined, value-oriented focus, with a strong emphasis on providing downside protection, is what we rely on to help investors achieve their financial goals.

# MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

## **Product design and distribution**

Above all, we remain committed to making it simple, fast and easy for our customers to access the products and services they need to build wealth and achieve financial security. Unsurprisingly, use of our Fast&Full® online insurance and investment application grew exponentially in the early months of the pandemic and continues to grow. We have entered into a number of new strategic agreements on both the Retail and Group sides of the business to make our products available to Canadians. Our products themselves – whether for individuals, small or medium-sized businesses – are designed to provide choice, protection and resilience. In 2020, we introduced new products including a 25-year renewable and convertible term solution and a disability rider on individual life policies, and we are one of the only insurers continuing to provide a guaranteed minimum withdrawal (GMWB) segregated fund solution in the market.

## **Moving forward**

It is not yet clear how 2021 will play out. It is clear that the world will be a different place once this pandemic has ended. Through prudence, care, empathy and resilience, anchored by the focus and dedication of our employees and business partners, we are working through the challenges of the pandemic, and its impacts on the markets and the global economy.

We appreciate the confidence and support of our shareholders; we are truly grateful for the trust our customers place in us.

Stay well and stay safe.



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**Mark Sylvia**

*President and Chief Executive Officer*  
February 24, 2021

# SOURCES OF EARNINGS

Source of earnings is a methodology for identifying and quantifying the various sources of International Financial Reporting Standards (IFRS) income of a life insurance company. It presents shareholders' net income in a different format from the traditional income statement form and provides a better understanding of Empire Life's sources of profit for each major product line.

## Expected Profit from In-Force Business

This source of earnings represents the profit the Company expects to generate on in-force business if experience is in line with the Company's best estimate assumptions for mortality, morbidity, persistency, investment returns, expenses and taxes.

## Impact of New Business

Writing new business typically adds economic value to a life insurance company. However, as of the point of sale, new business may have a positive or negative impact on earnings. A negative impact (new business strain) will result when the assumptions used in determining the profits in the actuarial liabilities at the point of sale exceeds the expected profit margin assumed in the product pricing. The impact of new business also includes acquisition expenses not covered by product pricing at the point of issue.

## Experience Gains and Losses

This item represents gains or losses due to the difference between actual experience and the best estimate assumptions. Possible areas of variances include benefit claims, policy persistency, expenses, investment income and others.

## Management Actions and Changes in Assumptions

This component includes earnings generated by management actions during the year (e.g. acquisition or sale of a block of business, changes to product price, fees or asset mix, etc.) or the impact of changes in assumptions or methodology used for the calculation of actuarial liabilities for in-force business.

## Other

This item includes any source of earnings from operations not included above.

## Earnings on Surplus

This component represents the pre-tax earnings on the shareholders' capital and surplus funds.

## Source of Earnings by Line of Business

For the twelve months ended December 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
Expected profit on in-force business	\$ 134	\$ 113	\$ 26	\$ 25	\$ 55	\$ 52			\$ 215	\$ 190
Impact of new business	(14)	(12)	(11)	(17)	9	2			(16)	(28)
Experience gains & losses	(95)	13	4	—	10	(19)			(81)	(6)
Management actions and changes in assumptions	(67)	(16)	—	2	80	51			13	37
Earnings (losses) on operations before income taxes	(43)	98	19	9	154	86	—	—	130	194
Earnings on surplus	—	—	—	—	—	—	70	54	70	54
Income (loss) before income tax	\$ (43)	\$ 98	\$ 19	\$ 9	\$ 154	\$ 86	\$ 70	\$ 54	\$ 200	\$ 247
Income taxes	(13)	24	2	2	40	19	15	15	47	60
Shareholders' net income (loss)	\$ (29)	\$ 74	\$ 14	\$ 7	\$ 115	\$ 67	\$ 54	\$ 39	\$ 153	\$ 187

# SOURCES OF EARNINGS

## Wealth Management

Wealth Management's experienced a loss on operation in 2020, compared to positive earnings in 2019. Expected profit on in-force business was higher in 2020 due to higher fee income anticipated from a higher starting point for assets under management (AUM) in 2020 compared to 2019. The impact of new business was higher in 2020 primarily driven by higher average strain from the mix of products sold. Experience losses in 2020 were primarily related to stagnant AUM growth driven by uneven equity market returns and sales results that were hampered by the effects of the COVID-19 pandemic. Experience gains in 2019 were driven by strong AUM growth on the segregated fund line fueled by strong equity market returns. Losses from management actions and changes in assumptions were primarily driven by unfavourable assumption updates and segregated fund guarantee reserve strengthening.

## Employee Benefits

Employee Benefit's earnings on operations were higher than the level achieved in 2019. Expected profit on in-force business was higher in 2020 due to continued growth in the in-force block from strong sales activity in 2019. The impact of new business was lower than 2019, primarily to due lower block transfers relative to the levels experienced in the previous year. Experience gains and losses were higher than 2019 primarily due to fewer health and dental claims as a result of COVID-19 related lockdowns and restrictions.

## Individual Insurance

The increase in Individual Insurance earnings on operations was primarily due to the favourable impact of assumption updates to policy liabilities in the fourth quarter and favourable experience gains from assets supporting liabilities, partially offset by unfavourable lapse experience.

## Capital & Surplus

Earnings from Capital and Surplus in 2020 were higher than 2019 primarily from higher realized investment gains on assets held in this segment.

# MANAGEMENT'S DISCUSSION AND ANALYSIS

**Dated as of February 24, 2021**

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, 2020 and 2019. This MD&A should be read in conjunction with the Company's December 31, 2020 consolidated financial statements, which form part of The Empire Life Insurance Company 2020 Annual Report dated February 24, 2021. 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](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 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 are generally accepted accounting principles as set out in the Handbook of the Chartered Professional Accountants of Canada. This MD&A makes reference to certain non-IFRS measures. These measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. They are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information 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 to date	
	2020	2019	2020	2019
Common shareholders' net income	\$ 72	\$ 76	\$ 140	\$ 174
Earnings per share - basic and diluted	\$ 73.53	\$ 77.25	\$ 141.80	\$ 176.58
Return on common shareholders' equity (quarterly annualized) <sup>1</sup>	17.8%	18.7%	8.5%	11.1%

Empire Life reported fourth quarter common shareholders' net income of \$72 million for 2020, compared to \$76 million for 2019. Full year common shareholders' net income was \$140 million compared to \$174 million in 2019. The decrease in earnings from 2019 was due, in part, to a large one-time gain recognized in 2019 related to a reinsurance recapture initiative. In 2020, earnings from the Wealth Management line were lower due to reserve strengthening and assumption updates in the Wealth Management line due to poor market returns early in the year, partially offset by increased earnings from the Individual Insurance line primarily as a result of asset trading gains from continued improvements in the Company's matching of assets and liabilities.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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

Sources of Earnings <sup>1</sup> (in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
Expected profit on in-force business	\$ 55	\$ 47	\$ 215	\$ 190
Impact of new business	(1)	(7)	(16)	(28)
Experience gains (losses)	61	5	(81)	(6)
Management actions and changes in assumptions	(22)	48	13	37
Earnings on operations before income taxes	92	94	130	194
Earnings on surplus	8	16	70	54
Income before income tax	101	110	200	247
Income taxes	25	30	47	60
Shareholders' net income	76	79	153	187
Dividends on preferred shares	(3)	(3)	(13)	(13)
Common shareholders' net income	\$ 72	\$ 76	\$ 140	\$ 174

The expected profit on in-force business for the fourth quarter and for the year increased by 16% and 13% respectively, due to higher levels of business inforce at the start of the year for all three business lines.

The improvement in impact of new business for the fourth quarter and the year was primarily driven by favourable new business profits at issue in the Individual Insurance line, combined with lower strain in the Employee Benefits line. For the year, the impact of new business improved over 2019 partially due to the Employee Benefits line where several new specialty partners were added in 2019 causing significant new business strain in that period. The Individual Insurance line also contributed to improved impact of new business as sales of term products, which generally contribute a positive impact of new business value were strong in the fourth quarter. The impact of new business in the Individual Insurance line is positive when the present value of future profits from new business exceeds the sum of the margins in the initial policy liabilities plus the expenses incurred at the point of sale.

The improvement in experience gains for the fourth quarter of 2020 is primarily attributable to the Wealth Management line as strong equity returns contributed to a partial reversal of provisions recorded for segregated fund benefit guarantees earlier in 2020. For the year, the increase in experience losses was primarily driven by the overall strengthening of policy liabilities supporting segregated fund benefit guarantees.

The effect of management actions and changes in assumptions in the fourth quarter of 2020 was lower than 2019 primarily due to unfavourable assumption updates in the Wealth Management line in 2020 and the favourable impact of a reinsurance recapture initiative in 2019, partially offset by favourable assumption updates in the Individual Insurance line. For the year, the effect of management actions and changes in assumptions was lower than 2019 primarily due to overall assumption updates which were less favourable than 2019, and due to the positive effect of a reinsurance recapture initiative which was recorded in 2019. This was partially offset by improved asset trading gains in the Individual Insurance line in 2020.

Earnings on surplus were lower in the fourth quarter of 2020 primarily due to lower realized gains on Available for Sale (AFS) assets. For the year, earnings on surplus were higher primarily due to realized gains on AFS bonds recorded earlier in the year and lower realized and unrealized losses on Fair Value through Profit and Loss (FVTPL) assets in this segment.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Selected Financial Information

Income Statement Financial Information (in millions of dollars)	For the years ended December 31		
	2020	2019	2018
Revenue			
Net premium income	\$ 860	\$ 910	\$ 874
Fee income	251	262	264
Investment income	329	326	308
Realized gain on FVTPL investments	155	105	12
Realized gain on AFS investments including impairment write downs	29	22	(1)
Fair value change in FVTPL investments	357	490	(318)
<b>Total revenue</b>	<b>1,982</b>	<b>2,115</b>	<b>1,138</b>
Expenses			
Benefits and expenses	\$ 1,758	\$ 1,843	\$ 931
Income and other taxes	67	81	60
<b>Total expenses</b>	<b>1,825</b>	<b>1,924</b>	<b>991</b>
Net income (loss) after tax	157	191	148
Participating policyholders' portion	4	3	(3)
Shareholders' net income	\$ 153	\$ 187	\$ 151
Dividends on preferred shares	13	13	13
Common shareholders' net income	\$ 140	\$ 174	\$ 137
Return on common shareholders' equity	8.5%	11.1%	9.4%

Revenue variability was driven primarily by the impact of market interest rate and equity movements on the 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		
	2020	2019	2018
Assets			
Total cash and investments	\$ 10,045	\$ 9,293	\$ 8,278
Other assets	214	169	168
Segregated fund assets	8,457	8,499	7,823
<b>Total assets</b>	<b>\$ 18,716</b>	<b>\$ 17,961</b>	<b>\$ 16,270</b>
Liabilities			
Insurance contract liabilities	\$ 7,145	\$ 6,074	\$ 5,176
Reinsurance liabilities	385	698	789
Subordinated debt	399	399	399
Other liabilities	382	351	300
Segregated fund policy liabilities	8,457	8,499	7,823
<b>Total liabilities</b>	<b>16,769</b>	<b>16,021</b>	<b>14,487</b>
Total equity	1,947	1,940	1,783
<b>Total liabilities and equity</b>	<b>\$ 18,716</b>	<b>\$ 17,961</b>	<b>\$ 16,270</b>

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Other Financial Information (in millions of dollars)	As at December 31		
	2020	2019	2018
<b>Assets under management<sup>1</sup></b>			
General fund assets <sup>1</sup>	\$ 10,259	\$ 9,462	\$ 8,447
Segregated fund assets <sup>1</sup>	8,457	8,499	7,823
Mutual fund assets <sup>1</sup>	120	139	145
Subordinated debt	399	399	399
Preferred shares	250	250	250
<b>Available regulatory capital</b>			
Tier 1	\$ 1,623	\$ 1,616	\$ 1,476
Tier 2	677	669	653
Total	2,300	2,285	2,129
<b>Surplus allowance and eligible deposits</b>	\$ 1,156	\$ 1,109	\$ 887
<b>Base solvency buffer</b>	\$ 2,541	\$ 2,191	\$ 2,029
<b>LICAT total ratio</b>	136%	155%	149%
<b>LICAT core ratio</b>	96%	109%	103%

	For the years ended December 31		
	2020	2019	2018
<b>Cash dividends per share</b>			
Preferred shares series 1	\$ 1.4375	\$ 1.4375	\$ 1.4375
Preferred shares series 3	\$ 1.2250	\$ 1.2250	\$ 1.2250
Common shares	\$ 179.6529	\$ 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.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## 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 2020 and 2019. 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	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
<b>Revenue</b>										
Net premiums	\$ 21	\$ 35	\$ 94	\$ 94	\$ 108	\$ 101	\$ —	\$ —	\$ 223	\$ 231
Investment income	9	9	1	1	59	57	16	17	85	84
Fair value change in FVTPL investments	11	(6)	1	—	70	(194)	—	—	81	(200)
Realized gain (loss) on FVTPL investments	3	1	—	—	16	60	(5)	(2)	14	59
Realized gain (loss) on AFS investments including impairment write downs	—	—	—	—	4	—	2	10	6	10
Fee income	63	63	3	3	—	—	—	—	66	66
Total revenue	107	102	99	97	257	24	12	25	475	249
<b>Expenses</b>										
Net benefits and claims	45	51	65	69	40	37	—	—	150	156
Net change in insurance and investment contract liabilities	(7)	4	3	2	97	(147)	—	—	93	(141)
Policy dividends	—	—	—	—	11	8	—	—	11	8
Operating, commission and interest expenses	36	37	27	23	41	34	4	4	108	99
Income and other taxes	8	2	3	3	19	27	2	8	33	40
Total expenses	82	94	98	97	208	(42)	6	12	394	162
<b>Net income (loss) after tax</b>	\$ 25	\$ 8	\$ 1	\$ —	\$ 49	\$ 67	\$ 6	\$ 13	\$ 81	\$ 87
Participating policyholders' portion									5	8
Dividends on preferred shares									3	3
Common shareholders' net income									\$ 72	\$ 76

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

For the years ended December 31 (in millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital and Surplus		Total	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
<b>Revenue</b>										
Net premiums	\$ 95	\$ 159	\$ 357	\$ 360	\$ 409	\$ 390	\$ —	\$ —	\$ 860	\$ 910
Investment income	38	40	4	5	222	215	65	65	329	326
Fair value change in FVTPL investments	31	18	5	4	321	473	—	(5)	357	490
Realized gain (loss) on FVTPL investments	4	1	4	—	154	111	(7)	(7)	155	105
Realized gain (loss) on AFS investments including impairment write downs	(1)	—	(1)	—	3	1	28	21	29	22
Fee income	238	249	13	13	—	—	—	—	251	282
<b>Total revenue</b>	<b>405</b>	<b>467</b>	<b>382</b>	<b>382</b>	<b>1,109</b>	<b>1,190</b>	<b>86</b>	<b>76</b>	<b>1,982</b>	<b>2,115</b>
<b>Expenses</b>										
Net benefits and claims	174	206	235	256	169	156	—	—	578	618
Net change in insurance and investment contract liabilities	138	18	21	18	600	773	—	—	759	808
Policy dividends	—	—	—	—	35	31	—	—	35	31
Operating, commission and interest expenses	135	144	97	91	136	134	16	16	385	386
Income and other taxes	(13)	24	14	11	50	31	17	16	67	81
<b>Total expenses</b>	<b>434</b>	<b>393</b>	<b>368</b>	<b>375</b>	<b>990</b>	<b>1,125</b>	<b>33</b>	<b>32</b>	<b>1,825</b>	<b>1,924</b>
<b>Net income (loss) after tax</b>	<b>\$ (29)</b>	<b>\$ 74</b>	<b>\$ 14</b>	<b>\$ 7</b>	<b>\$ 119</b>	<b>\$ 65</b>	<b>\$ 53</b>	<b>\$ 43</b>	<b>\$ 157</b>	<b>\$ 191</b>
Participating policyholders' portion									4	3
Dividends on preferred shares									13	13
Common shareholders' net income									\$ 140	\$ 174

## Total Revenue

Net premiums for the fourth quarter and the year were lower relative to the same periods in 2019 primarily due to lower sales of fixed annuity products in the Wealth Management line partially offset by higher net premiums in the Individual Insurance line from strong sales of the Company's term life products.

Investment income for the fourth quarter and the year was generally consistent with the amounts recorded in the same periods in 2019.

Assets classified as FVTPL experienced a gain in the fourth quarter relative to the same quarter in 2019 primarily due to gains on equity instruments backing insurance contract liabilities in the Individual Insurance line. For the year, gains on assets valued as FVTPL were lower than 2019 primarily due to lower gains from bonds supporting insurance contract liabilities in the Individual Insurance line, partially offset by higher gains from preferred shares held in the Wealth Management line.

Fee income for the fourth quarter was consistent with the same period in 2019. For the year, fee income declined by 11% compared to 2019 as volatile asset returns in the late first and second quarter resulted in lower average assets under management over the year.

## 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 were lower for the fourth quarter and the year by 4% and 6%, respectively driven primarily by fixed annuities in the Wealth Management line and lower health benefit claims in the Employee Benefits line, partially offset by higher claims in the Individual

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Insurance 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 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 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 increased for the fourth quarter and for the year compared to 2019 primarily due to higher commissions incurred in the Individual Insurance line as a result of higher sales.

## Product Line Results - Wealth Management

(in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
<b>Fixed Annuities</b>				
Assets under management <sup>1</sup>	\$ 950	\$ 958	\$ 950	\$ 958
Gross sales <sup>1</sup>	21	35	95	159
Net sales <sup>1</sup>	(9)	—	(19)	13
<b>Segregated Funds</b>				
Assets under management <sup>1</sup>	8,439	8,480	8,439	8,480
Gross sales <sup>1</sup>	234	243	759	856
Net sales <sup>1</sup>	(58)	(83)	(236)	(329)
Fee income	62	62	235	246
<b>Mutual Funds</b>				
Assets under management <sup>1</sup>	120	139	120	139
Gross sales <sup>1</sup>	1	2	8	8
Net sales <sup>1</sup>	(8)	(7)	(23)	(28)
Fee income	1	—	2	2
<b>Net income after tax</b>	\$ 25	\$ 8	\$ (29)	\$ 74

Fixed annuity assets under management decreased by 1% during the last 12 months. Gross sales in the fourth quarter and for the year were 40% lower as customers shifted away from fixed income products.

Segregated fund assets under management at the end of the period were unchanged from their levels at the beginning of the year. Gross sales in the fourth quarter of 2020 were 4% lower than the same period in 2019. For the year, gross sales were 11% lower than 2019 levels, reflecting the challenging sales environment experienced in 2020 and the effects of turbulent equity markets in the first half of the year. 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.

Segregated fund fee income for the fourth quarter was consistent with the same period in 2019. For the year, fee income from segregated funds was 4% lower than 2019 primarily due to lower average assets relative to 2019.

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.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Product Line Results - Employee Benefits

(in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
<b>Selected financial information</b>				
Annualized premium sales <sup>1</sup>	\$ 24	\$ 21	\$ 85	\$ 104
Net premiums	93	93	357	360
<b>Net income (loss) after tax</b>	<b>\$ 1</b>	<b>\$ —</b>	<b>\$ 14</b>	<b>\$ 7</b>

For the fourth quarter, annualized premium sales for Employee Benefits increased by 12% relative to 2019, primarily related to strong sales in core group benefit products and specialty arrangements, partially offset by lower block transfers from strategic partners. For the year, annualized premium sales were 18% lower than 2019, primarily due to lower overall sales in the core group benefit products, partially offset by an overall increase in sales from the strategic distribution partner arrangements early in the year. Over the last several years, Empire Life has entered into a number of strategic arrangements to expand market share in this space.

Net premiums for the fourth quarter and year decreased by less than 1% compared to the same periods in 2019, primarily due to premium rebates offered to customers in the spring to reflect lower health claims experience as a result of COVID-19 regional lockdowns and limited capacity offered by many health care providers. Empire Life continues to focus on profitable sales in the employee benefits market where price competition continues for all major product lines.

Net income increased in 2020 and relative to 2019 primarily due to experience gains on dental and extended health care benefits.

## Product Line Results - Individual Insurance

(in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
<b>Shareholders'</b>				
Shareholders' annualized premium sales <sup>1</sup>	\$ 9	\$ 5	\$ 25	\$ 21
Shareholders' net premiums	73	69	280	274
Net income (loss) after tax	43	62	115	67
<b>Policyholders'</b>				
Policyholders' annualized premium sales <sup>1</sup>	4	5	13	18
Policyholders' net premiums	35	32	128	116
Net income (loss) after tax	5	4	4	(1)
<b>Net income (loss) after tax</b>	<b>\$ 49</b>	<b>\$ 66</b>	<b>\$ 119</b>	<b>\$ 65</b>

Shareholders' annualized premium sales increased for the fourth quarter and the year compared to 2019 primarily due to increased sales of the Company's term life products. Policyholders' annualized premium sales declined compared to the fourth quarter of the prior year and were 25% lower for the full year as COVID-19 lockdowns and restrictions made underwriting of sales more challenging. Shareholders' total net premiums increased by 6% in the quarter and 2% for the year, primarily from stronger sales of term life products over the period. Policyholders' net premiums were 9% and 10% higher for the fourth quarter and full year respectively compared to 2019, primarily due to the effect of strong sales of the Company's participating life products in the last half of 2019.

Shareholders' net income was lower for the fourth quarter, primarily due to the impact of a reinsurance recapture initiative and the impact of a mortality table update on insurance contract liabilities recorded in the fourth quarter 2019 results. For the year, Shareholders' net income increased, primarily due to improved mortality experience, reduced losses on interest rate movements and improved matching of assets and liabilities, which offset the lower gain from the update of policy liability assumptions described in the following table and subsequent paragraphs.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

(in millions of dollars)	Year	
	2020	2019
<b>Components of pre-tax income increase from update of policy liability assumptions</b>		
Lapse/premium assumptions	\$ (98)	\$ (27)
Net investment assumptions	(49)	(120)
Mortality experience	(45)	12
Mortality table update	76	155
Reinsurance recapture	19	107
Deferred tax liability	117	—
Other	12	(69)
Total gain (loss) from update of policy liability assumptions (excludes policyholders' portion)	\$ 32	\$ 57

In 2020 the lapse/premium assumption change is related to updates of assumed lapse rates on renewable term, non-par whole life and universal life policies. The refinements to the lapse/premium assumptions for 2019 were primarily related to the adjustment of the lapse assumption on renewable term products.

The primary driver of the net investment assumptions change for 2020 is a decrease to the initial reinvestment rate (IRR) used in the valuation of liabilities. 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.

Updates to the mortality experience in 2020 are primarily related to revised projected assumptions related to renewable term business and to the partial recognition of the change described in the next paragraph.

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. Partial credit was taken for this change in 2019 with the remainder being recognized in 2020.

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 would increase its individual life retention from \$500 to \$1,500 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. An additional amount was recognized in 2020 as provisions from the actuarial liabilities were released.

Actuarial standards allow for a wide range of practice with respect to capitalization of the preferred tax treatment of dividends on Canadian equities that are supporting actuarial liabilities. In 2020, the Company updated its projections to be more consistent with industry practice, which resulted in a significant reduction in insurance contract liabilities.

## Results - Capital and Surplus

(in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
<b>Net income (loss) after tax</b>				
Net income (loss) after tax shareholders' portion	\$ 7	\$ 10	\$ 54	\$ 39
Net income (loss) after tax policyholders' portion	—	4	—	5
Net income (loss) after tax	\$ 6	\$ 13	\$ 54	\$ 44

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 2019, primarily due to lower realized gains on AFS assets in this portfolio. For the year, shareholders' net income was higher than 2019 primarily due to higher realized gains on AFS assets, partially offset by realized losses on FVTPL assets. Policyholders net income was lower than the comparable periods in 2019 primarily due to lower realized gains on AFS assets.

On February 17, 2021, the Company completed an offering of \$200 million aggregate principal 3.625% Limited Recourse Capital Notes Series 1 (Notes). In connection with the issuance of the Notes, the Company issued Non-Cumulative 5-Year Fixed Rate Reset Preferred Shares, Series 5 (Preferred Shares Series 5 to be held by a trustee for a newly formed trust. In case of non-payment of interest on or principal of the Notes when due, the recourse of each Note holder will be limited to that holder's proportionate share of the Limited Recourse Trust's assets, which will consist of the Preferred Shares Series 5 except in limited circumstances. The purpose of the sale of the Notes is to enlarge the Company's Tier 1 capital base with a view to optimizing Empire Life's capital structure within the parameters prescribed by the Superintendent of Financial Institutions for regulatory capital requirements.

## 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 \$10.635322 per common share on February 24, 2021 to all common shareholders of record March 11, 2021, payable April 1, 2021.

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	\$ 10.635322	April 1, 2021	March 11, 2021
Non-Cumulative Rate Reset Preferred Shares, Series 1 (TSX: EML.PR.A)	\$ 0.359375	April 17, 2021	March 18, 2021
Non-Cumulative Rate Reset Preferred Shares, Series 3	\$ 0.306250	April 17, 2021	March 18, 2021

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

## Total Cash Flow

(in millions of dollars)	Year to date	
	2020	2019
<b>Cash flow provided from (used for)</b>		
Operating activities	\$ 273	\$ 368
Investing activities	(20)	(337)
Financing activities	(205)	(96)
Net change in cash and cash equivalents	\$ 49	\$ (65)

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

The net change in cash and cash equivalents was an increase of \$49 million, made up of the following items:

- Lower cash provided from operating activities in 2020 relative to 2019 was primarily due to higher cash outflows related to changes in working capital levels.
- Cash used for investing activities declined in 2020 relative to 2019.
- An increase in cash used for financing activities in 2020 due to higher common share dividends and a special common share dividend of \$90 million in April 2020.

For an analysis of liquidity for Empire Life, see note 10(e) and note 27(b) to the 2020 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 the Company. Empire Life's investment strategy also includes the use of publicly-listed common 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 the Company. 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 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.

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, 2020.

## 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, 2020	December 31, 2019
Subordinated debentures	\$ 400	\$ 400
Equity		
Preferred shares	\$ 250	\$ 250
Common shares	\$ 1	\$ 1
Total Equity	\$ 251	\$ 251

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2020	December 31, 2019
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, 2020	December 31, 2019
Subordinated debentures <sup>(a)</sup>	December 2016	December 16, 2021	3.383%	\$ 200	\$ 200
Subordinated debentures <sup>(b)</sup>	September 2017	March 15, 2023	3.664%	\$ 200	\$ 200

<sup>(a)</sup> 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).

