

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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<b>OVERVIEW</b>	<b>12</b>
Corporate Overview	12
Corporate Developments and Actions	14
Outlook	15
Financial Objectives	15
Financial Highlights	16
Non-IFRS Financial Measures	17
<b>FINANCIAL PERFORMANCE</b>	<b>20</b>
2016 Consolidated Results of Operations	20
Fourth Quarter 2016 Performance	27
Quarterly Information	30
<b>BUSINESS SEGMENT RESULTS</b>	<b>31</b>
SLF Canada	31
SLF U.S.	35
SLF Asset Management	38
SLF Asia	41
Corporate	44
<b>INVESTMENTS</b>	<b>45</b>
Investment Profile	46
Debt Securities	47
Mortgages and Loans	49
Equities	50
Investment Properties	50
Derivative Financial Instruments and Risk Mitigation	51
Impaired Assets	52
Asset Default Provision	52
<b>RISK MANAGEMENT</b>	<b>53</b>
Risk Management Framework	53
Risk Culture and Philosophy	53
Risk Appetite and Risk Profile	54
Governance Structure and Accountabilities	54
Risk Management Policies	55
Risk Management Process	56
Risk Categories	56
<b>CAPITAL AND LIQUIDITY MANAGEMENT</b>	<b>72</b>
Principal Sources and Uses of Funds	73
Liquidity	73
Capital	74
Capital Adequacy	77
Financial Strength Ratings	78
Off-Balance Sheet Arrangements	79
Commitments, Guarantees, Contingencies and Reinsurance Matters	79
<b>ACCOUNTING AND CONTROL MATTERS</b>	<b>79</b>
Critical Accounting Policies and Estimates	79
Changes in Accounting Policies	85
Disclosure Controls and Procedures	86
<b>LEGAL AND REGULATORY PROCEEDINGS</b>	<b>87</b>

# Management's Discussion and Analysis

February 15, 2017

The following defined terms are used in this document.

Abbreviation	Description	Abbreviation	Description
<b>AFS</b>	Available-for-sale	<b>MD&amp;A</b>	Management's Discussion and Analysis
<b>AIF</b>	Annual Information Form	<b>MFS</b>	MFS Investment Management
<b>ASO</b>	Administrative Services Only	<b>MPF</b>	Mandatory Provident Fund
<b>AUM</b>	Assets Under Management	<b>OCI</b>	Other Comprehensive Income
<b>CEO</b>	Chief Executive Officer	<b>OSFI</b>	Office of the Superintendent of Financial Institutions
<b>CFO</b>	Chief Financial Officer	<b>ROE</b>	Return on Equity
<b>CGU</b>	Cash Generating Unit	<b>SEC</b>	United States Securities and Exchange Commission
<b>CSF</b>	Career Sales Force in SLF Canada	<b>SLEECs</b>	Sun Life Exchangeable Capital Securities
<b>DCAT</b>	Dynamic Capital Adequacy Testing	<b>SLF Asia</b>	Sun Life Financial Asia
<b>EPS</b>	Earnings Per Share	<b>SLF Asset Management</b>	Sun Life Financial Asset Management
<b>FVTPL</b>	Fair Value Through Profit or Loss	<b>SLF Canada</b>	Sun Life Financial Canada
<b>GB</b>	Group Benefits	<b>SLF Inc.</b>	Sun Life Financial Inc.
<b>GRS</b>	Group Retirement Services	<b>SLF U.K.</b>	SLF's United Kingdom business unit
<b>IASB</b>	International Accounting Standards Board	<b>SLF U.S.</b>	Sun Life Financial United States
<b>IFRS</b>	International Financial Reporting Standards	<b>SLGI</b>	Sun Life Global Investments (Canada) Inc.
<b>LICAT</b>	Life Insurance Capital Adequacy Test	<b>SLIM</b>	Sun Life Investment Management
<b>MCCSR</b>	Minimum Continuing Capital and Surplus Requirements	<b>Sun Life Assurance</b>	Sun Life Assurance Company of Canada

## How We Report Our Results

SLF Inc. is a publicly traded company domiciled in Canada and is the holding company of Sun Life Assurance. In this MD&A, SLF Inc. and its subsidiaries are collectively referred to as "the Company", "Sun Life Financial", "we", "our", and "us", and also includes, where applicable, our joint ventures and associates. Unless otherwise indicated, all information in this MD&A is presented as at and for the year ended December 31, 2016 and the information contained in this document is in Canadian dollars. Where information at and for the year ended December 31, 2016 is not available, information available for the latest period before December 31, 2016 is used. Except where otherwise noted, financial information is presented in accordance with IFRS and the accounting requirements of OSFI.

We manage our operations and report our financial results in five business segments: SLF Canada, SLF U.S., SLF Asset Management, SLF Asia and Corporate. Information concerning these segments is included in SLF Inc.'s annual and interim consolidated financial statements and accompanying notes ("Annual Consolidated Financial Statements" and "Interim Consolidated Financial Statements", respectively). Reported net income (loss) refers to Common shareholders' net income (loss) determined in accordance with IFRS.

Additional information relating to the Company can be found in SLF Inc.'s Annual Consolidated Financial Statements, Interim Consolidated Financial Statements and AIF for the year ended December 31, 2016. These documents are filed with securities regulators in Canada and are available at [www.sedar.com](http://www.sedar.com). SLF Inc.'s Annual Consolidated Financial Statements, annual MD&A and AIF are filed with the SEC in SLF Inc.'s annual report on Form 40-F and SLF Inc.'s interim MD&As and Interim Consolidated Financial Statements are furnished to the SEC on Form 6-Ks and are available at [www.sec.gov](http://www.sec.gov).

Information about non-IFRS financial measures and reconciliations to the closest IFRS measure can be found in the Non-IFRS Financial Measures section of this document.

## Forward-looking Statements

From time to time, the Company makes written or oral forward-looking statements within the meaning of certain securities laws, including the "safe harbour" provisions of the United States Private Securities Litigation Reform Act of 1995 and applicable Canadian securities legislation. Forward-looking statements contained in this MD&A include (i) statements relating to our growth strategies, financial objectives, future results of operations, and strategic goals; (ii) statements concerning the expected impact of the U.S. employee benefits business acquisition completed in 2016 on earnings per share, excluding transaction and integration costs and our expected pre-tax run rate synergies which are described in this MD&A under the heading Corporate Developments and Actions; (iii) statements concerning our medium-term financial objectives which are described in this MD&A under the heading Financial

Objectives, (collectively, our “medium-term financial objectives”); (iv) statements relating to productivity and expense initiatives, growth initiatives, 2017 Outlook and Priorities, and other business objectives; (v) statements that are predictive in nature or that depend upon or refer to future events or conditions; (vi) statements set out in this document under the heading Risk Management – Market Risk – Interest Rate and Equity Market Sensitivities; (vii) statements relating to cash flows, anticipated payment obligations, funding requirements and our ability to meet these obligations; (viii) statements relating to tax provisions; (ix) statements relating to risks and uncertainties; and (x) statements that include words such as “aim”, “anticipate”, “assumption”, “believe”, “could”, “estimate”, “expect”, “goal”, “initiatives”, “intend”, “may”, “objective”, “outlook”, “plan”, “project”, “seek”, “should”, “strategy”, “strive”, “target”, “will” and similar expressions are forward-looking statements. Forward-looking statements include the information concerning our possible or assumed future results of operations. These statements represent our current expectations, estimates and projections regarding future events and are not historical facts. Forward-looking statements are not a guarantee of future performance and involve risks and uncertainties that are difficult to predict. Future results and shareholder value may differ materially from those expressed in these forward-looking statements due to, among other factors, the matters set out in this MD&A under the headings Corporate Developments and Actions, Financial Objectives, Assumption Changes and Management Actions, Risk Management, Capital and Liquidity Management, and Critical Accounting Policies and Estimates and in SLF Inc.’s 2016 AIF under the heading Risk Factors, and the factors detailed in SLF Inc.’s other filings with Canadian and U.S. securities regulators, which are available for review at [www.sedar.com](http://www.sedar.com) and [www.sec.gov](http://www.sec.gov).

## Risk Factors

Important risk factors that could cause our assumptions and estimates, and expectations and projections to be inaccurate and our actual results or events to differ materially from those expressed in or implied by the forward-looking statements contained in this document, including our medium-term financial objectives, are set out below. The realization of our forward-looking statements, including our ability to meet our medium-term financial objectives, essentially depends on our business performance which, in turn, is subject to many risks. Factors that could cause actual results to differ materially from expectations include, but are not limited to: **credit risks** – related to issuers of securities held in our investment portfolio, debtors, structured securities, reinsurers, counterparties, other financial institutions and other entities; **market risks** – related to the performance of equity markets; changes or volatility in interest rates or credit spreads or swap spreads; real estate investments; and fluctuations in foreign currency exchange rates; **insurance risks** – related to mortality, morbidity, longevity and policyholder behaviour; product design and pricing; the impact of higher-than-expected future expenses; and the availability, cost and effectiveness of reinsurance; **business and strategic risks** – related to global economic and political conditions; changes in distribution channels or Client behaviour including risks relating to market conduct by intermediaries and agents; the impact of competition; the design and implementation of business strategies; changes in the legal or regulatory environment, including capital requirements and tax laws; tax matters, including estimates and judgments used in calculating taxes; the performance of our investments and investment portfolios managed for Clients such as segregated and mutual funds; our international operations, including our joint ventures; market conditions that affect our capital position or ability to raise capital; downgrades in financial strength or credit ratings; and the impact of mergers, acquisitions and divestitures; **operational risks** – related to breaches or failure of information system security and privacy, including cyber-attacks; our ability to attract and retain employees; the execution and integration of mergers, acquisitions and divestitures; legal, regulatory compliance and market conduct, including the impact of regulatory inquiries and investigations; our information technology infrastructure; a failure of information systems and Internet-enabled technology; dependence on third-party relationships, including outsourcing arrangements; business continuity; model errors; information management; the environment, environmental laws and regulations and third-party policies; and **liquidity risks** – the possibility that we will not be able to fund all cash outflow commitments as they fall due.

## Medium-Term Financial Objectives

The Company’s medium-term financial objectives are forward-looking non-IFRS financial measures. Our ability to achieve those objectives is dependent on our success in achieving growth initiatives and business objectives and on certain key assumptions that include: (i) no significant changes in the level of interest rates; (ii) average total equity market return of approximately 8% per annum; (iii) credit experience in line with best estimate actuarial assumptions; (iv) no significant changes in the level of our regulatory capital requirements; (v) no significant changes to our effective tax rate; (vi) no significant change in the number of shares outstanding; (vii) other key assumptions include: no material changes to our hedging program, hedging costs that are consistent with our best estimate assumptions, no material assumption changes including updates to the economic scenario generator and no material accounting standard changes, and (viii) our best estimate actuarial assumptions used in determining our insurance and investment contract liabilities. Our underlying ROE is dependent upon capital levels and options for deployment of excess capital. Our medium-term financial objectives do not reflect the indirect effects of interest rate and equity market movements including the potential impacts on goodwill or the current valuation allowance on deferred tax assets as well as other items that may be non-operational in nature.

Our target dividend payout ratio of 40%-50% of our underlying net income assumes that economic conditions and our results will enable us to maintain our payout ratio in the target range, while maintaining a strong capital position. The declaration, amount and payment of dividends is subject to the approval of SLF Inc.’s Board of Directors and our compliance with the capital requirements in the Insurance Companies Act (Canada). Additional information on dividends is provided in the section in this MD&A under the heading Capital and Liquidity Management – Shareholder Dividends.

Although considered reasonable by the Company, we may not be able to achieve our medium-term financial objectives as the assumptions on which these objectives were based may prove to be inaccurate. Accordingly, our actual results could differ materially from our medium-term financial objectives as described in this MD&A under the heading Financial Objectives. Our medium-term financial objectives do not constitute guidance.

The Company does not undertake any obligation to update or revise its forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events, except as required by law.

# Overview

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## Corporate Overview

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Sun Life Financial is a leading international financial services organization providing a diverse range of insurance, wealth and asset management solutions to individuals and corporate Clients. Sun Life Financial has operations in a number of markets worldwide, including Canada, the United States, the United Kingdom, Ireland, Hong Kong, the Philippines, Japan, Indonesia, India, China, Australia, Singapore, Vietnam, Malaysia and Bermuda. As of December 31, 2016, Sun Life Financial had total assets under management of \$903 billion.

### Mission

To help Clients achieve lifetime financial security.

### Vision

To be one of the best insurance and asset management companies globally.

### Strategy

We are leveraging our strengths around the world to help our Clients achieve lifetime financial security while creating value for our shareholders.

Our strategy is based on growing our balanced and diversified set of businesses as a part of our four pillar strategy. We have chosen to be active in businesses that are supported by strong growth prospects, demographic trends and long-term drivers of demand for the insurance industry – the aging of baby boomers, the downloading of responsibility from governments and employers to employees and the growth of the middle class in the emerging markets of Asia.

In targeting the four pillars, we are focused on products that have superior growth characteristics, strong product economics and lower capital requirements in order to reduce net income volatility and improve our ROE. The maintenance of a balanced and diversified portfolio of businesses remains fundamental to our strategy.

### Strategic areas of focus

Our four pillar strategy is supported by five strategic areas of focus, which enable us to deliver more effectively on our strategy.

1. **Client for life:** Our Clients are at the centre of everything we do. We are focused across all of our businesses on building lasting Client relationships by doing three things: making it easier to do business with us, being more proactive in contacting our Clients and delivering consistently superior Client service.
2. **Digital:** Our digital capabilities are critical, both to support our focus on our Clients for life and for efficiency and effectiveness. We will continue to invest in our digital capabilities – including both technologies and the talent and culture that will enable us to be more agile, bolder and faster. As we do this, we will focus investments on developing digital approaches to current interactions, being more proactive and personalized with our Clients and building new digital business models.
3. **Data and analytics:** Data is a valuable resource for us and we are focused on leveraging it further to deliver value to us and our Clients, while respecting our Clients' privacy. In particular we are finding ways to use data to strengthen Client relationships, and enhance our efficiency, effectiveness and profitability.
4. **Talent and culture:** Our people are our most important assets, and delivering on our strategy will require that we continue to attract and retain the best talent. Our goals are to attract a disproportionate share of top talent across our geographies, continue to build on our high performance culture and ensure that our focus on our Clients for life becomes deeply embedded in our culture.
5. **Financial discipline:** Continued financial prudence, disciplined capital allocation and strong execution will be crucial for us to meet our objectives. We seek to achieve top quartile total shareholder returns while maintaining a preferred risk and capital profile.

### Values

The following values guide us in achieving our strategy:

- Integrity – We are committed to the highest standards of business ethics and good governance.
- Engagement – We value our diverse, talented workforce and encourage, support and reward them for contributing to the full extent of their potential.
- Client Focus – We provide sound financial solutions for our Clients and always work with their interests in mind.
- Excellence – We pursue operational excellence through our dedicated people, our quality products and services and our value-based risk management.
- Value – We deliver value to the Clients and shareholders we serve and to the communities in which we operate.
- Innovation – We listen to our Clients to provide them with a better experience through innovative products and exceptional service.

## Four pillars

Our strategy is focused on four key pillars of growth, where we aim to be a leader in the markets in which we operate. We detail our continued progress in these pillars below. In 2016, we made significant progress on our strategy by focusing our resources on four key pillars for future growth:

### A Leader in Insurance and Wealth Solutions in our Canadian home market

- We retained our industry-leading positions in GB<sup>(1)</sup> and GRS<sup>(2)</sup> and ranked second in the individual insurance<sup>(3)</sup> business.
- The strategic investments we made in our businesses are delivering benefits as reflected in increased sales in our individual wealth manufactured products<sup>(4)</sup>, SLGI mutual funds and Sun GIF<sup>(5)</sup>, and our Defined Benefit Solutions products. SLGI completed its sixth full year of operations and continued to offer top-performing funds as all five of the Granite Managed Portfolios had four-year performance that exceeded the peer median<sup>(6)</sup>.
- We made significant investments to further enhance our Client experience and advance our digital innovation strategy, including the launch of Digital Health Solutions, a new business designed to help Canadians find new and better ways of accessing health care products and services. In addition, Client Solutions' Digital Benefits Assistant, which surfaces helpful ideas at the right time through our Clients' channel of choice, continued to build momentum by engaging Clients proactively and delivering personalized and relevant interactions. Other growth initiatives included the launch of automatic enrollment for SLGI's Private Client program, and GRS's MAX my money@work, a new digital Client enrollment tool.
- During 2016, we made enhancements to the my Sun Life Mobile App, enabling Clients to search for local healthcare providers and show Client ratings. This allows Clients to take a more active role in managing their health and well-being. In addition, the app allows Clients to submit claims and check coverage and savings balances.
- For the eighth year in a row, Canadians have voted Sun Life Financial as the "Most Trusted Life Insurance Company", part of the *Reader's Digest Trusted Brand*<sup>TM</sup> awards program.

### A Leader in global Asset Management

- MFS continued to deliver strong long-term investment performance and grew AUM to US\$426 billion as of December 31, 2016. We continued to invest in our technological infrastructure to ensure MFS continues to deliver world-class Client service and to position its platform for future growth.
- MFS was named *Equity Manager of the Year* in the U.K. by *Financial News* in October, 2016 in recognition for its Client service focus and long-term value.
- SLIM achieved strong sales growth and launched new products and funds, including Sun Life Institutional Investment (Canada) Inc.'s Short Term Private Fixed Income Plus Fund, Ryan Labs Asset Management Inc.'s ("Ryan Labs") strategies including Defensive Risk Premia, and two new funds from the Bentall Kennedy group of Companies ("Bentall Kennedy"), ending the year with net sales of \$4.5 billion and AUM of \$53.2 billion.
- Bentall Kennedy was ranked among the top five firms globally in the 2016 Global Real Estate Sustainability Benchmark rankings. This is the sixth year that the team at Bentall Kennedy has received this recognition.

### A Leader in U.S. Group Benefits and International high net worth solutions

- In the first quarter of 2016, we closed the acquisition of Assurant Inc.'s U.S. Employee Benefits business, adding new capabilities and scale to our group benefits business in the U.S. The acquired business includes the second largest preferred provider dental network in the U.S., a group life and disability business with products and capabilities in voluntary benefits and vision, and integrated capabilities in benefits communications, deductions reporting and administration.
- The U.S. employee benefits business acquired in 2016 is proceeding in line with expectations, including the realization of transaction synergies. We are achieving our objectives in integrating our products, distribution, account management teams, and other organizational structures.
- In Group Benefits, we continued to improve the profitability of the disability business through expense, claims management and pricing actions that we have taken over the past few years. Sales increased significantly year over year reflecting the contribution of the U.S. employee benefits business acquired since closing in 2016.
- International launched a new life insurance product to broaden our offering to the international life insurance market. International sales increased 16% compared to the prior year.

### A Leader in Asia through Distribution Excellence in Higher Growth Markets

- We have continued to invest in our Asia business, including acquiring full ownership of Sun Life Vietnam Insurance Company Limited, announcing we have agreed to an exclusive 15-year distribution agreement with FWD Life Insurance Company (Bermuda) Limited ("FWD") in Hong Kong and also to acquire its pension business consisting of the Mandatory Provident Fund and Occupational Retirement Schemes Ordinance businesses, acquiring full ownership of PT CIMB Sun Life in Indonesia and extending our bancassurance arrangement with PT Bank CIMB Niaga in Indonesia, and increasing our ownership in Birla Sun Life Insurance in India to 49%.
- Our individual insurance and wealth sales grew 29% and 25% respectively over 2015.

### Recognition

- For the eighth consecutive year, SLF Inc. has been the only North American insurance company to be listed among the 2016 Global 100 Most Sustainable Corporations in the World (the "Global 100").
- Sun Life Financial was ranked in the top ten in *The Globe and Mail's* Board Games 2016 annual rating of governance practices of Canadian Boards of Directors compiled by the Report on Business.
- Corporate Knights recognized Sun Life as one of 2016's Best 50 Corporate Citizens in Canada ranking.

(1) The 2016 Fraser Group, most recently published *Group Universe Report*, based on 2015 data as measured by revenue, including administrative services only premium equivalents.

(2) As measured by Benefits Canada magazine's 2016 *CAP Suppliers Report*, based on June 30, 2016 assets under administration, and released in December 2016.

(3) LIMRA, for the nine months ended September 30, 2016.

(4) Represents sales of individual wealth products developed by Sun Life, including Sun Life Global Investment mutual funds, Sun Life Guaranteed Investment Funds segregated funds, Guaranteed Investment Certificates, and Accumulation and Payout Annuities.

(5) Sun Life Guaranteed Investment Funds

(6) Morningstar performance statistics as at December 31, 2016 for performance of the funds since inception.

# Corporate Developments and Actions

The following developments and actions occurred since January 1, 2016.

Additional information concerning acquisitions and dispositions is provided in our 2016 Annual Consolidated Financial Statements.

## SLF U.S.

On March 1, 2016, we acquired Assurant, Inc.'s U.S. employee benefits business. The acquired business added new capabilities and scale to our leading group benefits business in the U.S. The acquired business includes a dental business and provider network, a group life and disability business, products and capabilities in voluntary benefits and vision, and integrated capabilities in benefits communications, deductions reporting, and administration. Also acquired in the transaction was Disability Reinsurance Management Services, Inc., which provides turnkey disability risk management products and services to other insurance companies. The purchase price for the acquisition was \$1,264 million, consisting of a ceding commission and a payment for the acquisition of direct subsidiaries. The acquisition was financed using a combination of cash and subordinated debt issued by SLF Inc.

The integration is progressing as expected and major milestones in 2016 included achieving our objectives in integrating our products, distribution, account management teams and other organizational structures. The contribution from the acquired business included the expected expense synergies for 2016 and favourable morbidity experience. We maintain our expectations of US\$100 million pre-tax run-rate synergies at the end of 2019<sup>(1)</sup> and an accretion of \$0.17 earnings per share to earnings in 2019<sup>(1)</sup>, excluding transaction and integration costs.

## SLF Asia

During 2016, we acquired full ownership of Sun Life Vietnam Insurance Company Limited ("Sun Life Vietnam", formerly PVI Sun Life Insurance Company Limited). On January 7, 2016, we increased our ownership interest in Sun Life Vietnam, from 49% to 75%, by acquiring from our joint venture partner PVI Holdings an additional 26% of the charter capital. On November 9, 2016, we acquired the remaining 25% of non-controlling interest from PVI Holdings.

On April 11, 2016, we increased our ownership in Birla Sun Life Insurance Company Limited ("BSLI") in India, from 26% to 49% by purchasing additional shares of BSLI from Aditya Birla Nuvo Limited.

On July 1, 2016, we increased our ownership interest in PT CIMB Sun Life in Indonesia, from 49% to 100%. We also entered into an extended bancassurance arrangement with PT Bank CIMB Niaga to strengthen our distribution capabilities.

On August 3, 2016, we entered into an agreement to acquire the Hong Kong pension business of FWD, consisting of Mandatory Provident Fund and Occupational Retirement Schemes Ordinance businesses. We will also enter into an exclusive 15-year distribution agreement with FWD that will allow us to distribute our pension products through FWD's agency force in Hong Kong. The transactions are expected to be completed in stages over the course of 2017 and 2018, subject to the receipt of regulatory approvals and satisfaction of customary closing conditions.

## Common Share Dividend Activity

SLF Inc. increased the dividend paid on its common shares in the first and third quarter of 2016 and paid total common shareholder dividends of \$1.62 per common share in 2016, compared to \$1.51 paid in 2015. In relation to the Canadian Dividend Reinvestment and Share Purchase Plan ("DRIP"), commencing with the dividends paid on March 31, 2016, common shares were acquired by the plan agent on the open market and no shares were issued from treasury in connection with the plan in 2016. In 2015, SLF Inc. issued approximately 2 million shares from treasury under its DRIP.

## Financing Arrangements

On February 19, 2016, SLF Inc. issued \$350 million principal amount of Series 2016-1 Subordinated Unsecured 3.10% Fixed/Floating Debentures due 2026. The net proceeds were used to partially fund the acquisition of the U.S. employee benefits business in March 2016 and for general corporate purposes.

On June 1, 2016, SLF Inc. redeemed all of the outstanding \$950 million principal amount of the Series B Senior Debentures in accordance with the terms of the Series B Senior Debentures.

On September 19, 2016, SLF Inc. issued \$1,000 million principal amount of Series 2016-2 Subordinated Unsecured 3.05% Fixed/Floating Debentures due 2028. The net proceeds from this issue of debentures were raised for general corporate purposes, including investments in subsidiaries and repayment of indebtedness.

On September 30, 2016, 1.1 million Class A Non-Cumulative 5-Year Rate Reset Preferred Shares Series 10R ("Series 10R Shares") were converted into Class A Non-Cumulative Floating Rate Preferred Shares Series 11QR ("Series 11QR Shares") through a holder option, on a one-for-one basis. After the conversion, 6.9 million Series 10R Shares and 1.1 million Series 11QR Shares were outstanding. For additional information, refer to Note 15 of our Annual Consolidated Financial Statements.

On December 19, 2016, we announced that the number of Class A Non-Cumulative Rate Reset Preferred Shares Series 12R (the "Series 12R Shares") that were elected to be converted into Class A Non-Cumulative Floating Rate Preferred Shares Series 13QR (the "Series 13QR Shares") was less than the one million shares required to give effect to conversions into Series 13QR Shares and accordingly no Series 12R Shares were converted into Series 13QR Shares.

On January 4, 2017, SLF Inc. announced its intention to redeem on March 2, 2017 all of the outstanding \$800 million principal amount of Series 2012-1 Subordinated Unsecured 4.38% Fixed/Floating Debentures. The redemption will be funded from existing cash and liquid assets.

(1) See the sections in this MD&A under the heading Forward-looking Statements. Expected accretion to earnings per share is a Non-IFRS financial measure which includes our expected pre-tax run rate synergies and reflects the exclusion of expected transaction and integration costs from expected reported net income. There is no directly comparable measure under GAAP and a reconciliation is not possible as it is forward-looking information.

## Outlook

We expect global growth to moderately increase this year. Canadian growth will improve with more stable commodity prices and on the flow-through impacts of expected stronger U.S. growth. Growth in Asia appears to have stabilized while moderate growth is expected in Europe. Higher inflation and improved economic prospects should lead to greater normalization of monetary policy in the U.S. and potential reductions in quantitative easing in other markets. Geopolitical uncertainty led by growing populism and uncertain trade environments may cause increased market volatility.

We will continue to focus on businesses with strong growth prospects fueled by consumer demand and favourable demographic trends. The aging of the population is expected to continue to drive the demand for greater security and protection of retirement savings. We will respond to this demand with retirement income solutions across various distribution and technology platforms. We will continue to observe the shift in responsibility for funding health and retirement needs from governments and employers to individuals, which has created new opportunities for group and voluntary benefits including the medical stop-loss insurance market in the U.S. We will continue to target higher growth markets in Asia, where we are present in seven markets. With the younger populations and rapidly growing middle class in Asian markets, demand for insurance and wealth products continues to increase. All of these trends are expected to support demand for the pension, savings and health care solutions provided by life insurance companies. Volatile equity markets have resulted in the demand for sophisticated investment and risk management solutions through asset management products. We believe that our asset management businesses will benefit from this environment.

Participants in the financial services sector are making significant investments in digital technology as advancements enable new possibilities that drive shifts in consumer preferences. Sun Life is responding to this trend with several strategic initiatives to establish new digital capabilities across our businesses to drive efficiencies, reach our Clients more effectively and explore new business opportunities.

## Financial Objectives

The company has outlined the following medium-term financial objectives:

Measure <sup>(1)</sup>	Medium-term objectives
<b>Underlying EPS growth</b> Growth in EPS reflects the Company's focus on generating sustainable earnings for shareholders.	8%-10%
<b>Underlying ROE</b> ROE is a significant driver of shareholder value and is a major focus for management across all businesses.	12%-14%
<b>Dividend payout ratio</b> Payout of capital serves shareholder value, based on underlying net income.	40%-50%

We continued to make progress against these objectives. Our 2016 underlying EPS growth was 1%, following a strong 2015 underlying EPS growth of 27%. We met our underlying ROE objective with 12.2% in 2016 and 12.8% in 2015, and also met our dividend payout ratio objective with 43% in 2016 and 40% in 2015.

Although considered reasonable by the Company, we may not be able to achieve our medium-term financial objectives as our assumptions may prove to be inaccurate. Accordingly, our actual results could differ materially from our medium-term financial objectives as described above. Our medium-term financial objectives do not constitute guidance. Our medium-term financial objectives are forward-looking non-IFRS financial measures and additional information is provided in this MD&A under the heading Forward-looking Statements – Medium-Term Financial Objectives.

<sup>(1)</sup> Underlying EPS, underlying ROE, and the dividend payout ratio are non-GAAP financial measures. See Non-IFRS Financial Measures. The dividend payout ratio represents the ratio of common shareholders' dividends to underlying net income. See Capital and Liquidity Management – Shareholder Dividends section in this MD&A for further information regarding dividends.

## Financial Highlights

(\$ millions, unless otherwise noted)	2016	2015	2014
<b>Net income (loss)</b>			
Reported net income (loss)	2,485	2,185	1,762
Operating net income (loss) <sup>(1)</sup>	2,487	2,253	1,920
Underlying net income (loss) <sup>(1)</sup>	2,335	2,305	1,816
<b>Diluted EPS (\$)</b>			
Reported EPS (diluted)	4.03	3.55	2.86
Operating EPS (diluted) <sup>(1)</sup>	4.05	3.68	3.13
Underlying EPS (diluted) <sup>(1)</sup>	3.80	3.76	2.96
Reported basic EPS (\$)	4.05	3.57	2.88
<b>Dividends per common share</b>	1.62	1.51	1.44
Dividend payout ratio based on reported net income <sup>(2)</sup>	40%	43%	50%
Dividend payout ratio based on underlying net income <sup>(1)(2)</sup>	43%	40%	49%
Dividend yield <sup>(3)</sup>	3.7%	3.6%	3.7%
MCCSR ratio <sup>(4)</sup>	226%	240%	217%
<b>Return on equity (%)</b>			
Reported ROE	13.0%	12.2%	11.2%
Operating ROE <sup>(1)</sup>	13.0%	12.6%	12.2%
Underlying ROE <sup>(1)</sup>	12.2%	12.8%	11.6%
<b>Premiums and deposits</b>			
Net premium revenue	15,048	10,395	9,996
Segregated fund deposits	11,550	12,047	9,249
Mutual fund sales <sup>(1)</sup>	84,728	76,551	66,619
Managed fund sales <sup>(1)(5)</sup>	40,270	30,079	29,868
ASO premium and deposit equivalents <sup>(1)</sup>	6,863	7,078	6,748
Total premiums and deposits <sup>(1)(5)</sup>	158,459	136,150	122,480
<b>Assets under management</b>			
General fund assets	161,071	155,413	139,419
Segregated fund assets	97,167	91,440	83,938
Mutual fund assets <sup>(1)</sup>	307,937	296,438	240,397
Managed fund assets and other AUM <sup>(1)</sup>	337,100	348,041	270,688
Total AUM <sup>(1)</sup>	903,275	891,332	734,442
<b>Capital</b>			
Subordinated debt and innovative capital instruments <sup>(6)</sup>	4,534	3,189	2,865
Participating policyholders' equity	412	168	141
Total shareholders' equity	21,956	21,250	18,731
Total capital	26,902	24,607	21,737

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

(2) See Capital and Liquidity Management – Shareholder Dividends section in this MD&A for further information regarding dividends.

(3) Dividend yield is calculated on dividends per common share paid divided by the daily annual average share price for the applicable period.

(4) MCCSR ratio of Sun Life Assurance.

(5) During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Managed fund sales were previously reported as \$31,079 million in 2015. For additional information, see Financial Performance – Sales.

(6) Innovative capital instruments consist of SLEECs which qualify as capital for Canadian regulatory purposes. For additional information, see the section in this MD&A under the heading Capital and Liquidity Management – Capital.

## Non-IFRS Financial Measures

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We report certain financial information using non-IFRS financial measures, as we believe that these measures provide information that is useful to investors in understanding our performance and facilitate a comparison of our quarterly and full year results from period to period. These non-IFRS financial measures do not have any standardized meaning and may not be comparable with similar measures used by other companies. For certain non-IFRS financial measures, there are no directly comparable amounts under IFRS. These non-IFRS financial measures should not be viewed as alternatives to measures of financial performance determined in accordance with IFRS. Additional information concerning these non-IFRS financial measures and reconciliations to the closest IFRS measures are included in the Supplementary Financial Information packages that are available on [www.sunlife.com](http://www.sunlife.com) under Investors – Financial results & reports.

