# Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") of the unaudited operating results and financial condition of The Empire Life Insurance Company ("Empire Life" or the "Company") for the second quarter of 2015 should be read in conjunction with the MD&A for the year ended December 31, 2014, the Company's annual audited financial statements, the notes relating thereto, and the quarterly unaudited financial statements and notes contained in this report, as well as the Company's MD&A and unaudited interim financial statements for the quarters of 2014 and the previous quarter of 2015. The unaudited condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as set out in the Handbook of the Chartered Professional Accountants of Canada. Unless otherwise noted, both the condensed consolidated financial statements and this MD&A are expressed in Canadian dollars.

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 long form prospectus which is available at www.sedar.com. No assurance can be given that results, performance or achievement expressed in, or implied by, any of the forward-looking information will occur, or if they do, that any benefits may be derived from them. Actual results may differ materially from those expressed or implied by such forward-looking information. See Forward-Looking Statements and Information section in this report.

The financial statements of the Company is prepared in compliance with International Financial Reporting Standards ("IFRS"), which is generally accepted accounting principles ("GAAP") as set out in the Handbook of the Chartered Professional Accountants of Canada. This MD&A makes reference to certain non-GAAP 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 reported under IFRS.  See Non-GAAP Measures section in this report.

## Financial Analysis

### Overview

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars except per share amounts) | **2015** | 2014 | **2015** | 2014 |
| Shareholders' net income | **$ 44.6** | $ 38.6 | **$ 70.2** | $ 56.4 |
| Earnings per share - basic and diluted | **$ 45.34** | $ 39.22 | **$ 71.30** | $ 57.27 |
| Return on shareholders' equity (annualized) (ROE) | **16.9%** | 16.8% | **13.5%** | 12.4% |

Empire Life reported second quarter shareholders' net income of $44.6 million for 2015, compared to $38.6 million for 2014. Year to date shareholders' net income was $70.2 million compared to $56.4 million in 2014.

The following table provides a breakdown of the sources of earnings[1] for the second quarter and year to date.

| Sources of Earnings | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 |
| Expected profit on in-force business | **$ 39.0** | $ 34.0 | **$ 76.4** | $ 64.8 |
| Impact of new business | **(7.0)** | (9.4) | **(14.4)** | (19.9) |
| Experience gains (losses) | **11.7** | 11.5 | **3.2** | 6.4 |
| Management actions and changes in assumptions | **—** | 8.0 | **—** | 8.0 |
| Earnings on operations before income taxes | **43.7** | 44.1 | **65.2** | 59.3 |
| Earnings on surplus | **13.7** | 6.9 | **25.7** | 14.1 |
| Income before income tax | **$ 57.4** | $ 51.0 | **$ 90.9** | $ 73.4 |
| Income taxes | **12.8** | 12.4 | **20.7** | 17.0 |
| Shareholders' net income | **$ 44.6** | $ 38.6 | **$ 70.2** | $ 56.4 |

[1] See Non-GAAP Measures

Shareholders' net income and ROE were higher relative to 2014 for both the second quarter and year to date primarily due to growing profit on in-force Wealth Management business and increased earnings on surplus. The Wealth Management product line's improved result was primarily due to the growth in segregated fund management fees and growth in segregated fund guarantee fees related to guaranteed minimum withdrawal benefit (GMWB) products. This improvement in fee income was primarily due to the positive impact of higher stock market levels for most of 2015 compared to the first half of 2014, positive segregated fund net sales in the last 12 months and product price increases. Earnings on surplus improved primarily due to increased gains on the sale of bonds.

The impact of new business improved, relative to 2014 primarily due to lower second quarter and year to date segregated fund sales and lower expenses.  Experience gains occurred in both years and primarily related to the favourable upward movement of interest rates in 2015, which positively affected the Individual Insurance product line. In 2014 favourable experience gains primarily related to strong stock markets, and surrender experience which positively affected the Individual Insurance product line.

The gain from management actions in 2014 resulted from a favourable settlement on a lawsuit which resulted in a gain for Empire Life.

Empire Life has three major product lines (Wealth Management, Employee Benefits and Individual Insurance) and maintains distinct accounts for Capital and Surplus. A discussion of each product line's 2015 net income compared to 2014 is shown in the Product Line Results sections later in this report.

On June 25, 2015 Empire Life filed a preliminary long form non-offering prospectus and other related filings with the securities regulatory authority in the province of Ontario. The purpose of filing the non-offering prospectus was to qualify Empire Life to raise regulatory capital in the form of preferred shares and subordinated debt, as well as other debt securities.  The final prospectus was filed on August 5, 2015.  There is no guarantee Empire Life will proceed with an offering.

Management's assessment of industry dynamics, risks and risk management, critical accounting estimates, strategy and outlook remains consistent with the disclosure in the 2014 Annual Management's Discussion and Analysis.

# Management's Discussion and Analysis

The following tables provide a summary of Empire Life results by major product line (figures in Management's Discussion and Analysis may differ due to rounding):