<sup>(b)</sup> 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 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 measure a 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%. The Office of the Superintendent of Financial Institutions (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)		2020	2020	2020	2020	2019
<b>Available capital</b>						
Tier 1	(A)	\$ 1,623	\$ 1,544	\$ 1,527	\$ 1,435	\$ 1,616
Tier 2	(B)	677	703	710	671	669
Total	(C)	\$ 2,300	\$ 2,247	\$ 2,237	\$ 2,106	\$ 2,285
<b>Surplus allowance and eligible deposits</b>	(D)	1,156	1,111	1,094	1,029	1,109
<b>Base solvency buffer</b>	(E)	2,541	2,542	2,510	2,371	2,191
<b>LICAT total ratio</b>	((C+D)/E * 100)	136%	132%	133%	132%	155%
<b>LICAT core ratio</b>	((C+70%D)/E * 100)	96%	91%	91%	91%	109%

## Other Comprehensive Income

(in millions of dollars)	Fourth quarter		Year to date	
	2020	2019	2020	2019
OCI, attributable to shareholders	\$ 4	\$ (16)	\$ 40	\$ 48
OCI, attributable to policyholders	(3)	(4)	—	1
Total other comprehensive income	\$ 1	\$ (20)	\$ 40	\$ 49

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

Other comprehensive income (OCI) increased in the fourth quarter, primarily due to unrealized fair value gains on AFS investments compared to a unrealized fair value losses on these assets, partially offset by a gain on re-measurement of post-employment benefit liabilities in the fourth quarter of 2019. For the year, OCI was lower relative to 2019, primarily due to a higher loss from the re-measurement of post-employment liabilities partially offset by unrealized fair value gains on AFS assets in 2020 relative to 2019.

Re-measurement of defined benefit pension plans does not immediately impact LICAT as each quarter's remeasurement gain or loss is amortized over 12 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 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 broadening distribution reach. Empire Life continues 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 provisions 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

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 the Company 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 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 external 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

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 2020 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.

## 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.

## Significant Developments

Commencing in the first quarter of 2020, the spread of the COVID-19 pandemic, given its severity and scale, continues to affect Empire Life's business, some of our clients and also continues to pose risks to the Canadian economy. The Company continues to adjust operations as government restrictions and measures evolve. As the impacts of the COVID-19 pandemic continue to materialize, management is monitoring the effects of the disruption on the Company's business strategies and initiatives and the effects on its financial results.

The COVID-19 pandemic has and may continue to result in disruptions to clients and the way in which business is conducted, including prolonged duration of employees working from home. To date, Empire Life has taken proactive measures through business continuity plans, carefully planning the return to premise for some employees, and management teams have increased their efforts to preserve the well-being of employees and our ability to serve clients. Processes supporting ongoing systems availability, stability and security are operating effectively and the Company continues to monitor the threat landscape.

The duration and impacts of the COVID-19 outbreak cannot currently be determined. If the COVID-19 pandemic is prolonged, or further diseases emerge that give rise to similar effects, there may be further negative effects on the Canadian economy as well as increased volatility in equity and fixed income markets. Unexpected developments in financial markets, regulatory environments, or consumer behaviour and confidence may also have adverse impacts on the Company's financial results and condition, and business.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## 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 objective of the hedging program is to partially protect the Company from future regulatory (LICAT) ration declines that might result from adverse stock market price changes. 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 \$5 million and \$3 million after tax respectively on its hedging program, primarily as Canadian equity markets experienced positive returns in the fourth quarter and for the year. This compares to a hedging program loss of \$2 million and \$11 million respectively for the comparable periods in 2019, primarily due to a rise in Canadian stock prices.

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, 2020, 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 2020	Dec 31 2019
Percentage of Segregated Fund Liabilities with:		
75% maturity guarantee and a 75% death benefit guarantee	6%	4%
75% maturity guarantee and a 100% death benefit guarantee	44%	46%
100% maturity and death benefit guarantee (with a minimum of 15 years between deposit and maturity date)	7%	7%
Guaranteed minimum withdrawal benefit (GMWB)	43%	43%

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

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

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

<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 December 31, 2020</b>						
Segregated fund guarantees	\$ 108	\$ 104	\$ (13)	\$ (86)	\$ (220)	
Other equity risk	37	18	(16)	(29)	(78)	
Equity hedge	(8)	(4)	5	12	20	
<b>Total</b>	<b>\$ 136</b>	<b>\$ 117</b>	<b>\$ (23)</b>	<b>\$ (103)</b>	<b>\$ (278)</b>	

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
<b>Total</b>	<b>\$ 31</b>	<b>\$ 14</b>	<b>\$ (18)</b>	<b>\$ (80)</b>	<b>\$ (256)</b>

Sensitivity to equity risk: Impact on LICAT	Increase			Decrease		
	20 %	10 %	10 %	20 %	30 %	
<b>As at December 31, 2020</b>						
Segregated fund guarantees	6 %	5 %	(1)%	(8)%	(16)%	
Other equity risk	— %	— %	— %	— %	(1)%	
Equity hedge	(1)%	— %	— %	1 %	1 %	
<b>Total</b>	<b>6 %</b>	<b>5 %</b>	<b>— %</b>	<b>(7)%</b>	<b>(16)%</b>	

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 %
<b>Total</b>	<b>(1)%</b>	<b>(2)%</b>	<b>(4)%</b>	<b>(12)%</b>	<b>(18)%</b>

In early 2020, Empire Life significantly increased the segregated fund guarantee liability because of market declines. This liability was further strengthened during the fourth quarter assumption update process, which offset most of the reduction in liability that arose from strong fourth quarter equity returns. These changes caused a significant increase in the potential positive net income impacts of a 10% and 20% increase in stock markets at the end of 2020 relative to the end of 2019.

These changes also caused an increase in the potential positive LICAT ratio impacts of favourable equity shocks and a decrease in the potential negative LICAT ratio impacts of unfavourable equity shocks.

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, 2020	\$ 2,687	\$ 931	\$ 52	\$ 2	\$ 654	\$ 12	\$ 147	\$ 682
December 31, 2019	\$ 2,701	\$ 882	\$ 51	\$ 2	\$ 650	\$ 6	\$ —	\$ 465

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2020, the aggregate amount at risk for all three categories of risk was \$946 million. At December 31, 2019, the aggregate amount at risk for these three categories of risk was \$890 million. For these three categories of risk, the amount at risk is not currently payable. Payment is contingent on future outcomes, including fund performance, deaths, deposits, withdrawals and maturity dates.

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

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, 2020 and December 31, 2019, is shown in the table below. This assumes no change in the ultimate reinvestment rate (URR).

Sensitivity to Market Interest Rates LICAT	Impact of 50 bps Decrease
December 31, 2020 LICAT total ratio	3%
December 31, 2019 LICAT total ratio	1%

## Operational Risk

Operational risk is broadly defined as the risk of loss resulting from human error, decisions, actions or failure to act, inadequate or failed internal processes and systems, or from external events that affect business operations. Operational risk is naturally present in all of Empire Life's business activities and is also embedded in the practices used to manage other risks. 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 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.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## (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, and is unable to maintain and effectively deploy resources with the in-depth knowledge and necessary skills needed to support business activities, 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 systems and/or 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 and Information Security 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, criminal activity, fraud or the loss of certain software licensing agreements could have a material adverse impact on Empire Life.

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 Vice-President, 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.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## (6) *Business Continuity Risk*

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 of key business functions occur as a result of an event, including pandemic, impacting the availability of trained employees, physical locations to conduct operations and/or access to technology. 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 services and failover capability designed to minimize downtime and accelerate system recovery. The Business Continuity Planning Team Chair reports at least annually to the Risk and Capital Committee of the Board on business continuity preparedness and operational resiliency.

## **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. As a long-term oriented underwriter and investor, Empire Life may be adversely affected if it does not adequately prepare for the direct or indirect negative impacts of environmental events and developments, including those related to impacts of climate changes and the transition to a lower-carbon economy. These events and developments may include increased frequency and severity of natural or human-made environmental disasters, longer-term shifts in climate patterns, emerging regulatory and public policy developments and the impacts on Empire Life's operations, invested assets, suppliers and customers.

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.

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](http://www.sedar.com). Additional disclosures of Empire Life's sensitivity to risks are included in note 27 to the 2020 consolidated financial statements.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## 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, 2020. Based on that evaluation, management concluded that Empire Life's disclosure controls and procedures were effective as at December 31, 2020.

## 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, 2020. Based on that evaluation, management concluded that Empire Life's internal control over financial reporting was effective as at December 31, 2020. No changes were made in Empire Life's internal control over financial reporting during the year ended December 31, 2020, 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 recorded in OCI. Additional information regarding pension and other employee future benefits is included in notes 2(k), and 12.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## *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 path and implications of COVID-19 on Canadian and international business operations, supply chains, travel, consumer confidence and business forecasts, and domestic and international securities markets, remains uncertain and is expected to continue into 2021. The progression of the virus, potential treatments and therapies, the availability of vaccines and actions taken by governments, businesses and individuals could vary by region and country and will impact economic recoveries. Empire Life continues to adjust operations as government restrictions and measures evolve. Our business continuity processes have been successful in ensuring that key business functions and normal operations continue through these unprecedented times. Processes supporting ongoing systems availability, stability and security are operating effectively and we continue to monitor the threat landscape. The majority of employees continue to work from home. Return to office activities have been carefully planned but remain appropriately flexible in response to government restrictions. Management remains focused on preserving the well-being of all employees and our ability to serve our customers.

The effects of the COVID-19 pandemic took a toll on the Canadian economy in 2020 as GDP contracted by an estimated 5.5% for the full year and, the Canadian dollar strengthened slightly to 1.29 (annual average) per U.S. dollar. Amid the backdrop of regional lockdowns and other restrictions, annual unemployment in Canada rose to 9.5%, the highest level in 25 years. The lingering effects of the pandemic will continue to weigh on 2021 and potentially beyond. The recovery of the Canadian and global economy will depend on the effectiveness of vaccine rollouts and limiting the effects of future waves of infections.

In response to the contracting economy, the Bank of Canada decreased the overnight rate to 0.25% in 2020 with the Bank of Canada indicating that the overnight rate is expected to remain low in the near-term. The Canadian Federal Bond yield curve shifted down with the 5-year rate decreasing from 1.68% to 0.39% in 2020 and the 30-year rate decreasing from 1.76% to 1.21% in 2020. While corporate and provincial bond spreads widened significantly in the first and second quarters and the effects of the pandemic took hold, spreads narrowed in the latter half of the year and ended 2020 near their opening levels. Interest rates have generally been lower than historic averages for several years.

Despite an uneven quarterly performance, global equity markets performed well in 2020 with the MSCI up over 16% for the year. The S&P 500 stock index was up 16.3% and the S&P/TSX composite index was up 2.2% 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 2021, the global economy is expected to have moderate growth. The Canadian economy is expected to rebound in 2021 and 2022 with forecast GDP of 4.0% and 4.8% respectively. The ability of economies to recover and grow in line with projections is highly dependent on the ability of governments to contain further spread of COVID-19 infection and achieve sufficient immunity through vaccinations to ease the containment measures currently in place. Other threats to economic growth include the impact of the energy policy on the regional economies of the

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

western provinces. Short-term interest rates may continue to stay at their historic low levels in the near-term. 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 and has remained low in the current COVID-19 pandemic. 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 experiencing uneven market returns in 2020; 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. Across all business lines, Empire Life is focused on growth and diversification of distribution as well digital enablement and adoption, all while maintaining personalized service.

As noted under the Regulatory Capital section, OSFI implemented its LICAT Guidelines on January 1, 2018. This Guideline established a new risk-based regulatory capital framework for life insurance companies and replaced the previous Minimum Continuing Capital and Surplus Requirements 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 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 guarantees 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 the final standard for IFRS 17 Insurance Contracts in June 2020. IFRS 17 includes 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 the Company's consolidated financial statements and has developed a plan to implement the changes required to be ready to report under the new standards when they take effect on January 1, 2023.

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

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

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distribution partners to adhere to the insurer's code of conduct and provide on-going monitoring of the advisors activities.

The cost of managing regulation is a concern. The insurance industry is facing more aggressive consumer and financial solvency regulation than in the past and must also absorb the cost of implementing IFRS 17. The regulation load is increasing operating costs without offsetting revenue gains. Empire Life must continue to grow its business to absorb these rising costs.

## 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)	2020	2020	2020	2020	2019	2019	2019	2019
<b>Revenue</b>	\$ 475	\$ 401	\$ 1,105	\$ 2	\$ 249	\$ 475	\$ 603	\$ 788
<b>Common shareholder's net income</b>	\$ 72	\$ 51	\$ 48	\$ (32)	\$ 76	\$ 35	\$ 20	\$ 43
<b>Earnings per share - basic and diluted</b>	\$ 73.53	\$ 51.91	\$ 48.42	\$ (32.05)	\$ 77.25	\$ 35.29	\$ 20.45	\$ 43.59

## Forward-Looking Statements and Information

Certain statements in this MD&A about Empire Life's current and future plans, expectations and intentions, results, market share growth and profitability, strategic objectives or any other future events or developments constitute forward-looking statements and information within the meaning of applicable securities laws. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements and information. Although management believes that the expectations and assumptions on which such forward-looking statements and information are based are reasonable, undue reliance should not be placed on the forward-looking statements and information because there can be no assurance that they will prove to be correct. By their nature, such forward-looking statements and information are subject to various risks and uncertainties, which could cause the actual results and expectations to differ materially from the anticipated results or expectations expressed. These risks and uncertainties include, but are not limited to, market risk including equity risk, hedging risk, interest rate risk, foreign exchange rate risk; liquidity risk; credit risk including counterparty risk; insurance risk including mortality risk, policyholder behaviour risk, expense risk, morbidity risk, product design and pricing risk, underwriting and claims risk, reinsurance risk; operational risk, including legal and regulatory compliance risk, model risk, human resources risk, third-party risk, technology and information security risk, 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](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.

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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 the Company's underlying financial results.

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

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

**Annualized premium sales** is used as a method of measuring sales volume. It is equal to the premium expected to be received in the first 12 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	December 31, 2020	December 31, 2019
(in millions of dollars)		
<b>Assets Under Management</b>		
General fund assets	\$ 10,259	\$ 9,462
Segregated fund assets	8,457	8,499
Total assets per financial statements	18,716	17,961
Mutual fund assets	120	139
Assets under management	\$ 18,836	\$ 18,100

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

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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

<b>As at</b>	<b>December 31, 2020</b>	<b>December 31, 2019</b>
(in millions of dollars)		
<b>DB plan assets</b>		
Segregated fund assets	\$ 208	\$ 203
Mutual fund assets	16	14

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

# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements in this annual report have been prepared by management, who is responsible for their integrity, objectivity and reliability. This responsibility includes selecting and applying appropriate accounting policies, making judgments and estimates, and ensuring information contained throughout the annual report is consistent with these statements. The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) and the accounting requirements of the Office of the Superintendent of Financial Institutions, Canada (OSFI).

The Company maintains a system of internal control over financial reporting which is designed to provide reasonable assurance that assets are safeguarded, expenditures are made in accordance with authorizations of management and directors, transactions are properly recorded, and the financial records are reliable for preparing the consolidated financial statements in accordance with (IFRS). Under the supervision of management, an evaluation of the effectiveness of the Company's internal control over financial reporting was carried out as at December 31, 2020. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2020.

The Board of Directors, acting through the Audit Committee which is comprised of directors who are not officers or employees of the Company, oversees management's responsibility for financial reporting and for internal control systems. The Audit Committee is responsible for reviewing the consolidated financial statements and annual report and recommending them to the Board of Directors for approval. The Audit Committee meets with management, internal audit and the external auditors to discuss audit plans, internal controls over accounting and financial reporting processes, auditing matters, and financial reporting issues.

The Appointed Actuary is appointed by the Board of Directors and is responsible for ensuring that the assumptions and methods used in the valuation of the policy liabilities are in accordance with accepted actuarial practice and regulatory requirements. The Appointed Actuary is required to provide an opinion regarding the appropriateness of the policy liabilities at the consolidated statement of financial position date to meet all policyholder obligations of the Company. Examination of supporting data for accuracy and completeness and analysis of Company assets for their ability to support the amount of policy liabilities are important elements of the work required to form this opinion. The Appointed Actuary is also required each year to analyze the financial condition of the Company and prepare a report for the Board of Directors. The analysis tests the capital adequacy of the Company under adverse economic and business conditions for the current year and the next four years.

PricewaterhouseCoopers' responsibility as external auditor is to report to the policyholders and shareholders regarding the fairness of presentation of the Company's annual consolidated financial statements. The external auditors have full and free access to, and meet periodically with, the Audit Committee to discuss their audit. The Independent Auditor's Report outlines the scope of their examination and their opinion.



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**Mark Sylvia**

*President and Chief Executive Officer*  
Kingston, Ontario  
February 24, 2021



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**Edward Gibson**

*Senior Vice-President, Chief Financial Officer and  
Chief Actuary*  
Kingston, Ontario  
February 24, 2021

# APPOINTED ACTUARY'S REPORT

## To the Policyholders and Shareholders of The Empire Life Insurance Company

I have valued the policy liabilities and reinsurance liabilities of The Empire Life Insurance Company for its Consolidated statements of financial position at December 31, 2020 and their change in the Consolidated statements of operations for the year then ended in accordance with accepted actuarial practice in Canada including selection of appropriate assumptions and methods.

In my opinion, the amount of policy liabilities net of reinsurance liabilities, makes appropriate provision for all policy obligations and the Consolidated financial statements fairly present the results of the valuation.



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**Dan Doyle, FSA, FCIA, MAAA**

*Fellow, Canadian Institute of Actuaries*

Kingston, Ontario

February 24, 2021

# INDEPENDENT AUDITOR'S REPORT

To the Policyholders and Shareholders of The Empire Life Insurance Company

## Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of The Empire Life Insurance Company and its subsidiaries (together, the Company) as at December 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

## What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2020 and 2019;
- the consolidated statements of operations for the years then ended;
- the consolidated statements of comprehensive income for the years then ended;
- the consolidated statements of changes in equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include significant accounting policies and other explanatory information.

## Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended December 31, 2020. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

# INDEPENDENT AUDITOR'S REPORT

Key audit matters	How our audit addressed the key audit matter
<p data-bbox="120 233 643 262"><b>Valuation of insurance contract liabilities</b></p> <p data-bbox="120 296 743 415"><i>Refer to note 2 – Significant Accounting Policies and note 10 – Insurance Contract Liabilities and Reinsurance Assets/Liabilities to the consolidated financial statements.</i></p> <p data-bbox="120 449 776 716">The Company has gross insurance contract liabilities of \$7.1 billion and reinsurance liabilities of \$0.4 billion as at December 31, 2020 on its consolidated statement of financial position (collectively, insurance contract liabilities). Insurance contract liabilities represent an estimate of the amount that, together with estimated future premiums and investment income, will be sufficient to pay future benefits, dividends, expenses and premium taxes on policies in force.</p> <p data-bbox="120 749 776 1016">Insurance contract liabilities are determined using the Canadian Asset Liability Method (CALM), as established by the Canadian Institute of Actuaries (CIA) (actuarial models). The CALM incorporates best-estimate assumptions for mortality, policy lapses, surrenders and future investment yields that require management judgment. The assumptions are based on experience studies, industry studies and requirements of the CIA.</p> <p data-bbox="120 1050 776 1266">We considered this a key audit matter due to the judgment applied by management when developing its valuation of the contract liabilities, which in turn led to a high degree of auditor judgment and effort in evaluating the assumptions. Professionals with specialized skill and knowledge in the field of actuarial sciences assisted us in performing our procedures.</p>	<p data-bbox="781 233 1393 291">Our approach to addressing the matter included the following procedures, among others:</p> <ul style="list-style-type: none"> <li data-bbox="781 325 1446 415">• Tested how management determined the valuation of the insurance contract liabilities, which included the following: <ul style="list-style-type: none"> <li data-bbox="829 449 1430 539">– Understood management’s method for determining the valuation of insurance contract liabilities.</li> <li data-bbox="829 573 1455 684">– Tested the operating effectiveness of relevant controls over the completeness and accuracy of the underlying policy data used in management’s valuation of insurance contract liabilities.</li> <li data-bbox="829 718 1463 869">– With the assistance of professionals with specialized skill and knowledge in the field of actuarial science assessed the reasonableness of the policy lapses and surrenders, mortality and future investment yields by: <ul style="list-style-type: none"> <li data-bbox="878 903 1414 993">◦ Evaluating management’s assumptions in accordance with actuarial principles and requirements of the CIA.</li> <li data-bbox="878 1026 1455 1138">◦ Evaluating experience studies conducted by the Appointed Actuary for appropriateness and considering the relationship of the results with industry studies.</li> </ul> </li> <li data-bbox="829 1171 1438 1323">– With the assistance of professionals with specialized skill and knowledge in the field of actuarial science, tested the appropriateness of the actuarial models used in developing the valuation of insurance contract liabilities, by: <ul style="list-style-type: none"> <li data-bbox="878 1356 1422 1446">◦ Assessing a sample of actuarial models to ensure the correct modeling of product features.</li> <li data-bbox="878 1480 1422 1570">◦ Assessing a sample of actuarial models to ensure the correct application of assumptions.</li> </ul> </li> </ul> </li> <li data-bbox="781 1604 1430 1715">• Tested the disclosures made in the consolidated financial statements, particularly on the sensitivity of significant assumptions on insurance contract liabilities.</li> </ul>

# INDEPENDENT AUDITOR'S REPORT

## Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions

# INDEPENDENT AUDITOR'S REPORT

are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Owen Thomas.

*PricewaterhouseCoopers LLP*

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**PricewaterhouseCoopers LLP**

*Chartered Professional Accountants, Licensed Public Accountants*

Toronto, Ontario

February 24, 2021

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(in thousands of Canadian dollars)

As at December 31	2020	2019
<b>Assets</b>		
Cash and cash equivalents (Note 3)	\$ 189,356	\$ 140,333
Investments		
Short-term investments (Note 3)	13,008	32,384
Bonds (Note 3)	8,027,780	7,509,652
Preferred shares (Note 3)	616,902	474,029
Common shares (Note 3)	918,700	842,029
Derivative assets (Note 3)	5,377	2,930
Mortgages (Note 3)	157,214	169,827
Loans on policies (Note 3)	56,458	55,363
Policy contract loans (Note 3)	60,407	66,520
<b>Total cash and cash equivalents and investments</b>	<b>10,045,202</b>	<b>9,293,067</b>
Accrued investment income	38,932	35,401
Insurance receivables (Note 4)	46,533	48,728
Current income taxes	38,795	—
Other assets (Note 5)	21,289	23,096
Property and equipment (Note 6)	18,301	22,016
Intangible assets (Note 7)	27,983	22,357
Investment in associate	21,301	17,541
Segregated fund assets (Note 8)	8,457,417	8,498,583
<b>Total assets</b>	<b>\$ 18,715,753</b>	<b>\$ 17,960,789</b>
<b>Liabilities</b>		
Accounts payable and other liabilities (Note 11)	\$ 130,971	\$ 106,037
Insurance payables (Note 9)	114,938	95,578
Current income taxes payable	—	44,592
Reinsurance liabilities (Note 10)	384,761	698,372
Insurance contract liabilities (Note 10)	7,145,461	6,073,868
Investment contract liabilities	29,041	28,866
Policyholders' funds on deposit	34,817	34,224
Provision for profits to policyholders	36,124	32,924
Deferred income taxes (Note 18)	35,711	8,805
Subordinated debt (Note 13)	399,442	399,098
Segregated fund policy liabilities	8,457,417	8,498,583
<b>Total liabilities</b>	<b>16,768,683</b>	<b>16,020,947</b>
<b>Equity</b>		
Preferred shares (Note 20)	249,500	249,500
Common shares (Note 20)	985	985
Contributed surplus	19,387	19,387
Retained earnings	1,602,915	1,636,152
Accumulated other comprehensive income	74,283	33,818
<b>Total equity</b>	<b>1,947,070</b>	<b>1,939,842</b>
<b>Total liabilities and equity</b>	<b>\$ 18,715,753</b>	<b>\$ 17,960,789</b>



**Duncan N. R. Jackman**  
Chairman of the Board



**Mark Sylvia**  
President and Chief Executive Officer

The accompanying notes are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands of Canadian dollars except per share amounts and shares authorized and outstanding)

For the year ended December 31	2020	2019
<b>Revenue</b>		
Gross premiums (Note 14)	\$ 1,081,630	\$ 1,091,828
Premiums ceded to reinsurers (Note 14)	(221,389)	(181,987)
Net premiums (Note 14)	860,241	909,841
Investment income (Note 3)	329,423	325,717
Fair value change in fair value through profit or loss assets	356,755	490,381
Realized gain (loss) on fair value through profit or loss assets sold	154,926	105,331
Realized gain (loss) on available for sale assets including impairment write downs (Note 3)	29,414	21,886
Fee income (Note 15)	251,343	261,745
Total revenue	1,982,102	2,114,901
<b>Benefits and expenses</b>		
Gross benefits and claims paid (Note 16)	715,766	720,316
Claims recovery from reinsurers (Note 16)	(137,475)	(102,055)
Gross change in insurance contract liabilities (Note 16)	1,071,593	897,445
Change in insurance contract liabilities ceded (Note 16)	(313,611)	(90,429)
Change in investment contracts provision	989	937
Policy dividends	35,166	31,438
Operating expenses (Note 17)	168,305	172,470
Commissions	226,441	214,263
Commission recovery from reinsurers	(23,880)	(15,509)
Interest expense	14,437	14,425
Total benefits and expenses	1,757,731	1,843,301
Premium tax	18,742	18,675
Investment and capital tax	4,066	3,770
<b>Net income before income taxes</b>	<b>201,563</b>	<b>249,155</b>
Income taxes (Note 18)	44,332	58,497
<b>Net income</b>	<b>\$ 157,231</b>	<b>\$ 190,658</b>
Less: net income (loss) attributable to participating policyholders	4,047	3,219
Shareholders' net income (loss)	153,184	187,439
Less: preferred share dividends declared (Note 21)	13,496	13,496
<b>Common shareholders' net income</b>	<b>\$ 139,688</b>	<b>\$ 173,943</b>
Earnings per share - basic and diluted (Note 19)	\$ 141.80	\$ 176.58
(2,000,000 shares authorized; 985,076 shares outstanding)		

The accompanying notes are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands of Canadian dollars)

For the year ended December 31	2020	2019
<b>Net income</b>	<b>\$ 157,231</b>	<b>\$ 190,658</b>
<b>Other comprehensive income (loss), net of income taxes:</b>		
Items that may be reclassified subsequently to net income:		
Unrealized fair value change on available for sale investments (Note 18)	78,894	65,612
Fair value change on available for sale investments reclassified to net income, including impairment write downs (Note 18)	(21,620)	(16,002)
Net unrealized fair value increase (decrease)	57,274	49,610
Items that will not be reclassified to net income:		
Remeasurements of post-employment benefit liabilities (Note 18)	(16,809)	(924)
Total other comprehensive income (loss)	40,465	48,686
<b>Comprehensive income (loss)</b>	<b>\$ 197,696</b>	<b>\$ 239,344</b>
<b>Comprehensive income (loss) attributable to:</b>		
Participating policyholders	\$ 4,036	\$ 3,949
Shareholders	193,660	235,395
Total	\$ 197,696	\$ 239,344

The accompanying notes are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(in thousands of Canadian dollars)