Operating net income (loss) and financial measures based on operating net income (loss), consisting of operating EPS or operating loss per share, and operating ROE, are non-IFRS financial measures. Operating net income (loss) excludes from reported net income the impact of the following amounts that when adjusted, enable our investors to better assess the underlying performance of our businesses: (i) certain hedges in SLF Canada that do not qualify for hedge accounting – this adjustment enhances the comparability of our net income from period to period, as it reduces volatility to the extent it will be offset over the duration of the hedges; (ii) fair value adjustments on MFS's share-based payment awards, that are settled with MFS's own shares and accounted for as liabilities and measured at fair value each reporting period until they are vested, exercised and repurchased – this adjustment enhances the comparability of MFS's results with publicly traded asset managers in the United States; (iii) acquisition, integration and restructuring amounts (including impacts related to acquiring and integrating acquisitions); (iv) goodwill and intangible asset impairment charges; and (v) other items that are not operational or ongoing in nature (e.g., gain or loss on disposal of businesses). Operating EPS also excludes the dilutive impact of convertible instruments.

Underlying net income (loss) and financial measures based on underlying net income (loss), consisting of underlying EPS or underlying loss per share, and underlying ROE, are non-IFRS financial measures. Underlying net income (loss) removes from operating net income (loss) the impact of the following items that create volatility in our results under IFRS, and when removed assist in explaining our results from period to period: (a) market related impacts; (b) assumption changes and management actions; and (c) other items that have not been treated as adjustments to operating net income, and when removed assist in explaining our results from period to period. Market related impacts include: (i) the impact of changes in interest rates that differ from our best estimate assumptions in the reporting period and on the value of derivative instruments used in our hedging programs, including changes in credit and swap spreads, and any changes to the assumed fixed income reinvestment rates in determining the actuarial liabilities; (ii) the impact of returns in equity markets, net of hedging, above or below our best estimate assumptions of approximately 2% per quarter in the reporting period and of basis risk inherent in our hedging program for products that provide benefit guarantees; and (iii) the impact of changes in the fair value of real estate properties in the reporting period. Additional information regarding these adjustments is available in the footnotes to the table included under the heading 2016 Consolidated Results of Operations in the Financial Performance section in this document. Assumption changes reflect the impact of revisions to the assumptions used in determining our liabilities for insurance contracts and investment contracts. The impact for insurance contracts and investment contracts of actions taken by management in the current reporting period, referred to as management actions include, for example, changes in the prices of in-force products, new or revised reinsurance on in-force business, and material changes to investment policies for assets supporting our liabilities. Underlying EPS also excludes the dilutive impact of convertible instruments.

Unless indicated otherwise, all factors discussed in this document that impact our results are applicable to reported net income (loss), operating net income (loss) and underlying net income (loss).

All EPS measures in this document refer to fully diluted EPS, unless otherwise stated. As noted above, operating EPS and underlying EPS exclude the dilutive impact of convertible instruments.

The following tables set out the amounts that were excluded from our operating net income (loss), underlying net income (loss) operating EPS and underlying EPS, and provide a reconciliation to our reported net income (loss) and reported EPS based on IFRS for 2016, 2015 and 2014. A reconciliation of our operating net income (loss) and underlying net income (loss) to our reported net income (loss) for the fourth quarters of 2016 and 2015 is provided in this MD&A under the heading Financial Performance – Fourth Quarter 2016 Performance.

## Reconciliation of Select Net Income Measures

(\$ millions, unless otherwise noted)

	2016	2015	2014
Reported net income	2,485	2,185	1,762
Certain hedges in SLF Canada that do not qualify for hedge accounting	(5)	21	(7)
Fair value adjustments on MFS's share-based payment awards	30	(9)	(125)
Acquisition, integration and restructuring	(27)	(80)	(26)
Total operating net income adjustments	(2)	(68)	(158)
Operating net income	2,487	2,253	1,920
Equity market impact	51	(128)	44
Interest rate impact	34	65	(179)
Increases (decreases) from changes in the fair value of real estate	22	20	12
Market related impacts	107	(43)	(123)
Assumption changes and management actions	45	(9)	227
Total underlying net income adjustments	152	(52)	104
Underlying net income	2,335	2,305	1,816
Reported EPS (diluted) (\$)	4.03	3.55	2.86
Certain hedges in SLF Canada that do not qualify for hedge accounting (\$)	(0.01)	0.03	(0.01)
Fair value adjustments on MFS's share-based payment awards (\$)	0.05	(0.01)	(0.21)
Acquisition, integration and restructuring (\$)	(0.04)	(0.13)	(0.04)
Impact of convertible securities on diluted EPS (\$)	(0.02)	(0.02)	(0.01)
Operating EPS (diluted) (\$)	4.05	3.68	3.13
Market related impacts (\$)	0.18	(0.07)	(0.20)
Assumption changes and management actions (\$)	0.07	(0.01)	0.37
Underlying EPS (diluted) (\$)	3.80	3.76	2.96

The following table shows the pre-tax amount of operating net income and underlying net income adjustments:

	2016	2015	2014
Reported net income (after tax)	2,485	2,185	1,762
Operating and underlying net income adjustments (pre-tax):			
Operating net income adjustments	(40)	(85)	(194)
Market related impacts	67	9	(180)
Assumption changes and management actions	10	(54)	277
Total operating and underlying net income adjustments (pre-tax)	37	(130)	(97)
Tax related to operating and underlying net income adjustments	113	10	43
Underlying net income (after tax)	2,335	2,305	1,816

Tax related to operating and underlying net income adjustments may vary from the expected effective tax rate range reflecting the mix of business based on the Company's international operations. The aggregate tax effect depends on whether the operating and underlying adjustment increases and reductions to pre-tax income occurred in high or low tax jurisdictions.

Management also uses the following non-IFRS financial measures:

**Return on equity.** IFRS does not prescribe the calculation of ROE and therefore a comparable measure under IFRS is not available. To determine reported ROE, operating ROE and underlying ROE, respectively, reported net income (loss), operating net income (loss) and underlying net income (loss) are divided by the total weighted average common shareholders' equity for the period.

**Adjusted revenue.** This measure is an alternative measure of revenue that provides greater comparability across reporting periods, by excluding the impact of: (i) exchange rate fluctuations, from the translation of functional currencies to the Canadian dollar, for comparisons ("Constant Currency Adjustment"); (ii) Fair value and foreign currency changes on assets and liabilities ("FV Adjustment"); and (iii) reinsurance for the insured business in SLF Canada's GB operations ("Reinsurance in SLF Canada's GB Operations Adjustment").

	2016	2015	2014
Revenues	28,573	19,274	25,764
Constant Currency Adjustment	432	—	(1,666)
FV Adjustment	2,233	(1,961)	6,172
Reinsurance in SLF Canada's GB Operations Adjustment	(2,758)	(4,684)	(4,565)
Adjusted revenue	28,666	25,919	25,823

**Adjusted premiums and deposits.** This measure is an alternative measure of premiums and deposits that provides greater comparability across reporting periods by excluding the impact of: (i) the Constant Currency Adjustment and (ii) the Reinsurance in SLF Canada's GB Operations Adjustment.

(\$ millions)	2016	2015	2014
Premiums and deposits <sup>(1)</sup>	158,459	136,150	122,480
Constant Currency Adjustment	4,355	–	(15,967)
Reinsurance in SLF Canada's GB Operations Adjustment	(2,758)	(4,684)	(4,565)
Adjusted premiums and deposits	156,862	140,834	143,012

(1) During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Prior periods have been restated to reflect this change.

**MFS pre-tax operating profit margin ratio.** This ratio is a measure of the profitability of MFS, which excludes the impact of fair value adjustments on MFS's share-based payment awards, investment income, and certain commission expenses that are offsetting. These amounts are excluded in order to neutralize the impact these items have on the pre-tax operating profit margin ratio and have no impact on the profitability of MFS. There is no directly comparable IFRS measure.

**Assumption changes and management actions.** In this MD&A, the impact of assumption changes and management actions on shareholders' net income (after-tax) is included in reported net income and operating net income and is excluded in calculating underlying net income, as described in this MD&A under the heading Financial Performance – 2016 Consolidated Results of Operations – Net Income.

Note 10.A of our Annual Consolidated Financial Statements shows the pre-tax impact of method and assumption changes on shareholder and participating policyholder Insurance Contract Liabilities net of reinsurance assets, excluding changes in other policy liabilities and assets.

The MD&A view of assumption changes and management actions is the impact on shareholders' net income (after tax). The Annual Consolidated Financial Statement view is a component of the change in total company liabilities. The following table provides a reconciliation of the differences between the two measures:

(\$ millions)	2016	2015 <sup>(7)</sup>
Impact of method and assumption changes on Insurance Contract Liabilities (pre-tax) <sup>(1)</sup>	(35)	(311)
Less: Participating Policyholders <sup>(2)</sup>	181	30
Add: Management Actions <sup>(3)</sup>	234	248
Other <sup>(4)</sup>	(8)	(2)
Assumption changes and management actions (pre-tax)	10	(95)
Less: Tax <sup>(5)</sup>	(35)	(45)
Assumption changes and management actions (after-tax) <sup>(6)</sup>	45	(50)

(1) Note 10.A of our Annual Consolidated Financial Statements shows the pre-tax impact of method and assumption changes on shareholder and participating policyholder Insurance contract liabilities net of reinsurance assets, excluding changes in other policy liabilities and assets. The amount shown in the table above is the income impact related to the amount shown in Note 10.A of our Annual Consolidated Financial Statements.

(2) Adjustment to remove the pre-tax impact of method and assumption changes on amounts attributed to participating policyholders.

(3) Adjustment to include the pre-tax impact of management actions on insurance contract liabilities and investment contract liabilities which include, for example, changes in the prices of in-force products, new or revised reinsurance on in-force business, and material changes to investment policies for assets supporting our liabilities.

(4) Adjustments to include the pre-tax impact of method and assumption changes on investment contracts and other policy liabilities.

(5) The tax impacts of assumption changes and management actions on insurance contract liabilities and investment contract liabilities, reflecting the effective tax rates in the jurisdictions in which we do business.

(6) Assumption changes and management actions is included in reported net income and operating net income and is excluded in calculating underlying net income, as described in this MD&A under the heading Financial Performance – 2016 Consolidated Results of Operations – Net Income.

(7) The impact to operating net income was a decrease of \$9 million, which is presented as an adjustment to arrive at underlying net income. \$41 million related to the SLF U.S. International wealth business recorded in Management Actions in the table above was included in the adjustment to operating net income.

**Impact of foreign exchange.** Several financial measures are presented on a constant currency adjusted basis to exclude the impact of foreign exchange rate fluctuations. These measures are calculated using the average or period end foreign exchange rates, as appropriate, in effect at the date of the comparative period.

**Real estate market sensitivities.** Real estate market sensitivities are non-IFRS financial measures, for which there are no directly comparable measures under IFRS so it is not possible to provide a reconciliation of these amounts to the most directly comparable IFRS measures.

**Other.** Management also uses the following non-IFRS financial measures for which there are no comparable financial measures in IFRS: (i) ASO premium and deposit equivalents, mutual fund sales, managed fund sales, life and health sales, and total premiums and deposits; (ii) AUM, mutual fund assets, managed fund assets, other AUM and assets under administration; (iii) effective income tax rates on an operating net income and underlying net income basis; (iv) the value of new business, which is used to measure the estimated lifetime profitability of new sales and is based on actuarial calculations; and (v) Sources of earnings is an alternative presentation of our Consolidated Statements of Operations that identifies and quantifies various sources of income. The Company is required to disclose its sources of earnings by its principal regulator, OSFI; (vi) dividend payout based on underlying net income.

# Financial Performance

## 2016 Consolidated Results of Operations

Unless indicated otherwise, all factors discussed in this document that impact our results are applicable to reported net income (loss), operating net income (loss) and underlying net income (loss).

### Net Income

Our reported net income was \$2,485 million for 2016, compared to \$2,185 million in 2015. Operating net income was \$2,487 million for 2016, compared to \$2,253 million in 2015. Underlying net income was \$2,335 million, compared to \$2,305 million in 2015.

The following table reconciles our net income measures and sets out the impact that other notable items had on our net income in 2016 and 2015.

(\$ millions, after-tax)	2016	2015
<b>Reported net income</b>	<b>2,485</b>	2,185
Certain hedges in SLF Canada that do not qualify for hedge accounting	(5)	21
Fair value adjustments on MFS's share-based payment awards	30	(9)
Acquisition, integration and restructuring <sup>(1)</sup>	(27)	(80)
<b>Operating net income<sup>(2)</sup></b>	<b>2,487</b>	2,253
Equity market impact		
Impact from equity market changes	62	(99)
Basis risk impact	(11)	(29)
Equity market impact <sup>(3)</sup>	51	(128)
Interest rate impact		
Impact from interest rate changes	45	3
Impact of credit spread movements	(41)	33
Impact of swap spread movements	30	29
Interest rate impact <sup>(4)</sup>	34	65
Increases (decreases) from changes in the fair value of real estate	22	20
Market related impacts	107	(43)
Assumption changes and management actions	45	(9)
<b>Underlying net income<sup>(2)</sup></b>	<b>2,335</b>	2,305
<b>Impact of other notable items on our net income:</b>		
Experience related items <sup>(5)</sup>		
Impact of investment activity on insurance contract liabilities	154	164
Mortality	(14)	29
Morbidity	(23)	–
Credit	64	72
Lapse and other policyholder behaviour	(11)	(14)
Expenses	(124)	(86)
Other	39	2

(1) In 2016, Acquisition, integration and restructuring amounts primarily related to integration costs of the U.S. employee benefits business acquisition in 2016, and the integration of Bentall Kennedy and Ryan Labs acquired in 2015. These costs were partially offset by a non-cash gain of \$37 million as a result of both remeasuring our existing investment to fair value upon acquiring control over the operations of Sun Life Vietnam Insurance Company Limited and remeasuring our existing investment to fair value upon acquiring control over the operations of PT CIMB Sun Life in Indonesia, which was partially offset by acquisition and integration costs. In 2015, Acquisition, integration and restructuring amounts consisted of \$63 million related to the closing of our wealth business in SLF U.S. International to new sales, which included assumption changes and management actions of \$41 million to reflect assumption updates including the expense strengthening associated with closing the business, and \$17 million related to our acquisitions and integrations of Bentall Kennedy, Prime Advisors Inc. ("Prime Advisors"), and Ryan Labs as well as acquisition costs related to the U.S. employee benefits business acquired in 2016.

(2) Represents a non-IFRS financial measure. See section under the heading Non-IFRS Financial Measures in this MD&A.

(3) Equity market impact consists primarily of the effect of returns in equity markets during the period, net of hedging, that differ from the best estimate assumptions used in the determination of our insurance contract liabilities of approximately 2% per quarter. Equity market impact also includes the income impact of the basis risk inherent in our hedging program, which is the difference between the return on underlying funds of products that provide benefit guarantees and the return on the derivative assets used to hedge those benefit guarantees.

(4) Interest rate impact includes the effect of interest rate changes that differ from best estimate assumptions and on the value of derivative instruments used in our hedging programs. Our exposure to interest rates varies by product type, line of business and geography. Given the long-term nature of our business, we have a higher degree of sensitivity in respect of interest rates at long durations. Interest rate impact also includes the income impact of changes in assumed fixed income reinvestment rates and of credit and swap spread movements.

(5) Experience related items reflect the difference between actual experience during the reporting period and best estimate assumptions used in the determination of our insurance contract liabilities.

Our reported net income for 2016 and 2015 included items that we believe are not operational in nature and which are, therefore, excluded in our calculation of operating net income. Operating net income for 2016 and 2015 excluded the net impact of certain hedges in SLF Canada that do not qualify for hedge accounting, fair value adjustments on MFS's share-based payment awards, and acquisition, integration and restructuring amounts. The net impact of these items reduced reported net income by \$2 million in 2016, compared to a reduction of \$68 million in 2015.

Our underlying net income for 2016 and 2015 excludes market related impacts and assumption changes and management actions. The net impact of market related impacts and assumption changes and management actions increased operating net income by \$152 million in 2016, compared to a decrease of \$52 million in the same period in 2015. Interest rates experience in the fourth quarter of 2016 reflects gains from large increases in long-term rates without similar increases in short-term rates, favourable impacts from rebalancing of hedges, and changes in the positioning of the asset portfolio as rates increased during the quarter.

Net income in 2016 also reflected gains from investment activities on insurance contract liabilities and positive credit experience, partially offset by unfavourable expense experience, reflecting incentive compensation costs arising from overall strong business performance and investment in growing our businesses, and unfavourable morbidity experience mainly in the U.S.

Net income in 2015 also reflected favourable impact from investment activity on insurance contract liabilities, positive credit and mortality experience, partially offset by unfavourable expense experience including investment in growing our businesses and lapse and other policyholder behaviour.

## Assets Under Management

AUM consist of general funds, segregated funds and other AUM. Other AUM includes mutual funds and managed funds, which include institutional and other third-party assets managed by the Company.

AUM were \$903.3 billion as at December 31, 2016, compared to AUM of \$891.3 billion as at December 31, 2015. The increase in AUM of \$12.0 billion between December 31, 2016 and December 31, 2015 resulted primarily from:

- (i) favourable market movements on the value of mutual funds, managed funds, and segregated funds of \$40.8 billion;
- (ii) business growth and activity of \$6.4 billion;
- (iii) an increase of \$2.2 billion from the change in value of FVTPL assets and liabilities; and
- (iv) the impact of the U.S. employee benefits business acquired in 2016 of \$2.4 billion; partially offset by
- (v) a decrease of \$25.5 billion from the strengthening of the Canadian dollar relative to exchange rates at the end of the fourth quarter of 2015;
- (vi) a decrease of \$9.0 billion from a reduction of assets related to a Bentall Kennedy Client<sup>(1)</sup>; and
- (vii) net outflow of mutual, managed, and segregated funds of \$5.3 billion.

General fund assets were \$161.1 billion at December 31, 2016, up \$5.7 billion from December 31, 2015. The increase in general fund assets was primarily attributable to:

- (i) business growth and activity of \$5.4 billion;
- (ii) the impact of the U.S. employee benefits business acquired in 2016 of \$2.4 billion; and
- (iii) an increase of \$2.2 billion from the change in value of FVTPL assets and liabilities; partially offset by
- (iv) a decrease of \$4.3 billion from a strengthening Canadian dollar against foreign currencies compared to the prior period exchange rates.

Segregated fund assets were \$97.2 billion as at December 31, 2016, compared to \$91.4 billion as at December 31, 2015. The increase in segregated fund assets was primarily due to favourable market movement of \$6.3 billion, net sales of \$2.0 billion, business growth and activity of \$0.2 billion, partially offset by the currency impact from the strengthening Canadian dollar of \$2.7 billion.

Mutual funds, managed funds and other AUM increased to \$645.0 billion, \$0.6 billion higher than as at December 31, 2015. The increase was mainly driven by favourable market movement of \$34.5 billion, business growth and activity of \$0.9 billion, partially offset by \$18.5 billion of currency impact from the strengthening Canadian dollar, net outflows of \$7.3 billion and a decrease of \$9.0 billion from a reduction of assets related to a Bentall Kennedy Client.

## Changes in Liabilities and Shareholders' Equity

Insurance contract liabilities balances before Other policy liabilities and assets of \$108.4 billion as at December 31, 2016 increased by \$4.7 billion compared to December 31, 2015, mainly due to balances arising from new policies, changes in balances on in-force policies (which include fair value changes on FVTPL assets supporting insurance contract liabilities), and the U.S. employee benefits business acquired in 2016, partially offset by the currency impact of the strengthening of the Canadian dollar relative to exchange rates at December 31, 2015.

Shareholders' equity, including preferred share capital, was \$22.0 billion as at December 31, 2016, compared to \$21.3 billion as at December 31, 2015. The \$0.7 billion increase in shareholders' equity was primarily due to:

- (i) shareholders' net income of \$2.6 billion in 2015, before preferred share dividends of \$96 million; and
- (ii) \$39 million from stock options exercised and \$4 million from stock-based compensation; partially offset by
- (iii) common share dividend payments of \$986 million;
- (iv) a decrease of \$634 million from the strengthening of the Canadian dollar relative to exchange rates at the end of the fourth quarter of 2015;
- (v) a decrease of \$76 million from other comprehensive income ("OCI") of joint ventures and associates;
- (vi) changes in liabilities for defined benefit plans of \$73 million;
- (vii) \$30 million related to the acquisition of non-controlling interests in Sun Life Vietnam; and
- (viii) net unrealized losses on AFS assets in OCI of \$14 million.

(1) During the second quarter of 2016, a Client of Bentall Kennedy exercised its right to acquire certain wholly-owned subsidiaries involved in the management of its assets. The transfer of the assets is expected to be completed in the first quarter of 2017, and from June 30, 2016, assets of \$9 billion related to this are not reported in AUM.

## Revenue

Revenue includes: (i) premiums received on life and health insurance policies and fixed annuity products, net of premiums ceded to reinsurers; (ii) net investment income comprised of income earned on general fund assets, realized gains and losses on AFS assets and changes in the value of derivative instruments and assets designated as FVTPL and currency changes on assets and liabilities; and (iii) fee income received for services provided. Premium and deposit equivalents from ASO, as well as deposits received by the Company on investment contracts such as segregated funds, mutual funds and managed funds are not included in revenue; however, the Company does receive fee income from these contracts, which is included in revenue. Fee income and ASO premium and deposit equivalents are an important part of our business and as a result, revenue does not fully represent sales and other activity taking place during the respective periods.

Net investment income can experience volatility arising from the quarterly fluctuation in the value of FVTPL assets and foreign currency changes on assets and liabilities, which may in turn affect the comparability of revenue from period to period. The change in fair value of FVTPL assets is driven largely by market related factors such as interest rates, credit spreads and equity returns. The debt and equity securities that support insurance contract liabilities are designated as FVTPL and changes in fair values of these assets are recorded in net investment income in our Consolidated Statements of Operations. Changes in the fair values of the FVTPL assets supporting insurance contract liabilities are largely offset by a corresponding change in the liabilities.

Revenue (\$ millions)	2016	2015	2014
<b>Premiums</b>			
Gross			
Life insurance	8,894	7,462	7,003
Health insurance	7,909	6,474	5,916
Annuities	2,624	2,888	2,580
	<b>19,427</b>	16,824	15,499
Ceded			
Life insurance	(1,772)	(1,962)	(1,698)
Health insurance	(2,247)	(4,093)	(3,803)
Annuities	(360)	(374)	(2)
	<b>(4,379)</b>	(6,429)	(5,503)
<b>Net premiums</b>	<b>15,048</b>	10,395	9,996
<b>Net investment income (loss)</b>			
Interest and other investment income	5,489	5,288	4,941
Fair value and foreign currency changes on assets and liabilities	2,233	(1,961)	6,172
Net gains (losses) on AFS assets	223	228	202
<b>Net investment income (loss)</b>	<b>7,945</b>	3,555	11,315
<b>Fee income</b>	<b>5,580</b>	5,324	4,453
<b>Total revenue</b>	<b>28,573</b>	19,274	25,764
<b>Adjusted revenue<sup>(1)</sup></b>	<b>28,666</b>	25,919	25,823

(1) Represents a non-IFRS financial measure that adjusts revenue for the impact of Constant Currency Adjustment, FV Adjustment, and Reinsurance in SLF Canada's GB Operations Adjustment as described in Non-IFRS Financial Measures.

Revenue of \$28.6 billion in 2016 was up \$9.3 billion from revenue of \$19.3 billion in 2015. The increase was primarily driven by increases in the fair value of FVTPL assets primarily due to decline in credit spreads, the partial recapture of a reinsurance agreement in GB in SLF Canada in 2016, higher net premium revenue in SLF U.S. and SLF Asia, and currency impact from the change in the Canadian dollar. The weakening of the Canadian dollar relative to average exchange rates in 2015 increased revenue by \$0.4 billion. Adjusted revenue in 2016 was \$28.7 billion, an increase of \$2.8 billion from 2015. The increase in adjusted revenue was primarily attributable to higher net premium revenue in SLF U.S., SLF Asia and SLF Canada.

Gross premiums were \$19.4 billion in 2016, up from \$16.8 billion in 2015. The increase of \$2.6 billion in gross premiums was primarily driven by increases in GB in SLF U.S., Individual Insurance and GB in SLF Canada, Hong Kong in SLF Asia, and currency impact from the weakening Canadian dollar, partially offset by decreases in GRS in SLF Canada.

Ceded premiums in 2016 were \$4.4 billion, compared to \$6.4 billion from 2015. The decrease of \$2.0 billion was primarily attributable to the impact of the partial recapture of a reinsurance agreement in GB in SLF Canada effective the first quarter of 2016 and a reinsurance agreement in Run-off Reinsurance we entered into during the third quarter of 2015. The impact of the ceded premiums was largely offset in recovered claims and benefits that were recorded as reinsurance recoveries in our Consolidated Statements of Operations.

Net investment income in 2016 was \$7.9 billion, up \$4.3 billion from \$3.6 billion in 2015. The increase in net investment income was primarily due to increases in the fair value of FVTPL assets compared to net losses in the prior year, across the Company.

Fee income was \$5.6 billion in 2016, compared to \$5.3 billion in 2015. The increase was driven by increased fee income in SLIM, SLF Canada, SLF Asia and SLF U.S., and currency impact from the weakening Canadian dollar.

## Premiums and Deposits

Premiums and deposits were \$158.5 billion in 2016, compared to \$136.2 billion in 2015, primarily attributable to higher fund sales, currency impact of \$4.4 billion from the change in the Canadian dollar, and increased net premium revenue, partially offset by lower segregated fund deposits and ASO premium and deposit equivalents. Adjusted premiums and deposits of \$156.9 billion in 2016 increased \$16.1 billion compared to 2015. The increase was largely driven by higher fund sales and net premium revenue, partially offset by decreased segregated fund deposits and ASO premium and deposit equivalents.

(\$ millions)	2016	2015	2014
<b>Premiums and Deposits</b>			
Net premium revenue	15,048	10,395	9,996
Segregated fund deposits	11,550	12,047	9,249
Mutual fund sales <sup>(1)</sup>	84,728	76,551	66,619
Managed fund sales <sup>(1)(2)</sup>	40,270	30,079	29,868
ASO premium and deposit equivalents <sup>(1)</sup>	6,863	7,078	6,748
<b>Total premiums and deposits<sup>(1)</sup></b>	<b>158,459</b>	136,150	122,480
<b>Adjusted premiums and deposits<sup>(1)(3)</sup></b>	<b>156,862</b>	140,834	143,012

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

(2) During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Managed fund sales were previously reported as \$31,079 million in 2015. For additional information, see Financial Performance – Sales.

(3) Represents a non-IFRS financial measure that adjusts premiums and deposits for the impact of Constant Currency Adjustment and Reinsurance in SLF Canada's GB Operations Adjustment as described in Non-IFRS Financial Measures.

Net life, health and annuity premiums were \$15.0 billion in 2016, up \$4.6 billion from 2015. The weakening of the Canadian dollar relative to average exchange rates in 2015 increased net premiums by \$248 million.

Segregated fund deposits were \$11.6 billion in 2016, compared to \$12.0 billion in 2015. The change was largely attributable to decrease in GRS in SLF Canada, partially offset by increase in individual wealth in SLF Canada.

Sales of mutual funds were \$84.7 billion in 2016, compared to \$76.6 billion in 2015, mainly driven by increased fund sales in MFS, currency impact from the change in the Canadian dollar, and higher fund sales from India and the Philippines in SLF Asia and SLGI in SLF Canada. The change of the Canadian dollar relative to average exchange rates in 2015 increased mutual fund sales by \$2.7 billion.

Sales of managed funds were \$40.3 billion in 2016, up \$10.2 billion from \$30.1 billion in 2015, primarily reflecting the acquisitions in SLIM in 2015, increased fund sales in MFS, currency impact from the change in the Canadian dollar, and higher sales in SLF Asia. The change of the Canadian dollar relative to average exchange rates in 2015 increased managed fund sales by \$1.4 billion.

ASO premium and deposit equivalents for 2016 decreased \$0.2 billion from 2015, primarily attributable to decreases in Hong Kong in SLF Asia and GRS in SLF Canada, partially offset by increase in GB in SLF Canada.

## Sales

In SLF Canada, life and health sales consist of sales of individual insurance and group benefits products; wealth sales consist of sales of individual wealth products and sales in GRS. In SLF U.S., life and health sales consist of sales by Group Benefits and individual life sales by International. In SLF Asia, life and health sales consist of the individual and group life and health sales from subsidiaries, joint ventures and associates based on our proportionate equity interest in the Philippines, Hong Kong, Indonesia, Vietnam, India, China, and Malaysia; wealth sales consist of Hong Kong wealth sales, Philippines mutual fund sales, wealth sales from the India and China insurance companies, and Birla Sun Life Asset Management Company's equity and fixed income mutual fund sales based on our proportionate equity interest. SLF Asset Management sales<sup>(1)</sup> consist of gross sales (inflows) for retail and institutional Clients; unfunded commitments are not included in sales.

(\$ millions)	2016	2015	2014
<b>Life and health sales<sup>(2)</sup></b>			
SLF Canada	950	836	843
SLF U.S.	1,148	801	774
SLF Asia	660	535	451
<b>Total life and health sales</b>	<b>2,758</b>	2,172	2,068
<b>Wealth sales<sup>(2)(3)</sup></b>			
SLF Canada <sup>(4)</sup>	13,200	14,621	13,791
SLF Asia	8,849	7,070	5,648
<b>Total wealth sales excluding SLF Asset Management</b>	<b>22,049</b>	21,691	19,439
SLF Asset Management sales <sup>(1)(2)</sup>	116,270	99,523	91,112
<b>Total wealth sales</b>	<b>138,319</b>	121,214	110,551
<b>Large case longevity insurance sale<sup>(2)(5)</sup> - SLF Canada</b>	<b>-</b>	5,260	-

(1) During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Gross sales for SLF Asset Management were previously reported as \$100,523 million in 2015. Gross and net sales for prior periods have been conformed to this approach. Revenue and other IFRS financial measures were not impacted.

(2) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

(3) Wealth sales exclude investment product sales of \$569 million in 2015 and \$935 million in 2014 in SLF U.S.'s International wealth business, which was closed to new sales in December 2015.

(4) In 2014, SLF Canada wealth sales included sales from Sun Life Institutional Investments (Canada) Inc. of \$25 million.

(5) Represents the transfer of longevity risk of BCE Inc.'s Bell Canada pension plan.

Total Company life and health sales were \$2,758 million in 2016, compared to \$2,172 million in 2015.

- SLF Canada life and health sales were \$950 million in 2016, compared to \$836 million in 2015, primarily due to higher sales in Individual Insurance & Wealth, partially offset by decreased sales in GB.
- SLF U.S. life and health sales were \$1,148 million in 2016, up \$347 million from 2015, largely driven by the U.S. employee benefits business acquisition in 2016, higher sales in Group Benefits, and currency impact of \$41 million from the weakening Canadian dollar.
- SLF Asia life and health sales were \$660 million in 2016, compared to \$535 million in 2015, mainly reflecting strong sales growth in Hong Kong, Malaysia, Indonesia, the Philippines and increased ownership in our businesses in India, Indonesia and Vietnam, partially offset by lower sales in China.

Total Company wealth sales were \$138.3 billion in 2016, compared to \$121.2 billion in 2015.

- SLF Canada wealth sales were \$13.2 billion in 2016, compared to \$14.6 billion in 2015, reflecting lower sales in GRS.
- SLF Asia wealth sales were \$8.8 billion in 2016, up \$1.7 billion compared to 2015, primarily driven by increased fund sales in India, higher individual wealth sales in China, growth in the MPF sales in Hong Kong and mutual fund sales in the Philippines.
- SLF Asset Management sales were \$116.3 billion in 2016, increased \$16.8 billion compared to 2015, largely due to higher fund sales from MFS, and organic growth and contribution from 2015 acquisitions in SLIM, and currency impact of \$4.1 billion from the weakening Canadian dollar.

## Benefits and Expenses

Total benefits and expenses were \$25.1 billion in 2016, up \$8.7 billion from \$16.4 billion in 2015.

(\$ millions)	2016	2015
<b>Benefits and Expenses</b>		
Gross claims and benefits paid	15,210	14,086
Changes in insurance/investment contract liabilities and reinsurance assets (net of reinsurance recoveries) <sup>(1)</sup>	1,198	(5,419)
Commissions	2,372	2,100
Operating expenses	6,000	5,037
Other <sup>(2)</sup>	348	571
<b>Total benefits and expenses</b>	<b>25,128</b>	16,375

(1) Includes increase (decrease) in insurance contract liabilities, decrease (increase) in reinsurance assets, increase (decrease) in investment contract liabilities, and reinsurance expenses (recoveries).

