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PRESENTATION

Unidentified Participant

Good morning. So we are ready to kick start day two of our financial summit. Thank you very much. Glad everybody made the trek from Scotiabank Center to the Royal York. So thank you very much again for your attention. And without further ado, I'm going to turn it over to Sumit Malhotra.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks very much, Brian, and good morning, everybody. Thank you for taking the time to join us for day two of our 17th annual financial summit. For those of you I haven't met, my name is Sumit Malhotra and I and the senior Canadian financial services analyst at Scotiabank GBM. We are going to commence our morning with presentations from the chief executives of each of the four publicly traded Canadian life insurance companies.

Following three consecutive years of double-digit growth, 2016 has thus far been a pause year for the Canadian life insurance sector with operating EPS for the sector relatively flat on a year-over-year basis. Despite the benefits arising from the capital deployment actions of the last few years, along with continued momentum in the wealth management operations of the group, volatility in both the macro backdrop and policyholder experience has resulted in operating ROEs stepping back to the 11% level.

That said, the capital position of the industry remains in good shape with the aggregate industry MCCSR ratio of 228% having helped to underpin at least one dividend hike over the past year from each of the four companies we will be hearing from this morning.

While global equity markets have bounced sharply since the Brexit lows in late June, the same cannot be said for long bond yields, which continue to hover near all-time lows on a global basis. Though the mark-to-market sensitivities of the Canadian life co's have declined significantly in the post crisis period, the negative impact of low interest rates on both run rate earnings and actuarial reserves has remained the dominant talking point around the sector and has resulted in the TSX Life & Health Insurance Index posting a 9% decline thus part in 2016.

With that said, we look forward to hearing from the chief executives as to how their companies are navigating these challenging operating conditions and what strategies are being deployed to improve operating returns and drive capital generation for shareholders going forward.

Without further ado, let me introduce our first guest this morning. We are very pleased to be joined by Mr. Donald Guloien, President and Chief Executive Officer of Manulife Financial. Donald joined Manulife in 1981 and has held his current position since 2009.

Before we begin, I will remind you that Donald's remarks may contain forward-looking statements and that actual results could differ materially from forecasts, projections or conclusions in these statements. Listeners can find additional details in the public filings of Manulife Financial.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Thanks, Sumit. That was an excellent introduction. You covered the industry pretty well.

Sumit Malhotra - *Scotiabank - Analyst*

Well, and I think I want to start with some of those things that I mentioned off the top. It certainly feels like, with this sector in particular, we spend a lot of time talking about factors that aren't directly under your control, whether that be the interest rate environment, to some extent regulatory or actuarial changes that are forthcoming.

I want to take a step back from that. Those are obviously important issues, but I want to talk about your business. I know this is a topic that is near and dear to your heart so I thought it would be the right place to start.

Leaving aside those big picture issues, and I know that is tough to do, what do you believe is being underappreciated, maybe underestimated in regards to Manulife Financial by the market?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, let me start by saying I think in the long run everything's under our control. And one of the things we have tried to do that you know well is try and reduce our sensitivity to those factors that are outside our control, the macro factors. We very substantially reduced the equity risk exposure of the Company. We have dramatically reduced the interest rate risk of the Company. But as you said, it still substantial for us and for other players and we have a very large legacy book.

So, the story of Manulife is we have roughly half our capital now tied up in legacy businesses, life and annuity businesses, principally in North America. And that's what gives rise to most of the volatility associated with our Company and we are constantly looking at ways to diminish that volatility, to reduce it and contain it. And the other time we are growing the other half of the business.

And the good news is we've got 50% of our capital tied up in businesses that by and large do not give rise to huge macroeconomic sensitivities, do not give rise to basis changes and all those other negative things that you've associated with the legacy businesses.

The principal areas of growth are in wealth and asset management globally and in the Asian business and both are doing very well. The wealth and asset management business has been growing, depending on how it's measured, roughly 30% a year on a compound annual growth rate.

We have been cash flow positive in virtually every quarter since the -- including the financial crisis. Very few companies can make that claim and it's contributing roughly 30% growth to earnings whether measured by net or EBITDA. So it is a very, very positive story.