For the year ended December 31	2020			2019		
	Shareholders'	Policyholders'	Total	Shareholders'	Policyholders'	Total
<b>Preferred shares (Note 20)</b>	\$ 249,500	\$ —	\$ 249,500	\$ 249,500	\$ —	\$ 249,500
<b>Common shares (Note 20)</b>	985	—	985	985	—	985
<b>Contributed surplus</b>	19,387	—	19,387	19,387	—	19,387
<b>Retained earnings</b>						
Retained earnings - beginning of year	1,597,668	38,484	1,636,152	1,492,447	35,265	1,527,712
Net income (loss)	153,184	4,047	157,231	187,439	3,219	190,658
Preferred share dividends declared	(13,496)	—	(13,496)	(13,496)	—	(13,496)
Common share dividends declared	(176,972)	—	(176,972)	(68,722)	—	(68,722)
Retained earnings - end of period	1,560,384	42,531	1,602,915	1,597,668	38,484	1,636,152
<b>Accumulated other comprehensive income (loss)</b>						
Accumulated other comprehensive income (loss) - beginning of year	32,190	1,628	33,818	(15,766)	898	(14,868)
Other comprehensive income (loss)	40,476	(11)	40,465	47,956	730	48,686
Accumulated other comprehensive income (loss) - end of period	72,666	1,617	74,283	32,190	1,628	33,818
<b>Total equity</b>	\$ 1,902,922	\$ 44,148	\$ 1,947,070	\$ 1,899,730	\$ 40,112	\$ 1,939,842
<b>Composition of accumulated other comprehensive income (loss) - end of period</b>						
Unrealized gain (loss) on available for sale financial assets	\$ 102,676	\$ 3,323	\$ 105,999	\$ 46,212	\$ 2,513	\$ 48,725
Remeasurements of post-employment benefit liabilities	(30,243)	(1,473)	(31,716)	(14,167)	(740)	(14,907)
Shareholder portion of policyholders' accumulated other comprehensive income	233	(233)	—	145	(145)	—
Total accumulated other comprehensive income (loss)	\$ 72,666	\$ 1,617	\$ 74,283	\$ 32,190	\$ 1,628	\$ 33,818

The accompanying notes are an integral part of these consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands of Canadian dollars)

For the year ended December 31	2020	2019
<b>Operating activities</b>		
Net income	\$ 157,231	\$ 190,658
Non-cash items affecting net income:		
Change in contract liabilities	1,072,582	898,382
Change in reinsurance liabilities	(313,611)	(90,429)
Fair value change in fair value through profit or loss assets	(356,755)	(490,381)
Realized (gain) loss on assets including impairment write downs on available for sale assets	(184,340)	(127,217)
Amortization related to discount on debt instruments	(80,137)	(88,161)
Amortization related to property and equipment and intangible assets (Notes 6 & 7)	11,226	9,975
Deferred income taxes (Note 18)	32,951	(1,147)
Other items	(65,890)	66,729
Cash provided from (used for) operating activities	273,257	368,409
<b>Investing activities</b>		
Portfolio investments		
Purchases and advances	(2,039,973)	(2,298,947)
Sales and maturities	2,012,546	1,996,910
Loans on policies		
Advances	(9,345)	(10,738)
Repayments	14,620	10,024
(Increase) decrease in short-term investments	19,376	(4,425)
Purchases of property and equipment and intangible assets (Notes 6 & 7)	(13,136)	(11,968)
Investment in associate	(3,760)	(17,541)
Cash provided from (used for) investing activities	(19,672)	(336,685)
<b>Financing activities</b>		
Dividends paid to common shareholders (Note 21)	(176,972)	(68,722)
Dividends paid to preferred shareholders (Note 21)	(13,496)	(13,496)
Interest paid on subordinated debt	(14,094)	(14,094)
Cash provided from (used for) financing activities	(204,562)	(96,312)
<b>Net change in cash and cash equivalents</b>	<b>49,023</b>	<b>(64,588)</b>
<b>Cash and cash equivalents - beginning of year (Note 3)</b>	<b>140,333</b>	<b>204,921</b>
<b>Cash and cash equivalents - end of year (Note 3)</b>	<b>\$ 189,356</b>	<b>\$ 140,333</b>
Supplementary cash flow information related to operating activities:		
Income taxes paid, net of (refunds)	\$ 114,790	\$ 28,729
Interest income received	192,830	190,431
Dividend income received	56,018	51,072

The accompanying notes are an integral part of these consolidated financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 1. Description of Company and Summary of Operations

The Empire Life Insurance Company (the Company or Empire Life) was founded in 1923 when it was organized under a provincial charter in Toronto. Authorization to continue as a federal corporation was obtained in 1987. The Company underwrites life and health insurance policies and provides segregated funds, mutual funds and annuity products for individuals and groups across Canada. The Company is a subsidiary of E-L Financial Corporation Limited (the Parent or E-L). The head office, principal address and registered office of the Company are located at 259 King Street East, Kingston, Ontario, K7L 3A8. Empire Life is a Federally Regulated Financial Institution, regulated by the Office of the Superintendent of Financial Institutions, Canada (OSFI). Empire Life became a public company on August 5, 2015 and registered as a public issuer with the Ontario Securities Commission. The Company established a mutual fund subsidiary in 2011, Empire Life Investments Inc. (ELII). ELII became a registered Investment Funds Manager on January 5, 2012. The head office for ELII is located at 165 University Avenue, 9th Floor, Toronto, Ontario, M5H 3B8.

These Consolidated Financial Statements were approved by the Company's Board of Directors (the Board) on February 24, 2021.

## 2. Significant Accounting Policies

### (a) Basis of preparation

The annual Consolidated Financial Statements of the Company for the year ended December 31, 2020 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

These Consolidated Financial Statements have been prepared on a fair value measurement basis, with the exception of certain assets and liabilities. Insurance contract liabilities and Reinsurance assets/liabilities are measured on a discounted basis in accordance with accepted actuarial practice. Investment contract liabilities, Mortgages, Policy contract loans and Loans on policies are carried at amortized cost. Certain other assets and liabilities are measured on a historical cost basis, as explained throughout this note. All amounts included in the Consolidated Financial Statements are presented in thousands of Canadian dollars except for per share amounts and where otherwise stated. These Consolidated Financial Statements also comply with the accounting requirements of OSFI, none of which are an exception to IFRS.

### (b) Basis of consolidation

The Company's Consolidated Financial Statements include the assets, liabilities, results of operations and cash flows of the Company and its wholly-owned and controlled subsidiary, ELII. The Company owns 100% of the voting shares and maintains control of its subsidiary. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date that control ceases. The financial statements of ELII are prepared for the same reporting period as the Company, using consistent accounting policies. All significant inter-company transactions, balances, income and expenses are eliminated in full on consolidation.

### (c) Critical accounting estimates and judgments

The preparation of the Consolidated Financial Statements, in accordance with IFRS, requires management to make judgments and estimates and form assumptions that affect the reported amounts of assets and liabilities as at the date of the Consolidated Financial Statements, and the reported amounts of revenue and expenses during the year. On an ongoing basis, management evaluates its judgments, estimates and critical assumptions in relation to assets, liabilities, revenues and expenses. Actual results could differ from these estimates and changes in estimates are recorded in the accounting period in which they are determined.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Company considers the following items to be particularly susceptible to changes in estimates and judgments:

**(i) Insurance-related liabilities**

Liabilities for insurance contracts are determined using the Canadian Asset Liability Method (CALM), which incorporates best-estimate assumptions for mortality, morbidity, policy lapses, surrenders, future investment yields, policy dividends, administration costs and margins for adverse deviation. These assumptions are reviewed at least annually and are updated to reflect actual experience and market conditions. Changes in the assumptions and margins for adverse deviation can have a significant impact on the valuation of insurance related liabilities.

Additional information regarding insurance-related liabilities is included in Notes 2(e), 2(l), 10 and 27.

**(ii) Financial instruments classification**

Management judgment is used to classify financial instruments as fair value through profit or loss (FVTPL), available for sale (AFS) 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 (OCI).

Additional information regarding financial instrument classification is included in Notes 2(d), 3(a), 3(b) and 10(c).

**(iii) Pension and other post-employment 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 recorded in OCI.

Additional information regarding pension and other post-employment benefits is included in Notes 2(k) and 12.

**(iv) Impairment**

AFS securities and loans and receivables are reviewed at each quarter-end reporting period to identify and evaluate investments that show indications of possible impairment. For AFS securities and loans and receivables, impairment losses are recognized if there is objective evidence of impairment as a result of an event that reduces the estimated future cash flows of the instrument and the impact can be reliably estimated. Objective evidence of impairment includes, but is not limited to, bankruptcy or default, delinquency by a debtor, and specific adverse conditions affecting an industry or a region. In addition, for equity securities, a significant or prolonged decline in the fair value of a security below its cost is objective evidence of impairment. The decision to record a write-down, its amount and the period in which it is recorded could change if management's assessment of those factors were different. Impairment write-downs on debt securities are not recorded when impairment is due to changes in market interest rates, if future contractual cash flows associated with the debt security are still expected to be recovered.

Additional information regarding impairment is included in Notes 2(d), 3(b), 10(c) and 27(c).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (d) Financial instruments

### (i) Fair value

Fair value is the amount of consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. When a financial instrument is initially recognized, its fair value is generally the value of the consideration paid or received. Subsequent to initial recognition, the fair value of a financial asset or liability quoted in an active market is generally the closing price. For financial instruments such as cash equivalents and short-term investments that have a short duration, the carrying value of these instruments approximates fair value.

Fair value measurements used in these Consolidated Financial Statements have been classified by using a fair value hierarchy based upon the transparency of the inputs used in making the measurements. The three levels of the hierarchy are:

Level 1 - Fair value is based on unadjusted quoted prices for identical assets or liabilities in an active market. The types of financial instruments classified as Level 1 generally include cash and exchange traded common and preferred shares and derivatives.

Level 2 - Fair value is based on quoted prices for similar assets or liabilities in active markets, valuation that is based on significant observable inputs, or inputs that are derived principally from or corroborated with observable market data through correlation or other means. The types of financial instruments classified as Level 2 generally include cash equivalents, government bonds, certain corporate and private bonds, short-term investments, certain common shares (real estate limited partnership units) and over the counter derivatives.

Level 3 - Fair value is based on valuation techniques that require one or more significant inputs that are not based on observable market inputs. These unobservable inputs reflect the Company's expectations about the assumptions market participants would use in pricing the asset or liability.

All of the Company's financial instruments requiring fair value measurement meet the requirements of Level 1 or Level 2 of the fair value hierarchy.

### (ii) Cash and cash equivalents and investments

Cash and cash equivalents are short-term, highly liquid investments that are subject to insignificant changes in value and are readily convertible into known amounts of cash. Cash equivalents comprise financial assets with maturities of three months or less from the date of acquisition.

Short-term investments comprise financial assets with maturities of greater than three months and less than one year when acquired.

Most financial assets supporting insurance contract liabilities and investment contract liabilities are designated as FVTPL. These assets may be comprised of cash and cash equivalents, short-term investments, bonds and debentures, common and preferred shares, futures, forwards and options. Changes in the fair value of these financial assets are recorded in Fair value change in FVTPL assets in the Consolidated Statements of Operations in the period in which they occur.

Most financial assets supporting capital and surplus and participating accounts are classified as AFS. These assets may be comprised of short-term investments, bonds and debentures or common and preferred shares. AFS assets are carried at fair value in the Consolidated Statements of Financial Position. Except for foreign currency gains and losses on monetary AFS assets and impairment losses, any changes in the fair value are recorded, net of income taxes, in OCI. Gains and losses realized on sale or maturity of AFS assets are reclassified from OCI to Realized gain (loss) on AFS assets in the Consolidated Statements of Operations.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

Loans and receivables may include mortgage loans, loans on policies and policy contract loans. These assets are recorded at amortized cost, using the effective interest rate method, net of provisions for impairment losses, if any. Mortgage loans are secured by real estate. Loans on policies and policy contract loans are secured by policy values. Loans and receivables are defined as non-derivative financial assets with fixed or determinable payments that are not quoted in active markets.

All transactions are recorded on the trade date. Transaction costs are expensed for FVTPL instruments and capitalized for all others.

## **(iii) Derivative financial instruments**

The Company uses derivative financial instruments to manage exposure to foreign currency, equity and other market risks associated with certain assets and liabilities. Derivative financial assets and liabilities are classified as FVTPL. Therefore, they are initially recorded at fair value on the acquisition date and subsequently revalued at their fair value at each reporting date. Derivative financial instruments with a positive fair value are disclosed as Derivative assets while derivative financial instruments with a negative fair value are disclosed as Other liabilities. Changes in fair value are recorded in Fair value change in FVTPL assets in the Consolidated Statements of Operations.

## **(iv) Impairment**

All investments other than FVTPL instruments are assessed for impairment at each reporting date. Impairment is recognized in Net income when there is objective evidence that a loss event has occurred which has impaired the estimated future cash flows of an asset.

### **(1) AFS debt instruments**

An AFS debt instrument would be identified as impaired when there is objective evidence suggesting that timely collection of the contractual principal or interest is no longer reasonably assured. This may result from a breach of contract by the issuer, such as a default or delinquency in interest or principal payments, or evidence that the issuer is in significant financial difficulty. Impairment is recognized through Net income. Impairment losses previously recorded in Net income are reversed if the fair value subsequently increases and can be objectively related to an event occurring after the impairment loss was recognized.

### **(2) AFS equity instruments**

Objective evidence of impairment of an equity instrument 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.

The accounting for an impairment that is recognized in Net income is the same as described for AFS debt instruments above with the exception that impairment losses previously recognized in Net income cannot be subsequently reversed through Net income. Any subsequent increase in value is recorded in OCI.

### **(3) Loans and receivables**

Mortgages and loans are individually evaluated for impairment in establishing the allowance for impairment.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

Objective evidence of impairment exists if there is no longer reasonable assurance of full collection of loan principal or loan interest related to a mortgage, policy contract loan or a loan on a policy. Events and conditions considered in determining if there is objective evidence of impairment include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability and credit worthiness of the borrower, repayment history or an assessment of the impact of current economic conditions. If objective evidence of impairment is found, allowances for credit losses are established to adjust the carrying value of these assets to their net recoverable amount and the impairment loss is recorded in Net income. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognized, the impairment loss is reversed by adjusting the allowance account and the reversal is recognized in Net income.

## **(v) Derecognition**

A financial asset is derecognized when the contractual rights to its cash flows expire or the Company has transferred its economic rights to the asset and substantially all risks and rewards. In instances where substantially all risks and rewards have not been transferred or retained, the assets are derecognized if the asset is not controlled through rights to sell or pledge the asset.

## **(vi) Other**

Insurance receivables and trade accounts receivables have been classified as loans or receivables and are carried at amortized cost. Trade accounts receivables are presented as Other assets. Accounts payable and other liabilities (excluding derivative liabilities) and Insurance payables have been classified as other financial liabilities and are carried at amortized cost. For these financial instruments, carrying value approximates fair value due to their short term nature.

## **(vii) Securities lending**

The Company engages in securities lending through its custodian as lending agent. Loaned securities are not derecognized and continue to be reported within Investments in the Consolidated Statements of Financial Position, as the Company retains substantial risks and rewards and economic benefits related to the loaned securities. For further details, refer to Note 3(e).

## **(e) Reinsurance**

The Company enters into reinsurance agreements in order to limit its exposure to significant losses. The Company has a Reinsurance Risk Management policy which requires that such arrangements be placed with well-established, highly rated reinsurers. Reinsurance is measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of each reinsurance treaty. Amounts due to or from reinsurers with respect to premiums received or claims paid are included in Insurance receivables and Insurance liabilities in the Consolidated Statement of Financial Position. Premiums for reinsurance ceded are presented as Premiums ceded to reinsurers in the Consolidated Statements of Operations. Reinsurance recoveries on claims incurred are recorded as Claims recovery from reinsurers in the Consolidated Statements of Operations. The reinsurers' share of Insurance contract liabilities is recorded as Reinsurance assets or Reinsurance liabilities in the Consolidated Statements of Financial Position at the same time as the underlying insurance contract liability to which it relates.

Reinsurance assets are reviewed for impairment at each reporting date or more frequently when an indication of impairment arises during the reporting year. Impairment occurs when objective evidence exists that not all amounts due under the terms of the contract will be received. If a reinsurance asset is determined to be impaired, it is written down to its recoverable amount and the impairment loss is recorded in the Consolidated Statements of Operations.

Gains or losses on buying reinsurance are recognized in the Consolidated Statements of Operations immediately at the date of purchase and are not amortized.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (f) Property and equipment

Property and equipment comprises own use land, buildings, leasehold improvements and furniture and equipment. All classes of assets are carried at cost less accumulated amortization including any impairment losses, except for land, which is not subject to amortization. Cost includes all expenditures that are directly attributable to the acquisition of an asset. Subsequent costs are included in the asset's carrying amount only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

Amortization is calculated to write down the cost of property and equipment to their residual values over their estimated useful lives as follows:

Land	No amortization
Building	Five percent (declining balance)
Furniture and equipment	Three to five years (straight-line)
Leasehold improvements	Remaining lease term (straight-line)

Amortization is included in Operating expenses in the Consolidated Statements of Operations.

The estimated useful lives, residual values and amortization methods are reviewed at each year-end, with the effect of any changes in estimate accounted for on a prospective basis. Impairment reviews are performed when there are indicators that the carrying value may not be recoverable. An impairment loss is recognized for the amount by which the carrying value of the asset exceeds its expected recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Impairment losses are recognized in the Consolidated Statements of Operations.

## (g) Intangible assets

Intangible assets include computer software, related licenses and software development costs, which are carried at cost less accumulated amortization and any impairment losses. Amortization of intangible assets is calculated using the straight-line method to allocate the costs over their estimated useful lives, which are generally between three and seven years. Amortization is included in Operating expenses in the Consolidated Statements of Operations. For intangible assets under development, amortization begins when the asset is available for use. The Company does not have intangible assets with indefinite useful lives.

Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates.

Impairment reviews are performed when there are indicators that the carrying value may not be recoverable. An impairment loss is recognized for the amount by which the carrying value of the asset exceeds its expected recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. Impairment losses are recognized in the Consolidated Statements of Operations.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## **(h) Investment in Associates**

Associates are entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the income or loss of the investee after the date of acquisition.

The Company's share of post-acquisition income or loss is recognized in the Consolidated Statements of Operations, and its share of OCI is recognized in the Consolidated Statements of Comprehensive Income. The Company determines at each reporting date whether there is any objective evidence that each investment in associates is impaired. The Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognizes the amount as share of income (loss) of associates in the Consolidated Statements of Operations. Income and losses resulting from transactions between the Company and its associates are recognized in the Company's financial statements only to the extent of unrelated investor's interests in the associates. Unrealized losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company.

## **(i) Segregated funds**

Certain insurance contracts allow the policyholder to invest in segregated investment funds managed by the Company for the benefit of these policyholders. Although the underlying assets are registered in the Company's name and the policyholder has no direct access to the specific assets, the contractual arrangements are such that the segregated fund policyholder bears the risk and rewards of the fund's investment performance. Segregated fund assets are not available to pay liabilities of the general fund. The assets of these funds are carried at their period-end fair values. The Company records a segregated fund policy liability equal to the fair value of the assets and any guarantees are recorded as an insurance contract liability. The Company's Consolidated Statements of Operations includes fee income earned for management of the segregated funds, as well as expenses related to the acquisition, investment management, administration and death benefit, maturity benefit and withdrawal guarantees of these funds. See Note 8 for details on segregated fund assets and changes in segregated fund assets.

The Company provides minimum guarantees on certain segregated fund contracts. These include minimum death, maturity and withdrawal benefit guarantees which are accounted for as insurance contracts. The actuarial liabilities associated with these minimum guarantees are recorded within Insurance contract liabilities. Sensitivity of the Company's liability for segregated fund guarantees to market fluctuations is disclosed in Note 27(a)(1).

## **(j) Subordinated debt**

Subordinated debt is recorded at amortized cost using the effective interest rate method. Interest on subordinated debt is reported as Interest expense in the Consolidated Statements of Operations.

## **(k) Employee benefits**

The Company provides employee pension benefits through either a defined benefit or a defined contribution component of its pension plan. The Company discontinued new enrolments in the defined benefit component effective October 1, 2011 and introduced a defined contribution component effective January 1, 2012 for new enrolments and for any existing employees who chose to transfer from the defined benefit component. The Company also provides other post-employment benefits.

### **(i) Pension benefits**

The defined benefit plan defines an amount of pension benefit that an employee will receive on retirement, dependent on factors such as age, years of service and compensation. The liability recognized in the balance sheet in respect of the defined benefit component is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using current interest rates of high-quality corporate bonds.

Defined benefit expense includes the net interest on the net defined benefit liability (asset) calculated using a discount rate based on market yields on high quality bonds as of prior-year end. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to OCI in the period in which they arise, and remain in accumulated other comprehensive income (AOCI). Past-service costs are recognized immediately in net income.

The defined contribution component of the Plan is a component under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay employees the benefits relating to employee service in the current and prior periods. The contributions are recognized as employee benefit expense when they are due.

## (ii) Other post-employment benefits

The Company also provides other post-employment benefits to their retirees. The entitlement to these benefits is conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using the same accounting methodology as used for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to OCI in the period in which they arise and remain in AOCI. These obligations are valued annually by independent actuaries and are not funded.

## (iii) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to either terminating the employment of current employees according to a detailed formal plan without realistic possibility of withdrawal or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

## (I) Insurance and investment contracts

### (i) Product classification

Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Company agrees to compensate a policyholder if a specified uncertain future event (other than a change in a financial variable) adversely affects the policyholder and the insurance contract has commercial substance. Any contracts not meeting the definition of an insurance contract under IFRS are classified as investment contracts or service contracts, as appropriate. Products issued by the Company that transfer significant insurance risk have been classified as insurance contracts in accordance with IFRS 4 *Insurance Contracts*. Otherwise, products issued by the Company are classified as either investment contracts in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or service contracts in accordance with IFRS 15 *Revenue from Contracts with Customers*. The Company defines significant insurance risk as the possibility of paying at least 2% more than the benefits payable if the insured event did not occur. When referring to multiple contract types, the Company uses the terminology policy liabilities.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts, however, can be reclassified as insurance contracts after inception if insurance risk becomes significant.

The Company classifies its insurance and investment contracts into three main categories: short-term insurance contracts, long-term insurance contracts and investment contracts.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (1) Insurance contracts

The Company's insurance contract liabilities are determined using accepted actuarial practices according to standards established by the Canadian Institute of Actuaries (CIA) and the requirements of OSFI. The Company uses CALM for valuation of insurance contracts, which satisfies the IFRS 4 *Insurance Contracts* requirements for eligibility for use under IFRS.

### (a) Short-term insurance contracts

These contracts include both annuity products and group benefits.

The annuity products classified as short-term insurance contracts are guaranteed investment options that provide for a fixed rate of return over a fixed period. Contracts include certain guarantees that are initiated upon death of the annuitant. The liabilities are determined using CALM.

The group benefits classified as short-term insurance contracts include short-term disability, health and dental benefits. Benefits are typically paid within one year of being incurred. Liabilities for unpaid claims are estimated using statistical analysis and Company experience for claims incurred but not reported.

### (b) Long-term insurance contracts

These contracts include insurance products, annuity products and group benefits. In all cases, liabilities represent an estimate of the amount that, together with estimated future premiums and investment income, will be sufficient to pay future benefits, dividends, expenses and premium taxes on policies in force.

The insurance products so classified are life insurance and critical illness that provide for benefit payments related to death, survival or the occurrence of a critical illness. Terms extend over a long duration. The annuity products classified as long-term insurance contracts include both annuities that provide for income payments for the life of the annuitant and guarantees associated with the Company's segregated fund products. The group benefits classified as long-term insurance contracts are life benefits which are payable upon death of the insured and disability benefits that provide for income replacement in case of disability.

The determination of long-term insurance contract liabilities requires best estimate assumptions that cover the remaining life of the policies. 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 insurance contract liabilities are adequate to pay future benefits. The resulting provisions for adverse deviation have the effect of increasing insurance contract liabilities and decreasing the income that otherwise would have been recognized at policy inception. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in Gross change in insurance contract liabilities and/or Change in insurance contract liabilities ceded in the Consolidated Statements of Operations in the year of the change.

Annually, the Appointed Actuary determines whether insurance contract liabilities (for both short-term and long-term categories) are sufficient to cover the obligations and deferred acquisition costs that relate to policies in force as at the date of the Consolidated Statements of Financial Position. A number of valuation methods are applied, including CALM, discounted cash flows and stochastic modeling. Aggregation levels and the level of prudence applied in assessing liability adequacy are consistent with requirements of the CIA. Any adjustment is recorded as a Gross change in insurance contract liabilities and/or Change in insurance contract liabilities ceded in the Consolidated Statements of Operations.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (2) Investment contracts

These contracts include annuity products that do not involve the transfer of significant insurance risk, either at inception or during the life of the contract. For the Company, products so classified are limited to term certain annuities that provide for income payments for a specified period of time.

Investment contract liabilities are recognized when contracts are entered into and deposits are received. These liabilities are initially recognized at fair value, and subsequently they are carried at amortized cost based on expected future cash flows using the effective interest rate method. The expected future cash flows are re-estimated at each reporting date and the carrying amount of the financial liability is recalculated as the present value of estimated future cash flows using the financial liability's original effective interest rate. Any adjustment is immediately recognized in the Consolidated Statements of Operations. Deposits and withdrawals are recorded in Investment contract liabilities on the Consolidated Statements of Financial Position.

## (ii) Premiums

Gross premiums for all types of insurance contracts are recognized as revenue when due and collection is reasonably assured. When premiums are recognized, policy liabilities are computed, with the result that benefits and expenses are matched with such revenue. Annuity premiums are comprised solely of new deposits on general fund products with a guaranteed rate of return and exclude deposits on segregated fund and investment contract products.

## (iii) Benefits and claims paid

Benefits are recorded as an expense when they are incurred. Annuity payments are expensed when due for payment. Health insurance claims are accounted for when there is sufficient evidence of their existence and a reasonable assessment can be made of the monetary amount involved. Benefits and claims paid include the direct costs of settlement. Reinsurance recoveries are accounted for in the same period as the related claim.

## (iv) Deferred acquisition costs

Distribution costs of segregated funds having a deferred sales charge are deferred and amortized over the term of the related deposits or the applicable period of such sales charge, as appropriate. These deferred costs form part of Insurance contract liabilities on the Consolidated Statements of Financial Position. The costs deferred in the period and amortization of deferred costs form part of the Gross change in insurance contract liabilities on the Consolidated Statements of Operations.

## (m) Participating policies

The Company maintains an account in respect of participating policies ("participating account"), separate from those maintained in respect of other policies, in the form and manner determined by OSFI under sections 456-464 of the *Insurance Companies Act*. The participating account includes all policies issued by the Company that entitle its policyholders to participate in the profits of the participating account. The Company has discretion as to the amount and timing of dividend payments which take into consideration the continuing solvency of the participating account. Dividends are paid annually, with a few older plans paying dividends every five years as per contractual provisions. Participating policyholder dividends are recognized as Policy dividends expense in the Consolidated Statements of Operations.