(2) Other includes net transfer to (from) segregated funds, premium taxes and interest expense.

Gross claims and benefits paid in 2016 were \$15.2 billion, up \$1.1 billion from 2015 primarily as a result of the acquisition of the U.S. employee benefits business in 2016, currency impact from the weakening Canadian dollar, and increases in GRS and GB in SLF Canada.

Changes in insurance/investment contract liabilities and reinsurance assets (net of recoveries) of \$1.2 billion, increased by \$6.6 billion over 2015. The change was primarily attributable to an increase in the fair value of assets supporting insurance contract liabilities as well as the impact of the partial recapture of a reinsurance agreement in GB in SLF Canada effective the first quarter of 2016.

Commission expenses of \$2.4 billion in 2016 were up \$0.3 billion from 2015. The increase was mainly attributable to increased commission expenses from the acquisition of the U.S. employee benefits business in 2016, higher sales in Individual Insurance & Wealth in SLF Canada, Hong Kong, the Philippines and Indonesia in SLF Asia, and currency impact of \$49 million from the weakening Canadian dollar.

Operating expenses of \$6.0 billion in 2016 were \$1.0 billion higher than 2015. Expenses increased primarily as a result of the acquisition of the U.S. employee benefits business in 2016 and SLIM acquisitions in 2015, increases in SLF Canada, SLF Asia, and currency impact of \$111 million from the weakening of the Canadian dollar. Additional information on operating expenses can be found in Note 18 in our 2016 Annual Consolidated Financial Statements.

Other expenses of \$0.3 billion were down \$0.3 billion from 2015 primarily as a result of an increase in net transfers from segregated funds.

## Assumption Changes and Management Actions

Due to the long-term nature of our business, we make certain judgments involving assumptions and estimates to value our obligations to policyholders. The valuation of these obligations is recorded in our financial statements as insurance contract liabilities and investment contract liabilities and requires us to make assumptions about equity market performance, interest rates, asset default, mortality and morbidity rates, lapse and other policyholder behaviour, expenses and inflation and other factors over the life of our products. We review assumptions each year, generally in the third quarter, and revise these assumptions if appropriate. We consider our actual experience in current and past periods relative to our assumptions as part of our annual review.

During 2016, the net impact of assumption changes and management actions resulted in an increase of \$45 million to reported net income and operating net income, compared to a decrease of \$50 million to reported net income and a decrease of \$9 million to operating net income in 2015.

### Assumption Changes and Management Actions by Type

2016		Full year
(\$ millions, after-tax)	Impact on net income	Comments
Mortality/morbidity	29	Updates to reflect mortality/morbidity experience.
Lapse and other policyholder behaviour	(81)	Updates to reflect lapse and other policyholder behaviour experience, largely in SLF U.S. businesses that are closed to new sales.
Expenses	(21)	Updates to reflect expense studies.
Investment returns	140	Updates to various investment related assumptions across the Company, which had the most significant impact in SLF U.S. and SLF Canada. The largest items were favourable changes to projected credit and swap spreads, partially offset by changes to returns on non-fixed income assets. In addition, the updates included a reduction of the provision for investment risk in SLF Canada <sup>(2)</sup> .
Model enhancements and other	(22)	Various enhancements and methodology changes across all jurisdictions, partially offset by net changes to provisions for reinsurance in SLF U.S.
<b>Total impact of assumption changes and management actions on net income<sup>(1)</sup></b>	<b>45</b>	

(1) Assumption changes and management actions is included in reported net income and operating net income and is excluded in calculating underlying net income, as described in this MD&A under the heading Financial Performance – 2016 Consolidated Results of Operations – Net Income. Further information can also be found under the heading Non-IFRS Financial Measures.

(2) Net income attributable to participating policyholders also increased due to a reduction of the provision for investment risk in SLF Canada. For additional information, see Note 10.A in our 2016 Annual Consolidated Financial Statements.

Additional information on estimates relating to our policyholder obligations, including the methodology and assumptions used in their determination, can be found in this MD&A under the heading Accounting and Control Matters – Critical Accounting Policies and Estimates and in Note 10 in our 2016 Annual Consolidated Financial Statements.

## Goodwill and Intangibles Impairment

The Company completed its annual goodwill and indefinite life intangible asset impairment testing in the fourth quarter of 2016. There were no goodwill impairment charges in 2016 or 2015. No impairment charges on intangible assets were recognized in 2016. There were no significant impairment charges on intangible assets in 2015.

## Income Taxes

In 2016, we had an income tax expense of \$619 million on reported net income before taxes of \$3,445 million, which resulted in an effective income tax rate of 18.0%. This compares to an income tax expense of \$599 million on reported net income before taxes of \$2,899 million and an effective income tax rate of 20.7% in 2015.

On an operating basis<sup>(1)</sup>, in 2016, we had an income tax expense of \$578 million on our operating net income before taxes of \$3,206 million, representing an effective income tax rate of 18.0%. This compares to an income tax expense of \$629 million on operating net income before taxes of \$3,044 million and an effective income tax rate of 20.7% in 2015.

On an underlying basis<sup>(1)</sup>, in 2016, we had an income tax expense of \$653 million on our underlying net income before taxes of \$3,129 million, representing an effective income tax rate of 20.9%. This compares to an income tax expense of \$622 million on underlying net income before taxes of \$3,089 million and an effective income tax rate of 20.1% in 2015.

Our effective tax rate is normally reduced below the statutory rate of 26.75% by various tax benefits, such as lower taxes on income subject to tax in foreign jurisdictions, a range of tax exempt investment income and other sustainable tax benefits that are expected to decrease our effective tax rate to a range of 18% to 22%. The effective tax rate calculated on an operating basis excludes amounts attributable to participating policyholders and non-operating items.

In 2016, our effective income tax rate on all bases was favourably impacted by tax exempt investment income, higher profits in foreign jurisdictions with lower tax rates, as well as the resolution of various tax audits.

In 2015, the impacts of higher taxes on distributions from foreign subsidiaries and unrecognized tax losses were primarily offset by favourable adjustments to prior years, which resulted from resolution of tax audits and finalization of prior years' tax returns in various jurisdictions such that the effective tax rate on all bases was in the expected range.

In the fourth quarter of 2016, our effective tax rates on reported net income, operating net income<sup>(1)</sup> and underlying net income<sup>(1)</sup> were 19.5%, 20.5%, and 16.5% respectively.

## Other Taxes

In addition to income taxes, we pay various indirect taxes in jurisdictions in which we carry on business. Indirect taxes include premium taxes, investment income tax, payroll related taxes, property taxes, sales taxes, business taxes and other taxes, as follows:

(\$ millions)	2016	2015
Income tax expense	619	599
Indirect taxes		
Premium taxes (net of premium taxes on ceded business) <sup>(1)</sup>	312	264
Payroll taxes	154	128
Property taxes	134	125
Goods and services tax (GST), harmonized tax (HST) and other sales taxes	103	85
Business taxes and other	18	13
Total indirect taxes	721	615
Total taxes	1,340	1,214
Reported effective income tax rate	18%	20.7%
Total taxes as a percentage of net income before deduction of total taxes	32.2%	34.5%

(1) Premium taxes include investment income tax.

## Impact of Foreign Exchange Rates

We have operations in many markets worldwide, including Canada, the United States, the United Kingdom, Ireland, Hong Kong, the Philippines, Japan, Indonesia, India, China, Australia, Singapore, Vietnam, Malaysia and Bermuda, and generate revenues and incur expenses in local currencies in these jurisdictions, which are translated to Canadian dollars.

Items impacting our Consolidated Statements of Operations are translated into Canadian dollars using average exchange rates for the respective period. For items impacting our Consolidated Statements of Financial Position, period end rates are used for currency translation purposes. The following table provides the most relevant foreign exchange rates over the past five quarters and two years.

Exchange rate	Quarterly					Full year	
	Q4'16	Q3'16	Q2'16	Q1'16	Q4'15	2016	2015
Average							
U.S. Dollar	1.335	1.304	1.289	1.373	1.335	1.325	1.278
U.K. Pounds	1.659	1.711	1.849	1.968	2.025	1.797	1.953
Period end							
U.S. Dollar	1.343	1.313	1.292	1.300	1.384	1.343	1.384
U.K. Pounds	1.657	1.703	1.720	1.867	2.040	1.657	2.040

In general, our net income benefits from a weakening Canadian dollar and is adversely affected by a strengthening Canadian dollar as net income from the Company's international operations is translated back to Canadian dollars. Conversely, in a period of losses, the weakening of the Canadian dollar has the effect of increasing the losses. The relative impact of foreign exchange in any given period is driven by the movement of foreign exchange rates as well as the proportion of earnings generated in our foreign operations. We generally express the impact of foreign exchange on net income on a year-over-year basis.

(1) Our effective income tax rate on operating net income is calculated using operating net income and income tax expense associated with operating net income. Our effective income tax rate on underlying net income is calculated using underlying net income and income tax expense associated with underlying net income. The effective tax rates calculated on an operating and underlying basis also exclude amounts attributable to participating policyholders.

During the fourth quarter of 2016, our reported net income, operating net income and underlying net income decreased by \$8 million, \$8 million and \$9 million, respectively, as a result of the strengthening Canadian dollar in the fourth quarter of 2016 relative to the average exchange rates in the fourth quarter of 2015. During the year 2016, our reported net income, operating net income and underlying net income increased by \$29 million, \$30 million and \$26 million, respectively, as a result of the weakening Canadian dollar in 2016 relative to the average exchange rates in 2015.

## Fourth Quarter 2016 Performance

### Net Income

Our reported net income was \$728 million in the fourth quarter of 2016, compared to \$536 million in the fourth quarter of 2015. Operating net income was \$732 million for the quarter ended December 31, 2016, compared to \$598 million for the same period in the prior year. Underlying net income was \$560 million in the fourth quarter of 2016, compared to \$646 million in the fourth quarter of 2015.

The following table reconciles our net income measures and sets out the impact that other notable items had on our net income in the fourth quarter of 2016 and 2015.

	Q4'16	Q4'15
(\$ millions, after-tax)		
<b>Reported net income</b>	<b>728</b>	536
Certain hedges in SLF Canada that do not qualify for hedge accounting	8	10
Fair value adjustments on MFS's share-based payment awards	10	(6)
Acquisition, integration and restructuring <sup>(1)</sup>	(22)	(66)
<b>Operating net income<sup>(2)</sup></b>	<b>732</b>	598
Equity market impact		
Impact from equity market changes	29	(1)
Basis risk impact	(3)	(3)
Equity market impact <sup>(3)</sup>	26	(4)
Interest rate impact		
Impact from interest rate changes	160	(16)
Impact of credit spread movements	(25)	(10)
Impact of swap spread movements	(5)	(9)
Interest rate impact <sup>(4)</sup>	130	(35)
Increases (decreases) from changes in the fair value of real estate	6	3
Market related impacts	162	(36)
Assumption changes and management actions	10	(12)
<b>Underlying net income<sup>(2)</sup></b>	<b>560</b>	646
<b>Impact of other notable items on our net income:</b>		
Experience related items <sup>(5)</sup>		
Impact of investment activity on insurance contract liabilities	15	73
Mortality	(4)	7
Morbidity	(13)	12
Credit	22	18
Lapse and other policyholder behaviour	(7)	(4)
Expenses <sup>(6)</sup>	(76)	(44)
Other	22	23

(1) In the fourth quarter of 2016, Acquisition, integration and restructuring amounts primarily related to the integrations of the U.S. employee benefits business we acquired in 2016, Bentall Kennedy acquired in 2015, and the buy-up of PT CIMB Sun Life in Indonesia in 2016. In the fourth quarter of 2015, Acquisition, integration and restructuring amounts consisted of \$63 million related to the closing of our wealth business in SLF U.S. International to new sales, which included assumption changes and management actions of \$41 million to reflect assumption updates including the expense strengthening associated with closing the business, and \$3 million related to the acquisition and integration of Bentall Kennedy, Prime Advisors and Ryan Labs and acquisition costs related to the U.S. employee benefits business acquired in 2016.

(2) Represents a non-IFRS financial measure. See section under the heading Non-IFRS Financial Measures in this MD&A.

(3) Equity market impact consists primarily of the effect of returns in equity markets during the period, net of hedging, that differ from the best estimate assumptions used in the determination of our insurance contract liabilities of approximately 2% per quarter. Equity market impact also includes the income impact of the basis risk inherent in our hedging program, which is the difference between the return on underlying funds of products that provide benefit guarantees and the return on the derivative assets used to hedge those benefit guarantees.

(4) Interest rate impact includes the effect of interest rate changes that differ from best estimate assumptions and on the value of derivative instruments used in our hedging programs. Our exposure to interest rates varies by product type, line of business, and geography. Given the long-term nature of our business, we have a higher degree of sensitivity in respect of interest rates at long durations. Interest rate impact also includes the income impact of changes in assumed fixed income reinvestment rates and of credit and swap spread movements.

(5) Experience related items reflect the difference between actual experience during the reporting period and best estimate assumptions used in the determination of our insurance contract liabilities.

(6) Expense experience in the fourth quarter of 2016 includes \$46 million (\$11 million in 2015) reflecting higher incentive plan payments related to strong operating results and long-term relative share performance.

Our reported net income for the fourth quarter of 2016 and 2015 included items that we believe are not operational in nature and which are, therefore, excluded in our calculation of operating net income. Operating net income for the fourth quarter of 2016 and 2015 excluded the net impact of certain hedges in SLF Canada that do not qualify for hedge accounting, fair value adjustments on MFS's share-based payment awards, and acquisition, integration and restructuring amounts. The net impact of these items reduced reported net income by \$4 million in the fourth quarter of 2016, compared to a reduction of \$62 million in the fourth quarter of 2015.

Our underlying net income for the fourth quarter of 2016 and 2015 excludes market related impacts and assumption changes and management actions. The net impact of market related impacts and assumption changes and management actions increased operating net income by \$172 million in the fourth quarter of 2016, compared to a decrease of \$48 million in the fourth quarter of 2015. Interest rates experience in the fourth quarter of 2016 reflects gains from large increases in long-term rates without similar increases in short-term rates, favourable impacts from rebalancing of hedges, and changes in the positioning of the asset portfolio as rates increased during the quarter.

Net income in the fourth quarter of 2016 also reflected positive credit experience and a lower level of gains from investing activity on insurance contract liabilities. This was partially offset by unfavourable expense experience, reflecting incentive compensation costs arising from overall strong business performance and investment in growing our businesses. We also experienced unfavourable morbidity results mainly in the U.S.

Net income in the fourth quarter of 2015 also reflected the favourable impact from investment activity on insurance contract liabilities largely in SLF Canada and SLF U.S., positive credit and morbidity and mortality experience, and other experience items including a change to post-retirement benefit liabilities in SLF U.S. This was partially offset by unfavourable expense experience including investment in growing our businesses.

## Performance by Business Group

We manage our operations and report our financial results in five business segments.

The following table sets out the differences between our reported net income (loss), operating net income (loss) and underlying net income (loss) by business segment. Unless indicated otherwise, all factors discussed in this document that impact our results are applicable to reported net income (loss), operating net income (loss) and underlying net income (loss).

	Q4 2016						Q4 2015
	SLF Canada	SLF U.S.	SLF Asset Management	SLF Asia	Corporate	Total	Total
(\$ millions, after-tax)							
Reported net income (loss)	398	106	198	58	(32)	728	536
Items excluded from operating net income:							
Certain hedges that do not qualify for hedge accounting	8	–	–	–	–	8	10
Fair value adjustments on MFS's share-based payment awards	–	–	10	–	–	10	(6)
Acquisition, integration and restructuring	–	(15)	–	(1)	(6)	(22)	(66)
Operating net income (loss) <sup>(1)</sup>	390	121	188	59	(26)	732	598
Market related impacts	130	32	–	6	(6)	162	(36)
Assumption changes and management actions	17	2	–	(9)	–	10	(12)
Underlying net income (loss) <sup>(1)</sup>	243	87	188	62	(20)	560	646

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

The following section describes the operations and financial performance of SLF Canada, SLF U.S., SLF Asset Management, SLF Asia and Corporate.

### SLF Canada

SLF Canada's reported net income was \$398 million in the fourth quarter of 2016, compared to \$210 million in the fourth quarter of 2015. Operating net income was \$390 million, compared to \$200 million in the fourth quarter of 2015. Operating net income in SLF Canada excludes the impact of certain hedges that do not qualify for hedge accounting in 2016 and 2015, which is set out in the table above.

Underlying net income in the fourth quarter of 2016 was \$243 million, compared to \$269 million in the fourth quarter of 2015. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The favourable effect of market related impacts in the fourth quarter of 2016 was primarily driven by interest rates and equity markets largely impacting Individual Insurance & Wealth, compared to the unfavourable effect in the fourth quarter of 2015, primarily driven by interest rates and equity markets.

Net income in the fourth quarter of 2016 also reflected new business gains in Individual Insurance & Wealth and GRS from strong sales and a release of a litigation provision in Individual Insurance & Wealth, partially offset by growth in our expenses including investment in our individual wealth business.

Net income in the fourth quarter of 2015 also reflected gains from investing activities on insurance contract liabilities in Individual Insurance & Wealth, new business gains in GRS and favourable disability experience in GB, partially offset by expense experience including investment in growing our individual wealth business.

## **SLF U.S.**

SLF U.S.'s reported net income was C\$106 million in the fourth quarter of 2016, compared to C\$100 million in the fourth quarter of 2015. Operating net income was C\$121 million, compared to C\$163 million in the fourth quarter of 2015. Operating net income in SLF U.S. excludes the impact of acquisition, integration and restructuring amounts, which are set out in the table above. Underlying net income was C\$87 million, compared to C\$158 million in the fourth quarter of 2015. There was minimal impact from the movement of the Canadian dollar relative to average exchange rates in the fourth quarter of 2015 since the average exchange rates were consistent.

In U.S. dollars, SLF U.S.'s reported net income was US\$80 million in the fourth quarter of 2016, compared to US\$75 million in the fourth quarter of 2015. Operating net income was US\$92 million in the fourth quarter of 2016, compared to US\$121 million in the fourth quarter of 2015. Underlying net income was US\$65 million in the fourth quarter of 2016, compared to US\$118 million in the fourth quarter of 2015. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The favourable effects of market related impacts in the fourth quarter of 2016 were primarily driven by interest rates, mainly in In-force Management partially offset by changes in credit spreads, compared to a favourable effect in the fourth quarter of 2015, primarily driven by interest rate and equity market changes.

Net income in the fourth quarter of 2016 also reflected the contribution of the U.S. employee benefits business acquired in 2016, favourable credit experience and gains from investing activity on insurance contract liabilities. These items were partially offset by unfavourable mortality experience in In-force Management and unfavourable morbidity experience in Group Benefits.

Net income in the fourth quarter of 2015 also reflected the impact in Group Benefits related to pricing increases on new and renewing business, expense actions, and continued investment in our disability claim operations. Results also reflected the favourable impact of investing activities on insurance contract liabilities, favourable credit experience, net realized gains on the sale of AFS assets, favourable mortality experience in International, and a change to post-retirement benefit liabilities. These items were partially offset by unfavourable group life claims experience.

## **SLF Asset Management**

SLF Asset Management's reported net income was C\$198 million in the fourth quarter of 2016, compared to C\$177 million in the fourth quarter of 2015. SLF Asset Management had operating net income and underlying net income of C\$188 million in the fourth quarter of 2016, compared to C\$183 million in the fourth quarter of 2015. Operating net income and underlying net income in SLF Asset Management excludes the impact of fair value adjustments on MFS's share-based payment awards, which is set out in the table above. There was minimal impact from movement of the Canadian dollar relative to average exchange rates in the fourth quarter of 2015 since the average rates were consistent.

SLF Asset Management's net income increased in the fourth quarter of 2016 compared to the same period in 2015 primarily due to MFS's results, as described below.

In U.S. dollars, MFS's reported net income was US\$142 million in the fourth quarter of 2016, compared to US\$126 million in the fourth quarter of 2015. MFS's operating net income was US\$135 million in the fourth quarter of 2016, compared to US\$131 million in the fourth quarter of 2015. Operating net income in MFS excludes the impact of fair value adjustments on share-based payment awards, which is set out in the table above. MFS's operating net income in U.S. dollars increased in the fourth quarter of 2016 compared to the same period in 2015, primarily due to higher average net assets and lower taxes in the quarter, partially offset by foreign exchange. MFS's pre-tax operating profit margin ratio was 35% in the fourth quarter of 2016, down from 38% in the fourth quarter of 2015.

SLIM's reported net income and operating net income was C\$9 million in the fourth quarter of 2016, unchanged from the fourth quarter of 2015.

## **SLF Asia**

SLF Asia's reported net income was \$58 million and operating net income was \$59 million in the fourth quarter of 2016, compared to reported net income and operating net income of \$73 million in the fourth quarter of 2015. Operating net income excludes the impact of acquisition, integration and restructuring amounts, which is set out in the table above. The impact of the change in the Canadian dollar in the fourth quarter of 2016 relative to average exchange rates in the fourth quarter of 2015 reduced reported net income, operating net income and underlying net income by \$2 million.

Underlying net income was \$62 million, compared to \$52 million in the fourth quarter of 2015. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The favourable effect of market related impacts in the fourth quarter of 2016 were primarily driven by interest rates, partially offset by equity markets, compared to the favourable effect in the fourth quarter of 2015, primarily driven by interest rate and equity market changes.

Net income in the fourth quarter of 2016 also reflected business growth, partially offset by growth in our expenses, including investment in our business, relative to the fourth quarter of 2015.

## **Corporate**

Corporate had reported net loss of \$32 million in the fourth quarter of 2016, compared to reported loss of \$24 million in the fourth quarter of 2015. Operating net loss was \$26 million in the fourth quarter of 2016, compared to an operating net loss of \$21 million in the same period in the prior year. Operating net loss excludes acquisition, integration and restructuring amounts in 2016 and 2015, which are set out in the table above. The strengthening Canadian dollar in the fourth quarter of 2016 relative to the U.K. pound in the fourth quarter of 2015 increased Corporate's reported net loss, operating net loss and underlying net loss by \$6 million, \$6 million and \$7 million, respectively.

Underlying net loss was \$20 million, compared to underlying net loss of \$16 million in the fourth quarter of 2015. Underlying net loss excludes from operating net loss market related impacts and assumption changes and management actions, which are set out in the table above. The unfavourable effect of market related impacts in the fourth quarter of 2016 were primarily driven by equity markets and interest rates, compared to the unfavourable effect in the fourth quarter of 2015, primarily driven by equity markets partially offset by interest rates.

SLF U.K.'s operating net income was \$26 million in the fourth quarter of 2016, compared to \$22 million in the fourth quarter of 2015. SLF U.K.'s net income in the fourth quarter of 2016 reflected unfavourable market related impacts and expense experience. Net income in the fourth quarter of 2015 reflected unfavourable equity markets and the impact of a tax rate change partially offset by the impact of interest rates.

Corporate Support had an operating net loss of \$52 million in the fourth quarter of 2016, compared to an operating net loss of \$43 million in the fourth quarter of 2015. Net loss in the fourth quarter of 2016 increased relative to the same period in 2015, primarily due to incentive compensation costs related to strong operating results and long-term relative share performance.

### Additional Financial Disclosure

Revenue for the fourth quarter of 2016 was \$2.4 billion, compared to \$5.6 billion in the fourth quarter of 2015. Revenues decreased primarily as a result of decreases in the fair value of FVTPL assets primarily due to increases in interest rates, partially offset by higher net premium revenue in SLF Canada, SLF U.S. and SLF Asia, including the partial recapture of a reinsurance agreement in GB in SLF Canada effective the first quarter of 2016. The currency impact from the change in the Canadian dollar relative to average exchange rates in the fourth quarter of 2015 increased revenue by \$58 million. Adjusted revenue was \$8.0 billion for the fourth quarter of 2016, compared to \$7.5 billion in the fourth quarter of 2015 primarily due to higher net premium revenue in SLF U.S. and SLF Asia.

Premiums and deposits were \$42.4 billion for the quarter ended December 31, 2016, compared to \$33.1 billion for the quarter ended December 31, 2015. Total adjusted premiums and deposits in the fourth quarter of 2016 were up \$8.9 billion compared to the same period in the prior year. In both cases, the increase was mainly due to increased fund sales, higher segregated fund deposits and net premium revenue, partially offset by lower ASO premium and deposit equivalents. The currency impact from the change in the Canadian dollar relative to average exchange rates in the fourth quarter of 2015 decreased total premiums and deposits by approximately \$76 million.

## Quarterly Information

The following table provides a summary of our results for the eight most recently completed quarters. A more complete discussion of our historical quarterly results can be found in our interim and annual MD&As for the relevant periods.

(\$ millions, unless otherwise noted)	Quarterly results							
	Q4'16	Q3'16	Q2'16	Q1'16	Q4'15	Q3'15	Q2'15	Q1'15
Total revenue	<b>2,366</b>	7,892	9,533	8,782	5,567	4,693	1,682	7,332
Common shareholders' net income (loss)								
Reported	<b>728</b>	737	480	540	536	482	726	441
Operating <sup>(1)</sup>	<b>732</b>	750	474	531	598	478	731	446
Underlying <sup>(1)</sup>	<b>560</b>	639	554	582	646	528	615	516
Diluted EPS (\$)								
Reported	<b>1.18</b>	1.20	0.78	0.88	0.87	0.79	1.18	0.72
Operating <sup>(1)</sup>	<b>1.19</b>	1.22	0.77	0.87	0.98	0.78	1.19	0.73
Underlying <sup>(1)</sup>	<b>0.91</b>	1.04	0.90	0.95	1.05	0.86	1.00	0.84
Basic reported EPS (\$)								
Reported	<b>1.19</b>	1.20	0.78	0.88	0.88	0.79	1.19	0.72
Reported net income (loss) by segment								
SLF Canada	<b>398</b>	184	185	169	210	127	337	150
SLF U.S.	<b>106</b>	253	54	95	100	64	134	35
SLF Asset Management	<b>198</b>	181	173	177	177	204	162	148
SLF Asia	<b>58</b>	92	68	91	73	77	93	68
Corporate	<b>(32)</b>	27	–	8	(24)	10	–	40
Total reported net income (loss)	<b>728</b>	737	480	540	536	482	726	441
Operating net income (loss) by segment <sup>(1)</sup>								
SLF Canada <sup>(1)</sup>	<b>390</b>	178	191	182	200	137	331	135
SLF U.S. <sup>(1)</sup>	<b>121</b>	268	64	110	163	64	134	35
SLF Asset Management <sup>(1)</sup>	<b>188</b>	188	153	170	183	176	173	168
SLF Asia <sup>(1)</sup>	<b>59</b>	89	68	60	73	77	93	68
Corporate <sup>(1)</sup>	<b>(26)</b>	27	(2)	9	(21)	24	–	40
Total operating net income (loss) <sup>(1)</sup>	<b>732</b>	750	474	531	598	478	731	446

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

### Third Quarter 2016

Reported net income was \$737 million and operating net income was \$750 million in the third quarter of 2016, reflecting higher levels of gains from investment activities on insurance contract liabilities, positive credit experience, equity markets, interest rates, assumption changes and management actions and other experience items. This was partially offset by mortality and expense experience, including investment in growing our businesses.

## Second Quarter 2016

Reported net income was \$480 million and operating net income was \$474 million in the second quarter of 2016, reflecting the unfavourable impact of interest rates, unfavourable morbidity experience, mainly in SLF U.S. Group Benefits notably from the stop-loss insurance business, and expense experience including investment in growing our businesses. This was partially offset by gains from investment activity on insurance contract liabilities, favourable impact of equity markets and positive credit experience.

## First Quarter 2016

Reported net income was \$540 million and operating net income was \$531 million in the first quarter of 2016, reflecting favourable impact of strong investing activities and positive morbidity experience, partially offset by unfavourable impacts from interest rates and equity markets.

## Fourth Quarter 2015

Reported net income was \$536 million and operating net income was \$598 million in the fourth quarter of 2015, reflecting favourable impact from investment activity on insurance contract liabilities largely in SLF Canada and SLF U.S., positive credit, morbidity and mortality experience, and other experience items including a change to post-retirement benefit liabilities in SLF U.S. This was partially offset by negative interest rate impact and unfavourable expense experience including investment in growing our businesses.

## Third Quarter 2015

Reported net income was \$482 million and operating net income was \$478 million in the third quarter of 2015, reflecting favourable impact from interest rates, investment activity on insurance contract liabilities, positive credit experience and policyholder behaviour. These items were partially offset by unfavourable equity market impact, morbidity and mortality experience, expense experience, and other experience items.

## Second Quarter 2015

Reported net income was \$726 million and operating net income was \$731 million in the second quarter of 2015, reflecting positive interest rate impact, investment activity on insurance contract liabilities, mortality, positive credit, morbidity experience, and business growth. These items were partially offset by unfavourable expense experience including investment in growing our businesses.

## First Quarter 2015

Reported net income was \$441 million and operating net income was \$446 million in the first quarter of 2015, reflecting gains from investment activity on insurance contract liabilities and positive mortality experience, offset by unfavourable impacts from assumption changes and management actions, net interest rate changes, lapse and other policyholder behaviour, and expense experience.

# Business Segment Results

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## SLF Canada

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### Business Profile

SLF Canada is the Canadian market leader in the group market segments and is a leading provider of retail insurance and investment advice, providing products and services to over six million people across Canada. Our distribution breadth, strong Client centric culture, technology leadership and brand recognition provide an excellent platform for growth. SLF Canada has three main business units – Individual Insurance & Wealth, Group Benefits and Group Retirement Services – which offer a full range of insurance, wealth and income products and services to employers, group members of company sponsored plans and individuals in their communities across Canada.

### Strategy

SLF Canada's mission is to help Clients achieve physical, mental and financial well-being throughout their life by employing our competitive advantages of a strong service culture, technology leadership and brand recognition across our businesses. SLF Canada is focused on leveraging our core strengths to accelerate the growth of our new products and businesses to better serve the retirement needs of Canadians.

SLF Canada is the largest provider of benefits and pensions in the workplace in Canada and we aim to further extend our leadership through unique capabilities such as our Total Benefits offering, which leverages our combined GRS and GB capabilities, and our industry leading Client focused culture. We continue to advance our digital strategy by investing in Client experience technology such as mobile applications and our Digital Benefits Assistant ("DBA"), which surfaces helpful ideas at the right time through our Clients' channel of choice, funding these innovations through productivity savings. SLF Canada is leveraging our worksite advantage to accelerate growth in our Client Solutions business, which focuses on providing a unique suite of products and services to members joining and leaving group plans along with a bridge to our CSF advisory services. We are expanding our leadership position in the Defined Benefit Solutions ("DBS") business through innovative de-risking solutions to meet emerging needs of the pension market.

Our industry-leading CSF provides holistic financial advice, including a complete suite of insurance, health and wealth products, through a sales power of over 4,100 located in over 1,200 communities across Canada. Furthermore, our strong franchise and deep expertise enable us to provide complete financial planning services, estate planning services and comprehensive retirement solutions. We are growing our presence in the wealth market through the expansion of our distribution and our continued investment in SLGI, whose mandate is to bring together the best asset managers and innovative investment solutions accessible for investors in either our retail (advisor-based market) or institutional (group retirement market) business lines.

## 2016 Business Highlights

We continued to build upon each of our core businesses by growing our share of the market across GRS, GB and Individual Insurance & Wealth.

- Individual Insurance & Wealth retained its first place position in the fixed annuities and critical illness markets at 27.7% and 28.5% of market share, respectively<sup>(1)</sup>.
- Individual Insurance & Wealth maintained its second place position in the individual life market growing annualized premiums by 9.5%, consistent with industry growth<sup>(1)</sup>. Insurance sales of \$475 million in 2016 grew 36% over 2015.
- Our CSF productivity improved over the prior year and sales power remains strong at over 4,100 across Canada.
- GB maintained its leadership position as the largest provider of employee benefit group insurance products in Canada for the seventh consecutive year<sup>(2)</sup>.
- GRS continued to be ranked #1 in the defined contribution market based on total Capital Accumulation Plan assets<sup>(3)</sup> and #1 in annuity sales<sup>(3)</sup>.