The other one is of course Asia that has margins -- it does have some sensitivity, but it has margins that more than compensate for that. And the third area is a basket of areas that -- everything from our CoverMe program which is direct-to-consumer here in Canada, the Manulife Bank -- a whole range of initiatives that are in the other category but contribute well above our cost of capital and do not give rise to exceptional volatility with respect to macroeconomic factors.

So, what we are trying to do essentially grow that latter bit and we are growing it very well. The other business is either declining or we've shut down various businesses, but we still have the back book to deal with and it does give rise to sensitivities.

I guess the sad part for me is that when interest rates move as much as they did in the last quarter or in the last year -- interest rates over the last year are down 160 basis points in Japan, negative rates right out to the 25 year mark on the curve.

We can deal with low rates, we can deal with negative rates, we can deal with high rates, but when rates change that much within a quarter it has a very substantial impact on our business. As you said, Sumit, not only impacting earnings but increasing the amount of capital that we have to hold.

Sumit Malhotra - *Scotiabank - Analyst*

That's a good start. Thank you for that. I want to get into some of the actual business factors, but I'd be remiss if I didn't start by asking you about the press release the Company issued last night about a change on your senior executive team. Just for the benefit of the room and in case anybody didn't see it, if you could just explain what that change is in regards to.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes, I'm very excited that Linda Mantia is joining the company from the Royal Bank. Linda has done a variety of roles at the Royal Bank but most recently their digital initiatives and she has led their card business. She also knows their private wealth business and set it up and managed it in London, England. A wonderful person, a great agent of change and that's what we want.

Basically our industry is changing; that's no secret to you. Every element from the products we sell to the rules under which we operate, regulatory structures, the way products are presented, the advent of digital and mobile on our business and I want a very aggressive agent to change it. Also look at legacy ways we do business and Linda will be a perfect person to do that.

Sumit Malhotra - *Scotiabank - Analyst*

And she will be coming in as --?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Chief Operating Officer and Linda will have a remit that includes essentially all the group functions except for finance and risk. So she has everything from marketing, M&A strategy, IT, data analytics, public affairs, government relations, a very wide remit.

Sumit Malhotra - *Scotiabank - Analyst*

All right, thank you for that. Let's move on to the numbers and earnings power. First half of the year you termed it as somewhat disappointing for Manulife. At least by my math earnings growth was -- core earnings were up about 2% year-over-year.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes.

Sumit Malhotra - *Scotiabank - Analyst*

You had an interesting statement on the call last month that it would be overly simplistic for us to take the numbers from the first half of the year multiply it by 2 and say that's the run rate earnings power. More of a shorter-term comment than you've made in the past in describing the business. So what exactly was it that happened in the first half that you think is not going to recur and we'll see stronger numbers in the balance of the year.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, the investment gains for one thing have been -- were negative or absent from core earnings in the first quarter, made a very small contribution in the second quarter. But because of the way we account for it doesn't go -- there's a possibility that it could enter in the second and the third and the fourth quarters.

The policyholder experience was negative in the second quarter and we do not believe that that will continue. We've got the ongoing momentum from the businesses being added, both the DBS business in Asia and of course Standard Life which is delivering essentially right on plan and the contribution those business will make as well as New York Life in the United States will be substantial and increasing, so that will be reflected.

So, there's a lot of elements of positive momentum that should affect the third and fourth quarter. I can't make any prediction; I'm not going to give guidance, but I think you'd be remiss to just double the first half numbers.

And the other element is if you look at our net income, of course it was up very substantially from last year and feel pretty good about that. And after all both are important. Core is the best measure we have of the earnings capacity of the Company going forward, but net is the one that enables us to pay dividends and add to capital.

Sumit Malhotra - *Scotiabank - Analyst*

One of the big themes around this Company has been the core earnings objective and when you can get to the $4 billion level. But I want to take a step back from that and think about profitability.

At your Investor Day, which was back in May of 2015, you gave us some interesting slides that showed the ROE of the Asia and wealth and asset management business are, depending on how you look at it, high teens, low 20s. Those are by my math about 35% of your aggregate business.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes.

Sumit Malhotra - *Scotiabank - Analyst*

The overall ROE of Manulife in this period without investment gains has hovered around 9%. So clearly your -- if I can call them your legacy businesses, especially in North America, would appear to have a very low ROE that is dragging down overall returns.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Correct.