At the end of the reporting period all participating insurance contract liabilities, both guaranteed and discretionary, are held within Insurance contract liabilities, Policyholders' funds on deposit and Provision for profits to policyholders. All participating policy reinsurance ceded at the end of the reporting period is held within Reinsurance assets or Reinsurance liabilities. Net income attributable to participating policyholders is shown on the Consolidated Statements of Operations. Comprehensive income attributable to participating policyholders is shown on the Consolidated Statements of Comprehensive Income. The portion of Retained earnings and Accumulated other comprehensive income (AOCI) in respect of participating policies is reported separately in the Policyholders' equity section of the Consolidated Statements of Changes in Equity.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (i) Investment policy

The investments in the participating account are subject to limits established by the *Insurance Companies Act* and to investment guidelines established by the Investment Committee of the Board. The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, concentration and asset quality limits for eligible investments. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable and measurable low levels.

## (ii) Investment income allocation

Investment income is recorded directly to each asset segment. When there is a deficiency of funds over assets, a portion of investment income is allocated to the Shareholders' Capital and Surplus segment from the participating account's asset segments in proportion to the deficiency of funds over assets of each segment. When there is an excess of funds over assets, a portion of investment income is allocated from the Shareholders' Capital and Surplus segment to the participating account's asset segments in proportion to the excess of funds over assets of each segment.

## (iii) Expense allocation

For purposes of allocation of profits to the participating account, expenses associated directly with the participating account will be attributed to the participating account. Expenses arising from or varying directly with various functional activities are charged to the participating account in proportion to statistics appropriate to each cost centre. Expenses incurred by overhead cost centres are charged to the participating account in proportion to expenses directly charged. Investment expenses are allocated monthly to the participating account in proportion to the Company's total funds at the beginning of each month. Premium taxes are allocated in proportion to taxable premiums. Other taxes, licenses, and fees are allocated to lines of business using cost centre methods.

## (iv) Income tax allocation

For the purpose of allocation of profits to the participating account, income taxes are allocated to the participating account in proportion to total taxable income for the Company.

## (n) Fee income

Fee income includes investment management, policy administration and guarantee fees that are recognized on an accrual basis, and surrender charges that are recognized as incurred. Fee income earned for investment management, administration and guarantees of the investment funds is based on the funds' closing net asset values.

## (o) Investment income

Interest income is recognized using the effective interest rate method. Fees that are an integral part of the effective yield of the financial asset are recognized as an adjustment to the effective interest rate of the instrument.

Dividend income is recognized when the right to receive payment is established, which is usually the ex-dividend date.

Interest income and dividend income are included in Investment income in the Consolidated Statements of Operations for all financial assets.

## (p) Income taxes

Income tax expense for the period is comprised of current and deferred tax. Tax is recognized in the Consolidated Statements of Operations except to the extent that it relates to items recognized in OCI or directly in equity. In these cases, the tax is recognized in OCI or directly in equity, respectively.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of each reporting period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

Deferred income tax assets and liabilities are recorded for the expected future income tax consequences of events that have been reflected in the consolidated financial statements. Deferred income taxes are provided for using the liability method. Under the liability method, deferred income taxes are recognized for all significant temporary differences between tax and financial statement bases for assets and liabilities and for certain carry-forward items.

Deferred income tax assets are recognized only to the extent that, in the opinion of management, it is probable that the deferred income tax assets will be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates, on the date of their substantive enactment.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets and they relate to income taxes levied by the same tax authority on the same taxable entity.

## **(q) Foreign currency translation**

The Company uses the Canadian dollar as both its functional and presentational currency.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognized in the Consolidated Statements of Operations.

For monetary financial assets designated as AFS, translation differences are recognized in the Consolidated Statements of Operations. Translation differences on non-monetary items, such as foreign denominated AFS common equities, are recognized in OCI and included in the AFS component within AOCI. On derecognition of an AFS non-monetary financial asset, the cumulative exchange gain or loss previously recognized in AOCI is recognized in the Consolidated Statements of Operations.

## **(r) Comprehensive income**

Comprehensive income consists of Net income and OCI. OCI includes items that may be reclassified subsequently to Net income: Unrealized fair value change on AFS investments, net of amounts reclassified to net income and the Amortization of loss on derivative investments designated as cash flow hedges. OCI also includes items that will not be reclassified to net income: Remeasurements of post-employment benefit liabilities. All OCI amounts are net of taxes.

## **(s) Provisions**

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. If the outflow of economic benefits is not probable, a contingent liability is disclosed unless the possibility of an outflow of economic benefits is remote. Any change in estimate of a provision is recorded in Net income. Provisions are not recognized for future operating losses. Provisions are measured as the present value of the expected expenditures to settle the obligation using a discount rate that reflects current market assessments of the time value of money and the risks specific to the obligation.

## **(t) Leases**

The Company leases certain property and equipment. When the Company enters into a lease as a lessee, a right-of-use asset and a lease liability is recognized in the Statements of Financial Position. The initial lease liability is computed based on the present value of the lease payments, discounted at the Company's incremental borrowing rate. Subsequent to the initial recognition the lease liability is measured at the amortized cost using the effective interest rate method and is included in Accounts payable and other liabilities. Interest expense is included in operating expenses. The depreciation on the corresponding right-of-use asset is included in operating expenses.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Company has elected to apply the option to recognize lease payments for short-term and low level assets on a straight-line basis over the lease term in operating expenses.

## (u) Earnings per share (EPS)

Basic EPS is calculated by dividing the Net income for the period attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. The Company does not have any potentially dilutive instruments. As a result, diluted EPS are the same as basic EPS.

## (v) Accounting changes

### (i) New accounting pronouncements issued but not yet effective

#### (1) IFRS 9 Financial Instruments

IFRS 9, effective for periods beginning on or after January 1, 2018 with retrospective application replaces IAS 39 *Financial Instruments: Recognition and Measurement* with a new mixed measurement model having three measurement categories of amortized cost, fair value through other comprehensive income (FVTOCI) and FVTPL for financial assets.

Under IFRS 9, all financial assets currently within the scope of IAS 39 will be measured at either amortized cost, FVTOCI or FVTPL. Classification will depend on the business model and the contractual cash flow characteristics of the financial asset. All equity instruments will be measured at FVTOCI or FVTPL. A debt instrument will be measured at amortized cost only if it is held to collect the contractual cash flows and the cash flows represent principal and interest. For financial liabilities designated as FVTPL, the change in the fair value attributable to changes in the liability's credit risk will be recognized in OCI.

On September 12, 2016, the IASB published an amendment to IFRS 4 *Insurance Contracts* (which will be subsequently changed to IFRS 17 *Insurance Contracts*). The amendment provides two options for insurance companies relating to IFRS 9:

- a temporary exemption from IFRS 9 for entities that meet specific requirements (applied at the reporting entity level);
- and the 'overlay approach'.

The Company has evaluated the criteria and will apply the temporary exemption for periods beginning before January 1, 2023, which allows continued application of IAS 39 instead of adopting IFRS 9, if the Company's activities are 'predominantly connected with insurance'. OSFI has also mandated that all Federally Regulated Life Insurance Companies defer the application of IFRS 9 until IFRS 17 is adopted.

Per the amendments to IFRS 4 Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts, companies applying the temporary exemption are required to disclose fair value information with respect to their investments in financial assets whose contractual cash flows reflect solely payments of principal and interest on the principal amount outstanding (SPPI), to enable users of financial statements to compare insurers applying the temporary exemption with entities applying IFRS 9. The Company's fixed income invested assets presented in Note 3(a) include cash equivalents, short-term investments, bonds, mortgages, loans on policies and policy contract loans and primarily have cash flows that qualify as SPPI. Fixed income invested assets which do not have SPPI qualifying cash flows as at December 31, 2020 and December 31, 2019 include mortgages with fair values of \$13.2 million and \$10.4 million, respectively.

The Company is currently evaluating the impact of IFRS 9 on its Consolidated Financial Statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## **(2) IFRS 17 Insurance Contracts**

The IASB issued the final IFRS 17 Standard on June 25 2020. IFRS 17 provides a comprehensive principle-based framework for the recognition, measurement, presentation and disclosures of all insurance contracts.

The new standard will replace IFRS 4 Insurance contracts. IFRS 17 requires entities to measure insurance contract liabilities at their current fulfillment cash flows and for revenue to be recognized as the service is provided over the coverage period. This new standard is required to be adopted retrospectively, if this is impracticable, the modified retrospective or fair value method may be used.

The effective dates for IFRS 17 and IFRS 9 have been deferred to annual reporting periods beginning on or after January 1, 2023. The Company is currently assessing the impact of adopting this standard on its Consolidated Financial Statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 3. Financial Instruments

### (a) Summary of Cash and cash equivalents and investments

The carrying values of cash and cash equivalents and investments are as follows:

As at December 31	2020			2019		
	Fair value through profit or loss	Available for sale	Total carrying value	Fair value through profit or loss	Available for sale	Total carrying value
<b>Asset category</b>						
Cash and cash equivalents						
Cash	\$ 35,201	\$ —	\$ 35,201	\$ 20,698	\$ —	\$ 20,698
Cash equivalents	154,155	—	154,155	119,635	—	119,635
<b>Total cash and cash equivalents</b>	<b>189,356</b>	<b>—</b>	<b>189,356</b>	<b>140,333</b>	<b>—</b>	<b>140,333</b>
Short-term investments						
Canadian federal government	4,999	4,999	9,998	13,988	—	13,988
Canadian provincial governments	—	—	—	6,463	—	6,463
Canadian municipal governments	—	—	—	897	—	897
Corporate	3,010	—	3,010	11,036	—	11,036
<b>Total short-term investments</b>	<b>8,009</b>	<b>4,999</b>	<b>13,008</b>	<b>32,384</b>	<b>—</b>	<b>32,384</b>
Bonds						
Canadian federal government	8,013	252,719	260,732	8,050	226,594	234,644
Canadian provincial governments	3,554,583	543,756	4,098,339	3,706,755	475,970	4,182,725
Canadian municipal governments	117,558	95,069	212,627	106,418	102,340	208,758
<b>Total Canadian government bonds</b>	<b>3,680,154</b>	<b>891,544</b>	<b>4,571,698</b>	<b>3,821,223</b>	<b>804,904</b>	<b>4,626,127</b>
Canadian corporate bonds by industry sector:						
Energy	141,206	62,341	203,547	107,996	60,018	168,014
Materials	16,193	7,030	23,223	15,799	6,822	22,621
Industrials	90,584	49,751	140,335	61,155	66,411	127,566
Consumer discretionary	15,068	6,336	21,404	15,263	991	16,254
Consumer staples	198,407	72,255	270,662	130,116	65,905	196,021
Health care	81,884	9,319	91,203	87,721	22,081	109,802
Financial services	642,664	363,736	1,006,400	615,089	296,760	911,849
Information Technology	181	5,116	5,297	—	—	—
Communication services	284,443	42,202	326,645	181,108	75,261	256,369
Utilities	628,449	77,174	705,623	479,903	99,925	579,828
Real estate	42,655	18,718	61,373	18,145	18,591	36,736
Infrastructure	418,409	59,328	477,737	319,442	30,810	350,252
<b>Total Canadian corporate bonds</b>	<b>2,560,143</b>	<b>773,306</b>	<b>3,333,449</b>	<b>2,031,737</b>	<b>743,575</b>	<b>2,775,312</b>
Foreign bonds						
Government	111,399	—	111,399	98,056	—	98,056
Corporate	11,234	—	11,234	10,157	—	10,157
<b>Total foreign bonds</b>	<b>122,633</b>	<b>—</b>	<b>122,633</b>	<b>108,213</b>	<b>—</b>	<b>108,213</b>
<b>Total bonds</b>	<b>6,362,930</b>	<b>1,664,850</b>	<b>8,027,780</b>	<b>5,961,173</b>	<b>1,548,479</b>	<b>7,509,652</b>
<b>Total preferred shares - Canadian</b>	<b>606,664</b>	<b>10,238</b>	<b>616,902</b>	<b>463,826</b>	<b>10,203</b>	<b>474,029</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

As at December 31	2020			2019		
	Fair value through profit or loss	Available for sale	Total carrying value	Fair value through profit or loss	Available for sale	Total carrying value
<b>Asset category</b>						
Common shares						
Canadian common shares	172,172	47,734	219,906	111,461	44,247	155,708
Exchange-traded funds	501,905	—	501,905	494,131	—	494,131
Canadian real estate limited partnership units	121,290	—	121,290	120,884	—	120,884
U.S.	42,046	—	42,046	42,306	—	42,306
Other	33,553	—	33,553	29,000	—	29,000
<b>Total common shares</b>	<b>870,966</b>	<b>47,734</b>	<b>918,700</b>	<b>797,782</b>	<b>44,247</b>	<b>842,029</b>
Total derivative assets	5,377	—	5,377	2,930	—	2,930
<b>Loans and receivables</b>						
Mortgages	—	—	157,214	—	—	169,827
Loans on policies	—	—	56,458	—	—	55,363
Policy contract loans	—	—	60,407	—	—	66,520
<b>Total financial instruments</b>	<b>\$ 8,043,302</b>	<b>\$ 1,727,821</b>	<b>\$ 10,045,202</b>	<b>\$ 7,398,428</b>	<b>\$ 1,602,929</b>	<b>\$ 9,293,067</b>

The following table presents the fair value of cash and cash equivalents and investments classified by the fair value hierarchy:

As at December 31	2020			2019		
	Level 1	Level 2	Total fair value	Level 1	Level 2	Total fair value
<b>Fair value through profit or loss:</b>						
Cash and cash equivalents	\$ 35,201	\$ 154,155	\$ 189,356	\$ 20,698	\$ 119,635	\$ 140,333
Short-term investments	—	8,009	8,009	—	32,384	32,384
Bonds	—	6,362,930	6,362,930	—	5,961,173	5,961,173
Preferred shares	606,664	—	606,664	463,826	—	463,826
Common shares	749,275	121,691	870,966	676,858	120,924	797,782
Derivative assets	5,361	16	5,377	2,928	2	2,930
<b>Available for sale:</b>						
Short-term investments	—	4,999	4,999	—	—	—
Bonds	—	1,664,850	1,664,850	—	1,548,479	1,548,479
Preferred shares	10,238	—	10,238	10,203	—	10,203
Common shares	47,734	—	47,734	44,247	—	44,247
<b>Loans and Receivables</b>						
Mortgages	—	170,886	170,886	—	175,229	175,229
Loans on policies	—	56,458	56,458	—	55,363	55,363
Policy contract loans	—	60,407	60,407	—	66,520	66,520
<b>Total</b>	<b>\$ 1,454,473</b>	<b>\$ 8,604,401</b>	<b>\$ 10,058,874</b>	<b>\$ 1,218,760</b>	<b>\$ 8,079,709</b>	<b>\$ 9,298,469</b>

The fair value of mortgages has been calculated by discounting cash flows of each mortgage at a discount rate appropriate to its remaining term to maturity. The discount rates are determined based on regular competitive rate surveys. The fair values of Loans on policies and Policy contract loans approximates their carrying values, due to the life insurance contracts that secure them.

The classification of a financial instrument into a level is based on the lowest level of input that is significant to the determination of the fair value. There were no transfers between Level 1 and Level 2 and

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

there were no Level 3 investments during the year ended December 31, 2020 or during the year ended December 31, 2019.

For additional information on the composition of the Company's invested assets and analysis of the Company's risks arising from financial instruments refer to Note 27 Risk Management.

## (b) Impairments

### (i) Loans and receivables

Investments in individual assets have been reduced by the following specific allowances for impairment:

As at December 31	2020			2019		
Impaired Loans	Recorded investment	Allowance for impairment	Carrying value	Recorded investment	Allowance for impairment	Carrying value
Mortgages	\$ 6,337	\$ 3,147	\$ 3,190	\$ 5,531	\$ 2,678	\$ 2,853
Policy contract loans	813	444	369	813	460	353
<b>Total</b>	<b>\$ 7,150</b>	<b>\$ 3,591</b>	<b>\$ 3,559</b>	<b>\$ 6,344</b>	<b>\$ 3,138</b>	<b>\$ 3,206</b>

The Company holds collateral with a fair value of \$3,190 (2019 \$2,853) in respect of these mortgages and \$369 (2019 \$353) in respect of these policy contract loans as at December 31, 2020. Mortgage loans are secured by real estate, and policy contract loans are secured by life insurance.

For the year ended December 31	2020	2019
Continuity of allowance for loan impairment:		
Allowance - beginning of year	\$ 3,138	\$ 3,374
Provision for loan impairment	618	634
Write-off of loans	(165)	(870)
<b>Allowance - end of year</b>	<b>\$ 3,591</b>	<b>\$ 3,138</b>

The Company has recorded interest income of \$751 (2019 \$669) on these assets.

### (ii) Available for sale

For the year-ended December 31, 2020, the Company reclassified a pre-tax loss of \$4,252 (2019 \$1,811) from OCI to Net income due to write downs of impaired AFS common and preferred shares. Management considers these assets to be impaired due to the length of time that the fair value was less than the cost and/or the extent and nature of the loss.

For additional information on the fair values of the Company's AFS investments, refer to Note 3(a). For analysis of the Company's risks arising from financial instruments, refer to Note 27.

## (c) Investment income

Investment income is comprised of the following:

For the year ended December 31	2020	2019
Interest income	\$ 271,271	\$ 276,364
Dividend income	57,279	49,592
Other	1,491	395
Provision for loan impairment	(618)	(634)
<b>Investment income</b>	<b>\$ 329,423</b>	<b>\$ 325,717</b>

Interest income includes \$62,916 (2019 \$66,265) relating to assets not classified as FVTPL.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (d) Derivative financial instruments

The values of derivative instruments are set out in the following table. The use of derivatives is measured in terms of notional principal amounts, which serve as the basis for calculating payments and are generally not actual amounts that are exchanged.

As at December 31	2020			2019		
	Notional principal	Fair value assets	Fair value liabilities	Notional principal	Fair value assets	Fair value liabilities
Exchange-traded						
Equity index futures	\$ 104,315	\$ 3,325	\$ 43	\$ 49,964	\$ 585	\$ 28
Equity options	122,828	2,033	—	537,772	2,342	—
Over-the-counter						
Foreign currency forwards	34,114	16	7	37,103	3	402
Cross currency swaps	20,980	3	1,360	20,980	—	1,610
<b>Total</b>	<b>\$ 282,237</b>	<b>\$ 5,377</b>	<b>\$ 1,410</b>	<b>\$ 645,819</b>	<b>\$ 2,930</b>	<b>\$ 2,040</b>

All contracts mature in less than one year. Fair value asset amounts are reported in the Consolidated Statements of Financial Position as Derivative assets. Fair value liability amounts are reported in the Consolidated Statements of Financial Position as part of Accounts payable and other liabilities. Fair value of exchange traded derivatives is determined based on Level 1 inputs. Foreign currency forward contracts are valued based primarily on the contract notional amount, the difference between the contract rate and the forward market rate for the same currency, interest rates and credit spreads.

Cross currency swaps are valued by discounting the future cash flows for both legs at the underlying market interest rate curves in each currency applicable at the valuation date. The sum of the cash flows denoted in the foreign currency is converted with the spot rate applicable at that time. The foreign currency leg, where Empire Life owes interest and principal, produces a negative fair value to Empire Life while the Canadian dollar leg produces a positive fair value to Empire Life. The net of these amounts represents the reported fair value of the cross currency swap. Contracts for which counterparty credit spreads are observable and reliable, or for which the credit-related inputs are determined not to be significant to fair value, are classified as Level 2.

For analysis of the Company's risks arising from financial instruments, refer to Note 27.

## (e) Securities Lending

The Company has a securities lending agreement with its custodian. Under this agreement, the custodian may lend securities from the Company's portfolio to other institutions, as approved by the Company, for periods of time. In addition to a fee, the Company receives collateral which exceeds the market value of the loaned securities, which is retained by the Company until the underlying security has been returned to the Company. In the event that any of the loaned securities are not returned to the custodian, at its option the custodian may either restore to the Company securities identical to the loaned securities or it will pay to the Company the value of the collateral up to but not exceeding the market value of the loaned securities on the date on which the loaned securities were to have been returned (Valuation Date) to the custodian. If the collateral is not sufficient to allow the custodian to pay such market value to the Company, the custodian shall indemnify the Company only for the difference between the market value of the securities and the value of such collateral on the Valuation Date. As a result, there is no significant exposure to credit risk associated with this securities lending agreement.

Income recognized from securities lending activities was as follows:

For the year ended December 31	2020	2019
General funds	\$ 1,593	\$ 986
Segregated funds	1,677	1,706
<b>Total</b>	<b>\$ 3,270</b>	<b>\$ 2,692</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

As at December 31, 2020 and December 31, 2019, the aggregate fair values of the Company's securities loaned and the collateral received were as follows:

As at December 31	2020			2019		
	General Funds	Segregated Funds	Total	General Funds	Segregated Funds	Total
Value of securities loaned	\$ 1,307,965	\$ 1,452,978	\$ 2,760,943	\$ 1,184,675	\$ 1,511,859	\$ 2,696,534
Value of collateral received	\$ 1,334,144	\$ 1,482,183	\$ 2,816,327	\$ 1,208,397	\$ 1,542,231	\$ 2,750,628

## 4. Insurance Receivables

As at December 31	2020	2019
Due from policyholders	\$ 2,946	\$ 3,047
Due and accrued from reinsurers	15,591	17,927
Fees receivable	14,415	15,512
Other	13,581	12,242
<b>Insurance receivables</b>	<b>\$ 46,533</b>	<b>\$ 48,728</b>

All amounts are expected to be recovered within one year of the Consolidated Statements of Financial Position date. These financial instruments are short-term in nature and their fair values approximate carrying values.

## 5. Other Assets

Other assets consist of the following:

As at December 31	2020	2019
Trade accounts receivable	\$ 7,245	\$ 13,180
Prepaid expenses	7,236	6,231
Right-of-use assets	6,808	3,685
<b>Other assets</b>	<b>\$ 21,289</b>	<b>\$ 23,096</b>

All amounts are expected to be recovered within one year of the Consolidated Statements of Financial Position date except for right-of-use assets of \$6,808 (2019 \$3,685). Trade accounts receivable are short-term in nature and their fair values approximate carrying value.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 6. Property and Equipment

		Land	Buildings	Furniture and equipment	Leasehold improvements	Total
<b>Cost</b>						
As at January 1, 2019	\$	2,318	\$ 13,038	\$ 43,766	\$ 8,291	\$ 67,413
Additions		—	1	2,255	719	2,975
Disposals		—	—	—	—	—
As at December 31, 2019		2,318	13,039	46,021	9,010	70,388
Additions		—	—	1,238	720	1,958
Disposals		—	—	—	—	—
<b>As at December 31, 2020</b>	<b>\$</b>	<b>2,318</b>	<b>\$ 13,039</b>	<b>\$ 47,259</b>	<b>\$ 9,730</b>	<b>\$ 72,346</b>
<b>Amortization</b>						
As at January 1, 2019	\$	—	\$ (4,779)	\$ (31,117)	\$ (6,941)	\$ (42,837)
Charge for the year		—	(413)	(4,780)	(342)	(5,535)
Disposals		—	—	—	—	—
As at December 31, 2019		—	(5,192)	(35,897)	(7,283)	(48,372)
Charge for the year		—	(392)	(4,880)	(401)	(5,673)
Disposals		—	—	—	—	—
<b>As at December 31, 2020</b>	<b>\$</b>	<b>—</b>	<b>\$ (5,584)</b>	<b>\$ (40,777)</b>	<b>\$ (7,684)</b>	<b>\$ (54,045)</b>
<b>Carrying amount</b>						
<b>December 31, 2020</b>	<b>\$</b>	<b>2,318</b>	<b>\$ 7,455</b>	<b>\$ 6,482</b>	<b>\$ 2,046</b>	<b>\$ 18,301</b>
December 31, 2019	\$	2,318	\$ 7,847	\$ 10,124	\$ 1,727	\$ 22,016

There were no asset impairments in 2020 or 2019.

## 7. Intangible Assets

		Intangible assets	
<b>Cost</b>			
As at January 1, 2019		\$	66,754
Additions			8,993
Disposals			—
As at December 31, 2019			75,747
Additions			11,179
Disposals			—
<b>As at December 31, 2020</b>	<b>\$</b>		<b>86,926</b>
<b>Amortization</b>			
As at January 1, 2019		\$	(48,950)
Charge for the year			(4,440)
Disposals			—
As at December 31, 2019			(53,390)
Charge for the year			(5,553)
Disposals			—
<b>As at December 31, 2020</b>	<b>\$</b>		<b>(58,943)</b>
<b>Carrying amount</b>			
<b>December 31, 2020</b>	<b>\$</b>		<b>27,983</b>
December 31, 2019	\$		22,357

There were no asset impairments during 2020 or 2019.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 8. Segregated Funds

(a) The following table identifies segregated fund assets by category of asset:

As at December 31	2020	2019
Cash	\$ 34,871	\$ 8,482
Short-term investments	410,641	595,621
Bonds	1,866,564	1,857,955
Common and preferred shares	6,207,527	6,100,714
Other assets	20,320	13,577
	<b>8,539,923</b>	<b>8,576,349</b>
Less segregated funds held within general fund investments	(82,506)	(77,766)
<b>Total</b>	<b>\$ 8,457,417</b>	<b>\$ 8,498,583</b>

(b) The following table presents the investments of the segregated funds measured on a recurring basis at fair value classified by the fair value hierarchy:

As at December 31	2020			2019		
	Level 1	Level 2	Total	Level 1	Level 2	Total
Cash	\$ 34,871	\$ —	\$ 34,871	\$ 8,482	\$ —	\$ 8,482
Short-term investments	—	410,641	410,641	—	595,621	595,621
Bonds	—	1,866,564	1,866,564	—	1,857,955	1,857,955
Common and preferred shares	6,207,527	—	6,207,527	6,100,714	—	6,100,714
<b>Total</b>	<b>\$ 6,242,398</b>	<b>\$ 2,277,205</b>	<b>\$ 8,519,603</b>	<b>\$ 6,109,196</b>	<b>\$ 2,453,576</b>	<b>\$ 8,562,772</b>

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2020 and December 31, 2019. There were no level 3 investments as at December 31, 2020 and December 31, 2019.

(c) The following table presents the change in segregated fund assets:

For the year ended December 31	2020	2019
Segregated fund assets - beginning of year	\$ 8,498,583	\$ 7,822,790
Additions to segregated funds:		
Amount received from policyholders	774,960	895,265
Interest	60,001	64,909
Dividends	157,007	165,247
Other income	15,676	23,061
Net realized gains on sale of investments	11,173	251,403
Net unrealized increase in fair value of investments	190,114	756,655
	<b>1,208,931</b>	<b>2,156,540</b>
Deductions from segregated funds:		
Amounts withdrawn or transferred by policyholders	1,014,459	1,220,537
Management fees and other operating costs	230,898	242,868
	<b>1,245,357</b>	<b>1,463,405</b>
Net change in segregated funds held within general fund investments	<b>(4,740)</b>	<b>(17,342)</b>
<b>Segregated fund assets - end of year</b>	<b>\$ 8,457,417</b>	<b>\$ 8,498,583</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (d) Empire Life's exposure to segregated fund guarantee risk

Segregated fund products issued by Empire Life contain death, maturity, and withdrawal benefit guarantees. Market price fluctuations impact the Company's estimated liability for those guarantees.