| For the three months ended June 30 | Wealth Management | | Employee Benefits | | Individual Insurance | | Capital and Surplus | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 |
| **Revenue** | | | | | | | | | | |
| Net premium income | **$ 30** | $ 39 | **$ 81** | $ 80 | **$ 92** | $ 95 | **$ —** | $ — | **$ 203** | $ 214 |
| Fee and other income | **51** | 44 | **3** | 2 | **1** | 1 | **—** | — | **55** | 47 |
| Investment income | **11** | 12 | **1** | 1 | **45** | 37 | **10** | 11 | **67** | 61 |
| Realized gain on FVTPL investments | **—** | 3 | **—** | — | **16** | 34 | **—** | — | **16** | 37 |
| Realized gain on available for sale investments including impairment write downs | **—** | 1 | **—** | — | **—** | — | **6** | 6 | **6** | 7 |
| Fair value change in FVTPL investments | **(21)** | 4 | **(2)** | 1 | **(284)** | 109 | **1** | — | **(306)** | 114 |
| Total Revenue | **71** | 103 | **83** | 84 | **(130)** | 276 | **17** | 17 | **41** | 480 |
| **Expenses** | | | | | | | | | | |
| Benefits and expenses | **51** | 89 | **76** | 79 | **(150)** | 251 | **3** | 5 | **(21)** | 424 |
| Income and other taxes | **5** | 3 | **3** | 2 | **5** | 8 | **4** | 3 | **17** | 17 |
| Total Expense | **56** | 92 | **79** | 81 | **(145)** | 259 | **7** | 8 | **(4)** | 441 |
| **Net income after tax** | **$ 15** | $ 11 | **$ 4** | $ 3 | **$ 15** | $ 17 | **$ 10** | $ 9 | **$ 45** | $ 39 |
| Participating policyholders' portion | | | | | | | | | **1** | 1 |
| Shareholders' net income | | | | | | | | | **$ 44** | $ 38 |
| Assets under management[2] | | | | | | | | | | |
| General fund assets | **$ 1,011** | $ 1,093 | | | | | | | **$ 6,948** | $ 6,399 |
| Segregated fund assets | **$ 7,170** | $ 6,522 | | | **$ 22** | $ 23 | | | **$ 7,192** | $ 6,545 |
| Mutual fund assets | **$ 154** | $ 66 | | | | | | | **$ 154** | $ 66 |
| Annualized premium sales[2] | | | **$ 11** | $ 12 | **$ 13** | $ 19 | | | | |

| For the six months ended June 30 | Wealth Management | | Employee Benefits | | Individual Insurance | | Capital and Surplus | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 | **2015** | 2014 |
| **Revenue** | | | | | | | | | | |
| Net premium income | **$ 77** | $ 100 | **$ 161** | $ 160 | **$ 183** | $ 183 | **$ —** | $ — | **$ 421** | $ 443 |
| Fee and other income | **101** | 85 | **5** | 4 | **1** | 1 | **—** | — | **107** | 90 |
| Investment income | **22** | 26 | **2** | 2 | **84** | 72 | **20** | 22 | **128** | 122 |
| Realized gain (loss) on FVTPL investments | **—** | 3 | **1** | — | **38** | 49 | **(1)** | — | **38** | 52 |
| Realized gain on available for sale investments including impairment write downs | **—** | 1 | **—** | — | **1** | — | **15** | 9 | **16** | 10 |
| Fair value change in FVTPL investments | **(9)** | 14 | **1** | 3 | **(17)** | 270 | **(1)** | — | **(26)** | 287 |
| Total Revenue | **191** | 229 | **170** | 169 | **290** | 575 | **33** | 31 | **684** | 1,004 |
| **Expenses** | | | | | | | | | | |
| Benefits and expenses | **153** | 205 | **158** | 158 | **274** | 549 | **5** | 11 | **589** | 923 |
| Income and other taxes | **8** | 6 | **6** | 5 | **5** | 9 | **8** | 5 | **27** | 25 |
| Total Expense | **161** | 211 | **164** | 163 | **279** | 558 | **13** | 16 | **616** | 948 |
| **Net income after tax** | **$ 30** | $ 18 | **$ 6** | $ 6 | **$ 11** | $ 17 | **$ 20** | $ 15 | **$ 68** | $ 56 |
| Participating policyholders' portion | | | | | | | | | **(2)** | — |
| Shareholders' net income | | | | | | | | | **$ 70** | $ 56 |
| Assets under management[3] | | | | | | | | | | |
| General fund assets | **$ 1,011** | $ 1,093 | | | | | | | **$ 6,948** | $ 6,399 |
| Segregated fund assets | **$ 7,170** | $ 6,522 | | | **$ 22** | $ 23 | | | **$ 7,192** | $ 6,545 |
| Mutual fund assets | **$ 154** | $ 66 | | | | | | | **$ 154** | $ 66 |
| Annualized premium sales[3] | | | **$ 23** | $ 23 | **$ 26** | $ 31 | | | | |

[2, 3] See Non-GAAP Measures

## Total Revenue

| (millions of dollars) | Second quarter 2015 | Second quarter 2014 | Year to date 2015 | Year to date 2014 |
|---|---|---|---|---|
| **Revenue** | | | | |
| Net premium income | **$ 203** | $ 214 | **$ 421** | $ 443 |
| Investment income | **67** | 61 | **128** | 122 |
| Fair value change in FVTPL investments including realized amounts | **(290)** | 152 | **12** | 339 |
| Realized gain (loss) on AFS investments including impairment write downs | **6** | 6 | **16** | 10 |
| Fee and other income | **55** | 47 | **107** | 90 |
| Total Revenue | **$ 41** | $ 480 | **$ 684** | $ 1,004 |

For the quarter, total revenue at Empire Life decreased by 92% to $41 million compared to $480 million in 2014. On a year to date basis, total revenue decreased by 32% to $684 million compared to $1 billion in 2014. Revenue volatility was primarily driven by the impact of market interest rate movements on Fair value change in FVTPL investments. Major revenue items are discussed below.

Net premium revenue for the quarter and year to date decreased in 2015 relative to 2014. The decrease related primarily to the fixed interest deferred annuity portion of the Wealth Management product line, which experienced weak demand due to the low interest rate environment.

Fair value change in FVTPL investments including realized amounts often causes large revenue volatility. These assets experienced a net loss in the second quarter of 2015 compared to a net gain for the same period in 2014. In 2015 the large loss was primarily from a decrease in bond prices (due to an increase in market interest rates). In 2014 the gain was primarily from an increase in bond prices (due to a decrease in market interest rates). For the year to date 2015 interest rates were stable resulting in a small gain compared to a large gain for the same period in 2014 when similar to above bond prices increased. For the second quarter and year to date, the impact of this on net income is largely reduced due to a corresponding change in insurance contract liabilities (discussed in the Total Benefits and Expenses section below).

Realized gain (loss) on available for sale investments including impairment write downs was a gain in both 2015 and 2014. In the second quarter and year to date 2015 the gain was primarily due to the sale of AFS bonds, while the gain in comparable periods in 2014 was primarily due to the sale of AFS equities. These gains and losses impact net income and are considered in the net income investment experience comments for each of the impacted product lines (see Product Line Results sections later in this report). The assets sold primarily backed capital and surplus.