Sumit Malhotra - *Scotiabank - Analyst*

So, balance sheet optimization is a term that we heard from this Company over the last few months. I wanted to ask you where exactly are you in that process. And does the additional leg down in interest rates make it even more difficult to divest of some of these lower return businesses and increase your weight to the things that we want to see get bigger with Manulife?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes, well, it does. So, you've put it beautifully and our job is to grow most rapidly those businesses that are way above our cost of capital and to try and shrink or certainly not grow substantially the ones that are below.

But a reminder to everyone in the room, the life insurance business is unlike cars and retail, and that is when you get out of a business that doesn't mean the capital disappears because people still pay the premiums and the capital can actually continue to go up for a period of time until it really goes into runoff. So it doesn't shrink as rapidly as one would like.

But what we are doing very effectively is growing the businesses that are contributing well above our cost of capital and also give rise to less volatility in earnings and basis changes and all those good things -- or all those negative things and trying to shrink the other side.

The balance sheet optimization is an attempt to look at capital market transactions or transactions with buyers to take blocks of business. We had a very successful transaction we did with New York Life where they took a block of life insurance and we actually got the 401(k) business in exchange. The value that they paid us for that business was actually very, very substantial and they looked at it quite differently than we did in terms of cost of capital.

The balance sheet optimization project is an attempt to find other transactions like what we do of that nature. Now we're not a position to announce anything, that requires a unique counterparty. If we talked about a counterparty that has the exact same expectations that we have around cost of capital we are not likely to make a trade.

If I went to Henry Kravis and said would you buy a block of capital consuming somewhat volatile business earning 4%? He's going to charge me enormously for taking it. But there are people who have different expectations and time horizons or people who are trying to build up a block of business or establish a beachhead. And we think there's enough people out there poking around at the life insurance business that we think there is a possibility of a transaction there and we would certainly be open to it.

But it's an easier thing to talk about. I have seen people say, gee, management seems open to this, this is fantastic. If they can just get rid of the 4% earning business, Manulife would be in great shape. That is easier said than done. We have to execute on that.

Sumit Malhotra - *Scotiabank - Analyst*

And so, when we are looking at -- let's just put this out there. So the ROE has been hovering, as I said, around 9% and markets are efficient. The stock has basically been trading at book value or below for some period of time.

BSO, as you've termed it, doesn't seem like it's a near-term driver of ROE expansion. So the investment gains come back at some point, that will help. But in your view what are the key factors we should be focusing on to get that ROE even back to a reasonable low-double-digit range where you were at not that long ago?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Growing the Asian and wealth management businesses, growing all those other businesses are way above our cost of capital. Again, the bank, CoverMe, affinity business, a whole variety of businesses that we have across the Company that are actually quite interesting and highly desirable. And the risk characteristics and earning characteristics and driving down costs and trying to contain the volatility associated with some of those legacy businesses, that's basically the recipe book.

But look, also very aggressively -- and don't read into my comments. I just can't make any comments about anything in the short-term around BSO. I guess what I know is we have in of blocks of business there and there's enough different people that are poking around the market that the odds of finding transactions -- and we have done some transactions, smaller ones -- it's certainly not an impossible endeavor. You get people with different expectations, different desires, a transaction can take place.

Sumit Malhotra - *Scotiabank - Analyst*

A year ago at this time your CFO was sitting here with me and we were joking that two years ago the night before he presented at the conference he did the Standard Life deal and last year was the distribution agreement with Standard Chartered. So thankful that didn't interrupt the dinner last night with another announcement, so thank you for that.

But that kind of brings us to capital deployment. You've talked about some of those transactions -- Standard Life, the distribution agreements in Asia, New York Life. It was a busy two-year period for Manulife from an acquisition or partnership perspective.

Are you in a pause now when it comes to acquisitions as you integrate or start to work through some of these newer initiatives? Or as Chief Executive are there some areas still on your wish list that you would like to infill via acquisition?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes, if I was to say a pause, sure as shooting within 24 hours something would emerge that would change it. But the fact is those transactions were ones that we had targeted for a long time as highly desirable transactions for our Company. There's really nothing that we have to do from a strategic perspective that I would consider to be a make or break.

So, whether it's a pause or not, we tend to be opportunistic. We also look out long-term highly desirable candidates including DBS, Standard Chartered and Standard Life, those were all there, and New York Life's 401(k) business. Very desirable properties and we've done them. There's nothing else out there that we are just dying to have, quite honestly. So if that leads to a pause, yes, it does and we can employ our capital in other ways.