## 9. Insurance Payables

As at December 31		2020		2019
Claims due and accrued	\$	49,207	\$	37,551
Payable to agents		21,564		16,688
Premiums paid in advance		1,008		2,456
Due to reinsurance companies		9,456		15,902
Other		33,703		22,981
Insurance payables	\$	114,938	\$	95,578

Of the above total, \$759 (2019 \$969) is expected to be settled more than one year after the Consolidated Statements of Financial Position date. Most of these financial instruments are short-term in nature and their fair value approximates carrying values.

## 10. Insurance Contract Liabilities and Reinsurance Assets/Liabilities

### (a) Nature and composition of insurance contract liabilities and related reinsurance

Insurance contract liabilities include life, health and annuity contracts on a participating and non-participating basis.

Changes in actuarial assumptions are made based on emerging and evolving experience with respect to major factors affecting estimates of future cash flows and consideration of economic forecasts of investment returns, industry and internal studies and requirements of the CIA and OSFI.

Insurance contract liabilities represent an estimate of the amount that, together with estimated future premiums and investment income, will be sufficient to pay future benefits, dividends, expenses, and premium taxes on policies in force. Insurance contract liabilities are determined using accepted actuarial practice according to standards established by the CIA and the requirements of OSFI.

The Company reinsures excess risks with Canadian regulated reinsurance companies. The reinsurance assets (liabilities) are determined based on both the premiums expected to be paid by the Company under reinsurance agreements over the duration of the insurance contracts that they support and the insurance claims expected to be received by the Company when an insured event occurs under those insurance contracts. The liability position of some of the reinsurance is due to the excess of future premiums payable over the expected benefit of reinsurance. The change in reinsurance liabilities is primarily related to the Company's revised mortality assumptions, which reduce the present value of insurance claims expected to be recovered from the reinsurance companies. The Company enters into reinsurance agreements only with reinsurance companies that have an independent credit rating of "A-" or better.

Reinsurance transactions do not relieve the original insurer of its primary obligation to policyholders.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Company is active in most life insurance and annuity product lines across Canada and does not operate in foreign markets. The table below shows the concentration of insurance contract liabilities and related reinsurance assets (liabilities) by type of contract:

As at December 31	2020			2019		
	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net
Participating Individual						
Life	\$ 824,384	\$ 8,631	\$ 833,015	\$ 701,185	\$ 10,313	\$ 711,498
Annuity	86	—	86	138	—	138
Non-participating Individual						
Life	4,752,536	511,682	5,264,218	4,013,248	797,015	4,810,263
Health	268,383	(8,832)	259,551	243,562	(8,476)	235,086
Annuity	1,033,955	(8,844)	1,025,111	902,530	(8,875)	893,655
Non-participating Group						
Life	34,157	(3,796)	30,361	28,499	(1,345)	27,154
Health	265,944	(114,080)	151,864	223,926	(90,260)	133,666
Annuity	44,428	—	44,428	44,838	—	44,838
Segregated fund deferred acquisition costs	(78,412)	—	(78,412)	(84,058)	—	(84,058)
<b>Total</b>	<b>\$ 7,145,461</b>	<b>\$ 384,761</b>	<b>\$ 7,530,222</b>	<b>\$ 6,073,868</b>	<b>\$ 698,372</b>	<b>\$ 6,772,240</b>

The Company expects to pay \$7,060,918 (2019 \$5,996,977) of Insurance contract liabilities and \$400,547 (2019 \$704,339) of Reinsurance liabilities more than one year after the Consolidated Statements of Financial Position date. The remaining balance is expected to be settled within one year.

The following segregated fund deferred acquisition costs are included in Insurance contract liabilities:

	2020	2019
Segregated funds deferred acquisition costs - beginning of year	\$ 84,058	\$ 87,517
Deferred during year	23,013	25,872
Amortized during year	(28,659)	(29,331)
<b>Segregated funds deferred acquisition costs - end of year</b>	<b>\$ 78,412</b>	<b>\$ 84,058</b>

Of the above total, \$30,863 (2019 \$30,576) is expected to be amortized during the next year.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (b) Change in insurance contract liabilities and reinsurance assets/liabilities

For the year ended December 31	2020			2019		
	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net	Gross insurance contract liabilities	Reinsurance (assets) liabilities	Net
Balance - beginning of year	\$ 6,073,868	\$ 698,372	\$ 6,772,240	\$ 5,176,423	\$ 788,801	\$ 5,965,224
Changes in methods and assumptions						
Non-participating policies						
Changes for expected mortality/morbidity	65,030	(1,116)	63,914	(60,206)	47,618	(12,588)
Update of mortality table	185,705	(261,583)	(75,878)	137,622	(292,750)	(155,128)
Lapse/premium assumption updates	114,801	(15,614)	99,187	31,968	(5,393)	26,575
Update of investment return assumptions	120,160	(23,949)	96,211	119,718	16,964	136,682
Model enhancements and other changes	(37,030)	25,363	(11,667)	59,077	10,783	69,860
Reinsurance recapture	(7,491)	(12,093)	(19,584)	(3,084)	(103,486)	(106,570)
Deferred future tax liability modeling updates	(108,116)	(8,527)	(116,643)	—	—	—
Participating policies						
Model enhancements and other changes	(497)	191	(306)	(9,634)	3,967	(5,667)
Normal changes						
New business	(30,897)	(1,484)	(32,381)	31,649	2,292	33,941
In-force business	769,928	(14,799)	755,129	590,335	229,576	819,911
Balance - end of year	\$ 7,145,461	\$ 384,761	\$ 7,530,222	\$ 6,073,868	\$ 698,372	\$ 6,772,240

Net changes in methods and assumptions summarized in the above tables are further explained as follows:

Changes in 2020 related to expected mortality projections are primarily related to revised assumptions for renewable term business. Changes made in 2019 for expected mortality were primarily related to revised projected assumptions for the individual life business, and to projected morbidity assumptions for group long-term disability (Group LTD) business.

In 2019 the universal life and non-participating individual insurance mortality tables were replaced by more recent industry tables. Actual/expected ratios were updated based on a combination of Empire Life and industry experience. Partial credit was taken for this change in 2019, with the remainder recognized in 2020.

In 2020 the lapse/premium assumption change is related to updates of assumed lapse rates on renewable term, non-par whole life and universal life policies as experience continues to unfold. In 2019 the lapse/premium assumption change was primarily related to updates to assumed lapse rates on renewable term policies, including a refinement on skew lapses for non-participating 10-year renewable term products.

In 2020 the investment return assumptions change is primarily related to two updates. On the individual insurance lines, decreases in the initial reinvestment rate (IRR) used in the valuation produced a liability increase. For segregated funds, liability increases are mainly due to fund mapping refinements as additional experience emerges. The primary drivers of the investment return change for 2019 were updates to the initial reinvestment rate (IRR) and ultimate reinvestment rate (URR) in the future scenario. Updates were also made to the equity mean reversion rate, the overall equity level in the production valuation model, and to the maturity assumptions for preferred shares. However, these items had a less significant impact when compared with the IRR and URR updates.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

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 to \$1,500 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. An additional amount was recognized in 2020 as provisions from the actuarial liabilities were released.

Actuarial standards allow for a wide range of practice with respect to capitalization of the preferred tax treatment of dividends on Canadian equities that are supporting actuarial liabilities. In 2020, the Company updated its projections to be more consistent with industry practice, which resulted in a significant reduction in insurance contract liabilities.

## (c) Mix of assets allocated to insurance, annuity, investment contract liabilities and equity

As at December 31, 2020					
	Insurance liabilities	Annuity liabilities	Investment contract liabilities	Equity and other liabilities	Total
Cash and cash equivalents & Short-term investments	\$ 153,996	\$ 38,891	\$ 1,647	\$ 7,830	\$ 202,364
Bonds	5,187,229	614,552	175,894	2,050,105	8,027,780
Mortgages	22,503	128,709	6,002	—	157,214
Preferred shares	234,436	187,723	7,744	186,999	616,902
Common shares	870,965	—	—	47,735	918,700
Derivative assets	3,344	—	—	2,033	5,377
Loans on policies	55,805	—	653	—	56,458
Policy contract loans	648	20,120	—	39,639	60,407
Other	24,930	4,918	760	182,526	213,134
<b>Total</b>	<b>\$ 6,553,856</b>	<b>\$ 994,913</b>	<b>\$ 192,700</b>	<b>\$ 2,516,867</b>	<b>\$ 10,258,336</b>

As at December 31, 2019					
	Insurance liabilities	Annuity liabilities	Investment contract liabilities	Equity and other liabilities	Total
Cash and cash equivalents & Short-term investments	\$ 119,451	\$ 7,956	\$ 1,816	\$ 43,494	\$ 172,717
Bonds	4,860,681	605,503	156,599	1,886,869	7,509,652
Mortgages	24,083	139,158	6,586	—	169,827
Preferred shares	103,865	176,915	4,854	188,395	474,029
Common shares	797,783	—	—	44,246	842,029
Derivative assets	588	—	—	2,342	2,930
Loans on policies	54,695	—	668	—	55,363
Policy contract loans	425	23,697	—	42,398	66,520
Other	20,940	5,251	643	142,305	169,139
<b>Total</b>	<b>\$ 5,982,511</b>	<b>\$ 958,480</b>	<b>\$ 171,166</b>	<b>\$ 2,350,049</b>	<b>\$ 9,462,206</b>

Provisions made for anticipated future losses of principal and interest on investments and included as a component of policy liabilities are \$256,800 (2019 \$215,400).

## (d) Fair value of insurance and investment contract liabilities and reinsurance assets/liabilities

In the absence of an active market for the sale of insurance and investment contract liabilities and reinsurance assets/liabilities, the actuarially determined values provide a reasonable approximation of their fair value. Investment contract liabilities are term certain annuities with a relatively short duration.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## (e) Liquidity

The Company defines liquid assets as high quality marketable investments that may be easily sold, meaning there exists an active market and observable prices for the investments. Liquid asset values are based on fair value as at the reporting date.

The Company defines cash demands or demand liabilities as those policyholder obligations that may be called on immediately at the discretion of the policyholder. More specifically, demand liabilities include cash surrender values under whole life insurance products as well as current accumulated values of annuity products. Amounts would be gross of any surrender charge or market value adjustment allowed under the terms of the contract. Demand liabilities are determined as though all such policyholders made their call at the same time and as such cannot be readily compared to insurance contract liabilities that are determined based on actuarial assumptions associated with lapse as well as other decrements.

The Company maintains a high level of liquid assets so that cash demands can be readily met. The Company's liquidity position is as follows:

As at December 31	2020	2019
<b>Assets:</b>		
Cash and cash equivalents & Short-term investments	\$ 202,364	\$ 172,717
Canadian federal and provincial bonds	4,359,071	4,417,369
Other readily-marketable bonds and stocks	4,335,512	3,583,047
<b>Total liquid assets</b>	<b>\$ 8,896,947</b>	<b>\$ 8,173,133</b>
<b>Liabilities:</b>		
Demand liabilities with fixed values	\$ 807,656	\$ 753,579
Demand liabilities with market value adjustments	1,217,439	1,219,282
<b>Total liquidity needs</b>	<b>\$ 2,025,095</b>	<b>\$ 1,972,861</b>

## 11. Accounts Payable and Other Liabilities

Accounts payable and other liabilities consist of:

As at December 31	2020	2019
Accounts payable	\$ 45,610	\$ 39,011
Post-employment benefit liability (Note 12)	68,527	42,616
Accrued interest on subordinated debt	2,554	2,554
Derivative liabilities (Note 3d)	1,410	2,040
Lease liabilities	6,798	3,683
Other	6,072	16,133
<b>Accounts payable and other liabilities</b>	<b>\$ 130,971</b>	<b>\$ 106,037</b>

Of the above total, \$74,094 (2019 \$42,616) is expected to be settled more than one year after the Consolidated Statements of Financial Position date. In the absence of an active market for post-employment benefit liabilities, the actuarially determined value provides a reasonable approximation of fair value. Derivative liabilities are carried at fair value, as disclosed in Note 3(d). All other amounts are short-term in nature and their fair value approximates carrying value.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 12. Employee Benefit Plans

Empire Life sponsors pension and other post-employment benefit plans for eligible employees. The Empire Life Insurance Company Staff Pension Plan (the Plan) consists of a defined benefit component and a defined contribution component. The Company discontinued enrolments in the defined benefit component effective October 1, 2011. The Company has supplemental arrangements that provide defined pension benefits in excess of statutory limits. In addition to pension benefits, the Company also provides for post-employment health and dental care coverage and other future benefits to qualifying employees and retirees.

The defined benefit component of the Plan is a final average salary pension plan, which provides benefits to members in the form of a guaranteed level of pension payable for life. The level of benefits provided depends on members' age, length of service and their salary in the final years leading up to retirement. Pensions generally do not receive inflationary increases once in payment. In the past, however, the Company has provided ad-hoc pension increases on its defined benefit staff pension plan. Increases take place at the discretion of the Board. The pension benefit payments are from trustee-administered funds.

The Company's staff pension plan is governed by the *Pension Benefits Act of the Province of Ontario*, as amended, which requires that the plan sponsor fund the defined benefits determined under the plan. The Company's supplemental employee retirement benefit plan is governed by provisions of the plan, which requires that the plan sponsor fund the defined benefits determined under the plan. The amount of funds contributed to these defined benefit pension plans by Empire Life is determined by an actuarial valuation of the Plans.

Under the defined contribution component, contributions are made in accordance with the provisions of the Plan documents.

A pension committee, composed of selected senior members of Empire Life's management and that of its parent, E-L Financial Corporation, oversees the Pension Plan of the Company. The Pension Committee reports to the Human Resources Committee of the Board three times each year. The Audit Committee of the Board approves the audited annual financial statements of the Pension Plan.

The other post-employment benefit plan provides for health, dental care, and other future defined benefits to qualifying employees and retirees. It is unfunded and the Company meets the benefit payment obligation as it falls due.

The following tables present financial information for the Company's defined benefit plans:

As at December 31	Pension benefits		Other post-employment benefits	
	2020	2019	2020	2019
Present value of obligations	\$ 280,587	\$ 249,494	\$ 8,919	\$ 8,656
Fair value of plan assets	220,979	215,534	—	—
Post-employment benefit asset (liability)	\$ (59,608)	\$ (33,960)	\$ (8,919)	\$ (8,656)

The post-employment benefit asset (liability), net of the cumulative impact of the asset ceiling, is included in the Consolidated Statements of Financial Position in Accounts payables and other liabilities (Note 11).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The movement in the present value of the defined benefit obligations over the year is as follows:

As at December 31	Pension benefits		Other post-employment benefits	
	2020	2019	2020	2019
Present value of defined benefit obligation - beginning of year	\$ 249,494	\$ 220,129	\$ 8,656	\$ 8,352
Current service cost	7,562	5,978	—	—
Past service cost	—	3,967	—	—
Interest expense	7,731	8,331	256	299
Decrease (increase) in net income before tax	15,293	18,276	256	299
Remeasurements				
(Gain) loss from changes in demographic assumptions	4,404	—	—	—
(Gain) loss from changes in financial assumptions	20,219	22,878	599	570
Actuarial (gain) loss from member experience	1,659	(116)	(229)	(282)
Decrease (increase) in OCI before tax	26,282	22,762	370	288
Employee contributions	1,334	1,397	—	—
Benefits paid	(11,816)	(13,070)	(363)	(283)
Present value of defined benefit obligation - end of year	\$ 280,587	\$ 249,494	\$ 8,919	\$ 8,656

The movement in the fair value of the Plan's defined benefit assets over the year is as follows:

As at December 31	Pension benefits	
	2020	2019
Fair value of defined benefit assets - at beginning of year	\$ 215,534	\$ 192,015
Interest income	6,730	7,339
Administrative expense	(291)	(243)
Increase (decrease) in net income before tax	6,439	7,096
Remeasurements		
Return on plan assets, excluding amounts included in interest income	3,797	21,790
Gain (loss) from changes in demographic assumptions	—	—
Gain (loss) from changes in financial assumptions	—	—
Actuarial gain (loss) from member experience	—	—
Change in effect of asset limit	—	—
Increase (decrease) in OCI before tax	3,797	21,790
Plan transfers / curtailments		
Employer contributions	5,691	6,306
Employee contributions	1,334	1,397
Benefits paid	(11,816)	(13,070)
Fair value of defined benefit assets - end of year	\$ 220,979	\$ 215,534

The actual return on defined benefit assets net of administrative expense, for the year ended December 31, 2020 was a gain of \$10,236 (2019 gain of \$28,886).

Defined benefit plan expense is recognized in Operating expenses. Remeasurements in the defined benefit plan are included in OCI. Operating expenses also include \$2,189 (2019 \$2,057) of employer contributions related to the defined contribution component of the Plan.

Expected contributions (including both employer and employee amounts) to the Company's defined benefit pension plans for the year ending December 31, 2021 are approximately \$8,288.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Plan invests primarily in Empire Life segregated and mutual funds. The fair value of the underlying assets of the funds and other investments are included in the following table:

As at December 31	2020		2019	
Equity				
Canadian	\$ 70,609	32%	\$ 75,336	35%
Foreign	57,521	26%	50,977	24%
Total equity	128,130	58 %	126,313	59 %
Debt				
Canadian	68,043	31%	65,194	30%
Cash, cash equivalent, accruals	5,946	3%	6,711	3%
Mutual funds	9,516	4%	8,312	4%
Other	9,344	4 %	9,005	4 %
Total fair value of assets	\$ 220,979	100%	\$ 215,535	100%

Fair value is determined based on Level 1 inputs for equities and Level 2 inputs for debt.

The following weighted average assumptions were used in actuarial calculations:

As at December 31	Pension benefits		Other post-employment benefits	
	2020	2019	2020	2019
Defined benefit obligation as at December 31:				
Discount rate - defined benefit obligation	2.55%	3.15%	2.40%	3.05%
Discount rate - net interest	3.15%	3.85%	3.05%	3.70%
Rate of compensation increase	3.00%	3.00%	n/a	n/a
Assumed health care cost trend rates at December 31:				
Initial health care cost trend rate	n/a	n/a	5.5%	5.5%
Cost trend rate declines to	n/a	n/a	4.0%	4.0%
Year ultimate health care cost trend rate is reached	n/a	n/a	2040	2040

Assumptions (in number of years) relating to future mortality, to determine the defined benefit obligation and the net benefit cost for the defined benefit pension plans are as follows:

As at December 31	2020	2019
Males aged 65 at measurement date	22.05	21.97
Females aged 65 at measurement date	24.74	24.66
Males aged 40 at measurement date	23.90	23.83
Females aged 40 at measurement date	26.41	26.34

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The following table provides the sensitivity of the defined benefit pension and other post-employment benefit obligations to changes in significant actuarial assumptions. For each sensitivity test, the impact of a reasonably possible change in a single factor is shown with other assumptions left unchanged. In practice, this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant actuarial assumptions the same method has been applied as when calculating the Post-employment benefit liability recognized within the Consolidated Statements of Financial Position.

As at December 31, 2020	Change in assumption	Impact on Pension Benefit Obligation		Impact on Other Post Employment Benefit Obligations	
		Increase	Decrease	Increase	Decrease
Discount rate	1% \$	(30,131) \$	38,490 \$	(1,064) \$	880
Rate of compensation increase	1% \$	12,653 \$	(10,484)	n/a	n/a
Health care cost increase	1%	n/a	n/a \$	870 \$	(1,064)
Life expectancy	1 year \$	5,958 \$	(6,014) \$	270 \$	(614)

As at December 31, 2019	Change in assumption	Impact on pension benefits		Impact on other post employment benefits	
		Increase	Decrease	Increase	Decrease
Discount rate	1% \$	(32,260) \$	42,785 \$	(838) \$	1,003
Rate of compensation increase	1% \$	12,660 \$	(11,262)	n/a	n/a
Health care cost increase	1%	n/a	n/a \$	965 \$	(817)
Life expectancy	1 year \$	6,685 \$	(6,887) \$	410 \$	(398)

The weighted average duration, in number of years, of the defined benefit obligations are:

As at December 31	2020	2019
Staff pension plan	12	15
Supplemental employee retirement plan	10	12
Other post-employment benefits	11	11

## Risks

Through its defined benefit pension plan and the other post-employment benefit plan, the Company is exposed to a number of risks, the most significant of which are detailed below:

### Asset volatility

The Plan obligations are calculated using a discount rate set with reference to corporate bond yields; if Plan assets underperform this yield, this will create a deficit. The pension plan holds a significant proportion of equities, which are expected to outperform corporate bonds in the long-term while producing volatility and risk in the short-term.

### Changes in bond yields

A decrease in corporate bond yields will increase Plan obligations, although this will be partially offset by an increase in the value of the Plans' bond holdings.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## Life expectancy

The majority of the Plans' obligations are to provide benefits for the life of the member, so increases in life expectancy will result in an increase in the Plans' liabilities.

In case of the funded plans, the Pension Committee ensures that the investment positions are managed in accordance with the investment philosophy outlined in the investment policy approved by the Human Resources Committee of the Board. The fundamental philosophy is to achieve acceptably high investment return over the long term without jeopardizing the level of security of the members' benefits and without introducing too much volatility into the Company's future expense. The Company's objective is to match assets to the pension obligations by investing in equities as well as fixed interest securities. The Company monitors how the duration and the expected yield of the investments are matching the expected cash outflows arising from the pension obligations. The Plan has not changed the processes used to manage its risks from previous periods. Investments are well diversified, such that the failure of any single investment would not have a material impact on the overall level of assets. The Plan invests primarily in Canadian Bonds and Equities through its' ownership of units in Empire Life segregated and mutual funds. The Company believes that equities offer the best returns over the long term with an acceptable level of risk.

The last triennial valuation on the Staff Pension Plan was completed in November 2020, as at December 31, 2019. The next triennial valuation will be completed in 2023, as at December 31, 2022.

## 13. Subordinated Debt

The table below presents the obligations included in Subordinated debt as at December 31.

As at December 31				2020	2019
	Interest rate	Earliest par call or redemption Date	Maturity	Carrying value	Carrying value
Series 2016-1 <sup>(1)</sup>	3.383 %	December 16, 2021	2026	199,820	199,639
Series 2017-1 <sup>(2)</sup>	3.664 %	March 15, 2023	2028	199,622	199,459
<b>Total Subordinated Debt</b>				<b>\$ 399,442</b>	<b>\$ 399,098</b>
<b>Fair Value</b>				<b>\$ 416,654</b>	<b>\$ 410,142</b>

<sup>(1)</sup> 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).

<sup>(2)</sup> Series 2017-1 Subordinated 3.664% Unsecured Debentures due 2028. From March 15, 2023, interest is payable at 1.53% over CDOR.

## 14. Insurance Premiums

For the year ended December 31	2020			2019		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life premiums	\$ 544,534	\$ (120,865)	\$ 423,669	\$ 525,273	\$ (120,236)	\$ 405,037
Health premiums	442,322	(100,331)	341,991	407,262	(61,573)	345,689
Total life and health premiums	986,856	(221,196)	765,660	932,535	(181,809)	750,726
Annuity premiums	94,774	(193)	94,581	159,293	(178)	159,115
<b>Total insurance premiums</b>	<b>\$ 1,081,630</b>	<b>\$ (221,389)</b>	<b>\$ 860,241</b>	<b>\$ 1,091,828</b>	<b>\$ (181,987)</b>	<b>\$ 909,841</b>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 15. Fee Income

For the year ended December 31	2020	2019
Investment management, policyholder administration and guarantee fees	\$ 239,473	\$ 249,714
Surrender charges and other miscellaneous fees	11,870	12,031
<b>Fee income</b>	<b>\$ 251,343</b>	<b>\$ 261,745</b>

## 16. Benefits and Expenses

### (a) Insurance contract benefits and claims paid

For the year ended December 31	2020			2019		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life claims	\$ 259,655	\$ (82,233)	\$ 177,422	\$ 231,237	\$ (67,615)	\$ 163,622
Health claims	280,732	(54,237)	226,495	279,398	(31,146)	248,252
Total life and health claims	540,387	(136,470)	403,917	510,635	(98,761)	411,874
Annuity benefits	175,379	(1,005)	174,374	209,681	(3,294)	206,387
<b>Benefits and claims paid</b>	<b>\$ 715,766</b>	<b>\$ (137,475)</b>	<b>\$ 578,291</b>	<b>\$ 720,316</b>	<b>\$ (102,055)</b>	<b>\$ 618,261</b>

### (b) Change in insurance contract liabilities and reinsurance ceded

For the year ended December 31	2020			2019		
	Gross	Reinsurance ceded	Net	Gross	Reinsurance ceded	Net
Life	\$ 868,145	\$ (289,466)	\$ 578,679	\$ 811,912	\$ (73,845)	\$ 738,067
Health	66,839	(24,176)	42,663	70,437	(18,398)	52,039
Total life and health	934,984	(313,642)	621,342	882,349	(92,243)	790,106
Annuity	136,609	31	136,640	15,096	1,814	16,910
<b>Change in insurance contract liabilities</b>	<b>\$ 1,071,593</b>	<b>\$ (313,611)</b>	<b>\$ 757,982</b>	<b>\$ 897,445</b>	<b>\$ (90,429)</b>	<b>\$ 807,016</b>

## 17. Operating Expenses

Operating expenses include the following:

For the year ended December 31	2020	2019
Salary and benefits expense	\$ 100,907	\$ 102,869
Professional services	14,864	16,922
Rent, maintenance and amortization of right-of-use assets	18,346	15,281
Amortization of property and equipment and intangibles	11,226	9,975
Other	22,962	27,423
<b>Total</b>	<b>\$ 168,305</b>	<b>\$ 172,470</b>

Significant components of other expenses include travel, advertising, and office supplies and services.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 18. Income Taxes

### (a) Income tax expense

The Company's income tax expense includes provisions for current and deferred taxes as follows:

For the year ended December 31	2020	2019
Current income tax expense	\$ 11,381	\$ 59,644
Deferred income tax expense (benefit)		
Relating to the origination and reversal of temporary differences	32,951	(1,147)
<b>Income tax expense</b>	<b>\$ 44,332</b>	<b>\$ 58,497</b>

During 2020 the Company paid income tax installments totaling \$114,790 (2019 \$28,729).