Fee and other income increased in 2015 relative to 2014 primarily due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products (see the Product Line Results - Wealth Management section later in this report).

## Total Benefits and Expenses

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 |
| **Benefits and expenses** | | | | |
| Net benefits and claims | **$ 151** | $ 145 | **$ 330** | $ 327 |
| Net change in insurance contract liabilities | **(263)** | 184 | **75** | 408 |
| Change in investment contracts provision | **—** | 1 | **1** | 1 |
| Policy dividends | **7** | 6 | **12** | 11 |
| Operating expenses | **36** | 36 | **71** | 72 |
| Net commissions | **46** | 48 | **95** | 94 |
| Interest expense | **2** | 4 | **5** | 10 |
| Total benefits and expenses | **$ (21)** | $ 424 | **$ 589** | $ 923 |

Total benefits and expenses at Empire Life for the quarter decreased to negative $21 million compared to $424 million in 2014. On a year to date basis, total benefits and expenses decreased to $589 million compared to $923 million in 2014. Expense volatility was primarily driven by the impact of market interest rate movements on Net change in insurance contract liabilities. Major benefit and expense items are discussed below.

Net benefits and claims variability is dependent on the claims incurred.  Generally, claims rise year over year due to growth of the insurance blocks, which was the case for the quarter and year to date for all lines of business except Wealth Management, which declined due to lower fixed interest deferred annuity withdrawals.  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 can be larger or smaller than the claims incurred depending on whether claims experience has been favourable or unfavourable. Claims experience is the combination of claims incurred compared to claims expected in product pricing and in insurance contract liabilities.  Year over year claims experience is discussed in each of the impacted product lines (see Product Line Results sections later in this report).

Net change in insurance contract liabilities varies with many factors including new business sold, claims incurred, surrender and lapse experience, assumptions about the future, and changes in the market value of assets matching insurance contract liabilities. For the quarter and year to date, the main reason for the large change from 2014 for this item was the change in insurance contract liabilities resulting from the fair value change in matching assets (described above in the Total Revenue section). Variability in the net change in insurance contract liabilities amounts does not, in isolation, impact net income as it must be looked at in concert with other lines of the statement of operations.

For the quarter net commissions decreased year over year primarily due to the decrease in Individual Insurance product sales.  For the year to date, net commissions increased primarily due to higher trailer commissions resulting from the growth of assets under management in the Wealth Management product line.

Interest expense decreased in 2015 relative to 2014 due to the redemption of $200 million 6.73% subordinated debentures on May 20, 2014.

## Product Line Results - Wealth Management

| (millions of dollars) | As at June 30 2015 | 2014 |
|---|---|---|
| **Assets under management**[4] | | |
| General fund annuities | **$ 1,011** | $ 1,093 |
| Segregated funds | **7,170** | 6,522 |
| Mutual funds | **154** | 66 |

| (millions of dollars) | Second quarter 2015 | 2014 | Year to date 2015 | 2014 |
|---|---|---|---|---|
| **Selected financial information** | | | | |
| Net fixed interest annuity premiums | **$ 30** | $ 39 | **$ 77** | $ 100 |
| Segregated fund gross sales[4] | **270** | 286 | **599** | 625 |
| Segregated fund net sales[4] | **68** | 88 | **146** | 195 |
| Segregated fund fee income | **50** | 44 | **99** | 84 |
| Mutual fund gross sales[4] | **22** | 13 | **49** | 27 |
| Mutual fund net sales[4] | **21** | 12 | **43** | 25 |
| Mutual fund fee income | **1** | — | **1** | — |
| **Net income after tax** | **$ 15** | $ 11 | **$ 30** | $ 18 |

Assets in Empire Life general fund annuities decreased by 8%, while segregated fund assets increased by 10% during the last 12 months. The decrease in the last 12 months for general fund annuities is related primarily to weak demand for fixed interest deferred annuity due to the low interest rate environment. The increase over the last 12 months for segregated funds was attributable to positive investment returns, due to the US stock market increase since June 30, 2014, and strong net sales (gross sales net of withdrawals) described below.

Premium revenue for the Wealth Management product line is comprised solely of new deposits on fixed interest annuities and excludes deposits on the segregated fund and mutual fund products. For the second quarter and year to date, fixed interest annuity premiums were down 22% and 24% respectively compared to 2014. For the quarter the decrease was primarily due to both fixed interest deferred and immediate annuities. For the year to date, the decrease was primarily due to decreased sales of fixed interest deferred annuities.

For the second quarter and year to date, segregated fund gross sales were down 6% and 4% respectively compared to 2014. This decrease was due to lower GMWB sales which decreased by $51 million and $87 million in the second quarter and year to date respectively compared to 2014. This was partly offset by increased sales of both 75% maturity guarantee products and 100% maturity guarantee products, which increased by $18 million and $17 million respectively in the second quarter and by $31 million each for the year to date compared to 2014. In the fourth quarter of 2014, Empire Life made significant changes to its segregated funds product line. Empire Life closed its existing segregated funds products to new policies effective October 31, 2014. In addition, on November 3, 2014 Empire Life launched a new suite of investment products including a new segregated funds family called Empire Life Guaranteed Investment Funds (GIF), as well as a stand-alone Guaranteed Interest Contract (GIC) and a new version of its GMWB product. Fees charged to the customer on the new product line are higher than the former product line. The new product line's pricing and features are Empire Life's response to the economic, regulatory and competitive landscape in the segregated fund product marketplace. On April 20, 2015, Empire Life added to this new family of products by launching a new series of Empire Life GIFs and a new segregated fund, Empire Life Monthly Income GIF. While sales are down slightly from last year (as described above), the launch of these new segregated fund products has gone well so far this year, achieving gross sales of $210 million for the second quarter and $421 million for the year to date which represented 78% and 70% of segregated fund gross sales respectively.

[4] See Non-GAAP Measures

Segregated fund net sales for the quarter and year to date were down 22% and 25% respectively compared to 2014 due to the above mentioned gross sales result and an increase in withdrawals.

Mutual fund sales continue to improve, but are still a small component of our Wealth Management assets under management. Empire Life continues to explore various strategic alternatives with respect to its mutual fund business.