Sumit Malhotra - *Scotiabank - Analyst*

Let's go right to that. So, on a lot of metrics your balance sheet looks healthier than we've ever seen it. MCCSR Is hovering around 230%, it has been pretty consistent for the last little while. Leverage, I know there were some transactions and I spoke with Steve about the issuances, the debt issuances you were able to do in Asia which was a new source of funding, if you will, for the Company.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

And very effective, yes.

Sumit Malhotra - *Scotiabank - Analyst*

So, a few moving parts there but leverage has obviously come down. So, when we look at your capital at the current levels is there anything that gives you pause to say don't completely know what the ramifications of a blackout would look like -- the obviously changing regulatory environment, macro volatility? Is the capital as healthy as it looks or is there any issue that says we're better off continuing to build and hold it steady for the time being?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

The capital is exactly as healthy as it looks. These low interest rates -- lower interest rates, the amount of capital that's required to sustain our ratios was very substantial this year, the impact. And God forbid if they went lower, that's something that we do think about.

You think about the risk of a deflation scenario, a long-term deflation scenario, that would have an impact on asset returns of all types, obviously not just interest rates. And that is a thing that we worry about. The other one we worry about is the LICAT introduction.

We all know what Jeremy Rudin has said, that it's going to be totally different. And we've seen obviously more aspects of it than the Street has, but it is going to be a totally different formula. And in the absence of any certainty you tend to be a little bit more conservative because it's far easier using excess capital than it is attracting it when you need it.

There's nothing that would give us any concern about the financial strength of Manulife or a [regulate] any concern, but we're going to err a little on the conservative side. A question that I'm sure you have in the back of your head is stock buybacks. We are trading below book value and we've historically felt that our business growth and acquisitions that we would like to do would be the best, highest and best use of excess capital.

Given that we've done most of the things we wanted to do on the acquisition front and that our business in Asia is largely self-sustaining, and the others aren't growing that fast and we're fine capital wise, we'll have to take a look. And I've answered that on a call a few times, that stock buybacks is another tool in the arsenal.

Sumit Malhotra - *Scotiabank - Analyst*

It's one that I think the market has been curious about. Prior to your current role, you were Chief Investment Officer of the Company. And it's fair to say Manulife had some challenges during the downturn. Your investment portfolio wasn't one of them.

So, as a guy who's got a reputation as a good investor, with your stock trading at 0.85, 0.9 book -- and we touched on this a little bit on the call. It's just been curious to me that if the capital is as healthy as it looks and you feel all right about where LICAT will take you, being able to turn that switch during periods where the stock is under pressure, not buying every day necessarily --.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes, yes.

Sumit Malhotra - *Scotiabank - Analyst*

It would seem to make a lot of sense as a savvy investor.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, it's funny, the savvy investor -- you are flattering me, but that's probably the biggest problem, stock buybacks. Because frankly as an investor I always look at stock buybacks as a lazy way of using capital.

Good management would find a way to invest in businesses or growth of their own business that was above the cost of capital and that's how they would add value. And that people who were buying back stock were trying to pump up their stock options or something like that. So I had a bit of an attitude frankly against stock buybacks.

But when you see periods of volatility where somebody's talking about the Chinese economy slowing down, remember August of last year, China was coming to this halt, it was hitting the wall -- it had all these colorful expressions and it was absolute nonsense and Manulife starts trading off. You sure wish you had a stock buyback program in place to take advantage of that.

And at times of Brexit volatility and things like that where Manulife sometimes seems like a bellwether for the risk on/risk off trade, and over the fullness of time those things even out. So, we'll have to take another look at it, but I blame myself. My mindset was good management should find other ways of deploying their capital other than just buying back their own stock.

And there is, shall we say, an agency problem or a conflict of interest with people trying to push up the value of their stock options and being the ones who can determine how much stock is trading. So, that was a long felt bias of mine on the investment side that has probably colored some of this quite frankly. And people on our Board felt the same way. It's obviously a Board decision, but this is something that we have to take a look at.

Sumit Malhotra - *Scotiabank - Analyst*

Well, I'm going to move off this, and I think you are right. As an industry, financial services has a bad habit of buying back stock at 2 times book and issuing below.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes.