To further build upon our leadership positions, significant investments have been made that have contributed to accelerate growth in our wealth businesses. These focus areas have resulted in the following outcomes:

- Wealth manufactured sales<sup>(4)</sup> in Individual Insurance & Wealth of \$3.4 billion were up 34% over the prior year. This includes sales of our segregated funds launched in the prior year, Sun Life Guaranteed Investment Funds, of \$629 million, which were up 143% over the prior year.
- SLGI completed its sixth full year of operation and continued to offer top-performing funds as all five of the Granite Managed Portfolios had four-year performance that exceeded the peer median<sup>(5)</sup> and four of the top selling MFS funds achieved a 5-star rating from Morningstar<sup>(5)</sup>. Total 2016 net sales of \$3.4 billion grew 60% over 2015, while industry mutual fund net flows were overall down.
- SLGI continued to build AUM to over \$15.6 billion driven by growth in sales across both its retail and institutional markets, ranking within the top five in net sales across all industry participants<sup>(6)</sup>.
- Client Solutions wealth rollover sales reached \$2.3 billion for the year.

To further enhance our Client experience, significant investments have been made to advance our digital innovation strategy in many areas including the following:

- Client Solutions' DBA, an innovative technology-based capability that proactively engages Clients, delivering personalized and relevant interactions across multiple channels, and further support Clients in their goal of well-being and financial security.
- Digital Health Solutions (DHS), a new business launched during the year, dedicated to helping Canadians find new and better ways of accessing health care products and services, make healthy choices to support wellness goals, and better manage chronic conditions with advanced technologies and insights.
- The launch of automatic enrollment for SLGI's Private Client program and GRS' new digital Client tool, MAX my money@work.

Throughout the year several awards were also received, recognizing our leadership position across Canada. Notable highlights in this area include:

- For the eighth year in a row, Canadians have voted Sun Life Financial as the "Most Trusted Life Insurance Company", as part of the *Reader's Digest's Trusted Brand™* awards program.
- SLF Canada received 22 awards at the annual Insurance and Financial Communicators Association (IFCA) awards ceremony; awards were received for marketing communications initiatives in a variety of categories across all business units.
- SLGI earned medals in the Client Relationship space in Wealth Professional's annual ranking of Canada's top fund providers.
- GB received Hermes Create Awards in five categories for their 2015 Rogers marketing campaign.
- SLGI was named in Benefits Canada's Top 40 Money Manager issue as fastest growing asset manager for the category of fund managers with greater than \$10 billion in AUM.

(1) LIMRA, for the nine months ended September 30, 2016.

(2) The 2016 Fraser Group, most recently published *Group Universe Report* (based on 2015 data as measured by revenue, including administrative services only premium equivalents).

(3) As measured by Benefits Canada magazine's *2016 CAP Suppliers Report*, based on June 30, 2016 assets under administration, and released in December 2016.

(4) Represents sales of individual wealth products developed by Sun Life including Sun Life Global Investment mutual funds, Sun Life Guaranteed Investment Funds segregated funds, Guaranteed Investment Certificates, and Accumulation and Payout Annuities

(5) Morningstar performance statistics as at December 31, 2016 for performance of funds since inception.

(6) IFIC, Investor Economics, company reports year to date as of the third quarter of 2016.

## Financial and Business Results

### Summary statements of operations

(\$ millions)	2016	2015	2014
Net premiums	7,389	5,021	4,700
Net investment income	3,751	2,527	6,017
Fee income	1,026	998	909
<b>Total revenue</b>	<b>12,166</b>	<b>8,546</b>	<b>11,626</b>
Client disbursements and change in insurance and investment contract liabilities	10,979	9,870	12,778
Commissions and other expenses	3,150	2,887	2,647
Reinsurance expenses (recoveries)	(3,332)	(5,227)	(4,723)
Income tax expense (benefit)	208	177	129
Participating policyholders' income and non-controlling interests in net income of subsidiaries	225	15	5
<b>Reported net income</b>	<b>936</b>	<b>824</b>	<b>790</b>
Less: Certain hedges that do not qualify for hedge accounting	(5)	21	(7)
<b>Operating net income<sup>(1)</sup></b>	<b>941</b>	<b>803</b>	<b>797</b>
Less: Market related impacts	114	(106)	(77)
Less: Assumption changes and management actions	(60)	15	51
<b>Underlying net income<sup>(1)</sup></b>	<b>887</b>	<b>894</b>	<b>823</b>
<b>Operating ROE (%)<sup>(1)</sup></b>	<b>12.1</b>	<b>10.5</b>	<b>10.8</b>
<b>Underlying ROE (%)<sup>(1)</sup></b>	<b>11.4</b>	<b>11.6</b>	<b>11.2</b>

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

Reported net income was \$936 million in 2016, compared to \$824 million in 2015. Operating net income was \$941 million in 2016, compared to \$803 million in 2015. Operating net income in SLF Canada excludes the impact of certain hedges that do not qualify for hedge accounting in 2016 and 2015, which is set out in the table above.

Underlying net income was \$887 million in 2016, compared to \$894 million in 2015. Underlying net income in SLF Canada excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The favourable effect of market related impacts in 2016 was primarily driven by equity markets and interest rates largely impacting Individual Insurance & Wealth, compared to an unfavourable effect in 2015 primarily driven by interest rates and equity markets.

Net income in 2016 also reflected gains from investing activities on insurance contract liabilities in Individual Insurance & Wealth, new business gains in individual insurance and GRS from strong sales, strong fee income in GRS, improvements in high-cost drug claims experience in GB and a release of a litigation provision in Individual Insurance & Wealth, partially offset by growth in our expenses including investment in our individual wealth business.

Net income in 2015 also reflected gains from investing activity on insurance contract liabilities in Individual Insurance & Wealth and new business gains primarily in GRS. These gains were partially offset by expense experience including investment in growing our individual wealth business, and, during the first half of 2015, unfavourable policyholder behaviour in Individual Insurance & Wealth. In GB, the unfavourable impacts of high-cost drug claims, though improving in the second half of 2015, were more than offset by positive disability experience.

Revenue was \$12.2 billion in 2016, an increase of \$3.7 billion from 2015, primarily due to a partial recapture of a reinsurance arrangement in GB and an increase in the fair value of non-hedging derivatives. Revenue excluding ceded premiums on reinsurance agreements of \$3.7 billion was \$15.8 billion, an increase of \$1.7 billion from 2015, primarily due to increases in the fair value of FVTPL assets.

Reinsurance recoveries of \$3.3 billion in 2016 were down \$1.9 billion from 2015, primarily due to a partial recapture of a reinsurance arrangement in GB.

SLF Canada had AUM of \$165.3 billion as at December 31, 2016, an increase of 8% from 2015 levels. The increase was driven primarily by positive net flows and favourable market performance in GRS.

## Results by Business Unit

### Net income by business unit

(\$ millions)	2016	2015	2014
Reported net income	936	824	790
Certain hedges that do not qualify for hedge accounting <sup>(1)</sup>	(5)	21	(7)
<b>Operating net income<sup>(2)</sup></b>	<b>941</b>	<b>803</b>	<b>797</b>
Individual Insurance & Wealth <sup>(2)</sup>	512	336	384
Group Benefits <sup>(2)</sup>	308	318	290
Group Retirement Services <sup>(2)</sup>	121	149	123

(1) In 2016, Certain hedges that do not qualify for hedge accounting consisted of \$(3) million in Individual Insurance & Wealth, \$(1) million in Group Benefits, and \$(1) million in Group Retirement Services.

(2) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

## **Individual Insurance & Wealth**

Individual Insurance & Wealth's focus is to help Canadians achieve lifetime financial security by delivering a leading suite of life and health insurance and investment products, excellent service and holistic advice with a focus on ease of doing business and strong risk management practices.

Our broad product shelf continues to offer a spectrum of choices to each Client in order to meet their holistic life, health and wealth needs. This includes our individual wealth manufactured products SLGI mutual funds and Sun Life Guaranteed Investment Funds segregated funds. Our products are marketed through a distinctive, multi-channel distribution model consisting of the CSF and third party distribution channels, including independent insurance and mutual fund licensed brokers and broker-dealers. Certain products, including accidental death insurance and personal health insurance, are marketed directly to retail Clients in partnership with our advice channels while our CSF also distributes non-SLGI mutual funds and certain third-party insurance products such as disability insurance.

Individual Insurance & Wealth's reported net income was \$509 million in 2016, compared to \$348 million in 2015. Operating net income was \$512 million in 2016, an increase of \$176 million from 2015. Net income in 2016 reflected favourable impact of interest rates and equity markets, strong gains from investing activity on insurance contract liabilities, new business gains from strong life insurance sales and a release of a litigation provision, partially offset by growth in our expenses including investment in our individual wealth business and unfavourable impact of assumption changes and management actions.

Net income in 2015 reflected strong investing activity gains offset by the unfavourable impacts of equity markets, interest rates and expense experience including investment in growing our individual wealth business.

Sales of individual life and health insurance products increased 36% from 2015 to \$475 million in 2016. The increase was largely driven by strong CSF and third party sales as a result of the tax legislation changes effective January 1, 2017.

Sales of individual wealth products of \$5.4 billion were level with solid 2015 results, with strong sales in SLGI mutual funds and Sun Life Guaranteed Investment Funds offset by weaker non-SLGI fund sales.

## **Group Benefits**

Our GB business unit is a leading provider of group life and health insurance products in Canada. We provide life, dental, extended health care, disability and critical illness benefits programs to employers of all sizes. In addition, our Client Solutions area leverages our worksite advantage to offer voluntary benefits solutions to individual plan members, including post-employment life and health plans to members exiting their employer-sponsored plan. We are an innovation leader, competing on the strength of an industry-leading technology platform, innovative mobile applications, a unique Total Benefits offering, and integrated health, wellness and disability management capabilities. Our products are marketed and distributed across Canada by experienced sales representatives in collaboration with independent advisors, benefits consultants and the CSF.

GB's Integrated Health Solutions brings together our significant investments in the areas of health and wellness, mental health, and aspects of our absence and disability management offering, to enhance the overall plan experience to both employers and plan members. Our integrated model, and focus on physical, mental and financial well-being is a unique, market-leading approach to health management.

GB's reported net income was \$307 million in 2016, compared to \$324 million in 2015. Operating net income was \$308 million in 2016, a decrease of \$10 million from 2015. Net income in 2016 reflected improvements in high-cost drug claim experience offset by unfavourable mortality experience and less favourable disability claims experience than 2015.

Net income in 2015 reflected positive disability experience, gains from investing activity and mortality gains partially offset by the unfavourable impacts of high-cost drug claims.

GB maintained the #1 market share position for overall revenue<sup>(1)</sup> in Canada while continuing to focus on Client service and productivity. Client retention remained strong, with cancellation rates at 2.3% of revenue compared to the industry average of 5.0%<sup>(1)</sup>.

## **Group Retirement Services**

GRS is the leading provider of defined contribution plans and defined benefit solutions in Canada. Our offering meets the complex plan and service requirements of medium-to-large organizations with industry-leading technology and expertise, while providing cost-effective solutions to the small employer market. In addition, our Client Solutions area leverages our worksite advantage to offer voluntary savings plans, including post-employment plans, to those members exiting their employer-sponsored plans. Other services and product offerings include: investment-only segregated funds and fixed rate annuities, stock plans, group life annuities, and pensioner payroll services. Our Defined Benefit Solutions business offers an expanding range of innovative de-risking solutions for defined benefit pension plans such as liability-driven investing, annuity buy-outs and buy-ins, and longevity insurance to meet the emerging needs of the pension market, further enhancing our leadership position.

Our products are marketed and distributed across Canada by experienced sales representatives in collaboration with a multi-channel distribution network of pension consultants and advisors and through teams dedicated to the defined contributions and defined benefit solutions markets.

GRS had reported net income of \$120 million in 2016, compared to \$152 million in 2015. Operating net income was \$121 million compared to \$149 million in 2015. Net income in 2016 reflected strong fee income, more than offset by unfavourable investing activity on insurance contract liabilities and lower new business gains compared to the prior year.

Net income in 2015 reflected strong new business gains driven by significant DBS sales, and gains from investing activity.

GRS's sales of \$7.8 billion in 2016 were down from record sales of \$14.5 billion in 2015 as the prior year included two large transactions totaling \$5.8 billion. In 2016, rollover sales from members leaving their defined contribution plans were \$2.3 billion, a 3% increase from a strong 2015.

(1) The 2016 Fraser Group, most recently published *Group Universe Report* (based on 2015 data as measured by revenue, including administrative services only premium equivalents)

GRS assets under administration of \$89.2 billion in 2016 grew by 11% over 2015, resulting from strong net sales and favourable markets.

## 2017 Outlook and Priorities

In 2017, we will continue to leverage our leadership position across our core businesses and distribution networks, and build on our objective of being a leader in physical, mental, and financial well-being in our Canadian home market. Shifting demographics, in particular the aging of baby boomers and their need for financial security in retirement, and the shift in financial responsibility from governments to individuals, in areas such as health care, are expanding the need of individuals to seek out effective financial protection and retirement planning solutions. Being a leader at the workplace and in communities across Canada with a full suite of solutions and advice positions us to continue to benefit from these trends in the coming years.

Our greatest opportunities for growth continue to lie in the accelerated development of our wealth businesses. While building new businesses is difficult and requires significant investment, the momentum achieved to-date is encouraging and validating of the overall strategy. Key areas of focus include:

- Growing our retail wealth business in Individual Insurance & Wealth through increased sales of our wealth products and services such as our segregated funds, Sun Life Guaranteed Investment Funds, and our SLGI wealth management solutions to further strengthen our position in the retirement market;
- Expanding our leadership position in the DBS business through innovative de-risking solutions to meet emerging needs of the pension market; and
- Further leveraging our worksite advantage to drive growth in our Client Solutions business by deepening our Client insurance and wealth relationships through effective Client touch points and solutions such as the Digital Benefits Assistant to meet our Clients' needs.

While focusing on the acceleration of our wealth businesses, we will maintain our leading positions in our core business through investment in distribution, product, Client-focused technology and productivity. Priorities in our 2017 plans include:

- Develop our new business area, Digital Health Solutions, and continue to develop digital solutions to our business processes and models focused on enhancing Client and shareholder value;
- Launching new and enhancing existing products that continue to support our CSF and third party advisors in offering customized financial plans and solutions to our Clients;
- Building further on our distribution organization to enable advisors to grow, with an emphasis on Client needs, a consultative approach, and excellent services; and
- Building further success in the group markets by continuing to focus on Client needs and enriching their experience.

## SLF U.S.

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### Business Profile

SLF U.S. has three business units: Group Benefits, International and In-force Management. Group Benefits provides insurance solutions to employers and employees including group life, disability, medical stop-loss, dental, and vision insurance products, as well as a suite of voluntary benefits products. International serves high net worth Clients in international markets, offering individual life insurance products and manages a closed block of wealth products. In-force Management includes certain closed individual life insurance products, primarily universal life and participating whole life insurance.

### Strategy

Over the past several years, SLF U.S. has taken steps to create a more sustainable business model, focusing our efforts on being a leader in the U.S. group benefits and international high net worth solutions markets. In the Group Benefits business, we have improved profitability and the acquisition of the U.S. employee benefits business has added both scale and new capabilities that we will leverage to drive growth in this business. We are also leveraging our leadership position in medical stop-loss to drive growth in sales and business in force. We have one of the broadest product portfolios in the Group Benefits industry and compete in all market segments. We are focused on deepening relationships with brokers, improving the Client experience and making our operations more efficient.

In the International business, we are focused on capitalizing on the growth of the high net worth population outside the U.S. and Canada leveraging our strong underwriting capabilities for large life insurance cases and our understanding of Clients' life insurance needs in key geographic regions. We will continue to leverage our deep distribution relationships and reputation in this market. We are developing new products and technology and enhancing our underwriting capabilities for our International life business, while continuing to serve our in-force International wealth Clients.

While growing our Group Benefits and International businesses, we are also focused on optimizing the underlying value of our In-force Management business which continues to generate earnings for SLF U.S.

### 2016 Business Highlights

We continued to improve performance in our business:

- In the first quarter of 2016, we closed the acquisition of the U.S. employee benefits business, creating the sixth largest group benefits business in the U.S. based on 2015 revenue, adding a dental business with the second largest dental provider network in the U.S., and accelerating the development of our worksite voluntary business.
- Integration of the U.S. employee benefits business acquired in 2016 remains on track and we are on target to deliver the planned synergies. We are achieving our objectives in integrating our products, technology platforms, and organizational structures.
- In Group Benefits, the management actions we have taken over the past few years, including improving our pricing and risk selection, reducing expenses, and managing claims, continued to improve the profitability of the life and disability business in 2016.
- International launched a new life insurance product to broaden our offering in the international life insurance market. We also leveraged our distinct capabilities to continue to underwrite profitable business in our target geographies.

## Financial and Business Results

### Summary statements of operations

(US\$ millions)	2016	2015	2014
Net premiums	4,302	3,307	3,959
Net investment income	1,597	645	2,795
Fee income	172	164	163
<b>Revenue</b>	<b>6,071</b>	<b>4,116</b>	<b>6,917</b>
Client disbursements and change in insurance contract liabilities	4,800	3,421	5,967
Commissions and other expenses	1,376	950	1,181
Reinsurance expenses (recoveries)	(541)	(577)	(613)
Income tax expense (benefit)	47	71	74
Participating policyholders' income and non-controlling interests in net income of subsidiaries	4	–	3
<b>Reported net income (loss)</b>	<b>385</b>	<b>251</b>	<b>305</b>
Less: Acquisition, integration and restructuring <sup>(1)</sup>	(42)	(46)	–
<b>Operating net income (loss)<sup>(2)</sup></b>	<b>427</b>	<b>297</b>	<b>305</b>
Less: Market related impacts	13	26	(37)
Less: Assumption changes and management actions	75	(70)	102
<b>Underlying net income (loss)<sup>(2)</sup></b>	<b>339</b>	<b>341</b>	<b>240</b>

### Selected financial information in Canadian dollars

(C\$ millions)	2016	2015	2014
<b>Revenue</b>	<b>8,024</b>	<b>5,253</b>	<b>7,637</b>
<b>Reported net income (loss)</b>	<b>508</b>	<b>333</b>	<b>341</b>
Less: Acquisition, integration and restructuring <sup>(1)</sup>	(55)	(63)	–
<b>Operating net income (loss)<sup>(2)</sup></b>	<b>563</b>	<b>396</b>	<b>341</b>
Less: Market related impacts	19	30	(40)
Less: Assumption changes and management actions	97	(75)	115
<b>Underlying net income (loss)<sup>(2)</sup></b>	<b>447</b>	<b>441</b>	<b>266</b>
<b>Operating ROE (%)<sup>(2)</sup></b>	<b>12.4</b>	<b>11.2</b>	<b>11.3</b>
<b>Underlying ROE (%)<sup>(2)</sup></b>	<b>9.9</b>	<b>12.8</b>	<b>8.9</b>

(1) In 2016 Acquisition, integration and restructuring amounts related to the acquisition costs of the U.S. employee benefits business acquired in 2016 in Group Benefits. In 2015, Acquisition, integration and restructuring amounts consisted of the impact of US\$46 million related to the closing of our wealth business in SLF U.S. International to new sales, which included assumption changes and management actions of US\$30 million to reflect assumption updates including the expense strengthening associated with closing the business.

(2) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

SLF U.S.'s reported net income was C\$508 million in 2016, compared to C\$333 million in 2015. Operating net income was C\$563 million in 2016, compared to C\$396 million in 2015. Operating net income in SLF U.S. excludes the impact of acquisition, integration and restructuring amounts which included assumption changes and management actions related to the closing of our International wealth business to new sales in 2015, which are set out in the table above. Underlying net income was C\$447 million in 2016, compared to C\$441 million in 2015. The impact of the weakening Canadian dollar in 2016 relative to average exchange rates in 2015 increased reported net income, operating net income and underlying net income by C\$18 million, C\$20 million and C\$16 million, respectively.

In U.S. dollars, SLF U.S.'s reported net income was US\$385 million in 2016, compared to US\$251 million in 2015. Operating net income was US\$427 million in 2016, compared to US\$297 million in 2015. Underlying net income was US\$339 million in 2016, compared to US\$341 million in 2015. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The favourable effect of market related impacts in 2016 was primarily driven by interest rates partially offset by credit spreads, compared to a favourable impact in 2015 primarily driven by credit spreads partially offset by equity market changes. Assumption changes and management actions in 2014 included the release of the future funding cost liability of US\$170 million related to our closed block of individual universal life insurance products.

Net income in 2016 also reflected the contribution of the U.S. employee benefits business acquired in 2016 that included favourable morbidity experience, and also reflected favourable credit experience, gains from investing activity on insurance contract liabilities, gains on the sale of AFS assets, and favourable mortality experience in International. These items are partially offset by unfavourable morbidity experience in stop-loss and unfavourable mortality experience in Group Benefits and In-force Management.

Net income in 2015 also reflected the impact in Group Benefits related to pricing increases on new and renewing business, expense actions, and continued investment in our disability claim operations. Results also reflected positive credit experience, net realized gains on the sale of AFS assets, favourable tax items related to prior years, the favourable impact of investing activities on insurance contract liabilities, favourable mortality experience in International, and a change to post-retirement benefit liabilities. These items were partially offset by unfavourable underwriting experience in Group Benefits and unfavourable mortality and policyholder behaviour experience in In-force Management.

Revenue for the year ended December 31, 2016 was US\$6.1 billion, an increase of US\$2.0 billion from 2015, primarily due to an increase in net investment income of US\$1.0 billion combined with an increase in net premiums of US\$1.0 billion. The increase in net investment income was largely due to increases in the fair value of FVTPL assets. The increase in premiums was largely due to the contribution of the U.S. employee benefits business acquired in 2016.

## Results by Business Unit

### Net income by business unit

(US\$ millions)	2016	2015	2014
<b>Reported net income (loss)</b>	<b>385</b>	251	305
Acquisition, integration and restructuring <sup>(1)</sup>	(42)	(46)	–
<b>Operating net income (loss)<sup>(2)</sup></b>	<b>427</b>	297	305
Group Benefits <sup>(2)</sup>	115	99	(55)
International <sup>(2)</sup>	222	114	161
In-force Management <sup>(2)</sup>	90	84	199

(1) In 2016 Acquisition, integration and restructuring amounts related to the acquisition costs of the U.S. employee benefits business acquired in 2016 in Group Benefits.

(2) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

### Group Benefits

The SLF U.S. Group Benefits business unit leverages its underwriting and claims capabilities and extensive distribution network to provide one of the broadest product portfolios in the industry including group life, long-term and short-term disability, medical stop-loss, dental and vision insurance, as well as a suite of voluntary products, to over 10 million group plan members and their dependents. Group Benefits also includes Disability Reinsurance Management Services, Inc., which provides turnkey disability risk management products and services to other insurance companies. Following the U.S. employee benefits business acquisition in 2016, the Group Benefits business now serves more than 60,000 employers in small, medium and large workplaces and has business in-force of US\$3.8 billion. Our products are sold through more than 28,000 independent brokers and benefits consultants and we support these brokers and consultants through a national team of sales representatives and a group of centralized internal sales representatives. Acquiring and retaining profitable business, building distribution effectiveness, enhancing the Client experience and driving operational efficiency are key drivers of our growth strategy.

We have a leadership position in the U.S. medical stop-loss insurance market, which provides insurance for companies that self-insure their medical plans by covering medical expenses in excess of a stated threshold. We provide coverage to nearly 1,900 employers with a median case size of approximately 400 employees. Gross premiums increased 16% in 2016, compared to 2015. We continue to grow and respond to emerging market trends to sustain our historically strong margins.

In our group life and disability businesses, the actions we have taken over the past several years to increase prices, enhance our underwriting processes, add resources to claims operations and reduce expenses continued to improve earnings. In our disability product lines, we are also leveraging our claims management and return to work capabilities, supporting workplace productivity gains for our employers to drive profitable, sustainable growth.

We offer a full spectrum of dental and vision products and capabilities, delivering the right product solution to best fit a Client's needs. We have the second largest preferred provider network ("PPO") in the U.S., with almost 123,000 dentists. Our large provider network and network recruiting capabilities have driven profitable growth in the small and mid-size case segments. We provide coverage to almost two million dental plan members and their dependents.

We are continuing to build out our product offerings and enrollment capabilities in our voluntary business, leveraging the new capabilities and technology that we acquired, and that have contributed to success of the U.S. employee benefits business in the voluntary market.

Group Benefits' reported net income was US\$73 million in 2016, compared to a reported net income of US\$99 million in 2015. Operating net income was US\$115 million, compared to an operating net income of US\$99 million in 2015. Operating net income excluded the impact of acquisition, integration and restructuring amounts related to our acquisition of the U.S. employee benefits business in 2016.

Net income for Group Benefits in 2016 reflected the contribution from the acquired business which included the expected expense synergies for 2016 and favourable morbidity experience. This was partially offset by unfavourable morbidity experience in stop-loss and unfavourable mortality experience. Net income in 2015 reflected the impact of price increases, expense actions, continued investment in our disability claim operations, positive credit experience and the favourable impact of actuarial assumption changes, partially offset by unfavourable underwriting experience.

Sales in Group Benefits in 2016 of US\$794 million increased 43% compared to 2015 and business in-force of US\$3.8 billion as at December 31, 2016 increased 46% compared to 2015, reflecting the contribution of the U.S. employee benefits business acquired in 2016.

### International

International offers individual life insurance solutions to high net worth individuals residing outside the U.S. and Canada. We have had a consistent presence in this market for nearly two decades and have built deep distribution relationships, a strong brand reputation, and strong underwriting capabilities, which combined with overall growth in the international high net worth market, have led to business growth over the past few years. As the population of international high net worth individuals and families continues to rise, we are focused on delivering insurance and intergenerational wealth transfer solutions. We also manage a block of International wealth investment products, which is closed to new sales.

International's reported net income was US\$222 million in 2016, compared to US\$68 million in 2015. Operating net income was US\$222 million in 2016, compared to US\$114 million in 2015. Operating net income excluded the impact of acquisition, integration and restructuring amounts which included assumption changes and management actions related to the closing of our International wealth business to new sales in 2015. Net income in 2016 largely included the net positive impact of assumption changes and management actions, as well as favourable net market impacts, favourable credit experience, the impact of favourable investing activity on insurance contract liabilities, and favourable mortality experience. Net income in 2015 reflected positive credit experience, favourable investing activity, and favourable mortality experience, partially offset by the impact of closing wealth products to new business.

Sales in International life insurance in 2016 were US\$71 million, an increase of 16% compared to 2015.

### **In-force Management**

SLF U.S.'s closed block of individual life insurance products consists of approximately 120,000 policies, primarily universal life and participating whole life insurance. Our In-force Management operations are focused on optimizing profitability and capital efficiency while continuing to provide high-quality service to Clients.

In-force Management's reported net income and operating net income were US\$90 million in 2016, compared to US\$84 million in 2015. Net income in 2016 included favourable credit experience and net realized gains on the sale of AFS assets, partially offset by the net adverse impact of assumption changes and management actions, unfavourable mortality experience, and unfavourable policyholder behaviour. Net income in 2015 included the net adverse impact of assumption changes and management actions. As well, results in 2015 reflected positive credit experience, net realized gains on the sale of AFS assets, the positive impact of changes in interest rates and credit spreads, a change to post-retirement benefit liabilities, and favourable tax items related to prior years, partially offset by unfavourable mortality and policyholder behaviour experience.

### **2017 Outlook and Priorities**

SLF U.S. will leverage its expanded product offering, scale and capabilities to achieve sustainable profitable growth. Successfully integrating the acquired U.S. employee benefits business will be a key priority for us over the next two years. International will leverage its specialized expertise in the international life insurance market to meet the complex needs of high net worth Clients and use its unique capability to underwrite large cases.

In the United States, employers are facing increasing complexity and costs which are expected to drive demand for supplemental insurance products including voluntary products and absence management capabilities that increase workplace productivity. As more employers decide to self-insure, the need for medical stop-loss coverage is expected to accelerate. Growth in the international market is being driven by the increase of high net worth individuals and families and new regulations that are creating demand in new geographies for trusted financial insurance and wealth transfer products.

SLF U.S. will leverage the capabilities we have built over the past several years and gained through the acquired U.S. employee benefits business, to drive sustainable growth. We will focus on enhancing profitability by executing the following components of our strategy:

- Driving growth in stop-loss by continuing to leverage our market-leading expertise, expanding distribution, developing differentiated products and services, and capitalizing on new market opportunities.
- Continuing to execute management actions to improve profitability in Group Benefits, investing in service, claims, and large case capabilities, and leveraging new capabilities and increased scale from the acquired U.S. employee benefits business to drive growth in the group and voluntary disability, dental and life insurance businesses.
- Building market share in International by focusing on profitable and growing geographies, improving the Client experience and enhancing our life insurance products and capabilities.
- Continuing to seek opportunities to optimize the In-force Management business through effective risk and capital management while continuing to serve our Clients.

## **SLF Asset Management**

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### **Business Profile**

SLF Asset Management is our asset management segment composed of MFS and SLIM.

MFS is a premier global asset management firm with investment offices in Boston, Hong Kong, London, Mexico City, Sao Paulo, Singapore, Sydney, Tokyo and Toronto, which offers a comprehensive selection of financial products and services. Drawing on an investment heritage that emphasizes collaboration and integrity, MFS actively manages assets for retail and institutional investors around the world through mutual and commingled funds, separately managed accounts, institutional products and retirement strategies.

SLIM is an institutional investment management business and has operations based in the U.S. and Canada. SLIM delivers customized fixed income solutions, including liability-driven investing, and a suite of alternative, yield-oriented asset classes, including private fixed income, real estate, and commercial mortgages.

### **Strategy**

The SLF Asset Management strategy is to design and deliver investment products through MFS and SLIM, that will deliver growth in traditional active asset management as well as liability-driven investing and alternative asset classes.

MFS continually strives to deliver superior investment performance and distinctive service to its retail and institutional Clients. The core tenets of MFS's investment approach are integrated research, global collaboration and active risk management. MFS also seeks to deepen relationships to become a trusted Client partner.

SLIM designs and delivers investment solutions for institutional investors through a comprehensive set of asset management capabilities that allow Clients with liability streams to meet their investment objectives through customized fixed income portfolios and alternative asset classes.

## 2016 Business Highlights

- 61%, 75% and 97% of MFS's U.S. retail mutual fund assets ranked in the top half of their Lipper categories based on three-, five- and ten-year performance, respectively, as of December 31, 2016.
- We continued our integrations of the completed acquisitions of Bentall Kennedy, Prime Advisors, and Ryan Labs in 2015, extending the capabilities of SLIM. SLIM's net sales were \$4.5 billion and AUM were \$53.2 billion.
- We continued to invest in our technological infrastructure to ensure MFS continues to deliver world-class Client service and to support future growth.
- Bentall Kennedy was ranked among the top five firms globally in the 2016 Global Real Estate Sustainability Benchmark rankings. This is the sixth year that the team at Bentall Kennedy has received this recognition.

## Financial and Business Results

### Summary statements of operations

(C\$ millions)

	2016	2015	2014
<b>Revenue</b>	<b>3,929</b>	3,731	3,025
Commissions and other expenses	<b>2,807</b>	2,616	2,202
Income tax expense (benefit)	<b>393</b>	424	332
<b>Reported net income</b>	<b>729</b>	691	491
Less: MFS's fair value adjustments on share-based payment awards	<b>30</b>	(9)	(125)
<b>Operating net income<sup>(1)</sup></b>	<b>699</b>	700	616
<b>Underlying net income<sup>(1)</sup></b>	<b>699</b>	700	616
<b>Assets under management (C\$ billions)<sup>(1)</sup></b>	<b>624.8</b>	629.6	500.7
<b>Sales (C\$ billions)<sup>(1)</sup></b>			
Gross <sup>(2)</sup>	<b>116.3</b>	99.5	91.1
Net <sup>(2)</sup>	<b>(12.2)</b>	(19.9)	1.2

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

(2) During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Gross sales for SLF Asset Management were previously reported as \$100.5 billion and net outflows were \$19.0 billion in 2015. For additional information, see Financial Performance – Sales.

SLF Asset Management's reported net income was C\$729 million in 2016, compared to C\$691 million in 2015. SLF Asset Management had operating net income and underlying net income of C\$699 million in 2016, compared to C\$700 million in 2015. Operating net income and underlying net income in SLF Asset Management excludes the impact of fair value adjustments on MFS's share-based payment awards, which is set out in the table above. The impact of the weakening Canadian dollar in 2016 relative to average exchange rates in 2015 increased reported net income, operating net income and underlying net income by \$25 million, \$24 million and \$24 million, respectively.

SLF Asset Management's net income increased in 2016 compared to the same period in 2015 primarily due to the 2015 acquisitions in SLIM.

Revenue for the year ended December 31, 2016 was \$3,929 million, compared to \$3,731 million in 2015. The increase was primarily due to the 2015 acquisitions in SLIM.