For the quarter and year to date, segregated fund fee income increased by 14% and 18% respectively in 2015 relative to 2014. The increase was due to growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. This improvement in fee income was primarily due to the positive impact of higher stock market levels for most of 2015 compared to the first half of 2014, positive segregated fund net sales in the last 12 months and product price increases. The higher stock markets had a positive impact on average assets under management and management fees earned, as stock markets were higher on average during the second quarter and year to date of 2015 than they were during the comparable periods of 2014.

During the second quarter and year to date earnings from this product line increased relative to 2014. The following table provides a breakdown of the components of this year over year change in net income.

| (millions of dollars) | Second quarter | Year to date |
|---|---|---|
| **Components of increase** | | |
| Increase in inforce profit margins | **$ 5** | **$ 11** |
| Worsened annuitant mortality experience | **(1)** | **—** |
| Improved investment experience | **—** | **1** |
| Total | **$ 4** | **$ 12** |

Higher net income on inforce business in 2015 was primarily due to the growth in segregated fund management fees and growth in segregated fund guarantee fees related GMWB products (as described above).

Worsened annuitant mortality experience relates to the fixed interest immediate annuity business.

Improved investment experience resulted from market interest rate movements and the availability of assets at attractive yields for matching fixed interest annuity contract liabilities.

## Product Line Results - Employee Benefits

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 |
| **Selected financial information** | | | | |
| Annualized premium sales[5] | **$ 11** | $ 12 | **$ 23** | $ 23 |
| Net premium revenue | **81** | 80 | **161** | 160 |
| **Net income after tax** | **$ 4** | $ 3 | **$ 6** | $ 6 |

For the quarter and year to date, sales in this product line decreased by 14% and 2% respectively in 2015 relative to 2014. The 2015 level of sales is a strong achievement particularly given the weak economic conditions in Canada. The economic weakness also contributed to this product line’s flat inforce premium revenue growth.

[5] See Non-GAAP Measures

During the second quarter and year to date earnings from this product line increased relative to 2014. The following table provides a breakdown of the components of this year over year change in net income.

| (millions of dollars) | Second quarter | Year to date |
|---|---|---|
| **Components of increase** | | |
| Improved (worsened) claims experience | **$ 1** | **$ (1)** |
| Lower new business strain | **—** | **1** |
| Total | **$ 1** | **$ —** |

In the second quarter of 2015 improved claims experience related to long-term disability results. For the year to date worsened claims experience related to life and health claims partly offset by improved long-term disability results.

Higher net income from lower new business strain in 2015 was primarily due to lower expenses.

## Product Line Results - Individual Insurance

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 |
| **Selected financial information** | | | | |
| Annualized premium sales[6] | **$ 13** | $ 19 | **$ 26** | $ 31 |
| Net premium revenue | **92** | 96 | **183** | 183 |
| **Net income (loss) after tax** | | | | |
| Net income after tax shareholders' portion | **$ 15** | $ 20 | **$ 15** | $ 22 |
| Net loss after tax policyholders' portion | **—** | (3) | **(4)** | (5) |
| Net income after tax | **$ 15** | $ 17 | **$ 11** | $ 17 |

For the second quarter and year to date, annualized premium sales in this product line decreased by 30% and 16% respectively compared to 2014. For the second quarter net premium revenue decreased by 4% compared to 2014 while growth was flat in 2015 for the year to date. This product line's second quarter and year to date sales result is attributable primarily to decreased sales of universal life and term products. The decrease in universal life sales primarily related to the investment fund component within these products as opposed to risk annualized premium sales. This decline in sales was partly offset by increased sales of participating products. Our recently launched EstateMax participating product contributed to this increase in participating product sales. EstateMax is distributed through professional financial advisors aimed at providing simple estate planning solutions to Canadian baby boomers. Empire Life believes that the market response has been favourable based on sales achieved and applications received in 2015. In recent years (beginning in 2011), Empire Life has been shifting its product mix toward shorter term products such as term life, while increasing prices on long-term products, due to the low long-term interest rate environment.

During the second quarter and year to date earnings from this product line decreased relative to 2014. The following table provides a breakdown of the components of this year over year change in net income.

| (millions of dollars) | Second quarter | Year to date |
|---|---|---|
| **Components of decrease** | | |
| 2014 favourable legal settlement | **$ (6)** | **$ (6)** |
| Worsened mortality, surrender and other experience | **$ (10)** | **$ (16)** |
| Improved investment experience | **13** | **15** |
| Increase in inforce profit margins | **1** | **1** |
| Total | **$ (2)** | **$ (6)** |

[6] See Non-GAAP Measures

During the second quarter of 2014 a favourable settlement on a lawsuit resulted in a $6 million gain after tax for Empire Life.

For the second quarter and year to date, mortality and surrender experience were unfavourable compared to favourable results in the comparable periods in 2014.

Investment experience improved in the second quarter and year to date of 2015 compared to the comparable periods in 2014 primarily due to the favourable impact from interest rate movements in the second quarter of 2015, and flat interest rates for the year to date in 2015, compared to unfavourable interest rate movements in 2014 (as demonstrated using 30 year bond yields in the following table).

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| | **2015** | 2014 | **2015** | 2014 |
| **Interest rate movement** | | | | |
| 30 year Canadian federal government bond yield | | | | |
| End of period | **2.30%** | 2.78 % | **2.30 %** | 2.78 % |
| Beginning of period | **1.98%** | 2.96 % | **2.36 %** | 3.24 % |
| Change during period | **0.32%** | (0.18)% | **(0.06)%** | (0.46)% |

During the second quarter of 2015 increases in market interest rates contributed to lower bond prices, which resulted in bond asset fair value losses. However, these losses were more than offset by decreased insurance contract liabilities resulting from these increases in market interest rates. The opposite result occurred during the second quarter of 2014. For the year to date the improved investment experience in 2015 was primarily due to the unfavourable interest rate movements during the year to date in 2014. While the impact of bond asset market value changes on net income is largely reduced due to a corresponding change in insurance contract liabilities, net income is impacted as it is not possible to perfectly match future liability cash flows with future asset cash flows.