Sumit Malhotra - *Scotiabank - Analyst*

I just think if -- from again a cost of capital perspective, if you are trading below levels that your cost of capital can easily exceed it would seem to make a lot of sense at those points. But I think we are on the same page there.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes, and when people are trying to justify investments and things and returns we are looking at that as an alternative. And saying we bought back our own stock at a discount to book. That's a hell of an attractive -- it creates a nice really nice tension.

Sumit Malhotra - *Scotiabank - Analyst*

Okay. Let's get to the actual business and DBS was an interesting --.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

It also, Sumit, would cause us to look at -- when we talk BSO, you look at that a little differently also too. A transaction that might not otherwise look as attractive but if it allowed you to buy back your stock and so on, you look at the full equation, you can come to a different conclusion.

Sumit Malhotra - *Scotiabank - Analyst*

Okay, we will look forward to those. Let's go to the actual business in DBS. For a number of years, you had talked about how expensive it was to grow or acquire distribution in Asia and that's why I think these two partnerships announced over the last year were received so well by the market.

Early days with DBS, the numbers from a top-line perspective have looked very strong. And one of the interesting comments that Manulife had made around that agreement was that DBS was incentivized to sell higher margin -- products that were higher-margin and higher profitability for Manulife.

Can you give us some detail on how exactly that's worked, what products are we talking about? And maybe higher level, in the first six months of the agreement, how's the relationship between the two companies in Asia?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, at a very high level, and we have different categories of products and we pay them differently. And plus we have just an agreement. DBS, there's lots of deals that we've passed on or got involved in but wouldn't pay the final price. We paid a full price for DBS because we had a good working relationship with DBS, had for years. We are their favorite second carrier even though we didn't have a relationship in place and we knew we could trust the management team, they are good people.

And it's been like that -- from well before the partnership actually started getting executed it was a great partnership and it continues to be. But they have a direct incentive to sell the products that we want to sell that have margin in them.

There is a terrible habit in bank assurance deals being volume based only. And banks sell these deposit replacement products which are not much better in the risk/reward profile than fixed deferred annuities in the United States. The least attractive thing we want to sell, the kind of businesses we've actually closed down.

So in those years in China and other places in Asia when you'd see companies growing by 150% a year, they were selling deposit replacement products that the bank could manufacture themselves but didn't choose to because they could earn a commission from an insurance company and get a better return for their customers than manufacturing it themselves. It made no sense at all.

So we didn't want a Bancassurance deal that our partner could profit by selling products like that. So we have basically a scale that has the different types of products and we annually revisit that with them to make sure that we are getting the margins and they care that were selling the right kind of products.

The other aspect about the DBS relationship, it has gone well beyond the contractual agreement. We raised capital in Singapore. They did a fantastic job for us. We distributed the first ever US REIT in Singapore and it was well received and DBS led that transaction.

They are giving us exposure to wealth management opportunities in Asia which is not part of the narrow contractual agreement. It's a very broad-based working arrangement between our two companies and going extremely well. Our business in Asia is up depending on how you measure it 40% to 50% year-over-year and it's very high margin.

Sumit Malhotra - *Scotiabank - Analyst*

A portion of Asia which is still very big for you from an earnings contribution perspective but not one we talk about as much anymore is Japan.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Yes.

Sumit Malhotra - *Scotiabank - Analyst*

And my question on Japan, in the last 18 months or so we had some conversations with Steve about the potential capital relief that Manulife would receive as the VA book in Japan starts to run off. He's been clear about it's not as big as we initially may have thought. I wanted to ask you (multiple speakers).

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Because it's been running off.

Sumit Malhotra - *Scotiabank - Analyst*

It's been running off.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

And we've been getting that relief the last three or four years.

Sumit Malhotra - *Scotiabank - Analyst*

My question is more the other way. Because the Asia earnings power has been so strong and actually quite resilient despite some of the equity market volatility that you mentioned earlier, is there any risk that we are going to see overall Asia earnings impacted by the earnings associated with that business starting to recede in a bigger way? Or in your view that's not really material to what we are talking about?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

No and most of it has run off. There will be a little bit more tailing off, but not significant. Relative to the earning power that's coming from a variety of places, from Indonesia, from Hong Kong. The Standard Chartered deal is giving us a whole new -- equivalent of a 401(k) business in Hong Kong adding to our business and giving us certainly number two, but our hope is to be number one market share in that market, a variety of things coming on stream. Singapore now is a really big contributor. That attenuation of business in Japan is not going to be a big factor.