## Results by Business Unit

### MFS

(C\$ millions)	2016	2015	2014
<b>Reported net income</b>	<b>700</b>	679	491
Less: Fair value adjustments on share-based payment awards	30	(9)	(125)
<b>Operating net income<sup>(1)</sup></b>	<b>670</b>	688	616
<b>Assets under management (C\$ billions)<sup>(2)</sup></b>	<b>571.6</b>	571.9	500.7
<b>Sales (C\$ billions)<sup>(2)</sup></b>			
Gross	108.2	96.5	91.1
Net	(16.7)	(20.5)	1.2

### Financial information in U.S. dollars

(US\$ millions)	2016	2015	2014
<b>Reported net income</b>	<b>528</b>	531	443
Less: Fair value adjustments on share-based payment awards	22	(9)	(114)
<b>Operating net income<sup>(1)</sup></b>	<b>506</b>	540	557
<b>Pre-tax operating profit margin ratio<sup>(2)</sup></b>	<b>36%</b>	40%	41%
<b>Assets under management (US\$ billions)<sup>(2)</sup></b>	<b>425.6</b>	413.2	431.0
<b>Average net assets (US\$ billions)<sup>(2)</sup></b>	<b>421.7</b>	434.0	425.5
<b>Sales (US\$ billions)<sup>(2)</sup></b>			
Gross	81.7	75.8	82.5
Net	(12.6)	(15.7)	1.2

(1) Represents a non-IFRS financial measure. For SLF Asset Management, underlying net income is generally expected to be equal to operating net income. See Non-IFRS Financial Measures.

(2) Pre-tax operating profit margin ratio, AUM, average net assets, and sales are non-IFRS financial measures. See Non-IFRS Financial Measures.

MFS actively manages assets for retail and institutional investors. Retail products, such as open- and closed-end mutual funds and private portfolios, are distributed through financial advisors and other professional buyers at major wirehouses, regional brokerage firms, independent broker dealers, bank-registered investment advisors, and wealth management firms. MFS also manages assets for institutional Clients and discretionary managers, including corporate and public pension plans, defined contribution plans, multi-employer plans, sovereign wealth funds, investment authorities, and endowments and foundations. Institutional products are sold by an internal sales force, which is aided by a network of independent consultants.

MFS's reported net income for 2016 was US\$528 million, compared to US\$531 million for 2015. MFS's operating net income was US\$506 million in 2016, compared to US\$540 million in 2015. MFS's operating net income in U.S. dollars for the year ended December 31, 2016 decreased compared to the same period in the prior year, primarily due to lower average net assets and higher operating costs.

### MFS AUM by Category

(US\$ billions)	2016	2015	2014
Institutional	157	157	173
U.S. Retail	183	169	168
Non-U.S. Retail	29	31	28
Insurance	57	56	62
<b>MFS AUM<sup>(1)</sup></b>	<b>426</b>	413	431

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures. Monthly Information on AUM is provided by MFS in its Corporate Fact Sheet, which can be found in the About MFS section of its website at [www.mfs.com/CorpFact](http://www.mfs.com/CorpFact).

AUM ended 2016 at US\$426 billion, an increase of 3% for the year, primarily driven by gross sales of US\$81.7 billion and asset appreciation of US\$25.0 billion, partially offset by redemptions of US\$94.3 billion. In 2016, Mutual funds experienced US\$0.6 billion in net outflows while managed funds had net outflows of US\$12.0 billion.

## SLIM

(C\$ millions)

	2016	2015
<b>Reported net income</b>	<b>29</b>	12
<b>Operating net income<sup>(1)</sup></b>	<b>29</b>	12
<b>Assets under management (C\$ billions)<sup>(1)</sup></b>	<b>53.2</b>	57.8
<b>Sales (C\$ billions)<sup>(1)(2)</sup></b>		
Gross	<b>8.1</b>	3.1
Net	<b>4.5</b>	0.5

<sup>(1)</sup> Represents a non-IFRS financial measure. For SLF Asset Management, underlying net income is generally expected to be equal to operating net income. See Non-IFRS Financial Measures.

<sup>(2)</sup> During 2016, we moved our sales reporting methodology for Bentall Kennedy's real estate investment management operations from an investment property activity basis to a Client cash flow basis to be consistent with the method used in our existing asset management operations. Gross sales and net sales for SLIM were previously reported as \$4.0 billion and \$1.5 billion in 2015, respectively. The revised sales reporting in SLIM is included in SLF Asset Management's gross and net sales. For additional information, see Financial Performance – Sales.

SLIM delivers customized fixed income solutions including liability-driven investing through: (i) Bentall Kennedy group of Companies, a real estate investment manager operating in Canada and the U.S.; (ii) Prime Advisors, Inc. ("Prime Advisors"), a U.S.-based investment management firm specializing in customized fixed income portfolios primarily for U.S. insurance companies; (iii) Ryan Labs Asset Management Inc., a New York-based asset manager specializing in fixed income and liability-driven investing; and (iv) Sun Life Institutional Investments (Canada) Inc. ("SLIIC") (previously called Sun Life Investment Management Inc.), our Canadian institutional asset manager which provides investment expertise in alternative asset classes and liability-driven investing to pension funds and other institutional investors. SLIM products are sold by the individual companies through internal sales teams.

SLIM's reported net income and operating net income for the year ended December 31, 2016 was C\$29 million, compared to C\$12 million in 2015. SLIM's net income in 2016 primarily reflected the results of the 2015 acquisitions in SLIM.

SLIM's AUM was C\$53.2 billion as at December 31, 2016, compared to C\$57.8 billion as at December 31, 2015. This decrease was mainly due to a \$9 billion decrease relating to a Client of Bentall Kennedy which exercised its right to acquire certain wholly-owned subsidiaries involved in the management of its assets<sup>(1)</sup> and due to the strengthening of the Canadian dollar relative to the exchange rates at the end of the fourth quarter of 2015, partially offset by net sales and asset appreciation.

## 2017 Outlook and Priorities

MFS's active management strategy focuses on delivering value to our Clients over the long term and our strong relative performance puts us in a competitive position over other asset managers. Notwithstanding a move by some investors to follow passive strategies, MFS is well positioned to attract flows from all Client sectors that are seeking capital appreciation over the long term based on our disciplined, long-term approach with a successful track record. Institutional investors are increasingly turning to solutions and alternative assets to help match assets and liabilities. SLIM's strategy is based on extending how we manage Sun Life Financial's general account to third-party institutional investors which, like Sun Life Financial, have long-dated liabilities that they must meet. SLIM's investment philosophy revolves around the belief that portfolios should be managed in a customized manner aligned with the profile of an institution's liabilities and that alternative, yield-oriented asset classes (such as private fixed income and real estate) can enhance returns.

SLF Asset Management 2017 priorities include four primary objectives:

- Deliver superior investment performance.
- Continue to raise the bar in providing exceptional service based on a deep understanding of Client needs.
- At MFS, focus particularly on our Blended Research products, which combine both fundamental and quantitative research, and on expanding our fixed income capabilities in strategies targeted to the institutional marketplace.
- At SLIM, leverage the capabilities of Bentall Kennedy, Prime Advisors, Ryan Labs and SLIIC to develop new products and expand distribution.

Initiatives related to expanding distribution, products, Client management and brand have been established to enable MFS and SLIM to accomplish these priorities. These initiatives are supported by an ongoing focus on people to ensure performance and growth objectives are achieved.

## SLF Asia

### Business Profile

Sun Life Financial's history in Asia dates back to the early 1890s. Today, SLF Asia operates through subsidiaries in the Philippines, Hong Kong, Indonesia<sup>(2)</sup>, and Vietnam<sup>(3)</sup>, as well as through joint ventures and associates with local partners in the Philippines, India<sup>(4)</sup>, China and Malaysia. These seven markets account for over 70% of Asia's total population. Our Regional Office in Hong Kong facilitates growth opportunities in Asia, and supports the sharing of best practices and resources throughout SLF Asia's operations.

We offer individual life insurance products in all seven markets, and group benefits and/or pension and retirement products in the Philippines, Hong Kong, Vietnam, India, China and Malaysia. We have also established asset management companies either directly or through joint ventures and associates in the Philippines, India and China. We distribute these insurance and wealth products to middle- and upper-income individuals, groups and affinity Clients through multiple distribution channels, with agency remaining the largest distribution channel. This helps move forward our goal of growing Asia through distribution excellence in higher growth markets.

<sup>(1)</sup> The transfer of the assets is expected to be completed in the first quarter of 2017, and from June 30, 2016, assets of \$9 billion related to this are not reported in SLIM's AUM.

<sup>(2)</sup> On July 1, 2016, we increased our ownership interest in PT CIMB Sun Life in Indonesia from 49% to 100%.

<sup>(3)</sup> We increased our ownership stake in Sun Life Vietnam from 49% to 75% on January 7, 2016, and to 100% on November 9, 2016.

<sup>(4)</sup> On April 11, 2016, we increased our ownership stake in BSLI in India from 26% to 49%.

## Strategy

Our goal is to strengthen our competitive position in Asia and to develop into a significant long-term revenue and earnings growth operation. As such, we continue to develop innovative products, expand distribution channels and leverage the Company's existing asset management capability in Asia. Local initiatives complement our efforts to leverage our worldwide resources to bring industry-leading products, services and best practices to Asia.

## 2016 Business Highlights

- We have continued to invest in our Asia business, including acquiring full ownership of Sun Life Vietnam Insurance Company Limited, announcing we have agreed to an exclusive 15-year distribution agreement with FWD Life Insurance Company (Bermuda) Limited ("FWD") in Hong Kong and also to acquire its pension business consisting of the Mandatory Provident Fund and Occupational Retirement Schemes Ordinance businesses, acquiring full ownership of PT CIMB Sun Life in Indonesia and extending our bancassurance arrangement with PT Bank CIMB Niaga in Indonesia, and increasing our ownership in Birla Sun Life Insurance in India to 49%.
- In the Philippines, individual insurance sales continued to grow, with agency sales increasing by 5% from 2015 and agency force growing to approximately 9,200 advisors as at the end of 2016. Sun Life of Canada (Philippines), Inc. maintained its position as the leading life insurance company in the Philippines.
- In Hong Kong, individual insurance sales grew 47% compared to 2015, measured in local currency, with 12% growth in agency and 130% in the financial intermediary channel. Agency headcount reached approximately 1,900 as at the end of 2016. Pension AUM reached C\$6.5 billion, a growth of 17%, measured in local currency, compared to 2015.
- In Indonesia, individual insurance sales grew 24% from 2015, measured in local currency, with agency headcount ending at approximately 10,100 as at the end of 2016.
- In Vietnam, agency sales grew from 2015, measured in local currency, due to organic growth and our increase in ownership in Sun Life Vietnam, and agency headcount was approximately to 2,900 as at the end of 2016.
- In India, individual insurance sales increased by 85% from 2015, measured in local currency, due to our increase in ownership in BSLI as well as organic sales growth. AUM of Birla Sun Life Asset Management Company ("BSLAMC"), our asset management joint venture, reached C\$18 billion.
- In China, individual insurance sales grew by 40% from 2015, with 87% growth in agency and 29% growth in bancassurance, measured in local currency.
- In Malaysia, individual insurance sales increased by 25% from 2015, measured in local currency, driven by growth in the bancassurance channel.

## Financial and Business Results

### Summary statements of operations

(\$ millions)	2016	2015	2014
Net premiums	1,854	1,171	804
Net investment income	761	52	832
Fee income	341	306	230
<b>Revenue</b>	<b>2,956</b>	1,529	1,866
Client disbursements and change in insurance contract liabilities	1,970	524	1,125
Commissions and other expenses	611	646	516
Income tax expense (benefit)	51	48	43
Participating policyholders' income and non-controlling interests in net income of subsidiaries	15	–	–
<b>Reported net income</b>	<b>309</b>	311	182
Less: Acquisition, integration and restructuring <sup>(1)</sup>	33	–	–
<b>Operating net income<sup>(2)</sup></b>	<b>276</b>	311	182
Less: Market related impacts	(13)	19	(12)
Less: Assumption changes and management actions	(6)	40	20
<b>Underlying net income<sup>(2)</sup></b>	<b>295</b>	252	174
<b>Operating ROE (%)<sup>(2)</sup></b>	<b>7.0</b>	9.2	6.8
<b>Underlying ROE (%)<sup>(2)</sup></b>	<b>7.5</b>	7.4	6.5

<sup>(1)</sup> In 2016, Acquisition, integration and restructuring amounts relate primarily to an adjustment for a non-cash gain of \$37 million to our reported net income as a result of both remeasuring our existing investment to fair value upon acquiring control over the operations of Sun Life Vietnam and remeasuring our existing investment to fair value upon acquiring control over the operations of PT CIMB Sun Life in Indonesia, partially offset by acquisition and integration costs.

<sup>(2)</sup> Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

Reported net income was \$309 million for 2016, compared to \$311 million for the same period in the prior year. Operating net income was \$276 million for 2016, compared to \$311 million for the same period in the prior year. Operating net income excludes the impact of acquisition, integration and restructuring amounts, which is set out in the table above. The impact of the change in the Canadian dollar in 2016 relative to average exchange rates in 2015 increased reported net income and operating net income by \$2 million and underlying net income by \$1 million.

Underlying net income for 2016 was \$295 million, compared to \$252 million for the same period in the prior year. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The unfavourable effect of market related impacts in 2016 was primarily driven by interest rates, compared to the favourable effect in 2015 primarily driven by equity markets and interest rates.

Net income for 2016 also reflected favourable impacts from business growth, partially offset by growth in our expenses including investment in our business, relative to 2015. Net income in both periods reflected the favourable effect of net realized gains on the sale of AFS assets.

SLF Asia's revenue was \$3.0 billion in 2016 compared to \$1.5 billion in 2015 due to organic business growth, increase in our ownership in our insurance businesses in Indonesia and Vietnam, and increases in the fair value of FVTPL assets in 2016 compared to net losses in 2015.

The following table shows the sales of individual insurance products by country in SLF Asia.

#### Individual insurance sales<sup>(1)</sup>

(\$ millions)	2016	2015	2014
Philippines	179	178	133
Hong Kong	217	144	124
Indonesia	57	45	41
India	68	37	40
China	55	40	49
Vietnam	9	9	7
Malaysia	43	35	28
<b>Total</b>	<b>628</b>	<b>488</b>	<b>422</b>

(1) Sales from joint ventures in the Philippines, Malaysia, China and India are based on our proportionate equity interest. We increased our ownership stake in Sun Life Vietnam from 49% to 100% during 2016, our stake in BSLI in India from 26% to 49% on April 11, 2016, and our stake in PT CIMB Sun Life in Indonesia from 49% to 100% on July 1, 2016.

Total individual life sales for 2016 were \$628 million, up 29% from 2015. On a constant currency basis, individual insurance sales increased 28%. Sales increased across the region, driven by organic sales growth as well as our increased ownership in our insurance businesses in India, Indonesia and Vietnam. We continued to build our agency and alternate distribution channels, leverage a more balanced product portfolio and increase efficiency and productivity while maintaining Client focus.

## Results by Business Unit

### Philippines

Our operations in the Philippines, established in 1895, distribute a diverse range of insurance and savings products largely through our career agency sales force and bancassurance channel. We offer individual and group life and health insurance products to individuals and businesses through our wholly-owned subsidiary, Sun Life of Canada (Philippines), Inc., and our joint venture with the Yuchengco Group, Sun Life Grepa Financial, Inc., in which we have a 49% ownership stake. In addition, we offer mutual funds through our wholly-owned subsidiary, Sun Life Asset Management Company.

Sun Life of Canada (Philippines), Inc. maintained its position as the leading life insurance company in the Philippines. Our career agency sales force increased by 20% to approximately 9,200 advisors in 2016. On a local currency basis, individual insurance sales were up 2% from 2015. Mutual fund AUM were C\$1.3 billion as at the end of 2016, 4% lower than 2015, measured in local currency.

### Hong Kong

Our Hong Kong operations offer a full range of products to address insurance and savings needs. We offer individual life and health insurance, mandatory provident funds (the government-legislated pension system), and pension administration to individuals and businesses through a career sales agency force and independent financial advisors.

Agency headcount reached approximately 1,900 as at the end of 2016. On a local currency basis, individual insurance sales were up 47% from 2015, with 12% growth in the agency channel and 130% growth in the financial intermediary channel. AUM in our pension business reached C\$6.5 billion, up 17% from 2015, measured in local currency.

### Indonesia

In Indonesia, we offer individual life and health insurance, as well as creditor life insurance, through a multi-channel distribution network. On July 1, 2016, we increased our ownership interest in PT CIMB Sun Life, our joint venture with PT Bank CIMB Niaga, from 49% to 100%. We also entered into an extended bancassurance arrangement with PT Bank CIMB Niaga to strengthen our distribution capabilities, serving the bank's Clients on an exclusive basis for most insurance products.

On a local currency basis, our individual life insurance sales in Indonesia were up 24% from 2015, driven primarily by organic growth in the bancassurance channel and increase in our ownership in PT CIMB Sun Life. Agency headcount increased to approximately 10,100 in 2016.

### Vietnam

In Vietnam, we offer individual insurance and pensions through Sun Life Vietnam Insurance Company Limited, our subsidiary, in which we increased our ownership stake from 49% to 100% during 2016 (from 49% to 75% on January 7, 2016, and to 100% on November 9, 2016). The products are distributed through a career agency sales force and a corporate sales team.

On a local currency basis, agency sales in Vietnam increased from 2015, as a result of strong sales momentum from our career agency force which reached approximately 2,900 advisors at the end of 2016, as well as increase in our ownership.

### India

Birla Sun Life Insurance Company Limited, our insurance joint venture with the Aditya Birla Group in India<sup>(1)</sup>, provides a full range of individual and group insurance, savings and retirement products through a multi-channel distribution network, including a career agency sales force, bancassurance distribution, brokers and worksite marketing.

(1) Our joint venture with the Aditya Birla Group in India includes a 49% stake in BSLI, increased from 26% on April 11, 2016, and a 49% stake in BSLAMC.

In addition, Birla Sun Life Asset Management Company Limited<sup>(1)</sup>, our asset management joint venture in India, offers a full range of mutual fund products to both individual and institutional investors. Independent financial advisors and banks distribute BSLI's mutual funds to the retail sector, while direct distribution serves corporate Clients.

On a local currency basis, individual life insurance sales at BSLI were up 85% from 2015 driven by growth in both the agency and bancassurance channels and by increase in our ownership. On a local currency basis, total gross sales in Birla Sun Life Asset Management Company Limited were up 30%, and AUM increased 29% from 2015. Total AUM for Birla Sun Life Asset Management Company at the end of 2016 were C\$37.0 billion, of which C\$18.1 billion is reported in our AUM.

### **China**

Sun Life Everbright Life Insurance Company Limited ("SLEB"), in which we have a 24.99% ownership stake, operates a multi-distribution model that combines a direct career agency, financial consultants, telemarketing, and bancassurance alliances to sell individual life and health insurance and savings products. Its branches operate in provinces that represent approximately 70% of China's population. SLEB has a 99% ownership stake in the Sun Life Everbright Asset Management Co., Ltd.

On a local currency basis, sales of individual insurance products by SLEB were up 40% in 2016 compared to 2015, with 87% growth in the agency channel, 29% in bancassurance and 59% in telemarketing. Agency headcount reached approximately 2,500 at the end of 2016, up 70% from 2015.

### **Malaysia**

Our operations in Malaysia offer individual and group insurance through Sun Life Malaysia Assurance Berhad and Sun Life Malaysia Takaful Berhad, our joint ventures with Khazanah Nasional Berhad and CIMB Group Holdings Berhad, in which we have a 49% ownership stake. The companies have an exclusive bancassurance agreement with CIMB Group to distribute insurance and takaful products through CIMB's bank network across Malaysia.

On a local currency basis, individual insurance sales in Malaysia were up 25% in 2016 compared to 2015, driven by growth in the bancassurance channel.

## **2017 Outlook and Priorities**

Asia's economic growth has underpinned the expansion of the life insurance industry. This, combined with favourable demographics, low penetration rates for insurance and significant growth of the middle class, provides tremendous opportunities for SLF Asia. On the other hand, changing regulatory regimes, increased competition from new entrants in the Asian market and economic uncertainty pose challenges to our businesses.

In order to strengthen our competitive position and grow SLF Asia to be a more significant contributor to overall earnings, we intend to focus our efforts on the following strategic initiatives:

- Continuing to grow in our existing seven markets by executing on our multichannel distribution strategy to reach our Clients;
- Building value and profitability in the markets where we operate with strong financial discipline and risk management;
- Creating a competitive suite of products to meet our Clients' needs;
- Continuing to build our brand recognition in each market;
- Investing in digital technology to support growth; and
- Establishing a strong foundation of values, people and partnerships to execute our strategy.

## **Corporate**

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Our Corporate segment includes the results of SLF U.K. and Corporate Support.

SLF U.K. has a run-off block of business consisting of approximately 675,000 in-force life and pension policies, with approximately £12.2 billion of AUM. Since December 2010, SLF U.K. has been closed to new business and focuses on supporting existing Clients. Most administrative functions have been outsourced to external service providers which are managed by an in-house management team.

Corporate Support operations consist of the Company's Run-off reinsurance business as well as investment income, expenses, capital and other items not allocated to Sun Life Financial's other business segments. Our Run-off reinsurance business is a closed block of reinsurance assumed from other insurers. Coverage includes long-term care, medical coverage, and guaranteed minimum income and death benefit coverage. The block also includes group long-term disability and personal accident which are 100% retroceded.

<sup>(1)</sup> Our joint venture with the Aditya Birla Group in India includes a 49% stake in BSLI, increased from 26% on April 11, 2016, and a 49% stake in BSLAMC.

## Financial and Business Results

### Summary statements of operations

(\$ millions)	2016	2015	2014
Net premiums	118	(28)	124
Net investment income	1,327	160	1,398
Fee income	53	83	88
<b>Revenue</b>	<b>1,498</b>	215	1,610
Client disbursements and change in insurance contract liabilities	1,118	(132)	1,312
Commissions and other expenses	375	361	324
Income tax expense (benefit)	(94)	(140)	(95)
Dividends paid to preferred shareholders	96	100	111
<b>Reported net income (loss)</b>	<b>3</b>	26	(42)
Less: Acquisition, integration and restructuring:			
SLF U.K.	–	–	–
Corporate Support	(5)	(17)	(26)
<b>Operating net income (loss)<sup>(1)</sup></b>	<b>8</b>	43	(16)
Less: Market related impacts	(13)	14	6
Less: Assumption changes and management actions	14	11	41
<b>Underlying net income (loss)<sup>(1)</sup></b>	<b>7</b>	18	(63)

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

The reported net income was \$3 million in the Corporate segment in 2016, compared to a reported net income of \$26 million in 2015. Operating net income was \$8 million in 2016, compared to an operating net income of \$43 million in 2015. Operating net income excludes acquisition, integration and restructuring amounts in 2016 and 2015, which are set out in the table above. The strengthening Canadian dollar in 2016 relative to the U.K. pound in 2015 decreased reported net income, operating net income and underlying net income by \$16 million, \$16 million and \$15 million, respectively.

Underlying net income was \$7 million in 2016, compared to an underlying net income of \$18 million in 2015. Underlying net income excludes from operating net income market related impacts and assumption changes and management actions, which are set out in the table above. The unfavourable effect of market related impacts in 2016 was primarily driven by equity markets, partially offset by swap spreads, compared to a favourable effect in 2015, primarily driven by interest rates partially offset by equity markets.

### Net income by business unit

(\$ millions)	2016	2015	2014
<b>Reported net income (loss)</b>	<b>3</b>	26	(42)
<b>Acquisition, integration and restructuring:</b>			
SLF U.K.	–	–	–
Corporate Support	(5)	(17)	(26)
<b>Operating net income (loss)<sup>(1)</sup></b>	<b>8</b>	43	(16)
SLF U.K. <sup>(1)</sup>	<b>184</b>	200	174
Corporate Support <sup>(1)</sup>	<b>(176)</b>	(157)	(190)

(1) Represents a non-IFRS financial measure. See Non-IFRS Financial Measures.

### SLF U.K.

SLF U.K.'s operating net income was \$184 million in 2016, compared to \$200 million in 2015. Net income in 2016 reflected gains on investing activities on insurance contract liabilities primarily as a result of actions to reduce inflation risks related to annuity payments, assumption changes and management actions, and favourable policyholder behaviour, partially offset by unfavourable market impacts. Net income in 2015 reflected favourable effect of interest rates, currency impacts, policyholder behaviour, mortality experience, and assumption changes and management actions, partially offset by equity markets.

### Corporate Support

In Corporate Support, the operating net loss was \$176 million in 2016, compared to an operating net loss of \$157 million in 2015. The increase in loss in 2016 relative to 2015 was primarily due to incentive compensation costs related to strong operating results and long-term relative share performance.

## Investments

The Company strives to ensure that all general fund investments are properly aligned with business objectives, meeting policyholder obligations, and that adequate liquidity is maintained at all times. Consideration is given in our investment process to a wide range of factors, including ensuring attractive risk and return profiles, appropriate diversification by asset type, credit exposure and sector, financial condition of issuers and borrowers, quality and value of underlying security and macro- and micro-economic developments

and trends including prospects for specific industry sectors. The Risk Review Committee of the Board of Directors approves policies that contain prudent standards and procedures for the investment of our general fund assets. These policies include requirements, restrictions and limitations for interest rate, credit, equity market, real estate market, liquidity, concentration, currency and derivative risks. Compliance with these policies is monitored on a regular basis and reported annually to the Risk Review Committee. The Governance, Nomination & Investment Committee of the Board of Directors monitors the Company's Investment Plan and investment performance, oversees practices, procedures and controls related to the management of the general fund investment portfolio and the company's asset management businesses, and reviews corporate governance guidelines and processes.

## Investment Profile

We had total general fund invested assets of \$142.4 billion as at December 31, 2016, compared to \$138.0 billion as at December 31, 2015. The increase in general fund invested assets of \$4.4 billion was primarily due to changes in operating activity, net fair value growth and the acquisition of the U.S. employee benefits business in 2016, partially offset by the currency impact of the strengthening Canadian dollar relative to exchange rates at the end of the fourth quarter of 2015. Our general fund is primarily invested in fixed income instruments, including debt securities and mortgages and loans, with 85.3% of the general fund invested assets invested in cash and fixed income investments. Equity securities and investment properties represented 4.0% and 4.6% of the portfolio, respectively, and the remaining 6.1% of the portfolio consisted of policy loans, derivative assets, and other invested assets. Our general fund invested assets are well diversified across investment types, geographies and sectors.

Additional detail on our investments is provided in Notes 5 and 6 to our 2016 Annual Consolidated Financial Statements.

The following table sets out the composition of our general fund invested assets<sup>(1)</sup>.

Investments <sup>(1)</sup>	December 31, 2016			December 31, 2015		
	Carrying value	Fair value	% of total carrying value	Carrying value	Fair value	% of total carrying value
(\$ millions)						
Cash, cash equivalents and short-term securities	8,642	8,642	6.1%	8,983	8,983	6.5%
Debt securities – FVTPL	59,466	59,466	41.9%	56,785	56,785	41.2%
Debt securities – AFS	12,421	12,421	8.7%	13,111	13,111	9.5%
Equity securities – FVTPL	5,016	5,016	3.5%	4,426	4,426	3.2%
Equity securities – AFS	758	758	0.5%	887	887	0.6%
Mortgages and loans	40,775	43,104	28.6%	39,103	41,849	28.3%
Derivative assets	1,608	1,608	1.1%	1,866	1,866	1.4%
Other invested assets	3,931	3,931	2.8%	3,111	3,111	2.3%
Policy loans	3,141	3,141	2.2%	3,151	3,151	2.3%
Investment properties	6,592	6,592	4.6%	6,540	6,540	4.7%
<b>Total invested assets</b>	<b>142,350</b>	<b>144,679</b>	<b>100%</b>	<b>137,963</b>	<b>140,709</b>	<b>100%</b>

(1) The invested asset values and ratios presented are based on the carrying value of the respective asset categories. The carrying values for FVTPL and AFS invested assets are generally equal to their fair values. For invested assets supporting insurance contracts, in the event of default, if the amounts recovered are insufficient to satisfy the related insurance contract liability cash flows that the assets are intended to support, credit exposure may be greater than the carrying value of the assets.

## Energy and Mining

As a leading international financial services organization we have a highly diversified portfolio that includes a variety of investment types spread across a broad range of sectors and geographies. As at December 31, 2016, our direct exposure to energy and mining through our debt securities and corporate loan holdings was approximately \$6.1 billion or 4% of total invested assets, and our indirect exposure through our mortgage and real estate holdings was approximately \$3.0 billion<sup>(1)</sup> or 2% of total invested assets.

### Debt Securities and Corporate Loans

As at December 31, 2016, our holdings in debt securities and corporate loans in the energy sector were \$5.4 billion, where 93% was investment grade (\$5.6 billion, of which 93% was rated investment grade as at December 31, 2015)<sup>(2)</sup>. Approximately 47% of our energy sector portfolio was invested in pipeline, storage and transportation entities, 12% was invested in integrated oil and gas entities, and the remaining portion was invested in companies involved in exploration and production, refining, and drilling and servicing, which included 4% in drilling and oil field services. This compared to approximately 45%, 15%, and 7% as at December 31, 2015, respectively.

As at December 31, 2016, our metals and mining sub-sector<sup>(3)</sup> holdings consisted of debt securities and were \$0.7 billion, of which 88% was investment grade (\$0.8 billion, of which 97% was investment grade as at December 31, 2015) and which are diversified across several different commodity types.

(1) The indirect exposure from mortgages and real estate includes real estate holdings and uninsured mortgages in Alberta and Texas.

(2) The credit risk ratings were established in accordance with the process described in our annual MD&A under the heading Risk Categories – Credit Risk Management Governance and Control.

(3) The metals and mining sub-sector is included in the Materials line of the Debt Securities by Issuer and Industry Sector table included in the Debt Securities section of our 2016 annual MD&A.

## Mortgage and Real Estate

Our mortgage and real estate portfolio includes office, industrial, retail, and multi-family buildings occupied by tenants in diversified industries. Our most significant property holdings in the oil and gas sector are located in Alberta, where our real estate holdings represented approximately 20% of our global real estate portfolio and our uninsured mortgage holdings represented approximately 6% of our global mortgage portfolio as at December 31, 2016. Market fundamentals within the province have deteriorated as a result of the sustained weakness in energy prices which resulted in rising vacancy levels and lower rental rates. These trends, should they continue, may lead to further reductions in real estate valuations in the province particularly in the office sector.

Within our Alberta mortgage and real estate portfolio, there has been no significant increase in arrears, mortgage defaults, and tenant insolvencies. We continue to closely monitor the effects of market changes in the energy sector on the real estate and mortgage portfolios.

## Debt Securities

Our debt securities portfolio is actively managed through a regular program of purchases and sales aimed at optimizing yield, quality and liquidity, while ensuring that it remains well diversified and duration-matched to insurance contract liabilities. As at December 31, 2016, we held \$71.9 billion of debt securities, representing 50.6% of our total invested assets compared to \$69.9 billion, representing 50.7% as at December 31, 2015. Debt securities with a credit rating of "A" or higher represented 69.6% of the total debt securities as at December 31, 2016, compared to 67.9% as at December 31, 2015. Debt securities with a credit rating of "BBB" or higher represented 97.6% of total debt securities as at December 31, 2016, compared to 96.9% as at December 31, 2015.

Corporate debt securities not issued or guaranteed by sovereign, regional and municipal governments represented 64.4% of our total debt securities as at December 31, 2016, compared to 66.0% as at December 31, 2015. Total government issued or guaranteed debt securities as at December 31, 2016 were \$25.6 billion, compared to \$23.8 billion as at December 31, 2015. With the exception of certain countries where we have business operations, including Canada, the United States, the United Kingdom and the Philippines, our exposure to debt securities from any single country did not exceed 1% of total invested assets on our Consolidated Statements of Financial Position as at December 31, 2016.

The carrying value of debt securities of governments and financial institutions by geographic location is presented in the following table.

### Debt Securities of Governments and Financial Institutions by Geography

(\$ millions)	December 31, 2016		December 31, 2015	
	Government issued or guaranteed	Financials	Government issued or guaranteed	Financials <sup>(1)</sup>
Canada	17,371	1,476	15,411	1,416
United States	1,890	4,733	1,702	4,828
United Kingdom	2,201	1,085	2,561	1,481
Philippines	2,619	15	2,745	15
Eurozone <sup>(2)</sup>	219	697	237	829
Other	1,305	1,297	1,111	1,231
<b>Total</b>	<b>25,605</b>	<b>9,303</b>	<b>23,767</b>	<b>9,800</b>

(1) Our grouping of debt securities by sector is based on the Global Industry Classification Standard from S&P Dow Jones Indices. Certain real estate debt securities were moved out from the Financials sector as of September 1, 2016. \$2.5 billion has been reclassified out of the Financials sector as at December 31, 2015 for comparability.