## Results - Capital and Surplus

| | Second quarter | | Year to date | |
|---|---|---|---|---|
| (millions of dollars) | **2015** | 2014 | **2015** | 2014 |
| **Net income after tax** | | | | |
| Net income after tax shareholders' portion | **$ 9** | $ 5 | **$ 18** | $ 10 |
| Net income after tax policyholders' portion | **1** | 4 | **2** | 5 |
| Net income after tax | **$ 10** | $ 9 | **$ 20** | $ 15 |

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.

During the second quarter and year to date earnings from this product line increased relative to 2014. The following table provides a breakdown of the components of this year over year change in net income.

| (millions of dollars) | **Second quarter** | **Year to date** |
|---|---|---|
| **Components of increase** | | |
| Increased net income from sale of investments | **$ —** | **$ 5** |
| Lower interest expense | **1** | **4** |
| Lower investment income | **—** | **(2)** |
| Gain (loss) on hedging instruments | **—** | **(2)** |
| Total | **$ 1** | **$ 5** |

Increased net income from sale of investments was primarily due to gains from the sale of AFS bonds in 2015.

Lower interest expense was due to the redemption of $200 million 6.73% subordinated debentures on May 20, 2014.

Lower investment income was primarily due to a decrease in invested assets resulting from the investments sold to fund the above mentioned redemption of subordinated debentures.

During the year to date of 2015 Empire Life experienced a loss of $2 million after tax on its hedging program (discussed in the Risk Management section later in this report).

## Total Cash Flow

| (millions of dollars) | Year to date 2015 | 2014 |
|---|---|---|
| **Cash Flow provided from (used for)** | | |
| Operating Activities | **$ 85** | $ 66 |
| Investing Activities | **(102)** | 162 |
| Financing Activities | **(4)** | (245) |
| Net change in cash and cash equivalents | **$ (21)** | $ (17) |

The increase in cash provided from operating activities in 2015 relative to 2014 was primarily due to changes in working capital levels.

The decrease in cash provided from investing activities during 2015 relative to 2014 was primarily driven by financing activities and the timing of portfolio investment transactions. In 2014 cash provided from investing activities included the sale of investments to fund Empire Life's May 20, 2014 redemption of $200 million of subordinated debentures (described below).

The decrease in cash used for financing activities during 2015 relative to 2014 was primarily due to Empire Life's 2014 redemption of its $200 million 6.73% subordinated debentures at par on May 20, 2014. In addition there was payment of $34 million of dividends to common shareholders by Empire Life in 2014 which did not recur in 2015. The Board of Directors takes a number of factors into consideration in determining the amount of the dividends, if any, including the financial performance of Empire Life, regulatory solvency requirements, capital ratios and growth opportunities. Based on the assessment of these factors, Empire Life has not paid a dividend to common shareholders so far in 2015.

For an analysis of liquidity for Empire Life, see note 10e) and note 27(a)(2)ii) to the 2014 consolidated financial statements.

## Financial Instruments

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

Empire Life is also subject to credit risk on these financial instruments which could result in a financial loss should the other party fail to discharge an obligation. This credit risk is derived primarily from investments in bonds, debentures, preferred shares, short-term investments and mortgages. Empire Life manages market risk exposure mainly through investment limits and oversight of its in-house investment managers and external investment firms by the 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 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 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 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, with total credit exposure limited to $100 million. Additional information regarding financial instruments is included in Notes 2d, 3, 10c, and 27 to the audited consolidated financial statements for the year ended December 31, 2014 and Notes 3, and 13 to the consolidated financial statements for the six-months ended June 30, 2015.

## Capital Resources

| | **Jun 30 2015** | Mar 31 2015 | Dec 31 2014 | Sep 30 2014 | Jun 30 2014 |
|---|---|---|---|---|---|
| **MCCSR Ratio** | **202%** | 190% | 197% | 231% | 231% |

Empire Life continues to maintain a strong balance sheet and capital position. The 2013 Debentures are rated by DBRS Limited ("DBRS") and A.M. Best Company, Inc. ("A.M. Best"). On May 21, 2015, DBRS confirmed its ratings of Empire Life including its issuer rating of "A" (sixth highest of 20 categories), its subordinated debt rating of "A (low)" (seventh highest of 20 categories) and its claims paying rating of "IC-2" (second highest of five categories). All ratings have a stable trend. According to DBRS, the assigned ratings reflect Empire Life's smaller scale and focused product range and improving levels of profitability and fixed charge coverage.

On May 19, 2015, A.M. Best confirmed its ratings of Empire Life including its issuer rating of "a" (sixth highest of 22 categories), its subordinated debt rating of "bbb+" (eighth highest of 22 categories) and its financial strength rating of "A (Excellent)" (third highest of 16 categories). All ratings have a stable trend. According to A.M. Best, the ratings reflect Empire Life's favourable risk-adjusted capital position, continued earnings growth and sustainable market presence in Canada with multiple lines of business.

Empire Life's risk-based regulatory capital ratio, as measured by MCCSR, of 202% as at June 30, 2015 continued to be above requirements, and above minimum internal targets.

The MCCSR ratio increased by 12 points from the previous quarter and by 5 points for the year to date. The change was due to increases in available regulatory capital and decreases in required regulatory capital for the quarter and increases in available regulatory capital partly offset by increases in required regulatory capital for the year to date, as shown in the table below.

| (millions of dollars) | **Jun 30 2015** | Mar 31 2015 | Dec 31 2014 | Sep 30 2014 | Jun 30 2014 |
|---|---|---|---|---|---|
| **Available regulatory capital** | | | | | |
| **Tier 1** | **$ 929** | $ 883 | $ 872 | $ 856 | $ 839 |
| **Tier 2** | **464** | 466 | 452 | 436 | 430 |
| **Total** | **$ 1,393** | $ 1,349 | $ 1,324 | $ 1,292 | $ 1,269 |
| **Required regulatory capital** | **$ 691** | $ 709 | $ 671 | $ 560 | $ 549 |

The increase in Tier 1 available regulatory capital from the previous quarter and for the year to date was primarily due to net income. For the year to date this was partly offset by an increase in negative reserves which decrease Tier 1 (but increase Tier 2 as described below).