Sumit Malhotra - *Scotiabank - Analyst*

The other key driver that you've talked about as improving ROE and driving earnings power going forward was the wealth and asset management business under Kai Sotorp's leadership. That business has been quite resilient in terms of new asset flows which has been a challenge across the wealth management industry, especially in these volatile markets. I think you've got something like 2 consecutive -- or 24 consecutive quarters, something like that, of positive flows.

On the other hand margin expansion story that you talked about at the Investor Day has been slow to get going. I know again shorter-term issues. So two questions there. Why do you think your flows in that business have been much more resilient than we've seen for the industry as a whole?

And number two, is the margin -- I don't want to call it weakness, but the margin declining moderately from where they were, is that a reflection of just market conditions or are there investments you are making in Asia and Europe that have resulted in some of that downward move?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well okay, the first question is how have we done so well? And I guess our managers have done an exceptionally good job, but I think -- you say why, is that luck or is that good fortune? I think it's because we have a global model. They get access to market intelligence around the world. And the world is getting flatter and you guys know that in the investment marketplace.

And where you've got counterpart to work for your firm sitting on the ground in various places around the world. So when somebody says China is hitting the wall, you can call people in China and say do you see a wall there anywhere and get the view right on the ground, you get better market intelligence than you do by reading the Wall Street Journal.

So, I think that's one of the contributing factors. We've got a very talented people, we give them a lot of scope to run according to their own portfolio. We don't impose a house view on them and we're able to attract some really talented people and actually, knock on wood, retain extremely talented people. So I'm very proud of the investment managers that we have in our [MAM] operation.

But we know that we don't have all the answers, so we also have open architecture in most around the world and we employ the best managers from other places. And so, that combination gives us a very, very strong bench. Our own team and other managers adding to that team, so we offer to open our architecture to the clients.

So we always have products that are doing pretty well, so that has led to the resilience and the growth, that combination of factors. Plus we have a big space, very good at alternative assets, which have been highly attractive to people so that's what we call our private asset management initiative where we are managing money for sovereign wealth funds, pension plans, other life insurance companies is also a growing part of the business.

So, there's a lot of things contributing to that overall success. The earnings contribution is substantial and increasing every year in roughly a 30% growth rate. And it doesn't require a lot of capital; it's a highly desirable business.

Sumit Malhotra - *Scotiabank - Analyst*

My second part of it was around the margins which have been --.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Oh yes, the margins. The margins are -- so the margin is really an issue of just the average margin. Every one of the businesses, there could be some minor exceptions, are growing their contribution of profit but what we are growing fastest in is some of the lower margin for instance the larger 401(k) business as a result of the New York Life thing.

So this is this funny thing with average margins. If you are growing faster -- all of them are contributing more profit which is what I care about. I want to produce profit. But if you are growing fastest in the lower margin businesses and growing slower in the higher-margin businesses, your margin is going to come down. But when they are all growing that's not a problem.

Sumit Malhotra - *Scotiabank - Analyst*

So right now you are saying we're not going to slow the growth just because it's in lower margin businesses. We're getting growth everywhere focused more on the net income than the --?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Absolutely, yes. I think you would have to agree that's the right thing to do. I'm not going to say shrink -- constrain the growth of the low margin business so that the average comes out better. If it was taking away from the high-margin business that would be another story if we are cannibalizing --.

Sumit Malhotra - *Scotiabank - Analyst*

So, it's more mix in your view than investment spend or some of those initiatives?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, mix is the biggest part. The second thing is investment spend. We are investing in a variety of tools and utilities and so on to make us more efficient in the long-term and more effective and deliver better results for clients. So the spend is increasing pretty substantially, the investment in the future. That is an important factor. But I think you're going to see margins coming back.

One of the biggest dynamics in that has been in the US 401(k) business where we were the small case leader essentially, which is a very high-margin business. The margins were going to come down in that business and we were pretty aggressive at re-pricing product because we didn't want to lose customers. And with the DOL and various forms of transparency being brought the pressure on margins is enormous.