(2) Our investments in Eurozone countries primarily included the Netherlands, Spain, Germany, and France. We did not have any direct exposure to Greece. Of our exposure to Eurozone countries, 99.8% was rated investment grade and 83.5% had a credit rating of "A" or higher as at December 31, 2016 and 99.1% was rated investment grade and 77.4% had a credit rating of "A" or higher as at December 31, 2015.

Our gross unrealized losses as at December 31, 2016 for FVTPL and AFS debt securities were \$0.72 billion and \$0.14 billion, respectively, compared with \$1.1 billion and \$0.22 billion, respectively, as at December 31, 2015. The decrease in gross unrealized losses was largely due to the impact of a decline in credit spreads offsetting the impact from rising interest rates.

## Debt Securities by Issuer and Industry Sector

(\$ millions)	December 31, 2016			December 31, 2015		
	FVTPL debt securities	AFS debt securities	Total	FVTPL debt securities	AFS debt securities	Total
Debt securities issued or guaranteed by:						
Canadian federal government	3,117	1,654	4,771	2,383	1,637	4,020
Canadian provincial and municipal government	11,452	1,148	12,600	10,555	836	11,391
U.S. government and agency	1,198	692	1,890	1,272	430	1,702
Other foreign government	5,578	766	6,344	5,916	738	6,654
Total government issued or guaranteed debt securities	21,345	4,260	25,605	20,126	3,641	23,767
Corporate debt securities by industry sector:						
Financials	7,757	1,546	9,303	7,867	1,933	9,800
Utilities	6,641	560	7,201	6,628	646	7,274
Consumer discretionary	2,465	693	3,158	2,375	893	3,268
Industrials	4,103	708	4,811	3,880	847	4,727
Consumer staples	2,253	442	2,695	2,100	580	2,680
Telecommunication services	1,786	288	2,074	1,859	372	2,231
Energy	3,900	516	4,416	3,727	831	4,558
Real estate <sup>(1)</sup>	1,977	324	2,301	2,038	418	2,456
Materials	1,203	263	1,466	1,249	319	1,568
Other	2,368	543	2,911	1,945	687	2,632
Total corporate debt securities	34,453	5,883	40,336	33,668	7,526	41,194
Asset-backed securities	3,668	2,278	5,946	2,991	1,944	4,935
Total debt securities	59,466	12,421	71,887	56,785	13,111	69,896

(1) Our grouping of debt securities by sector is based on the Global Industry Classification Standard from S&P Dow Jones Indices. Certain real estate debt securities were moved out from the Financials sector as of September 1, 2016 and classified under their own category. Prior periods were also restated.

Our debt securities as at December 31, 2016 included \$9.3 billion invested in the financial sector, representing approximately 12.9% of our total debt securities, or 6.5% of our total invested assets. This compares to \$9.8 billion, or 14.0% of the total debt security portfolio, or 7.1% of our total invested assets as at December 31, 2015.

Our debt securities as at December 31, 2016 included \$5.9 billion of asset-backed securities reported at fair value, representing 8.3% of our total debt securities, or 4.2% of our total invested assets. This compares to \$4.9 billion representing 7.1% of total debt securities, or 3.6% of our total invested assets as at December 31, 2015. The \$1.0 billion increase is primarily due to the purchase of "AAA" rated asset-backed securities. Asset-backed securities with a credit rating of "AAA" represented 85.5% of total asset-backed securities as at December 31, 2016, compared to 77.9% as at December 31, 2015.

The credit risk ratings in the following table were established in accordance with the process described in this MD&A under the heading Risk Categories - Credit Risk Management Governance and Control.

## Debt Securities by Credit Rating

(\$ millions)	December 31, 2016			December 31, 2015		
	FVTPL debt securities	AFS debt securities	Total	FVTPL debt securities	AFS debt securities	Total
Debt securities by credit rating:						
AAA	8,128	4,567	12,695	8,684	4,283	12,967
AA	11,905	1,727	13,632	10,046	1,189	11,235
A	20,798	2,914	23,712	19,526	3,709	23,235
BBB	17,347	2,778	20,125	16,974	3,316	20,290
BB and lower	1,288	435	1,723	1,555	614	2,169
Total debt securities	59,466	12,421	71,887	56,785	13,111	69,896

## Debt Securities by Geography

(\$ millions)	December 31, 2016			December 31, 2015		
	FVTPL debt securities	AFS debt securities	Total	FVTPL debt securities	AFS debt securities	Total
Debt securities						
Canada	22,507	3,589	26,096	20,400	3,373	23,773
United States	21,469	5,910	27,379	20,432	6,546	26,978
United Kingdom	5,621	659	6,280	6,416	662	7,078
Other	9,869	2,263	12,132	9,537	2,530	12,067
Total debt securities	59,466	12,421	71,887	56,785	13,111	69,896

## Mortgages and Loans

Mortgages and loans disclosures in this section are presented at their carrying value on our Consolidated Statements of Financial Position. As at December 31, 2016, we had a total of \$40.8 billion in mortgages and loans, representing 28.6% of our total invested assets, compared to \$39.1 billion representing 28.3% as at December 31, 2015. Our mortgage portfolio consisted almost entirely of first mortgages and our corporate loan portfolio consisted of private placement assets.

The carrying value of mortgages and loans by geographic location is presented in the following table<sup>(1)</sup>.

### Mortgages and Loans by Geography

(\$ millions)	December 31, 2016			December 31, 2015		
	Mortgages	Loans	Total	Mortgages	Loans	Total
Canada	8,234	13,120	21,354	8,067	13,271	21,338
United States	7,162	8,562	15,724	6,725	7,442	14,167
United Kingdom	–	803	803	–	886	886
Other	–	2,894	2,894	–	2,712	2,712
Total	15,396	25,379	40,775	14,792	24,311	39,103

(1) The geographic location for mortgages is based on the location of the property and for loans it is based on the country of the creditor's parent.

As at December 31, 2016, we held \$15.4 billion of mortgages, compared to \$14.8 billion as at December 31, 2015. Our mortgage portfolio consists entirely of commercial mortgages, including retail, office, multi-family residential, industrial and land properties. As at December 31, 2016, 27.2% of our commercial mortgage portfolio consisted of multi-family residential mortgages. Our uninsured commercial portfolio had a weighted average loan-to-value ratio of approximately 55% as at December 31, 2016, consistent with December 31, 2015. While we generally limit the maximum loan-to-value ratio to 75% at issuance, we may invest in mortgages with a higher loan-to-value ratio in Canada if the mortgage is insured by the Canada Mortgage and Housing Corporation ("CMHC"). The estimated weighted average debt service coverage for our uninsured commercial portfolio is 1.75 times. Of the \$3.1 billion of multi-family residential loans in the Canadian commercial mortgage portfolio, 90.7% were insured by the CMHC. There are no single family mortgages in our mortgage portfolio.

As at December 31, 2016, we held \$25.4 billion of corporate loans, compared to \$24.3 billion as at December 31, 2015. In the current low interest rate environment, our strategy is to continue to focus our efforts on the origination of new private placement assets. Private placement assets provide diversification by type of loan, industry segment and borrower credit quality. The loan portfolio consists of senior secured and unsecured loans to large- and mid-market sized corporate borrowers, securitized lease/loan obligations secured by a variety of assets, and project finance loans in sectors such as power and infrastructure.

The credit risk ratings in the following table were established in accordance with the process described in this MD&A under the heading Risk Categories – Credit Risk Management Governance and Control.

### Corporate Loans by Credit Rating

As at December 31 (\$ millions)

	2016	2015
Loans by credit rating:		
AAA	455	409
AA	3,594	3,174
A	11,529	11,532
BBB	9,039	8,499
BB and lower	762	697
Impaired	–	–
Total loans	25,379	24,311

As at December 31, 2016, 97.0% of our total corporate loan portfolio is investment grade, compared to 97.1% as at December 31, 2015.

The carrying value and allowance for mortgages and loans past due or impaired is presented in the following table.

## Mortgages and Loans Past Due or Impaired

December 31, 2016						
(\$ millions)	Gross carrying value			Allowance for losses		
	Mortgages	Loans	Total	Mortgages	Loans	Total
Not past due	15,378	25,379	40,757	–	–	–
Past due:						
Past due less than 90 days	2	–	2	–	–	–
Past due 90 days or more	–	–	–	–	–	–
Impaired	39	7	46	23 <sup>(1)</sup>	7	30
Total <sup>(1)</sup>	15,419	25,386	40,805	23	7	30

December 31, 2015						
(\$ millions)	Gross carrying value			Allowance for losses		
	Mortgages	Loans	Total	Mortgages	Loans	Total
Not past due	14,690	24,279	38,969	–	–	–
Past due:						
Past due less than 90 days	7	32	39	–	–	–
Past due 90 days or more	–	–	–	–	–	–
Impaired	137	7	144	42 <sup>(1)</sup>	7	49
Total <sup>(1)</sup>	14,834	24,318	39,152	42	7	49

(1) Includes \$21 million of sectoral provisions as at December 31, 2016, consistent with December 31, 2015.

Our impaired mortgages and loans, net of allowance for losses, were \$16 million as at December 31, 2016, compared to \$95 million as at December 31, 2015. The decrease of \$79 million was primarily due to the repayment and sale of impaired mortgages in the year. All of the impaired mortgages are in the United States.

## Equities

Our equity portfolio is well diversified and approximately 56.9% of our portfolio was invested in exchange-traded funds as at December 31, 2016, compared to 55.5% as at December 31, 2015. Exchange-traded fund holdings are primarily in the S&P/TSX 60 Index Fund and Standard & Poor's Depository Receipts. The carrying value of stocks by issuer country as at December 31, 2016 is set out in the following table.

### Equities by Issuer Country

(\$ millions)	December 31, 2016			December 31, 2015		
	FVTPL equities	AFS equities	Total	FVTPL equities	AFS equities	Total
Canada	3,404	37	3,441	2,887	40	2,927
United States	757	538	1,295	706	634	1,340
United Kingdom	126	5	131	112	5	117
Other	729	178	907	721	208	929
Total equity securities	5,016	758	5,774	4,426	887	5,313

As at December 31, 2016, 59.6% of our equity portfolio consisted of Canadian issuers; 22.4% of U.S. issuers; 2.3% of U.K. issuers; and 15.7% of issuers from other jurisdictions. Excluding exchange-traded funds and mutual funds, there were no issuers exceeding 1% of the equity portfolio as at December 31, 2016. As at December 31, 2016, our equity exposure to the energy sector was less than 10% of the total equity portfolio. Excluding exchange-traded funds, this exposure declines to 1%.

## Investment Properties

Office, retail and industrial properties are the major components of our investment properties portfolio, representing approximately 83% as at December 31, 2016. Our investment properties included 71.5% located in Canada, 27.4% in the United States and the remaining 1.1% in the United Kingdom as at December 31, 2016.

## Investment Properties by Type and Geography

(\$ millions)	December 31, 2016		December 31, 2015	
	Carrying value	% of total carrying value	Carrying value	% of total carrying value
Canada				
Office	1,680	25.5%	1,618	24.7%
Industrial	964	14.6%	931	14.2%
Retail	1,031	15.6%	988	15.1%
Other	1,038	15.8%	972	14.9%
United States				
Office	878	13.3%	979	15.0%
Industrial	372	5.6%	415	6.3%
Retail	459	7.0%	444	6.8%
Other	97	1.5%	90	1.4%
United Kingdom				
Office	24	0.4%	34	0.5%
Industrial	9	0.1%	11	0.2%
Retail	39	0.6%	45	0.7%
Other	1	—%	13	0.2%
Total investment properties	6,592	100%	6,540	100%

## Derivative Financial Instruments and Risk Mitigation

The fair value of derivative assets held by the Company was \$1,608 million, while the fair value of derivative liabilities was \$2,512 million as at December 31, 2016.

We use derivative instruments to manage risks related to interest rate, equity market, and currency fluctuations and in replication strategies to reproduce permissible investments. Our use of derivatives in these risk mitigation strategies does not mitigate all risk exposure; rather, they are used to keep us within our risk tolerance limits.

Certain of our derivatives are designated in qualifying hedging relationships for accounting purposes, and represented \$0.9 billion, or 1.6% of the total notional amount. Derivatives are designated in hedging relationships for accounting purposes to minimize accounting mismatches. These hedging relationships are documented at inception and hedge effectiveness is assessed on a quarterly basis.

Our derivatives designated in qualifying hedging relationships for accounting purposes include interest rate swaps, foreign exchange agreements, equity forwards and, previously, currency swaps. We designate certain interest rate swaps in fair value hedging relationships to hedge interest rate exposure on AFS assets. We also designate certain foreign exchange agreements in fair value and cash flow hedging relationships to manage foreign currency fluctuations associated with AFS assets. Additionally, we designate certain equity forwards in cash flow hedging relationships for anticipated payments of awards under certain stock-based compensation plans.

In addition to the general policies and monitoring, we use a variety of tools in counterparty risk management. Over-the-counter ("OTC") derivative transactions are executed under International Swaps and Derivatives Association ("ISDA") Master Agreements. A Credit Support Annex accompanies most of the ISDAs, which establish requirements for collateral.

The values associated with our derivative instruments are presented in the following table. Notional amounts serve as the basis for payments calculated under derivatives contracts and are not exchanged.

### Derivative Instruments

(\$ millions)	2016	2015
As at December 31		
Net fair value	(904)	(1,512)
Total notional amount	54,350	57,845
Credit equivalent amount <sup>(1)</sup>	510	607
Risk-weighted credit equivalent amount	5	7

(1) Amounts presented are net of collateral received

The total notional amount of our derivatives decreased to \$54.4 billion as at December 31, 2016 from \$57.8 billion as at December 31, 2015. The decrease in the total notional amount was primarily attributable to a decrease of \$2.2 billion in interest rate contracts for duration matching activities and a decrease of \$1.0 billion in currency contracts hedging foreign currency assets.

The net fair value of derivatives was a net liability of \$904 million as at December 31, 2016, compared to a net liability of \$1,512 million as at December 31, 2015, due primarily to the impact of the strengthening of the Canadian dollar against the U.S. dollar on foreign exchange contracts, partially offset by upward shifts in the yield curve.

As the regulator of the Canadian insurance industry, OSFI provides guidelines to quantify the use of derivatives. The credit equivalent amount, a measure used to approximate the potential credit exposure, is determined as the replacement cost of the derivative contracts having a positive fair value plus an amount representing the potential future credit exposure.

The risk-weighted credit equivalent amount is a measure used to determine the amount of capital necessary to support derivative transactions for certain Canadian regulatory purposes. It is determined by weighting the credit equivalent amount according to the nature of the derivative and the creditworthiness of the counterparties.

As at December 31, 2016, the credit equivalent amounts for foreign exchange contracts, interest rate contracts, and equity and other contracts were \$315 million, \$177 million and \$18 million, respectively. The corresponding risk-weighted credit equivalent amounts were \$2.8 million, \$2.2 million and \$0.2 million, respectively.

Additional detail on our derivative portfolio by derivative type is provided in Note 6.A.iv to our 2016 Annual Consolidated Financial Statements.

## Impaired Assets

The invested asset values and ratios presented in this section are based on the carrying value of the respective asset categories. Carrying values for FVTPL and AFS invested assets are generally equal to fair value.

Financial assets that are classified as FVTPL, which represented 46.7% of our invested assets as at December 31, 2016, do not have allowances for losses since changes in the fair value of these assets are recorded to income and the assets are recorded at fair value on our Consolidated Statements of Financial Position. In the event of default, if the amounts recovered are insufficient to satisfy the related insurance contract liability cash flows that the assets are intended to support, credit exposure may be greater than the carrying value of the asset.

In the absence of objective evidence of impairment, impairment losses are not recognized on AFS debt securities, equity securities and other invested assets. If the amortized cost of these assets is greater than their fair values, unrealized losses are recognized in OCI. Unrealized losses may be due to interest rate fluctuations or depressed fair values in sectors which have experienced strong negative market performance. The fair value of AFS securities in an unrealized loss position amounted to \$5.5 billion and the associated unrealized losses amounted to \$0.16 billion as at December 31, 2016, and \$6.0 billion and \$0.26 billion, respectively, as at December 31, 2015. The gross unrealized losses for FVTPL and AFS debt securities were \$0.72 billion and \$0.14 billion as at December 31, 2016, respectively, compared to \$1.1 billion and \$0.22 billion as at December 31, 2015, respectively. The decrease in gross unrealized losses was largely due to the impact of a decline in credit spreads offsetting the impact from rising interest rates.

Impaired mortgages and loans, net of allowance for losses, amounted to \$16 million as at December 31, 2016, compared to \$95 million as at December 31, 2015 for these assets.

## Asset Default Provision

We make provisions for possible future credit events in the determination of our insurance contract liabilities. The amount of the provision for asset default included in insurance contract liabilities is based on possible reductions in future investment yields that vary by factors such as type of asset, asset credit quality (rating), duration and country of origin. To the extent that an asset is written off, or disposed of, any amounts that were set aside in our insurance contract liabilities for possible future asset defaults in respect of that asset are released.

Our asset default provision reflects the provision relating to future credit events for fixed income assets currently held by the Company that support our insurance contract liabilities. Our asset default provision as at December 31, 2016 was \$2,247 million for losses related to possible future credit events for fixed income assets currently held by the Company that support our insurance contract liabilities. This represents 2.3% of the fixed income assets supporting insurance contract liabilities reported on our Consolidated Statements of Financial Position as at December 31, 2016.

Our asset default provision as at December 31, 2016 was \$170 million higher than the provision as at December 31, 2015, primarily due to increases in the provision for assets purchased, net of dispositions, including the impact of the U.S. employee benefits business acquired in 2016, partially offset by the release of provisions on fixed income assets supporting our insurance contract liabilities.

The following table sets out the changes in our asset default provision for existing fixed income investments.

(\$ millions)	2016	2015
Opening balance	2,077	1,916
Purchases, dispositions and net asset movement <sup>(1)</sup>	477	170
Changes in assumptions and methodologies	(2)	(8)
Changes in ratings	44	31
Release of provisions <sup>(2)</sup>	(271)	(254)
Currency	(78)	222
Closing balance	2,247	2,077

(1) Net movement reflects the fluctuation in the value of FVTPL assets arising from movements in interest rates, credit spreads and other factors that impact the market value of fixed income investments.

(2) This amount represents the orderly release of provisions for future credit events held in insurance contract liabilities.

# Risk Management

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## Risk Management Framework

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The Company has established a Risk Management Framework (“Risk Framework”) approved by the Board of Directors that prescribes a comprehensive set of protocols and programs that need to be followed in conducting business activities. The risks that arise when providing products and services to Clients and policyholders which are in line with our mission to help Clients achieve lifetime financial security are managed within these protocols and programs. Effective risk management is critical to the overall profitability, competitive market positioning and long-term financial viability of the Company. While all risk cannot necessarily be eliminated, the Risk Framework seeks to ensure that risks to a business undertaking are appropriately managed to achieve the Company’s business objectives over time and are not expected to exceed pre-established boundaries for risk taking. The Risk Framework, corporate strategy, and business objectives, are all aligned and risk management protocols and programs are embedded within every business segment.

As a large financial services organization operating in a complex industry, the Company encounters a variety of risks. We are subject to financial and insurance risks that are connected to our liabilities and also in connection with the management and performance of our assets, including how we match returns from assets with the payment of liabilities to our Clients. We also face risks in formulating our business strategy and business objectives, in carrying on our business activities in the pursuit of our strategy and objectives, and from external factors such as changes in the economic, political, competitive and regulatory environments. The Risk Framework covers all risks and these have been grouped into six major categories: credit, market, insurance, business and strategic, operational and liquidity risks. The Risk Framework sets out the key mandatory risk management processes in the areas of risk: appetite, identification, measurement, management, monitoring and reporting. The Risk Framework sets out both qualitative and quantitative measures and processes to control the risk the Company will bear in respect of each of these categories of risk and in aggregate.

## Risk Culture and Philosophy

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Our Risk Framework recognizes the importance of risk culture in the effective management of the Company’s risks. Risk culture relates to how we behave and respond, in addition to the requirements we set. It enables and rewards taking the right risks in an informed manner. It facilitates effective challenge and being transparent about risks and outcomes without fear of reprisal. It drives us to understand Client needs and preferences so that we can act in their best interests. Our risk culture is supported by a strong tone from the top which emanates from the Board of Directors and cascades through the Board Committees, our CEO and executive officers, management and staff. A key premise of our risk management culture is that all employees have an important role to play in managing the Company’s risks. In order to support employees in fulfilling their role, we have taken action to ensure our risk protocols and procedures are well defined and embedded in our day-to-day business activities, assess that appropriate resources and training are provided, have established and communicated a common philosophy and a high bar for integrity and conduct, and encourage every employee to openly identify risk exposures and communicate escalating risk concerns. The following six elements are foundational to our risk culture:

- Establishing tone from the top
- Encouraging transparency in risk-taking
- Performing effective challenge in conducting business decisions
- Aligning incentives and risk management practices
- Effectively communicating the risk culture expectations
- Establishing clear accountabilities

Our risk management program is embedded in the Company’s culture, which encourages ownership and responsibility for risk management at all levels. Our compensation programs are aligned to the organization’s risk management practices through our governance structure for the design and approval of incentive compensation plans and processes used to support the alignment of compensation and risk management. We continuously reinforce and embed the culture through communication and training on the risk culture elements at various forums and across various levels through training on the code of conduct annually, reinforcing accountability through performance reviews and compensation, and through defining roles, responsibilities and expectations in the risk management policies.

The Risk Framework sets out the Company’s risk philosophy and includes the following core principles.

## Strategic Alignment

Our corporate strategy and business objectives are required to be established within the boundaries set out in the Risk Framework and the Risk Appetite Policy. This requires us to consider whether a business activity will result in a risk profile that we are willing to accept and which we are prepared to manage. We have established a range of explicit risk appetite limits and control points for credit, market, insurance, operational and liquidity risks. Business and strategic risk is managed through our strategic and business planning process and controls over the implementation of these strategic and business plans. Risks associated with activities outside our risk appetite or outside the acceptable defined risks are avoided.

## Stakeholder Interests

Our Risk Appetite Policy considers the interests of a large number of key stakeholders, including policyholders, shareholders, debt-holders, employees, regulators, distributors, rating agencies and other capital markets participants. The Policy describes how to balance the needs, expectations, risk and reward perspectives, and investment horizons of these different stakeholders.

Effective risk management requires that objectives and incentives be aligned to ensure management’s decisions are aligned with the Company’s risk philosophy and risk appetite. To ensure this, business plans and strategies are independently tested to ensure that they operate within the boundaries and requirements set out in the Risk Framework and the Risk Appetite Policy, and the results of this testing are reported to the Board of Directors. Compensation programs for employees are approved by the Board of Directors and the

Board Committees and are aligned with the Company's risk philosophy, values, business and risk management strategies, and the long-term interests of stakeholders. In establishing annual performance objectives, we consider risk management goals to ensure that business decisions are consistent with the desired risk and return profile of the Company.

## Capability Alignment

We seek out profitable risk-taking opportunities in those areas where we have established risk management skills and capabilities. Conversely, we endeavour to avoid or transfer risks that are outside our risk-taking capability. Our ability to measure and evaluate risks, the quality of our risk governance and control environment, the depth and quality of our risk responses and the robustness of our pricing strategies are particularly important features of capabilities that we assess.

## Portfolio Perspective

In evaluating a particular risk, consideration is given to a portfolio perspective of risk and return including the explicit recognition of the impacts of diversification and concentration and how different risks interact with each other. This perspective is extended to the development of risk mitigation and pricing strategies, recognizing that often the most cost-effective way of managing risk involves utilizing available relationships already inherent in our business.

## Risk-Adjusted Returns

The financial return metrics which are used to assess business activities are required to be risk-adjusted. Financial return metrics are developed in consideration of the constraints set out in the Risk Appetite Policy, and reflect the expected costs of mitigation and the cost of risk capital required to support the risk taking activity.

## Risk Appetite and Risk Profile

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Our Risk Appetite Policy defines the amount and type of risk we are willing to accept in pursuit of our business objectives, and is approved by the Board of Directors. It is forward-looking and our strategic plan, capital plan, business plan and business objectives are established within its boundaries.

The Company's risk appetite seeks to balance the various needs, expectations, risk and reward perspectives and investment horizons of key stakeholders. In particular, our risk appetite supports the pursuit of shareholder value while ensuring that the Company's ability to pay claims and fulfill policyholder commitments is not compromised.

The Company's risk appetite is the primary mechanism to communicate its risk philosophy and the boundaries of permissible risk-taking across the enterprise. It ensures that business activities are assessed against performance criteria that are appropriately risk-adjusted. Our risk appetite supports the objective of maintaining adequate capital, managing return on equity, managing earnings volatility, managing long-term profitability and managing liquidity. To accomplish this, our risk appetite includes a wide array of qualitative and quantitative standards that reflect the Company's overall risk management principles and values.

We generally accept diversifiable risks and utilize risk pooling to create portfolios with relatively low liability volatility. We take risk where we have internal expertise such as actuarial, underwriting, claims management, investment and distribution or where reinsurance partners are able to supplement our internal expertise. We prefer risks where it is possible to diversify across various segments including products, geographies, distribution channels or asset classes in order to maximize diversification opportunities.

Our Risk Appetite Policy sets out specific constraints which define the aggregate level of risk that the Company is willing to accept. We translate our risk appetite constraints into specific risk limits by risk class and business segment. Our risk profile is measured, managed and monitored regularly to ensure that we operate within our risk appetite. Our risk appetite limits are reviewed periodically to reflect the risks and opportunities inherent in our evolving business strategies and operating environment.

## Governance Structure and Accountabilities

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Our Risk Framework sets out lines of responsibility and authority for risk-taking, governance and control. These governance requirements are summarized below.

### Board of Directors

Our Board of Directors is ultimately responsible for ensuring the oversight of all risks across the enterprise and has primary responsibility for taking action to ensure risk management policies, programs and practices are in place. By approving our Risk Framework and the Risk Appetite Policy, and providing ongoing oversight of the risk management programs, the Board of Directors monitors that the principal risks are appropriately identified and managed. The Board of Directors oversees business and strategic risk through review and approval of the business and strategic plans, and regularly discusses key themes, issues and risks emerging in connection with the design or implementation of these plans.

The Board of Directors has delegated primary oversight of risk management and capital management to its Risk Review Committee, which is a standing committee of the Board. The primary function of the Risk Review Committee is to assist the Board with oversight of the management of risk enterprise-wide, and of the risk management function to ensure that management has in place policies, processes and controls designed to identify and effectively manage the significant risks to which the Company is exposed and has sufficient capital to underpin those risks. The committee regularly monitors that the risk profile is within the agreed risk appetite of the Company and that the Company's capital position is in compliance with regulatory capital requirements, and recommends to the Board for approval, and monitors, the specific risk limits allocated to the businesses and the annual Capital Plan. The Committee meets with senior business and functional leaders who have first-hand knowledge of risks and the risk management programs, oversees the effectiveness of the risk management function, and obtains reports from internal audit on the effectiveness of risk controls within the business and risk function. The committee also oversees risk management activities of our subsidiaries and risk posed to the Company through its joint venture arrangements. It reviews and approves all risk management policies that are not otherwise assigned to other

Board committees and reviews compliance with those policies. In addition, where the Board has allocated oversight of specific risk management policies and programs to other Board committees, the Risk Review Committee is tasked with providing the Board with an integrated view of oversight of all risk management programs across all Board committees.

The Board of Directors has delegated to the Governance, Nomination & Investment Committee responsibilities related to review and monitoring the Company's Investment Plan and investment performance, overseeing practices, procedures and controls related to the management of the general fund investment portfolio and the Company's asset management businesses. In addition, the Committee is also responsible for developing effective corporate governance guidelines and processes including policies and processes to sustain ethical behaviour, and developing processes to assess the effectiveness of the Board and its Committees.

The Audit & Conduct Review Committee is responsible for assisting the Board of Directors in reviewing the integrity of financial statements and related information provided to shareholders and others, compliance with financial regulatory requirements, review and approval of compliance policies, adequacy and effectiveness of the internal controls implemented and maintained by management, compliance with legal and regulatory requirements and the identification and management of compliance risk, and assessing the qualifications, independence and performance of the external auditor.

The Management Resources Committee is responsible for assisting the Board of Directors in ensuring we have the leadership resources for succession of senior executive positions and programs to effectively attract, retain, develop and reward executives for achieving our strategic objectives. In addition, the Management Resources Committee reviews the design, approval and governance of incentive programs to align business objectives and incentives, and to ensure that these incentive programs do not encourage excessive risk taking.

### **Senior Management Committees**

The Executive Risk Committee ("ERC") is responsible for providing executive management oversight of the Company's enterprise risk management activities. This includes the review and articulation of the risk appetite, and oversight of the Company's risk profile and its alignment with the risk appetite. The ERC also oversees processes to ensure ongoing identification of major risks facing the Company and the oversight of strategies and tactics to manage those risks in accordance with the risk appetite and overall objective of promoting a balanced business and product model that will achieve agreed upon risk-adjusted returns and allocate capital accordingly.

The Investment & Credit Risk Committee is responsible for reviewing matters related to the management of the Company's general fund assets which includes providing oversight and direction on the current and potential credit and investment risk exposures facing the Company and mitigating strategies to ensure that effective credit risk management practices and controls are in place.

The Corporate Asset Liability Management Committee is responsible for providing executive oversight and direction for the effective measurement, control and management of the market and liquidity risks in the design and operation of general fund investment strategies for efficiently discharging the Company's general fund liabilities.

The Operational Risk & Compliance Committee is responsible for providing oversight and direction on the operational risk exposures facing the Company and to ensure that effective operational risk management practices and controls, including compliance programs, are in place.

The Insurance Risk Committee is responsible for providing oversight and direction on insurance risk exposures facing the Company and to ensure that effective insurance risk management practices and controls are in place.

### **Accountabilities**

Primary accountability for risk management is delegated by the Board of Directors to our CEO, and the CEO further delegates responsibilities throughout the Company through management authorities and responsibilities. The CEO delegates accountability for risk management to our executive officers, who are accountable for ensuring the management of risk in the scope of their business accountability is in accordance with the Board-approved Risk Framework, Risk Appetite Policy and risk management policies.

We have adopted the three lines of defence model to provide a consistent, transparent and clearly documented allocation of accountability and segregation of functional responsibilities. This segregation of responsibility helps to establish a robust control framework that promotes transparent and independent challenge of all risk taking activities, and encourages that all functions engage in self-critical examination to foster continuous improvement of the management of risk in our business.

The first line of defence is represented by business segment management who own the risks that are intrinsic to the business and have the primary responsibility to identify, measure, manage, monitor and report these risks.

The second line of defence includes the Chief Risk Officer ("CRO") and various functional heads who are responsible for providing independent oversight of our Company-wide risk management programs. The CRO is responsible for developing our Risk Framework and Risk Appetite Policy, and for overseeing the development and implementation of risk management strategies aimed at optimizing the risk-return profile of the Company. The CRO is supported by a network of business segment risk officers. The functional heads support the CRO in the implementation and communication of our Risk Framework and Risk Appetite Policy.

The Internal Audit function is the third line of defence and is responsible for providing independent assurance to the Audit & Conduct Review Committee on whether all significant risks are identified and appropriately reported to the Board Committees and executive officers, and assessing whether these risks are effectively controlled. Additionally, the Risk Review Committee may engage third-party independent reviews to supplement the third line of defence review of the effectiveness of the Company's risk management programs.

## **Risk Management Policies**

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In order to support the effective communication, implementation and governance of our Risk Framework, we have codified our processes and operational requirements in a comprehensive series of risk management policies and operating guidelines. These policies and guidelines promote the application of a consistent approach to managing risk exposures across our global business platform. The Board of Directors and Board Committees regularly review and approve significant changes to the risk management policies and also regularly review management's reporting and attestation on compliance to these policies.

## Risk Management Process

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The risk management process as set out in our Risk Framework is described below:

### Risk Identification and Measurement

All business segments employ a common approach to identify and measure risks. Business segments have accountability for identifying and managing risks facing their business. We have a process to identify and monitor emerging risks that may have a material impact on our finances, operations or reputation. We evaluate potential correlations between various risk events and categories, and monitor emerging risks, regulatory and rating agency requirements, and industry developments.

Risk measurement involves determining and evaluating potential risk exposures, and includes a number of techniques such as monitoring key risk indicators, assessing probability and severity of risks, and conducting stress testing.