### (b) Variance from statutory provision

Income taxes provided varies from the expected statutory provision as follows:

For the year ended December 31	2020	2019
Net income before income taxes	\$ 201,563	\$ 249,156
Income tax provision at statutory rates	53,310	66,450
Increase (decrease) resulting from:		
Tax paid on dividends	(12,630)	(10,360)
Miscellaneous	3,652	2,407
<b>Income tax expense</b>	<b>\$ 44,332</b>	<b>\$ 58,497</b>

The current enacted corporate tax rates as they impact the Company in 2020 stand at 26.45% (2019 26.67%). Expected future tax rates are as follows:

2021	26.37 %
2022	26.37 %
2023	26.37 %
2024	26.37 %
2025	26.37 %

The impact of future enacted corporate tax rates has been taken into consideration in the deferred tax calculation.

### (c) Deferred income taxes

In certain instances the tax basis of assets and liabilities differs from the carrying amount. These differences will give rise to deferred income taxes, which are reflected on the Consolidated Statements of Financial Position. These differences arise in the following items:

As at December 31	2020	2019
Insurance contracts	\$ (43,851)	\$ (10,882)
Portfolio investments	(4,627)	(6,009)
Post-employment benefit plans	17,183	11,169
Other, net	(4,416)	(3,083)
<b>Deferred income tax asset (liability)</b>	<b>\$ (35,711)</b>	<b>\$ (8,805)</b>

Of the above total, \$34,523 is expected to be paid (2019 \$7,222 paid) more than one year after the Consolidated Statements of Financial Position date.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The net movement on the deferred income tax account is as follows:

For the year ended December 31	2020	2019
Deferred income tax asset (liability) - beginning of year	\$ (8,805)	\$ (10,288)
Deferred income tax benefit (expense)		
Statement of operations	(32,951)	1,147
Other comprehensive income	6,045	336
Deferred income tax asset (liability) - end of year	\$ (35,711)	\$ (8,805)

## (d) Income taxes included in other comprehensive income

Other comprehensive income (loss) is presented net of income taxes.

The following income tax amounts are included in each component of **total OCI**.

For the year ended December 31	2020			2019		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 107,384	\$ 28,490	\$ 78,894	\$ 89,474	\$ 23,862	\$ 65,612
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(29,414)	(7,794)	(21,620)	(21,886)	(5,884)	(16,002)
Remeasurements of post-employment benefit liabilities	(22,855)	(6,046)	(16,809)	(1,260)	(336)	(924)
Total other comprehensive income (loss)	\$ 55,115	\$ 14,650	\$ 40,465	\$ 66,328	\$ 17,642	\$ 48,686

The following income tax amounts are included in each component of **shareholders' OCI**:

For the year ended December 31	2020			2019		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 103,147	\$ 27,365	\$ 75,782	\$ 83,481	\$ 22,264	\$ 61,217
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(26,282)	(6,964)	(19,318)	(16,920)	(4,520)	(12,400)
Remeasurements of post-employment benefit liabilities	(21,858)	(5,782)	(16,076)	(1,205)	(321)	(884)
Shareholder portion of policyholder other comprehensive income (loss)	\$ 120	\$ 32	\$ 88	\$ 30	\$ 7	\$ 23
Total other comprehensive income (loss)	\$ 55,127	\$ 14,651	\$ 40,476	\$ 65,386	\$ 17,430	\$ 47,956

The following income tax amounts are included in each component of **policyholders' OCI**:

For the year ended December 31	2020			2019		
	Before tax	Tax provision (recovery)	After tax	Before tax	Tax provision (recovery)	After tax
Unrealized fair value change on available for sale investments	\$ 4,237	\$ 1,125	\$ 3,112	\$ 5,993	\$ 1,598	\$ 4,395
Fair value change on available for sale investments reclassified to net income, including impairment write downs	(3,132)	(830)	(2,302)	(4,966)	(1,364)	(3,602)
Remeasurements of post-employment benefit liabilities	(997)	(264)	(733)	(55)	(15)	(40)
Shareholder portion of policyholder other comprehensive income (loss)	(120)	(32)	(88)	(30)	(7)	(23)
Total other comprehensive income (loss)	\$ (12)	\$ (1)	\$ (11)	\$ 942	\$ 212	\$ 730

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 19. Earnings Per Share

Earnings per share is calculated by dividing common shareholders' net income by the weighted average number of common shares outstanding. The preferred shares issued (refer to Note 20) do not dilute EPS as the preferred shares are not convertible into common shares.

Details of the calculation of the net income and the weighted average number of shares used in the EPS computations are as follows:

For the year ended December 31	2020	2019
Basic and diluted EPS		
Common shareholders' net income	\$ 139,688	\$ 173,943
Weighted average number of common shares outstanding	985,076	985,076
Basic and diluted EPS	\$ 141.80	\$ 176.58

## 20. Capital Stock

As at	December 31, 2020			December 31, 2019		
	Shares authorized	Shares issued and outstanding	Amount	Shares authorized	Shares issued and outstanding	Amount
Preferred shares						
Series 1	unlimited	5,980,000	\$ 149,500	unlimited	5,980,000	\$ 149,500
Series 3	unlimited	4,000,000	\$ 100,000	unlimited	4,000,000	\$ 100,000
Common shares	2,000,000	985,076	\$ 985	2,000,000	985,076	\$ 985

In the fourth quarter of 2017, Empire Life issued to E-L Financial Corporation Limited 4,000,000 Non-Cumulative Rate Reset Preferred Shares, Series 3 (Series 3 Preferred Shares) at \$25 per share. Holders of Series 3 Preferred Shares are entitled to receive fixed non-cumulative quarterly dividends yielding 4.90% annually, as and when declared by the Board of Directors of Empire Life, for the initial period ending on and including January 17, 2023. Thereafter, the dividend rate will be reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 3.24%. Holders of Series 3 Preferred Shares will have the right, at their option, to convert their shares into Non-Cumulative Floating Rate Preferred Shares, Series 4 (Series 4 Preferred Shares), subject to certain conditions, on January 17, 2023 and on January 17 every five years thereafter. Holders of the Series 4 Preferred Shares will be entitled to receive non-cumulative quarterly floating dividends, as and when declared by the Board of Directors of Empire Life, at a rate equal to the three-month Government of Canada Treasury Bill yield plus 3.24%. Subject to regulatory approval, Empire Life may redeem the Series 3 Preferred Shares, in whole or in part, at par, on January 17, 2023 and every five years thereafter.

In the first quarter of 2016, Empire Life issued to the public 5,980,000 Non-Cumulative Rate Reset Preferred Shares, Series 1 (Series 1 Preferred Shares) at \$25 per share. Holders of Series 1 Preferred Shares are entitled to receive fixed non-cumulative quarterly dividends yielding 5.75% annually, as and when declared by the Board of Directors of Empire Life, for the initial period ending on and including April 17, 2021. Thereafter, the dividend rate will be reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 4.99%. Holders of Series 1 Preferred Shares will have the right, at their option, to convert their shares into Non-Cumulative Floating Rate Preferred Shares, Series 2 (Series 2 Preferred Shares), subject to certain conditions, on April 17, 2021 and on April 17 every five years thereafter. Holders of the Series 2 Preferred Shares will be entitled to receive non-cumulative quarterly floating dividends, as and when declared by the Board of Directors of Empire Life, at a rate equal to the three-month Government of Canada Treasury Bill yield plus 4.99%. Subject to regulatory approval, Empire Life may redeem the Series 1 Preferred Shares, in whole or in part, at par, on April 17, 2021 and every five years thereafter.

The cost of issuance of the Series 1 Preferred Shares, \$5,150 less \$1,375 of income tax, was charged to retained earnings.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 21. Dividends

	Dividend declaration date	Shares issued and outstanding	Dividend rate per share	Total dividend (\$ 000's)	Dividend payment date
<b>Common shareholder dividends</b>					
<b>Common shares</b>	October 29, 2020	985,076	\$ 22.072300	\$ 21,743	December 8, 2020
	July 29, 2020	985,076	\$ 44.144700	\$ 43,486	September 9, 2020
	February 26, 2020	985,076	\$ 113.435853	\$ 111,743	April 8, 2020
	October 30, 2019	985,076	\$ 17.440800	\$ 17,181	December 10, 2019
	August 1, 2019	985,076	\$ 17.440800	\$ 17,180	September 12, 2019
	May 2, 2019	985,076	\$ 17.440800	\$ 17,181	June 11, 2019
	February 27, 2019	985,076	\$ 17.440800	\$ 17,180	April 4, 2019
<b>Preferred shareholder dividends</b>					
<b>Series 1</b>	October 29, 2020	5,980,000	\$ 0.359375	\$ 2,149	January 17, 2021
	July 29, 2020	5,980,000	\$ 0.359375	\$ 2,149	October 17, 2020
	April 30, 2020	5,980,000	\$ 0.359375	\$ 2,149	July 17, 2020
	February 26, 2020	5,980,000	\$ 0.359375	\$ 2,149	April 17, 2020
	October 30, 2019	5,980,000	\$ 0.359375	\$ 2,149	January 17, 2020
	August 1, 2019	5,980,000	\$ 0.359375	\$ 2,149	October 17, 2019
	May 2, 2019	5,980,000	\$ 0.359375	\$ 2,149	July 17, 2019
February 27, 2019	5,980,000	\$ 0.359375	\$ 2,149	April 17, 2019	
<b>Series 3</b>	October 29, 2020	4,000,000	\$ 0.306250	\$ 1,225	January 17, 2021
	July 29, 2020	4,000,000	\$ 0.306250	\$ 1,225	October 17, 2020
	April 30, 2020	4,000,000	\$ 0.306250	\$ 1,225	July 17, 2020
	February 26, 2020	4,000,000	\$ 0.306250	\$ 1,225	April 17, 2020
	October 30, 2019	4,000,000	\$ 0.306250	\$ 1,225	January 17, 2020
	August 1, 2019	4,000,000	\$ 0.306250	\$ 1,225	October 17, 2019
	May 2, 2019	4,000,000	\$ 0.306250	\$ 1,225	July 17, 2019
February 27, 2019	4,000,000	\$ 0.306250	\$ 1,225	April 17, 2019	

On February 24, 2021, subsequent to the date of these Consolidated Financial Statements, the Board approved the following cash dividends:

- \$10,476 (\$10.635322 per share) on the issued and outstanding Common Shares, payable on April 1, 2021.
- \$2,149 (\$0.359375 per share) on the issued and outstanding Series 1 Preferred Shares, payable on April 17, 2021.
- \$1,225 (\$0.306250 per share) on the issued and outstanding Series 3 Preferred Shares, payable on April 17, 2021.

## 22. Shareholders' Equity Entitlement

Shareholders' entitlement to \$3,594 (2019 \$3,369) of shareholders' equity is contingent upon future payment of dividends to participating policyholders.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 23. Segmented Information

The Company operates in the Canadian life insurance industry and follows a product line management approach for internal reporting and decision making. A description of the product lines is as follows:

The Wealth Management product line includes segregated funds, mutual funds, guaranteed interest rate annuities and annuities providing income for life.

The Employee Benefits product line offers group benefit plans to employers for medical, dental, disability, and life insurance coverage of their employees.

The Individual Insurance product line includes both non-participating and participating individual life and health insurance products.

Capital and Surplus is made up of assets held in the shareholders' and participating policyholders' equity accounts and other corporate items not allocated to other segments.

**Operating results** are segmented into three product lines along with the Company's capital and surplus as follows:

	For the year ended December 31, 2020					
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus		Total
Net premiums from external customers	\$ 94,581	\$ 357,039	\$ 408,621	\$ —	\$	860,241
Interest income	28,424	6,208	181,905	54,734		271,271
Total investment income	37,825	3,993	221,932	65,673		329,423
Fair value change in fair value through profit or loss assets	31,218	5,348	320,531	(342)		356,755
Realized gain (loss) on fair value through profit or loss assets	4,068	3,551	154,499	(7,192)		154,926
Realized gain (loss) on available for sale assets including impairment write downs	(1,130)	(950)	3,266	28,228		29,414
Fee income from external customers	238,186	12,626	368	163		251,343
Net benefits and claims	174,374	235,063	168,854	—		578,291
Net change in insurance contract liabilities	136,640	21,384	599,958	—		757,982
Change in investment contract provision	989	—	—	—		989
Policy dividends	—	—	35,166	—		35,166
Amortization of property and equipment and intangibles	2,169	3,567	5,490	—		11,226
Total operating expenses	60,861	50,612	55,335	1,497		168,305
Net commission expense	74,636	46,792	81,133	—		202,561
Interest expense	—	—	—	14,437		14,437
Premium tax	—	9,225	9,517	—		18,742
Investment and capital tax	—	—	4,066	—		4,066
Income tax expense (recovery)	(13,497)	4,866	36,332	16,631		44,332
Net income (loss) after tax	(29,255)	13,665	118,856	53,965		157,231

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

	For the year ended December 31, 2019				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Net premiums from external customers	\$ 159,115	\$ 360,383	\$ 390,343	\$ —	\$ 909,841
Interest income	30,202	6,445	183,162	56,555	276,364
Total investment income	39,656	4,520	215,123	66,418	325,717
Fair value change in fair value through profit or loss assets	17,772	4,313	473,402	(5,106)	490,381
Realized gain (loss) on fair value through profit or loss assets	1,147	181	110,575	(6,572)	105,331
Realized gain (loss) on available for sale assets including impairment write downs	101	85	502	21,198	21,886
Fee income from external customers	249,018	12,528	228	(29)	261,745
Net benefits and claims	206,387	255,856	156,018	—	618,261
Net change in insurance contract liabilities	16,910	17,569	772,537	—	807,016
Change in investment contract provision	937	—	—	—	937
Policy dividends	—	—	31,438	—	31,438
Amortization of property and equipment and intangibles	1,965	2,890	5,120	—	9,975
Total operating expenses	61,333	50,351	59,233	1,553	172,470
Net commission expense	83,162	40,641	74,951	—	198,754
Interest expense	—	—	—	14,425	14,425
Premium tax	—	8,109	10,566	—	18,675
Investment and capital tax	—	—	3,770	—	3,770
Income tax expense (recovery)	23,898	2,525	16,192	15,882	58,497
Net income (loss) after tax	74,182	6,959	65,468	44,049	190,658

**Assets** are segmented into three product lines along with the Company's capital and surplus as follows:

	For the year ended December 31, 2020				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 994,913	\$ 192,700	\$ 6,553,856	\$ 2,516,867	\$ 10,258,336
Segregated funds	8,439,229	—	18,188	—	8,457,417
<b>Total assets</b>	<b>\$ 9,434,142</b>	<b>\$ 192,700</b>	<b>\$ 6,572,044</b>	<b>\$ 2,516,867</b>	<b>\$ 18,715,753</b>

	For the year ended December 31, 2019				
	Wealth Management	Employee Benefits	Individual Insurance	Capital & Surplus	Total
Assets excluding segregated funds	\$ 958,480	\$ 171,166	\$ 5,982,511	\$ 2,350,049	\$ 9,462,206
Segregated funds	8,480,294	—	18,289	—	8,498,583
<b>Total assets</b>	<b>\$ 9,438,774</b>	<b>\$ 171,166</b>	<b>\$ 6,000,800</b>	<b>\$ 2,350,049</b>	<b>\$ 17,960,789</b>

While specific general fund assets are nominally matched against specific types of general fund liabilities or held in the shareholders' and policyholders' equity accounts, all general fund assets are available to pay all general fund liabilities, if required. Segregated fund assets are not available to pay liabilities of the general fund.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 24. Commitments and Contingencies

### Investment Commitments

In the normal course of business, outstanding investment commitments are not reflected in the Consolidated Financial Statements. There was \$40,012 (December 31, 2019, \$22,867) of outstanding commitments as at December 31, 2020. The outstanding commitments are payable at any time up to and including December 31, 2023.

### Other contingencies

The Company operates in the insurance industry and is subject to legal proceedings in the normal course of business. While it is not practicable to forecast or determine the final results of all pending or threatened legal proceedings, management does not believe that such proceedings (including litigation) will have a material effect on its results and financial position.

The Company by-laws provide indemnification to its current and former directors, officers and employees to the extent permitted by law, against contractual indemnities and liabilities arising from their service to the Company. The broad general nature of these indemnification by-laws does not permit a reasonable estimate of the maximum potential amount of any liability.

In certain cases, the Company would have recourse against third parties with respect to the foregoing items and the Company also maintains insurance policies that may provide coverage against certain of these items.

## 25. Related Party Transactions

The Company is a 98.3% owned subsidiary of E-L Financial Services Limited (ELFS) which in turn is a 100.0% owned subsidiary of E-L Financial Corporation Limited (E-L). E-L owns, directly and indirectly through ELFS, 99.4% of the common shares of Empire Life. The Company's ultimate controlling party is The Honourable Henry N. R. Jackman together with a trust created in 1969 by his father, Henry R. Jackman. In the normal course of business, the Company enters into transactions with E-L and other companies under common control or common influence involving the leasing of office property, investment management services and miscellaneous office services. The amounts earned and expensed were not significant. Some directors and officers have insurance and investment policies underwritten by the Company.

In the fourth quarter of 2017, the Company issued 4,000,000 Non-Cumulative Rate Reset Preferred Shares, Series 3 to E-L Financial Corporation Limited at \$25 per share. Refer to Note 20 for further details.

### Compensation of key management personnel

Key management personnel are comprised of directors and executive officers of the Company. The remuneration of key management personnel is as follows:

For the year ended December 31	2020	2019
Salaries and other short-term and long-term employee benefits	\$ 7,086	\$ 6,140
Post-employment benefits	525	398
<b>Total</b>	<b>\$ 7,611</b>	<b>\$ 6,538</b>

Post-employment benefits are comprised of employer current service costs for pension and other post-employment benefits.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 26. Capital Management

The Company aims to manage its regulatory capital in order to meet the regulatory capital adequacy requirements of the Insurance Companies Act (Canada) as established and monitored by OSFI. OSFI has implemented the Life Insurance Capital Adequacy Test (LICAT) framework to monitor capital adequacy. Under this framework, the Company's capital adequacy is measured as a ratio of Available Capital plus Surplus Allowance and Eligible Deposits divided by a Base Solvency Buffer. The components of the LICAT ratio are determined in accordance with the guidelines defined by OSFI. The regulator has established a Supervisory Target Total Ratio of 100% and a Supervisory Target Core Ratio of 70%. As at December 31, 2020 and December 31, 2019 the Company was in compliance with the applicable regulatory capital ratios.

## 27. Risk Management

The Company is exposed to risks arising from its investing activities and its insurance operations and to general reputation risk associated with these activities and its ability to manage specific risks. The following sections describe the principal risks and associated risk management strategies for the risks that management considers to be most significant in terms of likelihood and the potential adverse impact on the Company: market, liquidity, credit and insurance.

### Caution related to sensitivities

In the sections that follow, the Company provides sensitivities and risk exposure measures for certain risks. These include sensitivities due to specific changes in market prices and interest rates, based on the 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 the Company'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 the Company's future Net income, OCI, and capital sensitivities. Given the nature of these calculations, the Company cannot provide assurance that the 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.

### (a) Market risk

Market risk is the risk of loss arising from adverse changes in market rates and prices such as interest rates, trading prices of equities, real estate and other securities, credit spreads and foreign exchange rates.

Market risk is directly influenced by the volatility and liquidity in the markets in which the related financial instruments are traded, expectations of future price and yield movements and the composition of the Company's investment portfolio. Under the Canadian insurance accounting and regulatory regime the Company's results for any period reflect equity market values and interest rates at the end of the period through mark-to-market accounting. Consequently, a decline in public equity market values or changes in interest rates or spreads could result in material changes to net income attributed to shareholders, increases to regulatory capital requirements and reduction in the Company's capital ratios.

The Company buys investment quality bonds to support, to a very large extent, the liabilities under the insurance and annuity policies of the Company. The Company's investment strategy also includes the use of publicly-listed common stocks or exchange-traded funds (ETFs) to support the liabilities under its insurance policies. Cash flows arising from these investments are intended to match the liquidity requirements of the Company's policies, within the limits prescribed by the Company. However, if the

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Company does not achieve the expected returns underlying the pricing of its products, its operating results may be adversely affected.

Furthermore, a decrease in the fair value of the Company's common stock portfolio results in reduced shareholders' equity, reduced policyholders' surplus and a reduced LICAT position. Regulatory pressure to increase capital escalates as the LICAT position approaches OSFI's supervisory minimum. Net income would also be reduced if the declines in value are realized through dispositions or recognized in provisions for impairment.

The Company manages this risk exposure mainly through investment limits and oversight of its investment managers by the Chief Investment Officer, the Asset Management Committee, and the Investment Committee of the Board. The Investment Committee actively monitors the portfolio size and asset mix.

The Company's general fund investments are subject to limits established by the *Insurance Companies Act* and to investment guidelines established by the Investment Committee of the Board. The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, concentration and asset quality limits for eligible investments by segment. The Investment Committee receives reporting on general fund asset mix and performance by segment, derivatives matching, segregated fund asset mix and performance, and investment transactions for all funds. In addition, on at least a quarterly basis, management and the Company's investment managers report to the Investment Committee, and through the Investment Committee to the Board, on portfolio content, asset mix, the Company's matched position, the performance of general and segregated funds and compliance with the investment guidelines.

The Company has an Asset Management Committee, which meets regularly and reports at least quarterly to the Investment Committee of the Board. The mandate of the Asset Management Committee includes monitoring of the matched position of Empire's investments in relation to its liabilities within the various segments of the Company's operations. The matching process is designed to require that assets supporting policy liabilities closely match the timing and amount of policy obligations, and to plan for the appropriate amount of liquidity in order to meet its financial obligations as they fall due. Investments and asset/liability management guidelines, which are reviewed regularly with the Investment Committee, have been established to govern these activities. The Asset Management Committee reports regularly to the Investment Committee on the Company's matched positions, asset mixes, and investment allocation decisions relative to the Company's asset segments.

The Company has established a Capital Management Policy, capital management levels that exceed regulatory minimums and Financial Condition Testing (FCT) that takes into account the potential effect of adverse investment-risk scenarios (including adverse market conditions and adverse interest rates) on the Company's capital position and liquidity. Management monitors its LICAT position on a regular basis and reports at least quarterly to the Board on the Company's LICAT.

For the Company, the most significant market risks are equity risk, interest rate risk and foreign exchange rate risk.

## **(1) Equity risk**

The Company's investment portfolio consists primarily of bonds and equity securities and the fair value of its investments varies according to changes in general economic and securities market conditions, including volatility and declines in equity markets. Equity market volatility could occur as a result of general market volatility or as a result of specific social, political or economic events. A decline in securities markets could have an adverse impact on the return on assets backing capital, capital adequacy, and the management fees collected on segregated fund contracts, mutual funds and on index funds within universal life contracts and insurance policy liabilities and capital requirements, particularly in respect of segregated fund guarantees.

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The risk of fluctuation of the market value of the Company's segregated funds and mutual funds is generally assumed by the policyholders and unit holders, respectively. Market value variations of such assets will result in variations in the income of the Company to the extent management fees are determined in relation to the value of such funds. A significant and steady decline of the securities markets may result in net losses on such products which could adversely affect the Company. Additionally, certain of the Company's segregated fund products contain guarantees upon death, maturity or withdrawal, where the guarantee may be triggered by the market performance of the underlying funds. If a significant market decline is experienced, the resulting increased cost of providing these guarantees could have an adverse effect on the Company's financial position, LICAT position and results of operations. The Company has reinsured a portion of its segregated fund death benefit guarantee. The Company also has a semi-static, economic hedging program. The objective of the economic hedging program is to partially protect the Company from possible future LICAT ratio declines that might result from adverse stock market price changes. The program presently employs put options and futures on key equity indices. Improper use of these instruments could have an adverse impact on earnings. The Company manages this risk by applying limits 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.

The Company has an Equity Risk Hedging Policy to support general fund economic hedging programs. The policy outlines objectives, risk limits and authorities associated with its economic hedging activities. Management monitors its economic hedging activities on a regular basis and reports, at least quarterly, to the Risk and Capital Committee of the Board on the status of the economic hedging program.

The Company uses stochastic models to monitor and manage risk associated with segregated fund guarantees and establishes policyholder liability provisions in accordance with standards set forth by the CIA. Product development and pricing policies also require consideration of portfolio risk and capital requirements in the design, development and pricing of the products. The Chief Risk Officer reports quarterly to the Risk and Capital Committee of the Board on the nature and value of the Company's segregated fund guarantee liabilities, including capital requirements.

The following table summarizes the estimated potential impact on the Company of a change in global equity markets. The Company uses a 10% increase or decrease in equity markets as a reasonably possible change in equity markets. The Company has also disclosed the impact of a 20% increase or decrease in its equity market sensitivity. The amounts in the following table include the effect of Empire Life's general fund equity risk economic hedging program (described above). For segregated fund guarantees the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period end equity markets are high relative to market levels at the time that segregated fund policies were issued, the sensitivity is reduced. If period end equity markets are low relative to market levels at the time that segregated fund policies were issued, the sensitivity is increased.

	<b>As at December 31, 2020</b>			
	<b>10% Increase</b>	<b>10% Decrease</b>	<b>20% Increase</b>	<b>20% Decrease</b>
Shareholders' net income (including segregated fund guarantees)*	\$ 117,189	\$ (23,331)	\$ 136,863	\$ (103,028)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 3,511	\$ (3,511)	\$ 7,022	\$ (7,022)
Policyholders' other comprehensive income	\$ nil	\$ nil	\$ nil	\$ nil

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	As at December 31, 2019			
	10% Increase	10% Decrease	20% Increase	20% Decrease
Shareholders' net income (including segregated fund guarantees)*	\$ 13,800	\$ (17,521)	\$ 31,350	\$ (80,143)
Policyholders' net income	\$ nil	\$ nil	\$ nil	\$ nil
Shareholders' other comprehensive income	\$ 3,245	\$ (3,245)	\$ 6,490	\$ (6,490)
Policyholders' other comprehensive income	\$ nil	\$ nil	\$ nil	\$ nil

\*Includes the estimated impact on fee income net of trailer commissions after tax for a three month period.

For the life insurance business, the Company's policy is to use equity investments to cover a portion of the estimated insurance liability cash flows of non-participating life and universal life products beyond 20 years following the balance sheet date. The value of the liabilities supported by these equity investments depends on assumptions about the future level of equity markets. The best-estimate return assumptions for equities are primarily based on long-term historical averages of total returns (including dividends) for the Canadian equity market, which is 9.0% (2019 9.0%). The Company uses an assumption of 7.7% (2019 7.7%) to include provisions for moderate changes in equity rates of return determined in accordance with Canadian actuarial standards of practice. The returns are then reduced by margins to determine the net returns used in the valuation. Changes in the current market would result in changes to these assumptions.

The impact of an immediate change in equity markets is described above. If the change in equity markets persisted for one year, then a change to the actuarial future equity market return assumption would be made. For non-participating insurance business, a 1.0% decrease in future equity market returns would result in an increase to policy liabilities thereby reducing Net income by approximately \$166,100 (2019 \$127,300).