But then we also knew strategically we needed to be in the medium/large case market, so we did the transaction with New York Life that gave us capability there. We had a lot of additional expense associated with that. That creates a certain amount of distribution turmoil.

So I mean you've got two things happening. One is you are re-pricing your own high-margin business to make it lower margin to make sure that you keep customers. And the second is you are growing in the small -- the medium and large case market which has lower margin, so you are adding profitability but -- those two factors together had a big impact on margin compression. But all very positive.

Now the good news is we are well along in our integration efforts which is expensive. We're selling in both the large, small -- medium and large case market and actually we are seeing a real pickup in sales in the small case market, which is the high-margin stuff.

So, it's one of those other things -- I can see the pipeline before the earnings are bought of new business. And it's one of the factors that gives me more positive feeling towards the third and fourth quarter and into next year.

Sumit Malhotra - *Scotiabank - Analyst*

Last question for you, as always time never our friend. I want to marry a couple things. The E&E initiative, enterprise efficiency, you've talked about savings now, pretax savings exceeding $450 million ahead of plan.

Yesterday I had your counterparts in the banking sector here and two key buzzwords in banking over the last couple years have been restructuring and technology. At least simplistically some of the savings from the restructuring are being redeployed towards let's say new forms of distribution payments, some of those areas for the banks.

How do we think about that in relation to Manulife? You've talked a little bit about this in the past. It's not something we focus too much on. But how is Manulife changing the way that it interacts with its clients from a technology perspective and is E&E -- some of the savings furthering that myth?

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Very much so. Most of the savings, I think investors in the room would have liked more of the savings to fall to the bottom line, but most of those savings have been re-channeled into forward facing investments that make our people more efficient in their processes.

Quite frankly -- and this happened before the crisis, we were not spending enough on technology, not spending enough on forward facing initiatives, and not even spending enough at giving our employees the right tools they needed to do the job most effectively. And that leads to all kinds of inefficiencies in how we are managing the business.

So, during the financial crisis, obviously, when capital was a concern for the Company back in 2009/2010, you are not going to go too extravagant in investing for the future. But as things got better and as we had to -- we invoked the E&E initiative and we de-layered the organization, we took out a lot of cost, we redeployed most of that into future facing technology. Things like putting legacy systems together to be more efficient, giving our people the right kind of tools, but again the forward facing technology, the mobile apps.

So, we now have mobile apps for our bank. We don't want to be the only bank in the world that didn't have mobile apps. We can sell now policies and have them automatically underwritten through an iPad in less than a minute in China and (multiple speakers).

Sumit Malhotra - *Scotiabank - Analyst*

That's global.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Well, those things are being rolled out all around the world in different forms. We have all kinds of direct-to-consumer initiatives where people can buy online from us. We sell thousands of policies on WeChat directly. We have a variety of things and we're going to be laying out -- later this year introducing to our 401(k) and customers in plan advice on an automated basis, highly attractive user interfaces.

Essentially everything we develop now we have a view to expecting that it will be mobile in the future and if not at launch. That's one of the reasons why Linda is coming into the organization. She has a totally different mindset about customer centricity, e-marketing and digital that is very much in our wheelhouse.

But we led the industry in terms of having wellness be a part of a life insurance offering. It's called Vitality in the United States. We'll be introducing it in Canada in the fall. And we've launched and in Asia, it is called Manulife Move there. But all of them are basically marrying wellness with life insurance and redefining what the product is and differentiating it.

The business of competing for life insurance sales through agents because the argument being my product is $6.13 a thousand and the other guys is $6.35 a thousand and giving them crazy guarantees, that's not the future of the business. The future of the business is looking at it quite differently and that's what we're doing with these vitality initiatives and a variety of them.

So yes, I get quite excited about the revolution. The Global Mail had an interesting article talking about how life insurance companies are sort of -- the business is an old business and how companies are preparing for the future. And they captured a little tiny, tiny, tiny piece of what we're trying to do. But it's actually very exciting some of the ways that we'll do business. It will be entirely different five years from now from the way it is today.

Sumit Malhotra - *Scotiabank - Analyst*

Well, let's get some of the other issues behind us, get things moving in the right direction. We will probably focus a lot more on this next time around.

Donald Guloien - *Manulife Financial Corporation - President & CEO*

Thank you.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks for your time.