A robust stress testing program is an essential component of the Company's Risk Framework used to measure, monitor and mitigate the Company's risk exposures and ensure ongoing capital adequacy under plausible stress events. Stress testing is performed on key metrics such as earnings, regulatory capital ratios and liquidity to identify and monitor potential vulnerabilities to key risk drivers and ensure that the Company is operating within its risk appetite.

We develop and test a range of scenarios based on our internal assessment and regulatory guidance. Sensitivity testing is conducted on a regular basis and measures the earnings and MCCR impact from changes in underlying risk factors. Sensitivity testing is performed for individual risks and for consolidated risk exposures at different levels of stress and at various levels of aggregation. Scenario testing involves changes to a number of risk factors to assess the impact of and interaction between these risk factors. These scenarios include integrated scenario testing, reverse scenario testing and key assumption sensitivity testing. We also use the DCAT process, as required by our regulator, to project income and capital for a five-year period under plausible adverse scenarios.

### Risk Management, Monitoring and Reporting

Risk management decisions are formed by evaluating how well the outcomes of the risk measurements and risk assessments for a business activity conform to our risk appetite, including an assessment of risk-adjusted return.

Monitoring processes include oversight by the Board of Directors, which is exercised through Board Committees and senior management committees described in the section of this MD&A under the heading Governance Structure and Accountabilities.

Senior management committees, Board Committees and the Board of Directors regularly review reports that summarize our risk profile, including the exposures across our principal risks including any changes in risk trends and emerging risks. These committees also review the effectiveness of the mitigation strategies presented in the reports. On a regular basis, the Board of Directors and the Board Committees review and approve any significant changes to key policies for the management of risk and review compliance with these policies.

## Risk Categories

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The shaded text and tables in the following section of this MD&A represent our disclosure on credit, market and liquidity risks in accordance with IFRS 7 *Financial Instruments – Disclosures* and includes a discussion on how we measure risk and our objectives, policies and methodologies for managing these risks. The shaded text and tables represent an integral part of our audited annual Consolidated Financial Statements for the year ended December 31, 2016. The shading in this section does not imply that these disclosures are of any greater importance than non-shaded tables and text, and the Risk Management disclosure should be read in its entirety. This information should be considered carefully together with other information in this MD&A and in our 2016 AIF, our 2016 Consolidated Financial Statements and other reports and materials that we file with securities regulators.

In this section, segregated funds include segregated fund guarantees, variable annuities and investment products, and includes Run-off reinsurance in our Corporate business segment.

Our Risk Framework has grouped all risks into six major risk categories: credit, market, insurance, business and strategic, operational and liquidity risks.

## Credit Risk

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### Risk Description

Credit risk is the possibility of loss from amounts owed by our borrowers or financial counterparties. We are subject to credit risk in connection with issuers of securities held in our investment portfolio, debtors, structured securities, reinsurers, counterparties (including derivative, repurchase agreement and securities lending counterparties), other financial institutions and other entities. Losses may occur when a counterparty fails to make timely payments pursuant to the terms of the underlying contractual arrangement or when the counterparty's credit rating or risk profile otherwise deteriorates. Credit risk can also arise in connection with deterioration in the value of, or ability to realize, any underlying security that may be used as collateral for the debt obligation. Credit risk can occur as a result of broad economic conditions, challenges within specific sectors of the economy, or from issues affecting individual companies. Events that result in defaults, impairments or downgrades of the securities in our investment portfolio would cause the Company to record realized or unrealized losses and may cause an increase in our provisions for asset default, adversely impacting earnings.

## Credit Risk Management Governance and Control

We employ a wide range of credit risk management practices and controls, as outlined below:

- Credit risk governance practices are in place, including independent monitoring and review and reporting to senior management and the Risk Review Committee.
- Risk appetite limits have been established for credit risk.
- Income and regulatory capital sensitivities are monitored, managed and reported against pre-established risk limits.
- Comprehensive Investment and Credit Risk Management Policy, guidelines and practices are in place.
- Specific investment diversification requirements are in place, such as defined investment limits for asset class, geography, and industry.
- Risk-based credit portfolio, counterparty, and sector exposure limits have been established.
- Mandatory use of credit quality ratings for portfolio investments has been established and is reviewed regularly.
- Internal rating decisions for new fixed income investments and ongoing review of existing rating decisions are independently adjudicated by corporate risk management.
- Comprehensive due diligence processes and ongoing credit analyses are conducted.
- Regulatory solvency requirements include risk-based capital requirements and are monitored regularly.
- Comprehensive compliance monitoring practices and procedures including reporting against pre-established investment limits are in place.
- Reinsurance exposures are monitored to ensure that no single reinsurer represents an undue level of credit risk.
- Stress-testing techniques, such as DCAT, are used to measure the effects of large and sustained adverse credit developments.
- Insurance contract liabilities are established in accordance with Canadian actuarial standards of practice.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.

Our core principles of credit risk management include asset diversification, fundamental research and analysis of cash flows, proactive and continuous risk monitoring, active management and relative value assessment, all with the objective of optimizing risk-adjusted returns, with due consideration for the impacts of capital and taxation.

We rate fixed income investments primarily through the use of internally developed scorecards which combine an estimated probability of default, and loss given default to determine an expected loss and credit risk rating. This rating is expressed using a 22-point scale that is generally consistent with those used by external rating agencies, and is based on detailed examination of the borrower's, or issuer's, credit quality and the characteristics of the specific instrument. The probability of default assessment is based on borrower-level or issuer-level analysis, which encompasses an assessment of industry risk, business strategy, competitiveness, strength of management and other financial information. The loss given default assessment is based on instrument-level analysis, which considers the impact of guarantees, covenants, liquidity and other structural features. These scorecards provide input to stochastic value-at-risk models and are used to stress test the portfolio, which provide insight into the distribution and characteristics of credit risk within our portfolios. In accordance with our policies and under normal circumstances, our ratings cannot be higher than the highest rating provided by certain Nationally Recognized Statistical Rating Organizations ("NRSROs"). Certain assets, including those in our sovereign debt and asset-backed securities portfolios, are assigned a rating based on ratings provided by NRSROs using a priority sequence order of Standard & Poor's, Moody's, Fitch and DBRS Limited.

Additional information on credit risk can be found in Note 6 to our 2016 Annual Consolidated Financial Statements and in the Risk Factors section in our AIF.

## Market Risk

### Risk Description

We are exposed to financial and capital market risk, which is defined as the risk that the fair value or future cash flows of an insurance contract or financial instrument will fluctuate because of changes or volatility in market prices. Market risk includes equity, interest rate and spread, real estate and foreign currency risks.

### Market Risk Management Governance and Control

We employ a wide range of market risk management practices and controls, as outlined below:

- Market risk governance practices are in place, including independent monitoring and review and reporting to senior management and the Risk Review Committee.
- Risk appetite limits have been established for equity, interest rate, real estate and foreign currency risks.
- Income and regulatory capital sensitivities are monitored, managed and reported against pre-established risk limits.
- Comprehensive asset-liability management and hedging policies, programs and practices are in place.
- Regulatory solvency requirements include risk-based capital requirements and are monitored regularly.
- Product Design and Pricing Policy requires a detailed risk assessment and pricing provisions for material risks.
- Stress-testing techniques, such as DCAT, are used to measure the effects of large and sustained adverse market movements.
- Insurance contract liabilities are established in accordance with Canadian actuarial standards of practice.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.

Specific market risks and our risk management strategies are discussed below in further detail.

### Equity Risk

Equity risk is the potential for financial loss arising from declines or volatility in equity market prices. We are exposed to equity risk from a number of sources. A portion of our exposure to equity risk arises in connection with benefit guarantees on segregated fund contracts. These benefit guarantees may be triggered upon death, maturity, withdrawal or annuitization. The cost of providing for these

guarantees is uncertain, and will depend upon a number of factors including general capital market conditions, underlying fund performance, policyholder behaviour, and mortality experience, which may result in negative impacts on our net income and capital.

We generate revenue in our asset management businesses and from certain insurance and annuity contracts where fees are levied on account balances that are affected directly by equity market levels. Accordingly, we have further exposure to equity risk as adverse fluctuations in the market value of such assets will result in corresponding adverse impacts on our revenue and net income. In addition, declining and volatile equity markets may have a negative impact on sales and redemptions (surrenders) in these businesses, and this may result in further adverse impacts on our net income and financial position.

We also have direct exposure to equity markets from the investments supporting general account liabilities, surplus, and employee benefit plans. These exposures fall within our risk-taking philosophy and appetite, and are therefore generally not hedged.

### **Interest Rate and Spread Risk**

Interest rate and spread risk is the potential for financial loss arising from changes or volatility in interest rates or spreads when asset cash flows and the policy obligations they support are not matched. This may result in the need to either sell assets to meet policy payments and expenses or reinvest excess asset cash flows in unfavourable interest rate or spread environments. The impact of changes or volatility in interest rates or spreads is reflected in the valuation of our financial assets and liabilities for insurance contracts.

Our primary exposure to interest rate and spread risk arises from certain general account products and segregated fund contracts which contain explicit or implicit investment guarantees in the form of minimum crediting rates, guaranteed premium rates, settlement options and benefit guarantees. If investment returns fall below guaranteed levels, we may be required to increase liabilities or capital in respect of these contracts. The guarantees attached to these products may be applicable to both past premiums collected and future premiums not yet received. Segregated fund contracts provide benefit guarantees that are linked to underlying fund performance and may be triggered upon death, maturity, withdrawal or annuitization. These products are included in our asset-liability management program and the residual interest rate exposure is managed within our risk appetite limits.

Declines in interest rates or narrowing spreads can result in compression of the net spread between interest earned on investments and interest credited to policyholders. Declines in interest rates or narrowing spreads may also result in increased asset calls, mortgage prepayments and net reinvestment of positive cash flows at lower yields, and therefore adversely impact our profitability and financial position. Negative interest rates may additionally result in losses on our cash deposits and low or negative returns on our fixed income assets impacting our profitability. In contrast, increases in interest rates or a widening of spreads may have a material impact on the value of fixed income assets, resulting in depressed market values, and may lead to losses in the event of the liquidation of assets prior to maturity.

Significant changes or volatility in interest rates or spreads could have a negative impact on sales of certain insurance and annuity products, and adversely impact the expected pattern of redemptions (surrenders) on existing policies. Increases in interest rates or widening spreads may increase the risk that policyholders will surrender their contracts, potentially forcing us to liquidate assets at a loss and accelerate recognition of certain acquisition expenses. While we have established hedging programs in place and our insurance and annuity products often contain surrender mitigation features, these may not be sufficient to fully offset the adverse impact of the underlying losses.

We also have direct exposure to interest rates and spreads from investments supporting other general account liabilities, surplus and employee benefit plans. Lower interest rates or a narrowing of spreads will result in reduced investment income on new fixed income asset purchases. Conversely, higher interest rates or wider spreads will reduce the value of our existing assets. These exposures fall within our risk-taking philosophy and appetite and are therefore generally not hedged.

A sustained low interest rate environment may adversely impact our earnings, regulatory capital requirements and our ability to implement our business strategy and plans in several ways, including:

- Lower sales of certain insurance and wealth products, which can in turn pressure our operating expense levels;
- Shifts in the expected pattern of redemptions (surrenders) on existing policies;
- Higher hedging costs;
- Higher new business strain reflecting lower new business profitability;
- Reduced return on new fixed income asset purchases;
- The impact of changes in actuarial assumptions driven by capital market movements;
- Impairment of goodwill; and
- Additional valuation allowances against our deferred tax assets.

### **Market Risk Sensitivities**

We utilize a variety of methods and measures to quantify our market risk exposures. These include duration management, key rate duration techniques, convexity measures, cash flow gap analysis, scenario testing, and sensitivity testing of earnings and regulatory capital ratios versus risk appetite limits which are calibrated to our risk appetite.

Our earnings are affected by the determination of policyholder obligations under our annuity and insurance contracts. These amounts are determined using internal valuation models and are recorded in our Annual Consolidated Financial Statements, primarily as Insurance contract liabilities. The determination of these obligations requires management to make assumptions about the future level of equity market performance, interest rates, credit and swap spreads and other factors over the life of our products. Differences between our actual experience and our best estimate assumptions are reflected in our Annual Consolidated Financial Statements. Refer to the section of this MD&A under the heading Additional Cautionary Language and Key Assumptions Related to Sensitivities for important additional information regarding these estimates.

The market value of our investments in fixed income and equity securities fluctuates based on movements in interest rates and equity markets. The market value of fixed income assets designated as AFS that are held primarily in our surplus segment increases with

declining interest rates and decreases with rising interest rates. The market value of equities designated as AFS and held primarily in our surplus segment increases (decreases) with rising (declining) equity markets. Changes in the market value of AFS assets flow through OCI and are only recognized in net income when realized upon sale, or when considered impaired. The amount of realized gains (losses) recorded in net income in any period is equal to the unrealized gains (losses) or OCI position at the start of the period plus the change in market value during the current period up to the point of sale for those securities that were sold during the period. The sale or impairment of AFS assets held in surplus can therefore have the effect of modifying our net income sensitivity.

We realized \$41 million (pre-tax) in net gains on the sale of AFS assets during the fourth quarter of 2016 and \$223 million (pre-tax) in 2016 (\$39 million pre-tax in the fourth quarter of 2015 and \$228 million pre-tax in 2015). The net unrealized gains or OCI position on AFS fixed income and equity assets were \$86 million and \$125 million, respectively, after-tax as at December 31, 2016 (\$43 million and \$182 million, respectively, after-tax as at December 31, 2015).

The following table sets out the estimated immediate impact on, or sensitivity of our net income, our OCI, and Sun Life Assurance's MCCR ratio to certain instantaneous changes in interest rates and equity market prices as at December 31, 2016 and December 31, 2015.

## Interest Rate and Equity Market Sensitivities

As at December 31, 2016<sup>(1)</sup>

(\$ millions, unless otherwise noted)

Interest rate sensitivity <sup>(2)(6)</sup>	100 basis point decrease	50 basis point decrease	50 basis point increase	100 basis point increase
Potential impact on net income <sup>(3)(6)</sup>	\$(200)	\$(100)	\$50	\$50
Potential impact on OCI	\$550	\$250	\$(250)	\$(500)
Potential impact on MCCR <sup>(4)</sup>	8% points decrease	3% points decrease	4% points increase	7% points increase
Equity markets sensitivity <sup>(5)</sup>	25% decrease	10% decrease	10% increase	25% increase
Potential impact on net income <sup>(3)</sup>	\$(300)	\$(100)	\$100	\$250
Potential impact on OCI	\$(150)	\$(50)	\$50	\$150
Potential impact on MCCR <sup>(4)</sup>	3% points decrease	1% points decrease	2% points increase	4% points increase

As at December 31, 2015<sup>(1)</sup>

(\$ millions, unless otherwise noted)

Interest rate sensitivity <sup>(2)(6)</sup>	100 basis point decrease	50 basis point decrease	50 basis point increase	100 basis point increase
Potential impact on net income <sup>(3)(6)</sup>	\$(300)	\$(100)	\$50	\$50
Potential impact on OCI	\$500	\$250	\$(250)	\$(500)
Potential impact on MCCR <sup>(4)</sup>	10% points decrease	4% points decrease	4% points increase	7% points increase
Equity markets sensitivity <sup>(5)</sup>	25% decrease	10% decrease	10% increase	25% increase
Potential impact on net income <sup>(3)</sup>	\$(350)	\$(100)	\$100	\$300
Potential impact on OCI	\$(150)	\$(50)	\$50	\$150
Potential impact on MCCR <sup>(4)</sup>	4% points decrease	1% points decrease	2% points increase	4% points increase

(1) Net income and OCI sensitivities have been rounded to the nearest \$50 million. The sensitivities exclude the market impacts on the income from our joint ventures and associates, which we account for on an equity basis.

(2) Represents a parallel shift in assumed interest rates across the entire yield curve as at December 31, 2016 and December 31, 2015, with no change to the ASB promulgated Ultimate Reinvestment Rate ("URR"). Variations in realized yields based on factors such as different terms to maturity and geographies may result in realized sensitivities being significantly different from those illustrated above. Sensitivities include the impact of re-balancing interest rate hedges for dynamic hedging programs at 10 basis point intervals (for 50 basis point changes in interest rates) and at 20 basis point intervals (for 100 basis point changes in interest rates).

(3) The market risk sensitivities include the estimated mitigation impact of our hedging programs in effect as at December 31, 2016 and December 31, 2015, and include new business added and product changes implemented prior to such dates.

(4) The MCCR sensitivities illustrate the impact on Sun Life Assurance as at December 31, 2016 and December 31, 2015. This excludes the impact on assets and liabilities that are in SLF Inc. but not included in Sun Life Assurance.

(5) Represents the respective change across all equity markets as at December 31, 2016 and December 31, 2015. Assumes that actual equity exposures consistently and precisely track the broader equity markets. Since in actual practice equity-related exposures generally differ from broad market indices (due to the impact of active management, basis risk and other factors), realized sensitivities may differ significantly from those illustrated above. Sensitivities include the impact of re-balancing equity hedges for dynamic hedging programs at 2% intervals (for 10% changes in equity markets) and at 5% intervals (for 25% changes in equity markets).

(6) The majority of interest rate sensitivity, after hedging, is attributed to individual insurance products. We also have interest rate sensitivity, after hedging, from our fixed annuity and segregated funds products.

Our net income and MCCR sensitivities to changes in interest rates and equity markets have changed since December 31, 2015. The decrease in sensitivity to interest rates has resulted primarily from assumption changes and management actions, including the impact from increased levels of hedging. The decrease in sensitivity to equity markets has resulted primarily from assumption changes and management actions net of the impact from changes in equity markets during 2016.

The above sensitivities were determined using a 50 basis point change in interest rates and a 10% change in our equity markets because we believe that these market shocks were reasonably possible as at December 31, 2016. We have also disclosed the impact of a 100 basis point change in interest rates and a 25% change in equity markets to illustrate that significant changes in interest rates and equity market levels may result in other than proportionate impacts on our sensitivities at more significant market movements.

Interest rate sensitivities do not include any impact from changes to the ASB promulgated URR. In 2014, the Actuarial Standards Board (“ASB”) made changes to the Canadian actuarial standards of practice with respect to economic reinvestment assumptions used in the valuation of insurance contract liabilities. The changes relate to assumed future interest rates, credit spreads and the use of non-fixed income assets supporting fixed obligations. When the ASB promulgated these changes, the intention was to review these assumptions every five years, or sooner if circumstances warrant. Given the continuing low interest rates, we expect the ASB will revisit the reinvestment assumptions in 2017 but the magnitude of any potential changes due to the promulgation remains uncertain. Based on current assumptions, as at December 31, 2016, our estimated sensitivity to a 10 basis point decrease in the URR would have been a decrease in reported and operating net income of approximately \$75 million. The actual impact could differ from the Company’s estimate. The statements concerning expected URR changes are forward-looking.

### Credit Spread and Swap Spread Sensitivities

We have estimated the immediate impact or sensitivity of our shareholders’ net income attributable to certain instantaneous changes in credit and swap spreads. The credit spread sensitivities reflect the impact of changes in credit spreads on our asset and liability valuations (including non-sovereign fixed income assets, provincial governments, corporate bonds and other fixed income assets). The swap spread sensitivities reflect the impact of changes in swap spreads on swap-based derivative positions and liability valuations.

#### Credit Spread Sensitivities (\$ millions, after-tax)

Net income sensitivity <sup>(1)(2)</sup>	50 basis point decrease	50 basis point increase
<b>December 31, 2016</b>	<b>\$ (125)</b>	<b>\$ 125</b>
December 31, 2015	\$ (100)	\$ 75

(1) Sensitivities have been rounded to the nearest \$25 million.

(2) In most instances, credit spreads are assumed to revert to long-term insurance contract liability assumptions generally over a five-year period.

#### Swap Spread Sensitivities (\$ millions, after-tax)

Net income sensitivity <sup>(1)</sup>	20 basis point decrease	20 basis point increase
<b>December 31, 2016</b>	<b>\$ 25</b>	<b>\$ (25)</b>
December 31, 2015	\$ 50	\$ (50)

(1) Sensitivities have been rounded to the nearest \$25 million.

The credit and swap spread sensitivities assume a parallel shift in the indicated spreads across the entire term structure. Variations in realized spread changes based on different terms to maturity, geographies, asset classes and derivative types, underlying interest rate movements, and ratings may result in realized sensitivities being significantly different from those provided above. The credit spread sensitivity estimates exclude any credit spread impact that may arise in connection with asset positions held in segregated funds. Spread sensitivities are provided for the consolidated entity and may not be proportional across all reporting segments. Refer to the section of this MD&A under the heading Additional Cautionary Language and Key Assumptions Related to Sensitivities for important additional information regarding these estimates.

### Market Risk Management Strategies

Market risk is managed at all stages during the product life cycle including product design and development, ongoing review and positioning of our suite of products, and ongoing asset-liability management and hedge re-balancing.

We have implemented asset-liability management and hedging programs involving regular monitoring and adjustment of market risk exposures using assets, derivative instruments and repurchase agreements to maintain market risk exposures within our risk appetite. The general availability and cost of these hedging instruments may be adversely impacted by a number of factors including changes in market levels and volatility, and changes in the general market and regulatory environment within which these hedging programs operate. In particular, regulations for over-the-counter derivatives could impose additional costs and could affect our hedging strategy. In addition, these programs may themselves expose us to other risks.

Our market risk management strategies are developed based on policies and operating guidelines at the enterprise level, business segment level and product level. Liabilities having a similar risk profile are grouped together and a customized investment and hedging strategy is developed and implemented to optimize return within our risk appetite limits.

In general, market risk exposure is mitigated by the assets supporting our products. This includes holdings of fixed income assets such as bonds and mortgages. Derivative instruments may supplement these assets to reduce the risk from cash flow mismatches and mitigate the market risk associated with liability features and optionality. The following table sets out the use of derivatives across a number of our products as at December 31, 2016.

## Asset-Liability Management Applications for Derivative Usage

The primary uses of derivatives are set out in the table below.

Products/Application	Uses of Derivative	Derivatives Used
General asset-liability management – interest rate risk exposure for most insurance and annuity products	To manage the sensitivity of the duration gap between assets and liabilities to interest rate changes	Interest rate swaps, swaptions, floors and bond futures
Guarantees on insurance and annuity contracts – minimum interest rate guarantees, guaranteed surrender values and guaranteed annuitization options	To limit potential financial losses from significant reductions in asset earned rates relative to contract guarantees	Swaptions, floors, interest rate swaps, futures on interest rates and spread locks on interest rates
Segregated fund guarantees	To manage the exposure of product guarantees sensitive to movement in equity market and interest rate levels	Put and call options on equity indices, futures on equity indices, interest rate swaps and futures, and foreign exchange forwards
Currency exposure in relation to asset-liability management	To reduce the sensitivity to currency fluctuations by matching the value and cash flows of specific assets denominated in one currency with the value and cash flows of the corresponding liabilities denominated in another currency	Currency swaps and forwards
Credit exposure	To replicate credit exposures and enhance investment returns	Credit default swaps

## General Account Insurance and Annuity Products

Most of our expected sensitivity to changes in interest rates and about two-thirds of our expected sensitivity to changes in equity markets are derived from our general account insurance and annuity products. We have implemented market risk management strategies to mitigate a portion of the market risk related to our general account insurance and annuity products.

Individual insurance products include universal life and other long-term life and health insurance products. Major sources of market risk exposure for individual insurance products include the reinvestment risk related to future premiums on regular premium policies, asset reinvestment risk on both regular premium and single premium policies and the guaranteed cost of insurance. Interest rate risk for individual insurance products is typically managed on a duration basis, within tolerance ranges set out in the applicable investment policy or guidelines. Targets and limits are established so that the level of residual exposure is commensurate with our risk appetite. Exposures are monitored frequently, and assets are re-balanced as necessary to maintain compliance within policy limits using a combination of assets and derivative instruments. A portion of the longer-term cash flows are backed with equities and real estate.

For participating insurance products and other insurance products with adjustability features, the investment strategy objective is to provide a total rate of return given a constant risk profile over the long term.

Fixed annuity products generally provide the policyholder with a guaranteed investment return or crediting rate. Interest rate risk for these products is typically managed on a duration basis, within tolerance ranges set out in the applicable investment guidelines. Targets and limits are established such that the level of residual exposure is commensurate with our risk appetite. Exposures are monitored frequently, and are re-balanced as necessary to maintain compliance within prescribed tolerances using a combination of fixed income assets and derivative instruments.

Certain insurance and annuity products contain minimum interest rate guarantees. Market risk management strategies are implemented to limit potential financial loss due to reductions in asset earned rates relative to contract guarantees. These typically involve the use of hedging strategies utilizing interest rate derivatives such as interest rate floors, swaps and swaptions.

Certain insurance and annuity products contain features which allow the policyholders to surrender their policy at book value. Market risk management strategies are implemented to limit the potential financial loss due to changes in interest rate levels and policyholder behaviour. These typically involve the use of hedging strategies such as dynamic option replication and the purchase of interest rate swaptions.

Certain products have guaranteed minimum annuitization rates. Market risk management strategies are implemented to limit the potential financial loss and typically involve the use of fixed income assets, interest rate swaps, and swaptions.

## Segregated Fund Guarantees

Approximately one-third of our equity market sensitivity and a small amount of interest rate risk sensitivity as at December 31, 2016 are derived from segregated fund products. These products provide benefit guarantees, which are linked to underlying fund performance and may be triggered upon death, maturity, withdrawal or annuitization. The cost of providing these guarantees is uncertain and depends upon a number of factors including general capital market conditions, our hedging strategies, policyholder behaviour and mortality experience, each of which may result in negative impacts on net income and capital.

The following table provides information with respect to the guarantees provided for our segregated fund products.

### Segregated Fund Risk Exposures (\$ millions)

	December 31, 2016			
	Fund value	Amount at Risk <sup>(1)</sup>	Value of guarantees <sup>(2)</sup>	Insurance contract liabilities <sup>(3)</sup>
SLF Canada	12,354	348	10,961	499
SLF U.S.	4,361	430	4,681	171
Run-off reinsurance <sup>(4)</sup>	2,695	494	1,864	469
<b>Total</b>	<b>19,410</b>	<b>1,272</b>	<b>17,506</b>	<b>1,139</b>

	December 31, 2015			
	Fund value	Amount at Risk <sup>(1)</sup>	Value of guarantees <sup>(2)</sup>	Insurance contract liabilities <sup>(3)</sup>
SLF Canada	12,304	424	11,109	575
SLF U.S.	5,400	509	5,789	275
Run-off reinsurance <sup>(4)</sup>	2,950	569	2,129	570
<b>Total</b>	<b>20,654</b>	<b>1,502</b>	<b>19,027</b>	<b>1,420</b>

- (1) The Amount at Risk represents the excess of the value of the guarantees over fund values on all policies where the value of the guarantees exceeds the fund value. The Amount at Risk is not currently payable as the guarantees are only payable upon death, maturity, withdrawal or annuitization if fund values remain below guaranteed values.
- (2) For guaranteed lifetime withdrawal benefits, the value of guarantees is calculated as the present value of the maximum future withdrawals assuming market conditions remain unchanged from current levels. For all other benefits, the value of guarantees is determined assuming 100% of the claims are made at the valuation date.
- (3) The insurance contract liabilities represent management's provision for future costs associated with these guarantees and include a provision for adverse deviation in accordance with Canadian actuarial standards of practice.
- (4) The Run-off reinsurance business includes risks assumed through reinsurance of variable annuity products issued by various North American insurance companies between 1997 and 2001. This line of business is part of a closed block of reinsurance, which is included in the Corporate segment.

The movement of the items in the table above from December 31, 2015 to December 31, 2016 was primarily as a result of the following factors:

- (i) the total fund values decreased due to the net redemptions from legacy business and the strengthening of the Canadian dollar against the U.S. dollar;
- (ii) the amount at risk decreased due to positive fund returns, the net redemptions from legacy business and the strengthening of the Canadian dollar;
- (iii) the total value of guarantees decreased due to the net redemptions from legacy business and the strengthening of the Canadian dollar; and
- (iv) the total insurance contract liabilities decreased due to higher interest rates, favourable equity market movements, and the net redemptions from legacy business.

### Segregated Fund Hedging

Our hedging programs use derivative instruments to mitigate the interest and equity related exposure of our segregated fund contracts. As at December 31, 2016, over 90% of our segregated fund contracts, as measured by associated fund values, were included in a hedging program. While a large percentage of contracts are included in the hedging program, not all of our market risk exposure related to these contracts is hedged. For those segregated fund contracts included in the hedging program, we generally hedge the value of expected future net claims costs and associated margins.

The following table illustrates the impact of our hedging program related to our sensitivity to a 50 basis point and 100 basis point decrease in interest rates and a 10% and 25% decrease in equity markets for segregated fund contracts as at December 31, 2016 and December 31, 2015.

## Impact of Segregated Fund Hedging (\$ millions)

December 31, 2016

Net income sensitivity <sup>(1)(2)</sup>	Changes in interest rates <sup>(3)</sup>		Changes in equity markets <sup>(4)</sup>	
	50 basis point decrease	100 basis point decrease	10% decrease	25% decrease
Before hedging	(250)	(550)	(200)	(550)
Hedging impact	250	550	150	450
Net of hedging	–	–	(50)	(100)

December 31, 2015

Net income sensitivity <sup>(1)(2)</sup>	Changes in interest rates <sup>(3)</sup>		Changes in equity markets <sup>(4)</sup>	
	50 basis point decrease	100 basis point decrease	10% decrease	25% decrease
Before hedging	(200)	(450)	(200)	(600)
Hedging impact	200	500	150	500
Net of hedging	–	50	(50)	(100)

(1) Net income sensitivities have been rounded to the nearest \$50 million.

(2) Since the fair value of benefits being hedged will generally differ from the financial statement value (due to different valuation methods and the inclusion of valuation margins in respect of financial statement values), this will result in residual volatility to interest rate and equity market shocks in reported income and capital. The general availability and cost of these hedging instruments may be adversely impacted by a number of factors, including volatile and declining equity and interest rate market conditions.

(3) Represents a parallel shift in assumed interest rates across the entire yield curve as at December 31, 2016 and December 31, 2015, with no change to the ASB promulgated URR. Variations in realized yields based on factors such as different terms to maturity and geographies may result in realized sensitivities being significantly different from those illustrated above. Sensitivities include the impact of re-balancing interest rate hedges for dynamic hedging programs at 10 basis point intervals (for 50 basis point changes in interest rates) and at 20 basis point intervals (for 100 basis point changes in interest rates).

(4) Represents the respective change across all equity markets as at December 31, 2016 and December 31, 2015. Assumes that actual equity exposures consistently and precisely track the broader equity markets. Since in actual practice equity-related exposures generally differ from broad market indices (due to the impact of active management, basis risk and other factors), realized sensitivities may differ significantly from those illustrated above. Sensitivities include the impact of re-balancing equity hedges for dynamic hedging programs at 2% intervals (for 10% changes in equity markets) and at 5% intervals (for 25% changes in equity markets).

Our hedging strategy is applied both at the line of business or product level and at the Company level using a combination of longer-dated put options and dynamic hedging techniques (i.e., frequent re-balancing of short-dated interest rate and equity derivative contracts). We actively monitor our overall market exposure and may implement tactical hedge overlay strategies (primarily in the form of futures contracts) in order to align expected earnings sensitivities with risk management objectives.

### Real Estate Risk

Real estate risk is the potential for financial loss arising from fluctuations in the value of, or future cash flows from our investments in real estate. We are exposed to real estate risk and may experience financial losses resulting from the direct ownership of real estate investments or indirectly through fixed income investments secured by real estate property, leasehold interests, ground rents, and purchase and leaseback transactions. Real estate price risk may arise from external market conditions, inadequate property analysis, inadequate insurance coverage, inappropriate real estate appraisals or from environmental risk exposures. We hold direct real estate investments that support general account liabilities and surplus, and fluctuations in value will impact our profitability and financial position. A material and sustained increase in interest rates may lead to deterioration in real estate values. An instantaneous 10% decrease in the value of our direct real estate investments as at December 31, 2016 would decrease net income<sup>(1)</sup> by approximately \$200 million (\$175 million decrease as at December 31, 2015). Conversely, an instantaneous 10% increase in the value of our direct real estate investments as at December 31, 2016 would increase net income by approximately \$200 million (\$175 million increase as at December 31, 2015).

### Foreign Currency Risk

Foreign currency risk is the result of mismatches in the currency of our assets and liabilities (inclusive of capital), and cash flows. This risk may arise from a variety of sources such as foreign currency transactions and services, foreign currency hedging, investments denominated in foreign currencies, investments in foreign subsidiaries and net income from foreign operations. Changes or volatility in foreign exchange rates could adversely affect our financial condition and results of operations.