Tier 2 available regulatory capital did not change significantly from the previous quarter, but increased for the year to date primarily due to an increase in negative reserves which increase Tier 2 (but decrease Tier 1 as described above).

Regulatory capital requirements decreased from the previous quarter primarily due to the impact of higher interest rates which decreased required regulatory capital related to lapse risk. In addition required regulatory capital decreased due to the impact of lower investment exposures which were caused by decreased market value of bonds and stocks. During the year to date regulatory capital requirements increased primarily for the reasons described above except each item moved in the opposite direction.

## Other Comprehensive Income

| | | Second quarter | | | Year to date | |
|---|---|---|---|---|---|---|
| (millions of dollars) | | **2015** | 2014 | | **2015** | 2014 |
| Other comprehensive income (loss) | $ | (17.1) $ | 2.0 | $ | (3.2) $ | 14.7 |
| Less: Participating Policyholders | | **1.7** | 1.8 | | **0.8** | 0.4 |
| Other comprehensive income (loss), attributable to shareholders | **$** | **(15.4)** $ | 3.8 | **$** | **(2.4)** $ | 15.1 |

Other comprehensive income (OCI) decreased in the second quarter and year to date of 2015 relative to the comparable periods of 2014. For the second quarter this was primarily due to unrealized fair value decreases relating to AFS bonds in 2015. For the year to date this was primarily due to the realized gains reclassified to net income in 2015. This was partly offset by the remeasurement of post-employment defined benefit (“DB”) plans which had a gain for the second quarter and a small loss for the year to date in 2015 compared to losses for comparable periods in 2014. The improved result on DB plans in 2015 was primarily due to decreases in DB liabilities resulting from higher market interest rates partly offset by weak returns on DB plan assets in 2015 compared to the opposite result for these items during these periods in 2014.

Unrealized fair value increases and decreases on AFS bonds in OCI do not impact MCCSR. Remeasurement of DB plans does not immediately impact MCCSR as each quarter’s remeasurement gain or loss is amortized over 12 quarters for MCCSR purposes.

## Risk Management

Empire Life’s MCCSR ratio, among other things, is sensitive to stock market volatility, due primarily to liability and capital requirements related to segregated fund guarantees. As of June 30, 2015 Empire Life had $7.2 billion of segregated fund assets and liabilities. Of this amount, approximately $6.9 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

| | **Jun 30 2015** | Dec 31 2014 |
|---|---|---|
| **Percentage of segregated fund liabilities with:** | | |
| 75% maturity guarantee and a 75% death benefit guarantee | 0.1% | —% |
| 75% maturity guarantee and a 100% death benefit guarantee | 52.6% | 53.2% |
| 100% maturity and death benefit guarantees (with a minimum of 15 years between deposit and maturity date) | 5.8% | 5.4% |
| 100% maturity and death benefit guarantees (guaranteed minimum withdrawal benefit (GMWB)) | 41.5% | 41.4% |

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 ignores all the deposits in the customer’s policy where the fund value is above the guaranteed amount. Therefore, generally policy based guarantees 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 were issued, the sensitivity is reduced. If period end stock markets are low relative to market levels at the time that segregated fund policies were issued, the sensitivity is increased. The segregated fund regulatory capital and liability framework includes the use of "zero floors" (i.e. negative 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. In the first table below, Empire Life discloses the sensitivity of net income to changes in segregated fund guarantee insurance contract liabilities. There is a net loss resulting from a 20% decrease at June 30, 2015, but otherwise the amounts shown in the table are nil. These liabilities (present value of future benefits and expenses minus the present value of future fee revenue) are calculated using stochastic modeling techniques based on a range of future economic scenarios. The liabilities are the greater of: (i) the average of the amounts determined in the worst 20% of the scenarios; and (ii) zero. For the nil amounts shown in this table, the liability for Empire Life was negative. Therefore, the alternative level of zero is applied in these tests (zero floor) resulting in a net income impact of nil. Based on stock market levels at June 30 for 2015 and December 31 for 2014, the sensitivity of shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from stock market increases and decreases is as follows:

| $ millions | 10% Increase | 10% Decrease | 20% Increase | 20% Decrease |
|---|---|---|---|---|
| **Sensitivity To Segregated Fund Guarantees:** | | | | |
| June 30, 2015 Shareholders' net income | $ nil | $ nil | $ nil | $ (11) |
| December 31, 2014 Shareholders' net income | $ nil | $ nil | $ nil | $ nil |

The impact of stock market changes is not linear. Based on stock market levels at June 30, 2015 the sensitivity of shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from a 20% decrease in stock markets is a net loss of $11 million as illustrated in the table above. At a 30% decrease in stock markets the net loss at June 30, 2015 would be $95 million. At June 30, 2015 a 20% and 30% decrease in stock markets would result in an increase in net income by $27 million to a net gain of $16 million and by $49 million to a net loss of $46 million respectively from gains on equity hedging instruments. Based on stock market levels at December 31, 2014 the sensitivity of shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from a 20% decrease in stock markets is nil as illustrated in the table above. At December 31, 2014, a decrease in stock markets of 20.2% or more would result in a net loss greater than nil. At December 31, 2014 a 30% decrease in stock markets would result in a net loss of $76 million. At December 31, 2014 a 20.2% and 30% decrease in stock markets would result in an increase in net income by $9 million to $9 million and by $17 million to a net loss of $59 million respectively from gains on equity hedging instruments.

Empire has equity market risk related to its segregated fund products and from equity assets backing life insurance liabilities. Empire Life had been considering implementing a partial economic hedging program for some time. In the fourth quarter of 2014, Empire Life strengthened its stochastic model, which impacted its base capital position as well as its capital position under sensitivity tests. This encouraged Empire Life to begin implementation of the hedging program in November 2014. Therefore, during the fourth quarter of 2014, Empire initiated a semi-static hedging program, and expanded this program during the first half of 2015. The objective of the hedging program is to partially protect Empire from possible future MCCSR ratio declines that might result from adverse stock market price changes. The hedging program presently employs put options and short positions on key equity indices. Empire intends to protect 10% to 20% of overall income and MCCSR equity risk exposure by expanding the hedging program during 2015 and subsequent years.