The following table identifies the concentration of the Company's common equity holdings in Empire Life's investment portfolios:

As at December 31	2020	2019
Holdings of common equities in the 10 issuers to which the Company had the greatest exposure	\$ 675,244	\$ 648,049
Percentage of total cash and investments	6.7%	7.0%
Exposure to the largest single issuer of common equities	\$ 447,166	\$ 444,366
Percentage of total cash and investments	4.5%	4.8%

## (2) Interest rate risk

Interest rate risk arises when economic losses are incurred due to the need to reinvest or divest during periods of changing interest rates. Changes in interest rates, as a result of the general market volatility or as a result of specific social, political or economic events, could have an adverse effect on the Company's business and profitability in several ways. Certain of the Company's product offerings contain guarantees and, if long-term interest rates fall below those guaranteed rates, the Company may be required to increase policy liabilities against losses, thereby adversely affecting its operating results. Interest rate changes can also cause compression of net spread between interest earned on investments and interest credited to customers, thereby adversely affecting the Company's operating results.

Rapid declines in interest rates may result in, among other things, increased asset calls and mortgage prepayments and require reinvestment at significantly lower yields, which could adversely affect earnings. Additionally, during periods of declining interest rates, bond redemptions generally increase, resulting in the reinvestment of such funds at lower current rates. Rapid increases in interest rates may result in, among other things, increased surrenders. Fluctuations in interest rates may cause losses to the Company due to the need to reinvest or

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divest during periods of changing interest rates, which may force the Company to sell investment assets at a loss. In addition, an interest rate sensitivity mismatch between assets and the liabilities that they are designated to support could have an adverse effect on the Company's financial position and operating results.

The following tables summarize the estimated immediate financial impact on Net income and OCI as a result of an immediate change in interest rates.

	As at December 31, 2020			
	50 bps Increase	50 bps Decrease	100 bps Increase	100 bps Decrease
Shareholders' net income	\$ 11,547	\$ (12,325)	\$ 22,406	\$ (25,520)
Policyholders' net income	\$ 271	\$ (298)	\$ 519	\$ (625)
Shareholders' other comprehensive income	\$ (52,175)	\$ 61,963	\$ (94,562)	\$ 133,713
Policyholders' other comprehensive income	\$ (556)	\$ 583	\$ (1,086)	\$ 1,192

	As at December 31, 2019			
	50 bps Increase	50 bps Decrease	100 bps Increase	100 bps Decrease
Shareholders' net income	\$ 20,751	\$ (22,972)	\$ 39,524	\$ (48,444)
Policyholders' net income	\$ 233	\$ (254)	\$ 446	\$ (531)
Shareholders' other comprehensive income	\$ (45,776)	\$ 54,420	\$ (82,907)	\$ 117,484
Policyholders' other comprehensive income	\$ (1,288)	\$ 1,422	\$ (2,442)	\$ 2,979

The computation of policy liabilities takes into account projected investment income net of investment expenses from the assets supporting policy liabilities, and investment income expected to be earned on reinvestments. The assets supporting the policy liabilities are segmented from the assets backing shareholders' and policyholders' equity. For life and health insurance, the projected cash flows from the assets supporting policy liabilities are combined with estimated future reinvestment rates based on both the current economic outlook and the Company's expected future asset mix. In order to provide a margin that recognizes the mismatch of assets and liabilities, the cash flows are subjected to tests under a wide spectrum of possible reinvestment scenarios, and the policy liabilities are then adjusted to provide for credible adverse future scenarios.

In order to match the savings component of policy liabilities that vary with a variety of indices and currencies, the Company maintains certain equity, bond and currency financial instruments as part of its general fund assets. Asset-liability mismatch risk for these liabilities is monitored regularly.

For the life insurance business, where the insurance contract liabilities have a longer term than most available bonds and mortgages, the Company will need to reinvest net cash flows arising in the future to extend the duration of its assets. Under Canadian actuarial standards of practice, the yields assumed for these future reinvestments are related to current interest rates, the current economic outlook and the Company's expected future asset mix. The reinvestment assumption grades from the initial reinvestment rate (IRR) assumption to the ultimate reinvestment rate (URR) assumption over the rolling 40-year period following the balance sheet date.

The estimated impact of an immediate change in interest rates is described above. If interest rates increase or decrease during the next year, then a change to the IRR assumption would be required to take into account the then-current economic outlook. For non-participating insurance business, a 1.0% decrease in interest rates would cause a decrease in reinvestment assumption for the next 40-years, resulting in an increase to policy liabilities thereby reducing net income by approximately \$47,100 (2019 \$52,500). This assumes no change in the URR assumption.

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For investment income expected to be earned on reinvestments beyond the rolling 40-year period, the Company uses an URR assumption. Under Canadian actuarial standards of practice, the URR assumption is prescribed as a long-term ultimate risk-free reinvestment rate of 3.1% (2019 3.1%) plus a maximum amount for credit spreads minus asset default rates of 0.8% (2019 0.8%). The prescribed level of the URR assumption may be periodically changed by the actuarial standards setting body. As interest rates are currently lower than they were when the current URR assumptions were set, there may be a downward bias if the rates were to be updated.

In order to provide a margin that recognizes the longer-term mismatch, the cash flows are subjected to tests under a wide spectrum of possible reinvestment scenarios, and the insurance contract liabilities are then adjusted to provide for credible adverse future scenarios. The Company uses an URR of 3.9% (2019 3.9%) to adjust for credible adverse scenarios.

For annuity business, where the timing and amount of the benefit obligations can be more readily determined, much closer matching of the asset and liability cash flows is possible, and applied, which helps mitigate the potential impact on the business from a sudden increase or decrease in interest rates. For annuity business, the impact a 1.0% decrease in assumed IRR has on policy liabilities and subsequently on Net income is negligible as a result of the matching process described above.

Interest rate risk in Empire Life's investment portfolio is managed through Investment Committee established limits and regular reporting by management to the Investment Committee and the Board. The Company's investment guidelines establish investment objectives and eligible interest rate sensitive investments, as well as establish diversification criteria, exposure, concentration and asset quality limits for these investments. The Asset Management Committee oversees sensitivity to interest rates. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable levels and within risk tolerances. Product development and pricing policies and practices also require consideration of interest rate risk in the design, development and pricing of the products.

### **(3) Foreign exchange rate risk**

Foreign exchange rate risk arises when the fair value of cash flows of a financial instrument fluctuate due to changes in exchange rates. This can create an adverse effect on earnings and equity when measured in the Company's functional currency.

The Company's primary foreign currency exposure arises from portfolio investments denominated in US dollars. A 10% fluctuation in the US dollar would have an impact of approximately \$ nil (2019 \$ nil) on shareholders' Net income, \$ nil (2019 \$ nil) on policyholder's Net income, \$ nil (2019 \$ nil) on shareholders' OCI and \$ nil (2019 \$ nil) on policyholders' OCI. The Company's exposure to foreign currency risk in its financial liabilities is not material.

The Company uses derivative instruments, including futures contracts and foreign currency forward contracts, to manage foreign exchange risks. Improper use of these instruments could have an adverse impact on earnings. The Company manages this risk by applying limits 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.

The Company has a Foreign Exchange Risk Management Policy which outlines objectives, risk limits and authority associated with any foreign exchange rate exposure. Oversight and management of this policy falls under the responsibility of the Asset Management Committee, which reports exposures and any breaches to the Risk and Capital Committee of the Board.

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## (b) Liquidity risk

Liquidity risk is the risk that an entity will not be able to fund all cash outflow commitments or obligations as they fall due or that, in order to fund commitments, an entity may have to sell assets at depressed prices resulting in losses at time of sale. Cash outflows could be in the form of benefit payments to policyholders, expenses, asset purchases and interest on debt. The majority of the Company's obligations relate to its policy liabilities, the duration of which varies by line of business and expectations relating to key policyholder actions or events (i.e. cash withdrawal, mortality, and morbidity). The remaining obligations of the Company relate to the subordinated debt (refer to Note 13 - Subordinated Debt) and to ongoing operating expenses as they fall due, which are expected to settle in a very short period of time.

The Company's liquidity risk management strategy is to ensure that there will be sufficient cash to meet all financial commitments and obligations as they become due.

The Company's liquidity risk management program is monitored by management and by the Board of the Company through regular reporting to the Investment Committee. The Company monitors its cash flow obligations and meets its liquidity needs by holding high quality marketable investments that may be easily sold, if necessary, and by maintaining a portion of investments in cash and short-term investments.

The Company maintains a liquidity policy requiring an assessment of the Company's liquidity risk and specific procedures so that liquidity needs are met. Compliance with the policy is monitored by the Asset Management Committee and exposures and breaches are reported to the Investment Committee of the Board. The Company's current liquidity position as at December 31 is provided in a table in Note 10(e). Based on the Company's historical cash flows and current financial performance, management believes that the cash flows from the Company's operating activities will continue to provide sufficient liquidity for the Company to satisfy debt service obligations and to pay other expenses.

The following table shows details of the expected maturity profile of the Company's undiscounted obligations with respect to its financial liabilities and estimated cash flows of policy liabilities. Subordinated debt that are not due at a single maturity date are included in the tables in the year of final maturity. Actual maturities could differ from contractual maturities because of the borrower's right to call or extend prepay obligations, with or without prepayment penalties. Policy liability cash flows include estimates related to the timing and payment of death and disability claims, policy maturities, annuity payments, policyholder dividends, amounts on deposit, commission and premium taxes offset by contractual future premiums and fees on in-force business. Recoveries from reinsurance agreements are also reflected. Segregated fund liabilities are excluded from this analysis. These estimated cash flows are based on the best estimate assumptions, with margins for adverse deviations, used in the determination of policy liabilities. The actuarial and other policy liability amounts included in the Company's 2020 Consolidated Financial Statements are based on the present value of the estimated cash flows. Due to the use of assumptions, actual cash flows will differ from these estimates.

	As at December 31, 2020				
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total
Insurance contract liabilities	\$ 69,513	\$ 157,882	\$ 599,674	\$ 23,853,965	\$ 24,681,034
Investment contract liabilities	4,081	12,491	12,209	8,996	37,777
Subordinated debt	14,094	31,960	413,800	—	459,854
Preferred shares	156,549	93,082	—	—	249,631
Accounts payable and Other liabilities	249,898	32,242	70,421	—	352,561
Total liabilities	494,135	327,657	1,096,104	23,862,961	25,780,857
Operating lease commitments	—	—	—	—	—
<b>Total</b>	<b>\$ 494,135</b>	<b>\$ 327,657</b>	<b>\$ 1,096,104</b>	<b>\$ 23,862,961</b>	<b>\$ 25,780,857</b>

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	As at December 31, 2019					
	1 year or less	1 - 5 years	5 - 10 years	Over 10 years	Total	
Insurance contract liabilities	\$ 71,689	\$ 162,523	\$ 513,593	\$ 23,596,531	\$ 24,344,336	
Investment contract liabilities	3,823	12,418	11,665	9,882	37,788	
Subordinated debt	14,094	51,294	439,960	—	505,348	
Preferred shares	13,496	232,280	—	—	245,776	
Accounts payable and Other liabilities	227,908	7,044	42,616	—	277,568	
Total liabilities	331,010	465,559	1,007,834	23,606,413	25,410,816	
Operating lease commitments	115	—	—	—	115	
<b>Total</b>	<b>\$ 331,125</b>	<b>\$ 465,559</b>	<b>\$ 1,007,834</b>	<b>\$ 23,606,413</b>	<b>\$ 25,410,931</b>	

The Asset Management Committee, which meets regularly, monitors the matched position of the Company's investments in relation to its liabilities within the various segments of its operations. The matching process is designed to require that assets supporting policy liabilities closely match, to the extent possible, the timing and amount of policy obligations, and to plan for the appropriate amount of liquidity in order to meet its financial obligations as they fall due. The Company maintains a portion of its investments in cash, cash equivalents and short-term investments to meet its short-term funding requirements. As at December 31, 2020, 2.0% (2019 1.9%) of cash and investments were held in these shorter duration investments.

## (c) Credit risk

Credit risk is the possibility of loss from amounts either owed by financial counterparties, such as debtors, reinsurers and other financial institutions, or in connection with issuers of securities held in an asset portfolio. The Company is subject to credit risk which arises from debtors or counterparties who are unable to meet their obligations under debt or derivative instruments. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, cash and cash equivalents, mortgages and from reinsurers under reinsurance agreements.

The Company manages this risk by applying its investment guidelines and product design and pricing risk management policy established by the Investment Committee and Risk and Capital Committee of the Board respectively. 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 and Board committees review 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 the Company's Board on the credit risk to which the portfolio is exposed. The Reinsurance Risk Management Policy (along with supporting material in the Product Design and Pricing Risk Management Policy) establishes reinsurance objectives and limits, and requires ongoing evaluation of reinsurers for financial soundness. The Company enters into long-term reinsurance agreements only with reinsurance companies that have a credit rating of "A-" or better.

Credit risk analysis includes the consideration of credit spreads. From an investment perspective, when buying credit the Company is guided by two principles; first that there is a high likelihood of return of principal and second that there is an acceptable return on investment. The Company looks to obtain a risk/reward balance that aligns with its objectives and risk philosophy. When determining insurance contract liabilities, credit spreads and changes in credit spreads are reflected in the interest rate assumption.

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The Company has the following assets that are exposed to credit risk:

As at December 31	2020		2019	
Cash and cash equivalents	\$	189,356	\$	140,333
Short-term investments		13,008		32,384
Bonds		8,027,780		7,509,652
Preferred shares		616,902		474,029
Derivative assets		5,377		2,930
Mortgages		157,214		169,827
Reinsurance		141,136		113,107
Loans on policies		56,458		55,363
Policy contract loans		60,407		66,520
Accrued investment income		38,932		35,401
Insurance receivables		46,533		48,728
Trade accounts receivable		7,245		13,180
<b>Total</b>	<b>\$</b>	<b>9,360,348</b>	<b>\$</b>	<b>8,661,454</b>

Mortgages, Loans on policies and Policy contract loans are fully or partially secured.

The Company has made provision in its Consolidated Statements of Financial Position for credit losses. Provisions have been made partly through reduction in the value of the assets (see Note 3(b)) and partly through a provision in policy liabilities (see Note 10(c)).

## Concentration of credit risk

### (1) Bonds and debentures

The concentration of the Company's bond portfolio by investment grade is as follows:

As at December 31	2020		2019	
	Fair value	% of Fair value	Fair value	% of Fair value
AAA	\$ 394,570	5 %	\$ 348,815	5%
AA	2,289,540	28 %	1,167,357	16%
A	3,910,974	49 %	4,831,528	64%
BBB	1,429,025	18 %	1,161,952	15%
BB (and lower ratings)	3,671	— %	—	—%
<b>Total</b>	<b>\$ 8,027,780</b>	<b>100 %</b>	<b>\$ 7,509,652</b>	<b>100%</b>

Credit ratings are normally obtained from Standard & Poor's (S&P) and Dominion Bond Rating Service (DBRS). In the event of a split rating, the lower rating is used. Issues not rated by a recognized rating agency are rated internally by the Investment Department. The internal rating assessment is documented referencing suitable comparable investments rated by recognized rating agencies and/or methodologies used by recognized rating agencies.

Provincial bonds represent the largest concentration in the bond portfolio, as follows:

As at December 31	2020		2019	
Provincial bond holdings	\$	4,098,339	\$	4,182,725
Percentage of total bond holdings		51.1%		55.7%

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The following table profiles the bond portfolio by contractual maturity, using the earliest contractual maturity date:

As at December 31	2020		2019	
	Fair value	% of Fair value	Fair value	% of Fair value
1 year or less	\$ 188,385	2%	\$ 75,119	1%
1 - 5 years	678,391	8%	769,237	10%
5 - 10 years	696,271	9%	700,976	9%
Over 10 years	6,464,733	81%	5,964,320	80%
<b>Total</b>	<b>\$ 8,027,780</b>	<b>100 %</b>	<b>\$ 7,509,652</b>	<b>100%</b>

The following table discloses the Company's holdings of fixed income securities in the 10 issuers (excluding the federal government) to which the Company had the greatest exposure, as well as exposure to the largest single issuer of corporate bonds.

As at December 31	2020	2019
Holdings of fixed income securities* in the 10 issuers (excluding federal governments) to which the Company had the greatest exposure	\$ 4,886,504	\$ 4,744,433
Percentage of total cash and investments	48.6%	51.1%
Exposure to the largest single issuer of corporate bonds	\$ 236,086	\$ 199,877
Percentage of total cash and investments	2.4%	2.2%

\*Fixed income securities includes bonds, debentures, preferred shares and short term investments.

## (2) Preferred shares

The Company's preferred share investments are all issued by Canadian companies, with 1% (2019 1%) rated as P1, 97% rated as P2 (2019 97%) and the remaining 2% (2019 2%) rated as P3.

## (3) Mortgages

Mortgages in the province of Ontario represent the largest concentration with \$156,445 or 99% (2019 \$169,058 or 99%) of the total mortgage portfolio.

## (d) Insurance risk

The Company provides a broad range of life insurance, health insurance and wealth management products, employee benefit plans, and financial services that are concentrated by product line as follows:

(millions of dollars)	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2020	2019	2020	2019	2020	2019	2020	2019	2020	2019
<b>For the year ended December 31</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Net premium income	\$ 94.6	\$ 159.1	\$ 357.0	\$ 360.4	\$ 408.6	\$ 390.3	\$ —	\$ —	\$ 860.2	\$ 909.8
Fee and other income	238.2	249.0	12.6	12.5	0.4	0.2	0.1	—	251.3	261.7
<b>Total</b>	<b>\$ 332.8</b>	<b>\$ 408.1</b>	<b>\$ 369.6</b>	<b>\$ 372.9</b>	<b>\$ 409.0</b>	<b>\$ 390.5</b>	<b>\$ 0.1</b>	<b>\$ —</b>	<b>\$ 1,111.5</b>	<b>\$ 1,171.5</b>

Insurance risk is the risk that actual experience related to claims, benefit payments, expenses, cost of embedded product options and cost of guarantees associated with insurance risks, does not emerge as expected. The Company is exposed to various insurance risks as a result of the business it writes, including: mortality, policyholder behaviour (termination or lapse), expenses, morbidity, longevity, product design and pricing risk, underwriting and claims risk and reinsurance risk.

Economic and environmental events, such as natural disasters, human-made disasters as well as pandemics, could occur in regions where Empire Life has significant insurance coverage, impacting financial results.

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The Company regularly evaluates its exposure to foreseeable risks through stress testing techniques including FCT analysis.

The principal risk the Company faces under insurance contracts is the risk that experience on claims, policy lapses and operating expenses will not emerge as expected. To the extent that emerging experience is more favourable than assumed in the valuation, income will emerge. If emerging experience is less favourable, losses will result. Therefore, the objective of the Company is to establish sufficient insurance liabilities to cover these obligations with reasonable certainty.

The computation of insurance liabilities and related reinsurance recoverable requires “best estimate” assumptions covering the remaining life of the policies. Assumptions in use are based on past experience, current internal data, external market indices and benchmarks which reflect current observable market trends and other published information. These assumptions are made for mortality, morbidity, longevity, lapse, expenses, inflation and taxes. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviations from best estimates is calculated separately for each variable and included in policy liabilities. These margins are intended to allow for possible deterioration in experience and to provide greater confidence that policy liabilities are adequate to pay future benefits. The effect of these margins is to increase policy liabilities over the best estimate assumptions.

The margins for adverse deviation used by the Company are within the target range established by the CIA. A correspondingly larger margin is included in the insurance contract liabilities if an assumption is susceptible to change or if there is more uncertainty about the best estimate assumption. Each margin is reviewed annually for continued appropriateness.

Policy liability assumptions are reviewed and updated at least annually by the Company’s Appointed Actuary. The impact of changes in those assumptions is reflected in earnings in the year of the change. Details related to the changes in assumptions are also discussed with the Audit Committee of the Board. The methods for arriving at the most important of these assumptions are outlined below. Also included are measures of the Company’s estimated net income sensitivity to changes in best estimate assumptions in the non-participating insurance liabilities, based on a starting point and business mix as of December 31, 2020. For participating business it is assumed that changes will occur in policyholder dividend scales corresponding to changes in best estimate assumptions such that the net change in participating insurance contract liabilities is immaterial.

## **(1) Mortality**

The Company carries out annual internal studies of its own mortality experience. The valuation mortality assumptions are based on a combination of this experience and recent CIA industry experience. An increase in the rate of mortality will lead to a larger number of claims (and claims could occur sooner than anticipated), which for life insurance, will increase expenditures and reduce profits for the shareholders.

For non-participating insurance business, a 2.0% increase in the best estimate mortality assumption would increase policy liabilities thereby decreasing Net income by approximately \$17,100 (2019 \$15,800).

For annuity business, lower mortality (or longevity) is financially adverse so a 2.0% decrease in the best estimate mortality assumption would increase policy liabilities thereby decreasing Net income by approximately \$9,000 (2019 \$3,300).

## **(2) Policyholder behaviour (termination or lapse)**

Policy termination (lapse) and surrender assumptions are based on a combination of the Company’s own internal termination studies (conducted annually) and recent CIA industry experience. Separate policy termination assumptions are used for permanent cash-value business, for renewable term insurance, term insurance to age 100 and for universal life

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

insurance. In setting policy termination rates for renewable term insurance, it is assumed that extra lapses will occur at each renewal point and that healthy policyholders are more likely to lapse at that time than those who have become uninsurable.

Acquisition costs may not be recovered fully if lapses in the early policy years exceed those in the actuarial assumptions. An increase in policy termination rates early in the life of the policy would tend to reduce profits for shareholders. An increase in policy termination rates later in the life of the policy would tend to increase profits for shareholders if the product is lapse supported (such as term insurance to age 100), but decrease shareholder profits for other types of policies.

For non-participating insurance and annuity business a 10.0% adverse change in the lapse assumption would result in an increase to policy liabilities thereby decreasing Net income by approximately \$183,500 (2019 \$152,300). For products where fewer terminations would be financially adverse to the Company, the change is applied as a decrease to the lapse assumption. Alternatively, for products where more terminations would be financially adverse to the Company, the change is applied as an increase to the lapse assumption.

### (3) Expenses

Policy liabilities provide for the future expense of administering policies in force, renewal commissions, general expenses and taxes. Expenses associated with policy acquisition and issue are specifically excluded. The future expense assumption is derived from internal cost studies and includes an assumption for inflation.

An increase in the level of expenses would result in an increase in expenditure thereby reducing profits for the shareholders.

For non-participating insurance business and annuity business combined, a 5% increase in the maintenance expense assumption would result in an increase to policy liabilities thereby reducing net income by approximately \$9,800 (2019 \$6,300).

### (4) Morbidity

The Company carries out annual internal studies of its own morbidity experience where morbidity refers to both the rates of accident or sickness and the rates of recovery from the accident or sickness. The valuation assumptions are based on a combination of internal experience and recent CIA industry experience.

For individual and group critical illness business, the incidence rates (or rates of accident or sickness) are the key assumption related to morbidity. An increase in incidence rates would result in an increase in the number of claims which increases expenditures and reduces shareholders' profits. For group long-term disability business the termination rates (or rates of recovery) are the key assumption related to morbidity. A decrease in termination rates would result in disability claims persisting longer which increases expenditures.

For non-participating insurance business where morbidity is a significant assumption, a 5% adverse change in the assumption would result in an increase to policy liabilities thereby reducing Net income by approximately \$8,400 (2019 \$7,900).

### (5) Product design and pricing risk

The Company is subject to the risk of financial loss resulting from transacting insurance business where the costs and liabilities assumed in respect of a product exceed the expectations reflected in the pricing of the product. This risk may be due to an inadequate assessment of market needs, a poor estimate of the future experience of several factors, such as mortality, morbidity, lapse experience, future returns on investments, expenses and taxes, as well as the introduction of new products that could adversely impact the future behaviour of policyholders.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

For certain types of contracts, all or part of this risk may be shared with or transferred to the policyholder through dividends and experience rating refunds or through the fact that the Company can adjust the premiums or future benefits if experience turns out to be different than expected. For other types of contracts, the Company assumes the entire risk and thus must carry out a full valuation of the commitments in this regard. Empire Life may transfer some of this risk through a reinsurance arrangement.

The Company manages product design and pricing risk through a variety of enterprise-wide programs and controls. The key programs and controls are described as follows. The Company has established policy liabilities in accordance with standards set forth by the CIA. Experience studies (both Company-specific and industry level) are factored into ongoing valuation, renewal and new business processes so that policy liabilities, as well as product design and pricing, take into account emerging experience. The Company has established an active capital management process that includes a Capital Management Policy and capital management levels that exceed regulatory minimums. As prescribed by regulatory authorities, the Appointed Actuary conducts FCT and reports annually to the Audit Committee on the Company's financial condition, outlining the impact on capital levels should future experience be adverse. The Company has a Product Design and Pricing Risk Management Policy governing all of its major product lines. This policy, which is established by the Product Management Review Committee ("PMRC") and approved by the Risk and Capital Committee of the Board, defines the Company's product design and pricing risk management philosophy. The policy sets out principles for prudent product design and pricing, approval authorities, product concentration limits, and required product development monitoring processes and controls.

## **(6) Underwriting and claims risk**

The Company is subject to the risk of financial loss resulting from the selection and underwriting of risks to be insured and from the adjudication and settlement of claims. Many of the Company's individual insurance and group disability products provide benefits over the policyholder's lifetime. Actual claims experience may differ from the mortality and morbidity assumptions used to calculate the related premiums. Catastrophic events such as earthquakes, acts of terrorism or an influenza pandemic in Canada could result in adverse claims experience.

In addition to the risk management controls described above under Product Design and Pricing Risk, the Company also manages underwriting and claims risk through its Underwriting and Liability Risk Management Policy which governs each of its major product lines. This policy is established by the PMRC and approved by the Risk and Capital Committee of the Board. It defines the Company's underwriting and claims management philosophy and sets out principles for prudent underwriting and claims management including, underwriting classification, claims requirements, approval authorities and limits, and ongoing risk monitoring. The Company uses reinsurance to mitigate excessive exposure to adverse mortality and morbidity experience. The PMRC reviews and establishes retention limits for its various product lines and the Risk and Capital Committee of the Board recommends changes to these retention limits for approval by the board.

## **(7) Reinsurance risk**

The Company is subject to the risk of financial loss due to inadequate reinsurance coverage or a default of a reinsurer. Amounts reinsured per life vary according to the type of protection and the product. The Company also maintains a catastrophe reinsurance program, which provides protection in the event that multiple insured lives perish in a common accident or catastrophic event. Although the Company relies on reinsurance to mitigate excessive exposure to adverse mortality and morbidity experience, reinsurance does not release it from its primary commitments to its policyholders and it is exposed to the credit risk associated with the amounts ceded to reinsurers. The availability and cost of reinsurance are subject to prevailing reinsurance market conditions, both in terms of price and availability, which can also affect earnings.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

The Reinsurance Risk Management Policy establishes reinsurance objectives and limits, and requires ongoing evaluation of reinsurers for financial soundness. As reinsurance does not release a company from its primary commitments to its policyholders, an ongoing oversight process is critical. The PMRC reports annually to the Risk and Capital Committee of the Board on reinsurance activities. Most of Empire Life's reinsurance is on an excess basis, meaning Empire Life retains 100% of the risk up to its retention level. Effective April 1, 2020, Empire Life updated its single life retention limit for new business to \$1,500 in face amount (previously \$500). For some insurance risk categories and/or products, retention levels below this maximum are applied. Reinsurance is used to limit losses, minimize exposure to significant risks and to provide capacity for growth. As a result of the retention limit increase, recapture provisions of all eligible reinsurance treaties were exercised commencing April 1, 2020. These activities result in an increase in insurance risk for Empire Life, which it deems acceptable.

As a result of this reinsurance strategy, the Company utilizes lower than average levels of reinsurance, compared to Canadian competitors, and absorbs the resultant negative impact on short-term earnings due to additional sales strain. The Company does not have any assumed reinsurance business.

## (e) COVID-19 Pandemic

In March 2020, the World Health Organization declared a pandemic related to the COVID-19 virus. The spread of the pandemic, given its severity and scale has affected and may continue to affect the Company's financial results, its customers and continues to pose risks to the Canadian economy. The Company continues to adjust its operations, where necessary, as government restrictions and measures evolve.

The duration and impact of the COVID-19 pandemic cannot currently be determined. If the pandemic is prolonged, including the possibility of subsequent waves, or further diseases emerge that give rise to similar effects, the adverse impact on the economy could deepen and results in further volatility and declines in equity markets and interest rates, increases in credit risk, insurance claims, or disruptions in business operations. These economic conditions may contribute to uncertainty over the carrying value of certain assets and liabilities in these financial statements. The Company has considered these events and their effects when applying the measurement techniques for critical accounting estimates and judgments provided in Note 2(c). The potential effect on the Company's financial results due to fluctuations in equity markets and interest rates are provided in Note 27(a).

## 28. Subsequent Event

On February 17, 2021, the Company issued \$200 million of Limited Recourse Capital Notes Series 1 (LRCN Series 1) with recourse limited to assets held by a third party trustee in a trust which will be consolidated in these financial statements. Payments of interest and principal in cash on the LRCN Series 1 are made at the discretion of the Company and non-payment of interest and principal in cash does not constitute an event of default. In the event of a non-payment of interest, the sole remedy of noteholders shall be the delivery of the holders' proportionate share of the trust assets. In such an event, the delivery of the trust assets will represent the full and complete extinguishment of the Company's obligations under the LRCN Series 1.

The trust assets consist of \$200 million of Empire Life Non-Cumulative 5-year Fixed Rate Reset Preferred Shares, Series 5 which were issued concurrently with the LRCN Series 1 at a rate of \$1000 per Series 5. Holders of the LRCN Series 1 are entitled to receive semi-annual payments at a rate of 3.625% per annum until April 17, 2026. Thereafter, the yield will reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 3.082%.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(in thousands of Canadian dollars except for per share amounts, shares authorized and outstanding and where otherwise stated)

## 29. Comparative figures

Certain prior year figures have been reclassified to conform to the current year's presentation.

# GLOSSARY OF TERMS (unaudited)

## **Accumulated Other Comprehensive Income (AOCI)**

A separate component of shareholders' and policyholders' equity which includes net unrealized gains and losses on available for sale securities, unamortized gains and losses on cash flow hedges, unrealized foreign currency translation gains and losses and remeasurement of post-employment benefit liabilities. These items have been recognized in comprehensive income, but excluded from net income.

## **Active Market**

An active market is a market in which the items traded are homogeneous, willing buyers and sellers can normally be found at anytime and prices are available to the public.

## **Available For Sale (AFS) Finance Assets**

Non-derivative financial assets that are designated as AFS or that are not classified as loans and receivables, held to maturity investments, or held for trading. Most financial assets supporting capital and surplus are classified as AFS.

## **Canadian Asset Liability Method (CALM)**

The prescribed method for valuation of policy liabilities in Canada. CALM is a prospective basis of valuation which uses the full gross premium for the policy, the estimated expenses and obligations under the policy, current expected experience assumptions plus a margin for adverse deviations, and scenario testing to assess interest rate risk and market risks.

## **Canadian Institute of Actuaries (CIA)**

As the national organization of the Canadian actuarial profession, the CIA means to serve the public through the provision by the profession of actuarial services and advice of the highest quality. The CIA ensures that the actuarial services provided by its members meet accepted professional standards; and assists actuaries in Canada in the discharge of their professional responsibilities.

## **Canadian Life and Health Insurance Association (CLHIA)**

The Canadian Life and Health Insurance Association (CLHIA) is an organization representing life insurance and health insurance providers in Canada. The industry develops guidelines, voluntarily and proactively, to respond to emerging issues and to ensure consumer interests are protected.

## **Chartered Professional Accountants of Canada (CPA Canada)**

Canada's not-for-profit association for Chartered Professional Accountants (CPA) provides information and guidance to its members, students and capital markets. Working in collaboration with its provincial member organizations, CPA Canada supports the setting of accounting, auditing and assurance standards for business, not-for-profit organizations and government, and develops and delivers education programs.

## **Earnings on Surplus**

This source of earnings represents the pre-tax earnings on the shareholders' capital and surplus funds.

## **Effective Interest Method**

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

## **Expected Profit from In-Force Business**

This source of earnings represents the profit Empire Life expects to generate on in-force business if experience is in line with the Empire Life's best estimate assumptions for mortality, morbidity, persistency, investment returns, expenses and taxes.

## **Experience Gains and Losses**

This source of earnings represents gains or losses due to the difference between actual experience and the best estimate assumptions.

# GLOSSARY OF TERMS (unaudited)

## **Fair Value Through Profit or Loss (FVTPL)**

Invested assets are classified as financial instruments at FVTPL if they are held for trading, or if they are designated by management under the fair value option. Most financial assets supporting insurance contract liabilities and investment contract liabilities are classified as FVTPL.

## **Impact on New Business**

Writing new business typically adds economic value to a life insurance company. At the point of sale, new business may have a positive or negative impact on earnings. A negative impact (new business strain) will result when the provision for adverse deviation included in the actuarial liabilities at the point of sale exceeds the expected profit margin in the product pricing. The impact of new business also includes any excess acquisition expenses not covered by product pricing at the point of issue.

## **International Financial Reporting Standards (IFRS)**

Refers to the international accounting standards that were adopted in Canada, effective January 1, 2011; these are now Canadian Generally Accepted Accounting Principles (CGAAP) for publicly accountable enterprises.

## **Life Insurance Capital Adequacy Test (LICAT)**

The LICAT measures the capital adequacy of an insurer and is one of several indicators used by OSFI to assess an insurer's financial condition. The LICAT Ratio is the ratio of eligible capital to the base solvency buffer, each as calculated under OSFI's published guidelines.

## **Management Actions and Changes in Assumptions**

This source of earnings component includes earnings generated by management actions during the year (e.g. acquisition or sale of a block of business, changes to product price, fees or asset mix, etc.) or the impact of changes in assumptions or methodology used for the calculation of actuarial liabilities for in-force business.

## **Other Comprehensive Income (OCI)**

Unrealized gains and losses, primarily on financial assets backing Capital and Surplus, are recorded as Other Comprehensive Income ("OCI") or Other Comprehensive Loss ("OCL"). When these assets are sold or written down the resulting gain or loss is reclassified from OCI to net income. Remeasurements of post-employment benefit liabilities are also recorded as OCI or OCL. These remeasurements will not be reclassified to net income and will remain in AOCI.

## **Office of the Superintendent of Financial Institutions Canada (OSFI)**

The primary regulator of federally chartered financial institutions and federally administered pension plans in Canada. OSFI's mission is to safeguard policyholders, depositors and pension plan members from undue loss.

## **Participating Policies**

The participating account includes all policies issued by the Company that entitle its policyholders to participate in the profits of the participating account. The Company has discretion as to the amount and timing of dividend payments which take into consideration the continuing solvency of the participating account.

## **Return on Common Shareholders' Equity (ROE)**

A profitability measure that presents the net income available to common shareholders as a percentage of the average capital deployed to earn the income.

# PARTICIPATING ACCOUNT MANAGEMENT POLICY

## Purpose

The Participating Account Management Policy sets out the management objectives for oversight of the participating account of The Empire Life Insurance Company (“Empire Life” or the “Company”).

## Scope

This policy applies to all policies issued in the participating account of Empire Life that entitle its policyholders to participate in the profits of the participating account. Most policies are credited with dividends annually, while a few older plans receive the dividends every five years as per contractual provisions.

## Policy

### Description of the Participating Account and its Policies

Empire Life maintains an account in respect of participating policies (“participating account”), separate from those maintained in respect of other policies, in the form and manner determined by the Office of the Superintendent of Financial Institutions under section 456 of the Insurance Companies Act. The participating account includes all policies issued by Empire Life that entitle its policyholders to participate in the profits of the participating account.

Empire Life does not maintain sub-accounts within the participating account for life, disability and annuity plans, other funds, or blocks of business acquired from other companies. Empire Life does not have any closed blocks of participating business established as part of the demutualization of a mutual company into a shareholder company.

### Investment Policy

The general fund investments in the participating account are subject to limits established by the Insurance Companies Act and to investment guidelines established by the Investment Committee of Empire Life’s Board of Directors (the “Board”). The investment guidelines are designed to limit overall investment risk by defining investment objectives, eligible investments, diversification criteria, exposure, concentration and asset quality limits for eligible investments. The objective is to maximize investment yields while managing the default, liquidity and reinvestment risks at acceptable and measurable low levels.

Within the participating account, Empire Life has established three asset segments to nominally match the investments to the specific type of liabilities or surplus as follows: Protection Par, Miscellaneous Insurance Par and Policyholders’ Surplus. Each asset segment is assigned specific assets in an amount approximately equal to its total liabilities or surplus.

The Investment Committee receives monthly reporting on general fund asset mix and performance and investment transactions for all funds by asset segment. In addition, on at least a quarterly basis, management and the Company’s investment managers report to the Investment Committee, and through the Investment Committee to the Board of Directors, on portfolio content, asset mix, the Company’s matched position, the performance of general and segregated funds, and compliance with the investment guidelines. The investment guidelines are reviewed at least annually by the Board.

### Investment Income Allocation

Investment income is recorded directly to each asset segment. A portion of investment income is allocated to or from the Shareholders’ Capital and Surplus segment from or to the participating account’s asset segments in proportion to the deficiency or excess of funds over assets of each segment.

### Expense Allocation

General expenses are allocated to the participating account using cost centre methods. Expenses associated directly with the participating account are so charged. Expenses arising from or varying directly with various functional activities are charged to the participating account in proportion to statistics appropriate to each cost centre. Expenses incurred by overhead cost centers are charged to the participating account in proportion to expenses directly charged.

Investment expenses are allocated monthly to the participating account in proportion to the Company’s total funds at the beginning of each month.

# PARTICIPATING ACCOUNT MANAGEMENT POLICY

Premium taxes are allocated in proportion to taxable premiums. Other taxes, licenses, and fees are allocated to lines of business using cost centre methods.

## Income Tax Allocation

Income taxes are allocated to the participating account in proportion to total taxable income for the Company. Deferred tax assets and liabilities are treated consistently between participating and non-participating accounts.

## Surplus Management

The level of surplus in the participating account will be managed by Company management taking into consideration the continuing solvency of the participating account, the participating account's ability to fulfill all of its contractual obligations and the extent to which existing participating business is financing new participating business.

## Transfers to Shareholder Accounts

It is Empire Life's intention to transfer the full permitted percentage of distributable participating profits to the shareholder accounts as allowed by section 461 of the Insurance Companies Act.

## Appointed Actuary

Annually, the Board will consider the Appointed Actuary's opinion on the continuing fairness of this policy to participating policyholders.

## Process to Approve (and Frequency)

This policy is reviewed annually by the Vice President & Product Actuary. All non-material amendments must be approved by the Product Management Review Committee. Material amendments must be approved by the Product Management Review Committee and the Board. The principal factors that would be expected to change the policy include changes in legislation, regulation of participating account, accepted actuarial practice, capital requirements, taxation and accounting rules or fundamental changes to the circumstances of the Company.

This policy will also be reviewed if the Company decides to stop accepting new business in the participating account.

# PARTICIPATING POLICYHOLDER DIVIDENDS POLICY

## Purpose

The Participating Policyholder Dividends Policy (the “dividend policy”) sets out the process for determining, recommending and declaring dividends for policies issued in the participating account of The Empire Life Insurance Company (“Empire Life” or the “Company”).

## Scope

This dividend policy applies to each policy issued in the participating account of Empire Life that entitles its policyholder to participate in the profits of the participating account. Most policies are credited with dividends annually, while a few older plans receive the dividends every five years as per contractual provisions.

## Policy Dividends are Declared at the Discretion of the Board

The aggregate amount of dividend and allocation of the dividend to the different classes of participating policies is declared annually at the discretion of the Board of Directors (the “Board”) of Empire Life under section 464(1) of the Insurance Companies Act. Before declaring the aggregate amount of dividend, the Board will consider Company management’s recommendations for policyholder dividends and the Appointed Actuary’s opinion on the conformity of the proposed dividend to this policy and its fairness to participating policyholders. Company management’s recommendations and the Appointed Actuary’s opinions shall be prepared in compliance with applicable legislative and regulatory requirements, and generally accepted actuarial practice with such changes as determined by the Office of the Superintendent of Financial Institutions.

## Principal Factors that Affect the Aggregate Amount of Dividends

The aggregate amount of dividends will reflect operating income on all participating life, annuity and disability coverages, dividends on deposit, participating paid-up additions and participating term additions, as well as income attributable to surplus in the participating account. The aggregate amount of dividends will also be influenced by considerations such as, solvency of the participating account, its ability to fulfill all contractual obligations, the extent to which surplus in the participating account is financing new business, changes in legislation, regulation of the participating account, taxation, accounting rules or fundamental changes in the circumstances of the Company.

## Principal Sources of Income

The principal sources of income considered for determining the aggregate amount of dividends are investment income, asset defaults, mortality, lapses, expenses and taxes. The actual experience of the participating account will be reviewed annually by Company management. The sources of income may be adjusted to smooth fluctuations in experience and provide for transitions during periods of major change over a period not to exceed five years. The Company uses a temporary contribution to policyholder surplus philosophy, so that contributions to policyholder surplus from participating account income are expected to be returned to policyholders over the lifetime of the policy. Since actual experience cannot be known in advance, the aggregate amount of dividends and allocation of the dividends cannot be guaranteed. As a result, dividends will increase or decrease depending on actual experience.

## Dividend Allocation

Policyholders participate in this distribution through the setting of dividend scales, which allocate the aggregate amount of dividends among different dividend classes. The Company establishes dividend classes for participating policyholders based on the original pricing assumptions used when setting the guaranteed values provided by the policies. The Company uses a combination of factor-based and pricing methods when setting the dividend scale to allocate the aggregate amount of dividends among different dividend classes. The basic concept of this method is to allocate the aggregate amounts of dividends among dividend classes in the same proportion as the policies are considered to have contributed to the aggregate amount of dividends over the long term. The fundamental objective in the allocation of dividends is the maintenance of reasonable equity between dividend classes and between generations of policyholders, taking into account practical considerations and limits.

# PARTICIPATING POLICYHOLDER DIVIDENDS POLICY

Company management will review the underlying experience, assumptions and procedures for participating dividend scales annually. Material changes in actual experience will be passed through to participating policyholders within two years of the experience change to the extent that they are not anticipated in the current dividend scale, any additional reserves or other similar experience leveling mechanisms. Company management will prepare a written report which describes the underlying experience, assumptions and procedures for the proposed dividend scale recommendations.

The dividend scales may also be adjusted to reflect specific policyholder behaviour, such as experience for lapses or for policy loans taken at guaranteed rates.

For certain blocks of policies, the policyholder dividend scale may be determined using methods which are designed to approximate the contribution to income of those blocks.

Termination dividends are not payable under any participating policies issued by Empire Life.

## Appointed Actuary

Annually, the Board will consider the Appointed Actuary's opinion on the continuing fairness of this policy to participating policyholders.

## Process to Approve (and Frequency)

This policy is reviewed annually by the Vice President & Product Actuary. All non-material amendments must be approved by the Product Management Review Committee. Material amendments must be approved by the Product Management Review Committee and the Board. The principal factors that would be expected to change the policy include changes in legislation, regulation of participating account, accepted actuarial practice, capital requirements, taxation and accounting rules or fundamental changes to the circumstances of the Company.

This policy will also be reviewed if the Company decides to stop accepting new business in the participating account.

# PARTICIPATING ACCOUNT FINANCIAL DISCLOSURE

	2020	2019
<b>Participating Surplus</b>		
Surplus and Accumulated OCI - beginning of year	\$ 40,112	\$ 36,163
Net Income and OCI, before dividends	41,857	38,086
Amounts transferred to shareholders per S.461 of the ICA	—	—
Amounts transferred to shareholders per S.462(a) of the ICA, if included in net income	(2,655)	(2,699)
Net Income and OCI	39,202	35,387
Policyholder dividends, excluding ERRs	(35,166)	(31,438)
Surplus and Accumulated OCI - end of year	44,148	40,112
<b>Total Participating Assets</b>		
	\$ 903,884	\$ 780,330
Section 462 transfer as a % of Distributable Profits	7.28 %	7.61 %

# CORPORATE GOVERNANCE OVER RISK MANAGEMENT

The Empire Life Insurance Company (the “Company”) is a stock company that has both shareholders and participating policyholders. The Company also has a mutual fund subsidiary, Empire Life Investments Inc. (“ELII”).

Pursuant to the *Insurance Companies Act* (Canada) (the “Act”) each holder of one or more participating policies is entitled to one vote in the election of policyholders’ directors, and each shareholder is entitled to one vote per share held in the election of shareholders’ directors. At least one-third of directors are elected as policyholder directors and the balance are elected as shareholder directors. The Company is governed by the Act, which contains provisions concerning corporate governance. The Company’s governance system is supported by internal audit, internal risk management, corporate compliance, external audit by an independent chartered accountants firm, and examination by the Office of the Superintendent of Financial Institutions Canada (“OSFI”).

Management is responsible for identifying risks and determining their impact upon the Company. Management is also responsible for establishing appropriate policies, procedures, and controls to mitigate risks. The Company has senior management level risk committees, which report to the Board of Directors and/or its Committees and an internal risk management department, led by the Chief Risk Officer, which supports enterprise risk management activities across the Company. An internal audit function is responsible for assessing the adequacy and adherence to the systems of internal control. The results of internal audit’s reviews are reported to management and to the Audit Committee of the Board of Directors regularly throughout the year.

Management is supervised in the completion of these responsibilities by the Board of Directors and its Committees. Senior management of the Company reports regularly to the Board on its risk management policies and procedures.

The Board of Directors has plenary power. The Board’s responsibility is to oversee the conduct of the business and affairs of the Company including oversight and monitoring of the Company’s risk management. The Board discharges these responsibilities directly and through delegation to Board Committees and management. The Board met six times in 2020 and is scheduled to meet at least six times in 2021.

The risk management functions overseen by the Board include those relating to market risk (including interest rate risk, equity risk, real estate risk and foreign exchange rate risk), liquidity risk, credit risk, insurance risk (including mortality risk, policyholder behavior (termination or lapse) risk, expense risk, morbidity risk as well as product design and pricing risk, underwriting and claims risk and reinsurance risk), operational risk (including legal and regulatory compliance risk, model risk, human resources risk, third party risk, technology and information security risk and business continuity risk) and business and strategic risk. Please see the section titled “Risk Factors” in the Company’s Annual Information Form available at [www.sedar.com](http://www.sedar.com) for more details on these risks. Primary responsibility for oversight of some of these risks is delegated to five standing Committees of the Board, whose roles and responsibilities are specifically defined. Those not delegated to a standing Committee remain with the Board. The following is a brief summary of some of the key responsibilities of the five Committees.

The Audit Committee has statutory responsibility under the Act to oversee, on behalf of the Board, the Company’s financial reporting, accounting and financial reporting systems and internal controls. The Committee also oversees work related to stress testing.

The Investment Committee assists the Board in monitoring the Company’s investment and lending policies, standards and procedures and in monitoring the Company’s investment activities and portfolios. Some of the activities of the Investment Committee are prescribed by the Company’s Investment Guidelines, which reflect the requirements of the Act. The Committee also monitors the Company’s asset/liability management activities.

The Human Resources Committee is responsible for reviewing and monitoring the Company’s human resources practices, including employee and executive compensation, succession planning, workforce and pension and benefit plans.

The Conduct Review Committee is responsible for oversight of procedures established to identify material related party transactions pursuant to the Act. The Committee also monitors certain corporate policies, including procedures with respect to the Company’s Code of Business Conduct, conflicts of interest, the Company’s personal trading policy, confidentiality of information, consumer complaints, privacy, regulatory compliance and outsourcing.

The Risk and Capital Committee is responsible for oversight of the Company’s risk and capital management activities.

The Committee also assists the Board in its oversight role with respect to the management of the Company’s enterprise risk management framework and risk appetite framework; the identification, review and assessment of the Company’s primary risks; the review and assessment of the Company’s risk management strategies; and the deployment and use of capital.

# CORPORATE INFORMATION

## Corporate Head Office

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The Empire Life Insurance Company is a member of Assuris. Assuris is the not for profit organization that protects Canadian policyholders if their life insurance company fails.

Details about Assuris' protection are available at [www.assuris.ca](http://www.assuris.ca) or by calling the Assuris Information Centre at 1 866 878-1225.

## RETAIL SALES OFFICES

### WESTERN CANADA

#### Vancouver Retail Sales Office

N302-5811 Cooney Road, North Tower  
Richmond, British Columbia V6X 3M1  
604 232-5557  
1 888 627-3591

#### Calgary Retail Sales Office

310-1167 Kensington  
Calgary, Alberta T2N 1X7  
403 269-1000  
1 800 656-2878

### ONTARIO

#### Burlington Retail Sales Office

307-5500 North Service Road  
Burlington, Ontario L7L 6W6  
905 335-6558  
1 888 548-4729

#### Toronto Retail Sales Office

200 -36 York Mills Road  
Toronto, Ontario M2P 2E9  
416 494-0900  
1 888 548-4729

### QUEBEC

#### Montréal Retail Sales Office

1600-600 de Maisonneuve Boulevard W.  
Montréal, Quebec H3A 3J2  
514 842-9151  
1 800 371-9151

#### Québec Retail Sales Office

100-1220 Lebourgneuf Boulevard  
Québec, Quebec G2K 2G4  
418 628-1220  
1 888 816-1220

## GROUP SALES OFFICES

### WESTERN CANADA

#### Vancouver Group Sales Office

N302-5811 Cooney Road, North Tower  
Richmond, British Columbia V6X 3M1  
604 232-5558  
1 800 547-0628

#### Calgary Group Sales Office

310-1167 Kensington  
Calgary, Alberta T2N 1X7  
403 262-6386  
1 888 263-6386

### ONTARIO

#### Burlington Group Sales Office

307-5500 North Service Road  
Burlington, Ontario L7L 6W6  
905 335-6558  
1 800 663-9984

#### Toronto Group Sales Office

200-36 York Mills Road  
Toronto, Ontario M2P 2E9  
416 494-6834  
1 800 361-7980

### QUEBEC

#### Montréal Group Sales Office

1600A-600 de Maisonneuve Boulevard W.  
Montréal, Quebec H3A 3J2  
514 842-0003  
1 800 561-3738

# BOARD OF DIRECTORS

## SHAREHOLDERS' DIRECTORS

**John F. Brierley**<sup>1, 2, 5</sup>

Corporate Director

**Scott F. Ewert**<sup>1, 4, 5</sup>

Vice President and Chief Financial Officer  
E-L Financial Corporation Limited

**Edward M. Iacobucci**<sup>1, 2, 3</sup>

Professor of Law  
University of Toronto

**Duncan N.R. Jackman**<sup>5</sup>

Chairman of the Board  
The Empire Life Insurance Company

**Clive P. Rowe**<sup>4, 5</sup>

Corporate Director

**Patricia M. Volker**<sup>1, 3, 5</sup>

Corporate Director

## POLICYHOLDERS' DIRECTORS

**Mark J. Fuller**<sup>2, 3, 5</sup>

President and Chief Executive Officer  
Ontario Pension Board

**Harold W. Hillier**<sup>1, 2, 3, 4</sup>

Corporate Director

**Mark Sylvia**

President and Chief Executive Officer  
The Empire Life Insurance Company

**Jacques Tremblay**<sup>3, 5</sup>

Partner  
Oliver Wyman Actuarial Consulting

## HONORARY CHAIRMAN

**The Honourable Henry N.R. Jackman**

Honorary Chairman  
The Empire Life Insurance Company

<sup>1</sup> Member of Audit Committee

<sup>2</sup> Member of Conduct Review Committee

<sup>3</sup> Member of Human Resources Committee

<sup>4</sup> Member of Investment Committee

<sup>5</sup> Member of Risk and Capital Committee

# CORPORATE MANAGEMENT

**Mark Sylvia**

President and Chief Executive Officer

**Richard Carty**

General Counsel and Senior Vice-President, Human Resources

**Edward Gibson**

Senior Vice-President, Chief Financial Officer and Chief Actuary

**Ian Hardacre**

Senior Vice-President and Chief Investment Officer

**Michael Perry**

Senior Vice-President, Group Solutions

**Steve Pong**

Senior Vice-President, Retail

**Kathy Thompson**

Senior Vice-President and Chief Risk Officer

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## EMPIRE LIFE ANNUAL REPORT 2020

The Empire Life Insurance Company (Empire Life) is a proud Canadian company that has been in business since 1923. We offer individual and group life and health insurance, investment and retirement products, including mutual funds through our wholly-owned subsidiary Empire Life Investments Inc.

Empire Life is among the top 10 life insurance companies in Canada<sup>1</sup> and is rated A (Excellent) by A.M. Best Company<sup>2</sup>. Our mission is to make it simple, fast and easy for Canadians to build wealth, generate income, and achieve financial security.

Follow us on social media @EmpireLife or visit [www.empire.ca](http://www.empire.ca) for more information.

<sup>1</sup> Based on total assets as reported in December 31, 2019 OSFI filings

<sup>2</sup> As at June 24, 2020. For the latest rating, access [www.ambest.com](http://www.ambest.com).

### Transfer Agent and Registrar

AST Trust Company (Canada)  
1 Toronto Street, Suite 1200  
Toronto, Ontario, M5C 2V6  
Phone 416-682-3860  
Toll Free 800-387-0825  
[www.astfinancial.com/ca-en](http://www.astfinancial.com/ca-en)

### Stock Exchange Listing

Preferred Shares, Series 1 EML.PR.A

### Reporting Procedure for Accounting and Auditing Matters

If you have a complaint regarding accounting, internal controls or auditing matters or a concern regarding questionable accounting or auditing matters, you should submit your written complaint or concern to:

Mr. John Brierley  
The Empire Life Insurance Company  
259 King Street East  
Kingston, ON, K7L 3A8  
Email: [johnbrierley12@gmail.com](mailto:johnbrierley12@gmail.com)  
Phone: 705-250-3133

You may submit your complaint or concern anonymously. Your submission will be kept confidential and will be treated in accordance with the Company's policy for reporting accounting and auditing matters.

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[empire.ca](http://empire.ca) [info@empire.ca](mailto:info@empire.ca) 1 877 548-1881

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