There is income statement volatility from this hedging program. Based on current equity market levels, Empire has required capital for MCCSR purposes related to segregated fund guarantees, but does not have policy liabilities related to these guarantees on its balance sheet. Therefore a by-product of hedging MCCSR exposure is income statement volatility, as the gains or losses from hedging instruments are not offset by changes in policy liabilities related to segregated fund guarantees on the income statement. During the first half of 2015 Empire Life experienced a loss of $2 million after tax on its hedging program. During 2015 and subsequent years, Empire Life expects to expand its hedging program and expects an increase in income statement volatility as a result.

Based on stock market levels on the dates indicated below the sensitivity of Empire Life's MCCSR ratio to stock market increases and decreases for all Empire Life stock market exposures, including segregated fund guarantees, is as follows (excluding the effect of Empire Life's equity risk hedging program):

| Excluding Equity Risk Hedge | 10% Increase | 10% Decrease | 20% Increase | 20% Decrease |
|---|---|---|---|---|
| **Sensitivity To Stock Markets:** | | | | |
| June 30, 2015 MCCSR Ratio | **(0.4)%** | **(11.9)%** | **(0.9)%** | **(26.2)%** |
| December 31, 2014 MCCSR Ratio | **9.0 %** | **(11.6)%** | **15.3 %** | **(25.5)%** |

The June 30, 2015 and December 31, 2014 amounts in the following table include the effect of Empire Life's equity risk hedging program (described below):

| Including Equity Risk Hedge | 10% Increase | 10% Decrease | 20% Increase | 20% Decrease |
|---|---|---|---|---|
| **Sensitivity To Stock Markets:** | | | | |
| June 30, 2015 MCCSR Ratio | **(2.3)%** | **(9.6)%** | **(4.5)%** | **(20.6)%** |
| December 31, 2014 MCCSR Ratio | **8.8 %** | **(11.2)%** | **14.9 %** | **(24.4)%** |

As of December 2014, the equity hedging program was only partially implemented. It provided $4 million of relief in the 10% stock market decrease scenario and $9 million of relief in the 20% stock market decrease scenario. As at June 30, 2015, it provided $11 million of relief in the 10% stock market decrease scenario and $27 million of relief in the 20% stock market decrease scenario. The full program provides roughly 2.5 times the December 2014 level of protection. Empire Life notes that the program is mainly comprised of put options owned by Empire Life, so the benefits are focused on the more adverse 30% stock market decrease and 40% stock market decrease scenarios.

Based on stock market levels as at June 30, 2015 and December 31, 2014, the sensitivity of shareholders' net income (excluding changes in segregated fund guarantee insurance contract liabilities) resulting from stock market increases and decreases is as follows (excluding the effect of Empire Life's equity risk hedging program):

| (in millions of dollars) | 10% Increase | 10% Decrease | 20% Increase | 20% Decrease |
|---|---|---|---|---|
| **Excluding Equity Risk Hedge** | | | | |
| June 30, 2015 Shareholders' net income | **$ 17** | **$ (17)** | **$ 34** | **$ (34)** |
| December 31, 2014 Shareholders' net income | **$ 23** | **$ (23)** | **$ 46** | **$ (46)** |

The June 30, 2015 and December 31, 2014 amounts in the following table include the effect of Empire Life's equity risk hedging program (described above):

| (in millions of dollars) | 10% Increase | 10% Decrease | 20% Increase | 20% Decrease |
|---|---|---|---|---|
| **Including Equity Risk Hedge** | | | | |
| June 30, 2015 Shareholders' net income | **$ 10** | **$ (6)** | **$ 22** | **$ (7)** |
| December 31, 2014 Shareholders' net income | **$ 21** | **$ (19)** | **$ 42** | **$ (37)** |

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

The amount at risk related to segregated fund maturity guarantees and segregated fund death benefit guarantees and the resulting actuarial liabilities and MCCSR required capital for Empire Life segregated funds is as follows:

| Segregated Funds | Guarantee > Fund Value | | Death Benefit > Fund Value | | GMWB Top-up | Actuarial | MCCSR |
|---|---|---|---|---|---|---|---|
| (millions of dollars) | Fund Value | Amount At Risk | Fund Value | Amount At Risk | Amount At Risk | Liabilities | Required Capital |
| **June 30, 2015** | **$ 15** | **$ 4** | **$ 1,063** | **$ 27** | **$ 429** | **$ nil** | **$ 111** |
| December 31, 2014 | $ 49 | $ 2 | $ 360 | $ 10 | $ 380 | $ nil | $ 102 |

The first four columns of the above table show all segregated fund policies where the future maturity guarantee, or future death benefit guarantee, is greater than the fund value. The amount at risk represents the excess of the future maturity guarantee or future death benefit guarantee amount over the fund value for these policies. The fifth column of the above table shows GMWB top-up exposure.  The GMWB top-up amount at risk represents the amount that could be paid by Empire Life to GMWB policyholders if the net return on each GMWB policyholder’s assets is zero for the remainder of each GMWB policyholder’s life, based on life expectancy. As at June 30, 2015, the aggregate amount at risk was $460 million, an increase from the aggregate amount at risk of $392 million as at December 31, 2014.

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 actuarial 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 upon future maturity of the segregated fund policies, or upon future death of the segregated fund policyholders, or upon the occurrence of future top-up payments to GMWB policyholders. The amounts at risk in June 2015 increased from the December 2014 levels for fund value guarantee exposure, death benefit guarantee exposure, and GMWB top-up exposure due primarily to the recent decrease in many global stock markets. The quarterly update of segregated fund policy data on our stochastic model resulted in an increase in required regulatory capital.

In addition, Empire Life’s MCCSR ratio is sensitive to changes in market interest rates.  The impact of an immediate 1% decrease in interest rates, and a 1% decrease in assumed initial reinvestment rate (IRR) for nonparticipating insurance business and segregated fund guarantees, is shown in the table below. This assumes no change in the ultimate reinvestment rate (URR). The first column below excludes the impact of market value changes in available for sale (AFS) bonds. The AFS bonds provide a natural economic offset to the interest rate risk arising from our product liabilities.  The second column below shows the impact if the AFS bonds were sold to realize the gains from a 1% decrease in interest rates.

| | Before The Sale of AFS Assets | After The Sale of AFS Assets |
|---|---|---|
| | 1% Decrease | 1% Decrease |
| **Sensitivity To Market Interest Rates:** | | |
| June 30, 2015 MCCSR Ratio | **(37)%** | **(30)%** |
| December 31, 2014 MCCSR Ratio | **(35)%** | **(28)%** |

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 long form non-offering prospectus available at www.sedar.com. Additional disclosures of Empire Life’s sensitivity to risks are included in note 27 to the 2014 consolidated financial statements.

## Quarterly Results

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

| | **Jun 30 2015** | Mar 31 2015 | Dec 31 2014 | Sep 30 2014 | Jun 30 2014 | Mar 31 2014 | Dec 31 2013 | Sep 30 2013 |
|---|---|---|---|---|---|---|---|---|
| **Revenue** | **$ 41** | $ 643 | $ 541 | $ 381 | $ 480 | $ 524 | $ 322 | $ 235 |
| **Shareholders' Net income** | **$ 44** | $ 26 | $ 18 | $ 24 | $ 38 | $ 18 | $ 30 | $ 32 |
| **Earnings per share - basic and diluted** | **$ 45.34** | $ 25.97 | $ 18.44 | $ 24.49 | $ 39.22 | $ 18.05 | $ 30.97 | $ 32.98 |

For the second quarter of 2015, total revenue at Empire Life decreased by 92% to $41 million compared to $480 million in the second quarter of 2014. The decrease was primarily due to a large fair value decrease in FVTPL investments in 2015 compared to a large increase for this item in the second quarter of 2014. In the second quarter of 2015 interest rates increased resulting in a large decrease in bond prices, while the opposite occurred in the second quarter of 2014 (see Total Revenue section earlier in this report). Revenue volatility during the most recent eight quarters was primarily driven by the impact of market interest rate movements on Fair value change in FVTPL investments. The impact of this on net income is largely reduced due to a corresponding change in insurance contract liabilities.

For the second quarter of 2015, net income was higher relative to the second quarter of 2014 primarily due to growing profit on in-force Wealth Management business. See Product Line Results sections earlier in this report for further information on quarterly results.

Net income variability during the most recent eight quarters was primarily driven by long-term interest rate movements. Long-term interest rates decreased resulting in unfavourable net income in the individual insurance product line during the quarter ending March 31, 2015 and all 2014 quarters. Long-term interest rates increased, resulting in favourable net income in the individual insurance product line during the second quarter of 2015 and the two 2013 quarters shown in the above table. During all 2015 quarters and all 2014 quarters, Empire Life achieved strong year over year growth in the Wealth Management product line net income. This product line’s strong result was primarily due to the growth in segregated fund management fees and growth in segregated fund guarantee fees related to GMWB products. Strong fee income was primarily due to the positive impact of favourable stock market conditions on management fees earned, strong segregated fund sales and higher GMWB prices.

## Forward-looking Statements and Information

Certain statements in this MD&A about the Company’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, investment risks, market risks, market price fluctuations, interest rate risks, foreign currency risks, liquidity risks, credit risks, hedging risks, counterparty risks, insurance risks, experience risks, product design and pricing risks, underwriting and claims risks, reinsurance risks, risks with respect to competition, risks with respect to financial strength, capital adequacy risks, operational risks, risks with respect to regulatory matters, risks with respect to distribution channels, reliance on key personnel, ability to attract employees, pension risks, risks with respect to changes to applicable income tax legislation, risks with respect to litigation, risks with respect to reputation, risks with respect to modelling, risks with respect to risk management policies, risks with respect to intellectual property, risks with respect to significant ownership of common shares, risks with respect to market value, risks with respect to regulatory constraints and liquidity and price risks. Please see the section titled "Risk Factors" in Empire Life's final non-offering prospectus dated August 5, 2015 available at www.sedar.com for more details on these risks.

Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements and information include that the general economy remains stable; assumptions on interest rates, mortality rates and policy liabilities; and capital markets continue to provide access to capital. These factors are not intended to represent a complete list of the factors that could affect the Company; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein.

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

The forward-looking information contained herein is expressly qualified in its entirety by this cautionary statement. When relying on the Company'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. The Company 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, except as required by law.

## Non-GAAP Measures

The Company uses non-GAAP measures including source of earnings, annualized premium sales, assets under management, mutual fund gross and net sales and segregated fund gross and net sales 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. The Company also believes that securities analysts, investors and other interested parties frequently use non-GAAP measures in the evaluation of issuers. The Company's management also uses non-GAAP measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and to determine components of management compensation.

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

Annualized premium sales is used as a method of measuring sales volume. It is equal to the premium expected to be received in the first twelve months for all new individual insurance and employee benefit policies sold during the period. Mutual fund gross and net sales and segregated fund gross and net sales are also used as measures of sales volume. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

Assets under management is a non-GAAP measure of the assets managed by Empire Life, which includes general fund assets, mutual fund assets and segregated fund assets. They represent the total assets of Empire Life and the assets its customers invest in. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

# Management's Discussion and Analysis

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 June 30 | | As at December 31 |
|---|---|---|---|
| (in millions of dollars) | **2015** | 2014 | 2014 |
| **Assets under management** | | | |
| General fund assets | **$ 6,948** | $ 6,399 | $ 6,779 |
| Segregated fund assets | **7,192** | 6,545 | 6,948 |
| Total assets per financial statements | **14,140** | 12,944 | 13,727 |
| Mutual fund assets | **154** | 66 | 109 |
| Assets under management | **$ 14,294** | $ 13,010 | $ 13,836 |

The above table includes the following amounts held by Empire Life's DB plans.

| | As at June 30 | | As at December 31 |
|---|---|---|---|
| (in millions of dollars) | **2015** | 2014 | 2014 |
| **DB Plan Assets** | | | |
| Segregated fund assets | **$ 179** | $ 170 | $ 175 |
| Mutual fund assets | **10** | 10 | 10 |

**Mark Sylvia**
President and Chief Executive Officer
August 7, 2015