As an international provider of financial services, we operate in a number of countries, with revenues and expenses denominated in several local currencies. In each country in which we operate, we generally maintain the currency profile of assets to match the currency of aggregate liabilities and required surplus. This approach provides an operational hedge against disruptions in local operations caused by currency fluctuations. Foreign currency derivative contracts such as currency swaps and forwards are used as a risk management tool to manage the currency exposure in accordance with our Asset Liability Management Policy. As at December 31, 2016 and December 31, 2015, the Company did not have a material foreign currency risk exposure on a functional currency basis.

Changes in exchange rates can affect our net income and surplus when financial results in functional currencies are translated into Canadian dollars. Net income earned outside of Canada is generally not currency hedged and a weakening in the local currency of our foreign operations relative to the Canadian dollar can have a negative impact on our net income reported in Canadian currency. A strengthening in the local currency of our foreign operations relative to the Canadian dollar would have the opposite effect. Regulatory capital ratios could also be impacted by changes in exchange rates to the extent that changes in available capital and required capital do not offset.

(1) Net income sensitivities have been rounded to the nearest \$25 million.

## Additional Cautionary Language and Key Assumptions Related to Sensitivities

Our market risk sensitivities are measures of our estimated change in net income and OCI for changes in interest rates and equity market price levels described above, based on interest rates, equity market prices and business mix in place as at the respective calculation dates. These sensitivities are calculated independently for each risk factor, generally assuming that all other risk variables stay constant. The sensitivities do not take into account indirect effects such as potential impacts on goodwill impairment or valuation allowances on deferred tax assets. The sensitivities are provided for the consolidated entity and may not be proportional across all reporting segments. Actual results can differ materially from these estimates for a variety of reasons, including differences in the pattern or distribution of the market shocks, the interaction between these risk factors, model error, or changes in other assumptions such as business mix, effective tax rates, policyholder behaviour, currency exchange rates and other market variables relative to those underlying the calculation of these sensitivities. The extent to which actual results may differ from the indicative ranges will generally increase with larger capital market movements. Our sensitivities as at December 31, 2015 have been included for comparative purposes only.

We have also provided measures of our net income sensitivity to instantaneous changes in credit spreads, swap spreads, real estate price levels, and capital sensitivities to changes in interest rates and equity price levels. The real estate sensitivities are non-IFRS financial measures. For additional information, see Non-IFRS Financial Measures. The cautionary language which appears in this section is also applicable to the credit spread, swap spread, real estate, and MCCR ratio sensitivities. In particular, these sensitivities are based on interest rates, credit and swap spreads, equity market, and real estate price levels as at the respective calculation dates and assume that all other risk variables remain constant. Changes in interest rates, credit and swap spreads, equity market and real estate prices in excess of the ranges illustrated may result in other-than-proportionate impacts.

As these market risk sensitivities reflect an instantaneous impact on net income, OCI and Sun Life Assurance's MCCR ratio, they do not include impacts over time such as the effect on fee income in our asset management businesses.

The sensitivities reflect the composition of our assets and liabilities as at December 31, 2016 and December 31, 2015, respectively. Changes in these positions due to new sales or maturities, asset purchases/sales, or other management actions could result in material changes to these reported sensitivities. In particular, these sensitivities reflect the expected impact of hedging activities based on the hedge programs in place as at the December 31 calculation dates. The actual impact of hedging activity can differ materially from that assumed in the determination of these indicative sensitivities due to ongoing hedge re-balancing activities, changes in the scale or scope of hedging activities, changes in the cost or general availability of hedging instruments, basis risk (i.e., the risk that hedges do not exactly replicate the underlying portfolio experience), model risk, and other operational risks in the ongoing management of the hedge programs or the potential failure of hedge counterparties to perform in accordance with expectations.

The sensitivities are based on methods and assumptions in effect as at December 31, 2016 and December 31, 2015, as applicable. Changes in the regulatory environment, accounting or actuarial valuation methods, models, or assumptions (including changes to the ASB promulgated URR) after those dates could result in material changes to these reported sensitivities. Changes in interest rates and equity market prices in excess of the ranges illustrated may result in other than proportionate impacts.

Our hedging programs may themselves expose us to other risks, including basis risk (i.e., the risk that hedges do not exactly replicate the underlying portfolio experience), derivative counterparty credit risk, and increased levels of liquidity risk, model risk and other operational risks. These factors may adversely impact the net effectiveness, costs, and financial viability of maintaining these hedging programs and therefore adversely impact our profitability and financial position. While our hedging programs are intended to mitigate these effects (e.g., hedge counterparty credit risk is managed by maintaining broad diversification, dealing primarily with highly rated counterparties, and transacting through International Swaps and Derivatives Association agreements that generally include applicable credit support annexes), residual risk, potential reported earnings and capital volatility remain.

For the reasons outlined above, our sensitivities should only be viewed as directional estimates of the underlying sensitivities of each factor under these specialized assumptions, and should not be viewed as predictors of our future net income, OCI, and capital sensitivities. Given the nature of these calculations, we cannot provide assurance that actual impact will be consistent with the estimates provided.

Information related to market risk sensitivities and guarantees related to segregated fund products should be read in conjunction with the information contained in the sections in this MD&A under the headings Outlook and Critical Accounting Policies and Estimates. Additional information on market risk can be found in Note 6 of our 2016 Annual Consolidated Financial Statements and the Risk Factors section in our AIF.

## Insurance Risk

### Risk Description

Insurance risk is the uncertainty of product performance due to differences between the actual experience and expected experience in the areas of mortality, morbidity, longevity and policyholder behaviour. In addition, product design and pricing, expense and reinsurance risks impact multiple risk categories, including insurance risk.

### Insurance Risk Management Governance and Control

We employ a wide range of insurance risk management practices and controls, as outlined below:

- Insurance risk governance practices are in place, including independent monitoring and review and reporting to senior management and the Risk Review Committee.
- Risk appetite limits have been established for mortality and morbidity, longevity and policyholder behaviour risks.
- Income and regulatory capital sensitivities are monitored, managed and reported against pre-established risk limits.
- Comprehensive Insurance Risk Policy, guidelines and practices are in place.

- The global underwriting manual aligns underwriting practices with our corporate risk management standards and ensures a consistent approach in insurance underwriting.
- Board-approved maximum retention limits (amounts issued in excess of these limits are reinsured) are in place.
- Detailed procedures, including criteria for approval of risks and for claims adjudication are established and monitored for each business segment.
- Underwriting and risk selection standards are established and overseen by the corporate underwriting and claims risk management function.
- Diversification and risk pooling is managed by aggregation of exposures across product lines, geography and distribution channels.
- The Insurance Risk Policy, and Investment and Credit Risk Management Policy establish acceptance criteria and protocols to monitor the level of reinsurance ceded to any single reinsurer or group of reinsurers.
- Reinsurance counterparty risk is monitored, including through annual reporting to the Risk Review Committee.
- Concentration risk exposure is monitored and mitigated on group policies in a single location to avoid a catastrophic event occurrence resulting in a significant impact.
- Various limits, restrictions and fee structures are introduced into plan designs in order to establish a more homogeneous policy risk profile and limit potential for anti-selection.
- Regulatory solvency requirements include risk-based capital requirements and are monitored regularly.
- The Product Design and Pricing Policy requires detailed risk assessment and pricing provision for material risks.
- Company specific and industry level experience studies and sources of earnings analysis are monitored and factored into valuation, renewal and new business pricing processes.
- Stress-testing techniques, such as DCAT, are used to measure the effects of large and sustained adverse movements in insurance risk factors.
- Insurance contract liabilities are established in accordance with Canadian actuarial standards of practice.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.

We use reinsurance to limit losses, minimize exposure to significant risks and to provide additional capacity for growth. Our Insurance Risk Policy sets maximum global retention limits and related management standards and practices which are applied to reduce our exposure to large claims. Amounts in excess of the Board-approved maximum retention limits are reinsured. On a single life or joint-first-to-die basis our retention limit is \$25 million in Canada and is US\$25 million outside of Canada. For survivorship life insurance, our maximum global retention limit is \$30 million in Canada and is US\$30 million outside of Canada. In certain markets and jurisdictions retention levels below the maximum are applied. Reinsurance is utilized for numerous products in most business segments, and placement is done on an automatic basis for defined insurance portfolios and on a facultative basis for individual risks with certain characteristics. Reinsurance is used to provide catastrophic mortality and morbidity coverage for the Canadian GB business.

Our reinsurance coverage is well diversified and controls are in place to manage exposure to reinsurance counterparties. Reinsurance exposures are monitored to ensure that no single reinsurer represents an undue level of credit risk. This includes performing periodic due diligence on our reinsurance counterparties as well as internal credit assessments on counterparties with which we have material exposure. While reinsurance arrangements provide for the recovery of claims arising from the liabilities ceded, we retain primary responsibility to the policyholders.

Specific insurance risks and our risk management strategies are discussed below in further detail.

### **Mortality and Morbidity Risk**

Mortality and morbidity risk is the risk that future experience could be worse than the assumptions used in the pricing and valuation of products. Mortality and morbidity risk can arise in the normal course of business through random fluctuation in realized experience, through catastrophes, or in association with other risk factors such as product development and pricing or model risk. Adverse mortality and morbidity experience could also occur through systemic anti-selection, which could arise due to poor plan design, or underwriting process failure or the development of investor-owned and secondary markets for life insurance policies.

The risk of adverse morbidity experience also increases during economic slowdowns, especially with respect to disability coverages, as well as with increases in high medical treatment costs and growth in utilization of specialty drugs. This introduces the potential for adverse financial volatility in our financial results. External factors including medical advances could adversely affect our life insurance, health insurance, critical illness, disability, long-term care insurance and annuity businesses.

Detailed uniform underwriting procedures have been established to determine the insurability of applicants and to manage exposure to large claims. These underwriting requirements are regularly scrutinized against industry guidelines and oversight is provided through a corporate underwriting and claim management function.

We do not have a high degree of concentration risk to single individuals or groups due to our well-diversified geographic and business mix. The largest portion of mortality risk within the Company is in North America. Individual and group insurance policies are underwritten prior to initial issue and renewals, based on risk selection, plan design, and rating techniques.

The Insurance Risk Policy approved by the Risk Review Committee includes limits on the maximum amount of insurance that may be issued under one policy and the maximum amount that may be retained. These limits vary by geographic region and amounts in excess of limits are reinsured to ensure there is no exposure to unreasonable concentration of risk.

### **Longevity Risk**

Longevity risk is the potential for economic loss, accounting loss or volatility in earnings arising from adverse changes in rates of mortality improvement relative to the assumptions used in the pricing and valuation of products. This risk can manifest itself slowly over time as socioeconomic conditions improve and medical advances continue. It could also manifest itself more quickly, for example, due to medical breakthroughs that significantly extend life expectancy. Longevity risk affects contracts where benefits are based upon the likelihood of survival (for example, annuities, pensions, pure endowments, segregated funds, and specific types of health contracts). Additionally, our longevity risk exposure is exacerbated for certain annuity products such as guaranteed annuity options by an increase in equity market levels.

To improve management of longevity risk, we monitor research in the fields which could result in mortality improvement. Stress-testing techniques are used to measure and monitor the impact of extreme mortality improvement on the aggregate portfolio of insurance and annuity products as well as our own pension plans.

### **Policyholder Behaviour Risk**

We can incur losses due to adverse policyholder behaviour relative to the assumptions used in the pricing and valuation of products with regard to lapse of policies or exercise of other embedded policy options.

Uncertainty in policyholder behaviour can arise from several sources including unexpected events in the policyholder's life circumstances, the general level of economic activity (whether higher or lower than expected), changes in pricing and availability of current products, the introduction of new products, changes in underwriting technology and standards, as well as changes in our financial strength or reputation. Uncertainty in future cash flows affected by policyholder behaviour can be further exacerbated by irrational behaviour during times of economic turbulence or at key option exercise points in the life of an insurance contract.

Various types of provisions are built into many of our products to reduce the impact of uncertain policyholder behaviour. These provisions include:

- Surrender charges which adjust the payout to the policyholder by taking into account prevailing market conditions.
- Limits on the amount that policyholders can surrender or borrow.
- Restrictions on the timing of policyholders' ability to exercise certain options.
- Restrictions on both the types of funds Clients can select and the frequency with which they can change funds.
- Policyholder behaviour risk is also mitigated through reinsurance on some insurance contracts.

### **Product Design and Pricing Risk**

Product design and pricing risk is the risk a product does not perform as expected, causing adverse financial consequences. This risk may arise from deviations in realized experience versus assumptions used in the pricing of products. Risk factors include uncertainty concerning future investment yields, policyholder behaviour, mortality and morbidity experience, sales levels, mix of business, expenses and taxes. Although some of our products permit us to increase premiums or adjust other charges and credits during the life of the policy or contract, the terms of these policies or contracts may not allow for sufficient adjustments to maintain expected profitability. This could have an adverse effect on our profitability and capital position.

Our Product Design and Pricing Policy, approved by the Risk Review Committee, establishes the framework governing our product design and pricing practices and is designed to align our product offerings with our strategic objectives and risk-taking philosophy. Consistent with this policy, product development, design and pricing processes have been implemented throughout the Company. New products follow a stage-gate process with defined management approvals based on the significance of the initiative, and each initiative is subject to a risk assessment process to identify key risks and risk mitigation requirements, and is reviewed by multiple stakeholders. Additional governance and control procedures are listed below:

- Pricing models, methods, and assumptions are subject to periodic internal peer reviews.
- Experience studies, sources of earnings analysis, and product dashboards are used to monitor actual experience against those assumed in pricing and valuation.
- On experience rated, participating, and adjustable products, emerging experience is reflected through changes in policyholder dividend scales as well as other policy adjustment mechanisms such as premium and benefit levels.
- Limits and restrictions may be introduced into the design of products to mitigate adverse policyholder behaviour or apply upper thresholds on certain benefits.

### **Expense Risk**

Expense risk is the risk that future expenses are higher than the assumptions used in the pricing and valuation of products. This risk can arise from general economic conditions, unexpected increases in inflation, slower than anticipated growth, or reduction in productivity leading to increases in unit expenses. Expense risk occurs in products where we cannot or will not pass increased costs onto the Client and will manifest itself in the form of a liability increase or a reduction in expected future profits.

We closely monitor expenses through an annual budgeting process and ongoing monitoring of any expense gaps between unit expenses assumed in pricing and actual expenses.

### **Reinsurance Risk**

We purchase reinsurance for certain risks underwritten by our various insurance businesses. Reinsurance risk is the risk of financial loss due to adverse developments in reinsurance markets (for example, discontinuance or diminution of reinsurance capacity, or an increase in the cost of reinsurance), insolvency of a reinsurer or inadequate reinsurance coverage.

Changes in reinsurance market conditions, including actions taken by reinsurers to increase rates on existing and new coverage and our ability to obtain appropriate reinsurance, may adversely impact the availability or cost of maintaining existing or securing new reinsurance capacity, with adverse impacts on our business strategies, profitability and financial position. There is an increased possibility of rate increases or renegotiation of legacy reinsurance contracts by our reinsurers, as the global reinsurance industry continues to review and optimize their business models. In addition, changes to the regulatory treatment of reinsurance arrangements could have an adverse impact on our capital position.

We have an Insurance Risk Policy, and Investment and Credit Risk Management Policy approved by the Risk Review Committee which set acceptance criteria and processes to monitor the level of reinsurance ceded to any single reinsurer or group of reinsurers. These policies also set out criteria for determining which reinsurance companies qualify as suitable reinsurance counterparties and require that all agreements include provisions to allow action to be taken, such as recapture of ceded risk (at a potential cost to the Company), in the event that the reinsurer loses its legal ability to carry on business through insolvency or regulatory action. Periodic due diligence is performed on the reinsurance counterparties with which we do business and internal credit assessments are performed on reinsurance counterparties with which we have material exposure. Reinsurance counterparty credit exposures are monitored closely and reported annually to the Risk Review Committee.

New sales of our products can be discontinued or changed to reflect developments in the reinsurance markets. Rates for in-force reinsurance treaties can be either guaranteed or adjustable for the life of the ceded policy. There is generally more than one reinsurer supporting a reinsurance pool to diversify this risk.

Additional information on insurance risk can be found in Note 7 to our 2016 Annual Consolidated Financial Statements and in the Risk Factors section in our AIF.

## Business and Strategic Risk

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### Risk Description

Business and strategic risk includes risks related to changes in the economic or political environment, changes in distribution channels or Client behaviour, changes in the competitive environment, risks relating to the design or implementation of our business strategy, and changes in the legal or regulatory environment.

### Business and Strategic Risk Management Governance and Control

We employ a wide range of business and strategic risk management practices and controls, as outlined below:

- Business and strategic risk governance practices are in place, including independent monitoring and review and reporting to senior management, the Board of Directors and the Board Committees.
- Business and strategic risk is managed through our strategic and business planning process and controls over the implementation of these plans. These plans are reviewed and discussed by our Executive Team and the key themes, issues and risks emerging are discussed by the Board of Directors and the Board Committees.
- Our business and strategic plans are subject to approval by the Board of Directors, which also receives regular reviews of implementation progress against key business plan objectives.
- Comprehensive policies including the Risk Framework, Risk Appetite Policy, Product Design and Pricing Policy, and Capital Risk Policy are in place.
- Our corporate strategy and business objectives are established within the boundaries of the Risk Appetite Policy. Our business strategies and plans are designed to align with our risk appetite, our capital position and our financial performance objectives.
- Our risk appetite is periodically assessed, taking into consideration the economic and regulatory environments in which we operate.
- Merger, acquisition and divestiture transactions are governed by a Board-approved risk management policy and significant transactions require the approval of the Board of Directors.
- Stress-testing techniques, such as DCAT, are used to measure the effects of large and sustained adverse scenarios.
- Key and emerging risks are identified, monitored and reported, including emerging regulatory changes that may have a material impact on our finances, operations or reputation.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.

Specific business and strategic risks are discussed below in further detail.

### Economic and Political Risk

We operate in various geographies and our business and financial operations are susceptible to global economic, political and regulatory changes. Our overall business and financial operations may be affected by global economic and capital markets conditions through economic shocks transmitted directly or indirectly to other countries as a result of the increasingly connected global markets resulting in market volatility, heightened credit risk, reduced valuation of investments and decreased economic activity. Continued economic and political uncertainty may give rise to increased business and strategic risks including those associated with industry restructuring, mergers and acquisitions, new competitive dynamics and significant changes in the legal, regulatory and tax regimes in which our businesses operate. In addition, adverse economic conditions often arise in conjunction with volatile and deteriorating capital markets conditions, and Client behaviour which can have a direct material adverse impact on our sales and profitability, credit and financial strength ratings, and capital and liquidity positions.

### Distribution Risk

Failure to achieve planned distribution scale or appropriate and compliant distribution of products could materially impact our financial and strategic objectives. This includes the inability to attract and retain intermediaries and agents at a cost that is financially feasible to the Company, or to develop online sales and Client support capabilities and technologies. Distribution risk may also be influenced where our distribution or product strategy and related services (including online sales and Client support capabilities and technologies) are not developed, modified or executed in line with our strategic objectives or in consideration of the changes in Client behaviour or our regulatory environment. In addition, the lack of a well-diversified distribution model in some of our countries may cause over-reliance on agency channel or key partners.

### Competition Risk

Competition from insurance companies, banks, asset managers, mutual fund companies, financial planners and other service providers (including new entrants and non-traditional financial services companies) is intense, and could adversely affect our business in certain countries.

The businesses in which we engage are highly competitive and our ability to sell our products is dependent on many factors, including scale, price and yields offered, distribution channels, e-business capabilities, financial strength ratings, range of product lines and product quality, brand strength, investment performance, historical dividend levels and the ability to provide value added services to distributors and Clients. In certain markets, some of our competitors may be superior to us on one or more of these factors. Our competitors have significant potential to disrupt our business through targeted strategies to reduce our market share which may include targeting our key people or bancassurance partners and other distributors or aggressively pricing their products.

Technology is driving rapid change in the financial services sector and is enabling new entrants to compete or offer services to our competitors to enhance their ability to compete in certain segments of the insurance market. New entrants may use new technologies,

including advanced data and analytic tools and different processes to challenge traditional insurance companies. The impact of disruption from changing technology and innovation by competitors (including non-traditional competitors) may require us to adapt at a more rapid pace, create margin pressures as the non-traditional competitors may have lower priced products and distribution costs, and may offer a better user-experience or functionality. The risk of disruption may also impact our distribution models as new and low cost digital based business models emerge in connection with the distribution of financial services and products, such as robo advisors. These risks are evolving rapidly with an increasing number of digital users and are difficult to anticipate and respond to proactively, and may adversely impact our profitability and financial position.

### **Implementation of Business Strategy**

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

### **Changes in Legal and Regulatory Environment**

Most of our businesses are subject to extensive regulation and supervision. Changes to legislation, regulations or government policies, or the manner in which they are interpreted or enforced, may require that we make significant changes to our strategy, may result in increased implementation costs and diversion of resources to manage the change, could impact financial reporting, accounting processes and capital requirements, and could impact the ability of sales intermediaries to distribute our products, all of which could have an adverse effect on our business and operations. Our failure to comply with existing and evolving regulatory requirements could also result in regulatory sanctions and could affect our relationships with regulatory authorities and our ability to execute our business strategies and plans.

These changes could impact our capital requirements, the regulatory framework for pension arrangements and policies, the regulation of selling practices, sales intermediaries (such as bancassurance) and product structures, solvency requirements, executive compensation, corporate governance practices and could impose restrictions on our foreign operations, which may include changes to the limits on foreign ownership of local companies.

### **Investment Performance**

Investment performance risk is the possibility that we fail to achieve the desired return objectives on our investment portfolio, or that our asset management businesses fail to design or execute investment strategies in order to achieve competitive returns on our products. Failure to achieve investment objectives may adversely affect our revenue and profitability through slower growth prospects and adverse impacts on policyholder or Client behaviour.

### **International Operations**

The future success of our businesses in our international operations depends in large part on our ability to grow and compete in the markets where we operate. Challenges in these markets pose strategic and execution risk including our ability to attract and retain qualified employees and executives with local experience and critical skills, political, legal, economic, competition or other risks, risks associated with joint venture operations, developing and executing our risk management practices, and our ability to attract, retain, expand and diversify distribution channels.

### **Mergers, Acquisitions and Divestitures**

We regularly explore opportunities to selectively acquire other businesses or to divest ourselves of all or part of certain businesses, in support of our growth and strategic objectives. These transactions introduce the risk of financial loss due to a potential failure to achieve the expected financial or other strategic objectives. There is a risk that we may be unable to make an appropriate acquisition in a desired market or business line or are unable to realize the financial and strategic benefits of the transactions due to competitive factors, regulatory requirements or other factors. These risks could adversely impact our ability to achieve our financial and strategic objectives.

Additional information on business and strategic risk can be found in the Risk Factors section in our AIF.

## **Operational Risk**

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### **Risk Description**

Operational risk is the risk of loss (financial and non-financial) resulting from inadequate or failed internal processes, people and systems or from external events. Operational risk is present in all of our business activities and encompasses a broad range of risks as described below. Operational risk management is embedded in the practices utilized to manage other risks and, therefore, if not managed effectively, operational risk can impact our ability to manage other key risks.

### **Operational Risk Management Governance and Control**

We employ a wide range of operational risk management practices and controls, as outlined below:

- Operational risk governance practices are in place, including independent monitoring and review and reporting to senior management and the Board Committees.
- Comprehensive Operational Risk Management Policies, guidelines and practices are in place.
- Our governance practices, corporate values, Code of Conduct and Company-wide approach to managing risk set the foundation for mitigating operational risks.
- Our Code of Conduct sets the tone for a strong ethical culture, and we regularly review and update the Code of Conduct to ensure that it continues to meet the expectations of regulators and other stakeholders. All our directors and employees must reconfirm annually their understanding of and commitment to comply with the Code of Conduct.
- We have established appropriate internal controls and systems, compensation programs, and seek to hire and retain competent people throughout the organization and provide ongoing training to our people.

- Stress-testing techniques, such as DCAT, are used to measure the effects of large and sustained adverse scenarios.
- We mitigate a portion of our operational risk exposure through our corporate insurance program by purchasing insurance coverage that seeks to provide insurance against unexpected material losses resulting from events such as criminal activity, property loss or damage and liability exposures, or that satisfies legal requirements and contractual obligations.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.

Specific operational risks and our risk management strategies are discussed below in further detail.

### **Information Security and Privacy Risks**

Our business is dependent on maintaining a secure environment for our Clients, employees and other parties' information. This requires the effective and secure use of information technology systems, including controls around logical access, physical access and data management. We engage with various stakeholders through web based technology and mobile applications, and use technology to collect, process and maintain information relating to business transactions and financial reporting, as well as the personal information of our Clients and employees. We also obtain services from a wide range of third-party service providers and have outsourced certain business and information technology functions to third parties in various jurisdictions.

We continue to make investments in technology, processes and cyber security professionals to position us to be better prepared to deal with the evolving threat landscape. Our security framework includes policies and procedures that are aligned with recognized industry standards and are compliant with applicable laws and regulations. We have well-established security controls (including logical, physical and data management controls) and processes that are intended to protect information and computer systems including information security risk assessments and privacy impact assessments. The framework also includes technology, process and behavioural based controls to protect our information systems and the data entrusted to us by our Clients and employees. As part of the overall security program, we provide security awareness training sessions for all new employees and on an annual basis thereafter.

In particular, privacy breaches could occur and may result in unauthorized access and disclosure or use of personal information. Many jurisdictions in which we do business are developing and implementing reporting requirements relating to cyber security and more stringent consumer privacy legislation. Our global privacy program requires adherence to our global privacy commitment, local laws and local privacy policies. We monitor emerging privacy legislation and we have established a network of privacy officers in the business segments to monitor and provide guidance on handling personal information and for reporting privacy incidents to appropriate management for response and resolution. In addition, we conduct privacy impact assessments, training and regular monitoring and reporting to help mitigate these risks.

Social media risks could also significantly impact our reputation due to the broad reach and real-time interaction of such media. We monitor social media to enable us to take action to mitigate an event that could potentially have a negative impact on our brand.

### **Human Resources Risk**

We operate in an increasingly competitive and global business environment and ensuring our ability to attract, retain and enable high performing talent that is diverse and engaged is essential to meeting the needs of our Clients. The loss of our top talent could have a material adverse effect on our reputation and business objectives given their skills, knowledge of our business, years of industry experience and the potential difficulty of promptly finding qualified replacements. If we are unable to attract, retain or effectively deploy resources with the in-depth knowledge and necessary skills required, or design compensation programs that effectively drive employee behaviour, our ability to achieve business objectives, including meeting Client requirements, operational, financial and growth goals, could be adversely affected.

To mitigate this risk, we have comprehensive Human Resource policies, practices and programs in place. Our recruiting, rewards and development programs seek to attract, build and retain high performing talent and build strong succession plans. We also measure and monitor employee engagement regularly to ensure we create and maintain a work environment where all employees are able to contribute effectively.

### **Execution and Integration Risks Relating to Mergers, Acquisitions and Divestitures**

We regularly explore opportunities to acquire other financial services businesses or to divest ourselves of all or part of certain businesses, in support of our growth and strategy goals. In 2015 and 2016, we have announced acquisitions in various markets and have increased our ownership interests in certain of our joint ventures and associates in Asia. These transactions introduce the risks related to completing the transactions as planned including effective separation and integration of the transferred businesses, and effective or efficient integration, restructuring or reorganization of the businesses after the transactions have closed, and motivating and retaining personnel to effectively execute these transactions. These risks could have an impact on our business relationship with various stakeholders including future employees, Clients, distributors and partners. Anticipated cost synergies or other expected benefits may not materialize due to a failure to successfully integrate the acquired business with our existing operations.

To mitigate this risk, we have established procedures to oversee the execution and integration of merger and acquisition transactions. Regular updates on the execution and integration risks relating to these transactions are provided to the Board of Directors, Board Committees and senior management committees, as appropriate.

### **Regulatory Compliance, Legal and Conduct Risk**

We are subject to extensive regulatory oversight by insurance and financial services regulators in the jurisdictions in which we conduct business. In recent years, there has been an increased focus by regulators globally on Client fairness, conduct and anti-money laundering. Failure to comply with applicable laws or to conduct our business consistent with changing regulatory or public expectations could adversely impact our reputation and may lead to regulatory proceedings, penalties, restrictions on our business, litigation or an inability to carry out our business strategy.

Our Chief Compliance Officer oversees our comprehensive Company-wide compliance framework, which is consistent with regulatory guidance from OSFI and other regulators. This framework promotes proactive, risk-based management of compliance and regulatory

risk, and includes: Company-wide and business segment policies, standards and operating guidelines, programs to promote awareness of laws and regulations that impact us, ongoing monitoring of emerging legal issues and regulatory changes and training programs. There are also new employee orientation programs that include anti-money laundering and anti-terrorist financing, anti-bribery and corruption, privacy and information security risk management. To ensure effective oversight and implementation, the framework is supported by a network of compliance officers and the general counsel in each business segment. The Chief Compliance Officer reports regularly to the Board of Directors and Board Committees on the state of compliance, key compliance risks, emerging regulatory trends, escalation of key issues and key risk indicators.

### **Information Technology Risk**

The use of technology and computer systems is essential in supporting and maintaining business operations. We use technology to support virtually all aspects of our business and operations. The rapidly changing business environment increases the risk of our technology strategy not being agile enough to adapt to new business demands in a timely manner leading to financial losses, increased costs and the inability to meet Client needs.

To manage the risks associated with our technology infrastructure and applications, we have implemented a number of policies, standards and controls through our technology approval and governance model to ensure ongoing operational and data integrity, information security and systems availability. A system development methodology and process has also been designed and implemented.

### **Third-Party Risk**

We engage in a variety of third-party relationships, including distributors, consultants, outsourcing service providers and suppliers. Our profitability or reputation could be impacted if these third parties are unable to meet their ongoing service commitments or perform to expected standards.

To manage these risks, we have established Company-wide policies and standards which are consistent with OSFI's and other local regulatory requirements. Our outsourcing and supplier risk management programs include specific requirements, guidelines and methodologies to effectively identify, assess, manage, monitor and report on the outsourcing and supplier risks.

### **Business Disruption Risk**

Our businesses are dependent on the availability of trained employees, physical locations to conduct operations, and computer and Internet-enabled technology. A significant business disruption to our operations can result if one or more of these key elements are negatively impacted.

To manage this risk, we have implemented a business continuity program to facilitate the recovery of critical business operations. This program encompasses business continuity planning, crisis management and disaster recovery. Our policy, standard and operating procedures establish consistent processes designed to ensure that key business functions can continue and normal operations can resume effectively and efficiently should a major disruption occur. Each business area maintains its own business continuity plan under the oversight of the business continuity program and these elements are updated and tested on a regular basis. In addition, we conduct mandatory business continuity awareness training for all employees annually and have off-site backup facilities and failover capability designed to minimize downtime and accelerate recovery time in the event of a major disruption.

### **Model Risk**

We use complex models to support many business functions including product development and pricing, capital management, valuation, financial reporting, planning, hedging, asset-liability management and risk management. The risk of inappropriate or erroneous design or use of models could have an adverse impact including errors in financial reporting impacting our profitability and financial position.

To manage model risk, we have established robust, Company-wide model risk management procedures with respect to building, changing and using models. The policy and operating guidelines set out minimum, risk-based requirements to ensure that models are effectively controlled, maintained and appropriately understood by users.

### **Information Management Risk**

As an international provider of financial services, we deal with extensive information across a number of countries. Our business decisions are dependent on the accuracy and completeness of the underlying data and information. Information management risk is the inability to capture, manage, retain and dispose records and data, and the inability to provide data on a timely and accurate basis to support the business decisions. Failure to manage these risks could have financial or reputational impacts, and may lead to regulatory proceedings, penalties and litigations.

To manage and monitor information management risk, we have robust internal control framework, data governance and record management practices in place to ensure accuracy and completeness of the underlying data as well appropriate retention of the information.

### **Environmental Risk**

Our financial performance may be adversely affected if we do not adequately prepare for the direct or indirect negative impacts of environmental events and developments, including climate change. These include impacts from related emerging regulatory and public policy developments, and their impacts on our suppliers and Clients. External factors such as stakeholder expectations around environmental performance, resource constraints, impact of climate change and costs associated with adaptation are also potential sources of environmental risk. Climate change risks may also affect our Clients and our suppliers, which could have a negative impact on our operations and performance. Further, an environmental issue on a property owned by us or on any property with which we are affiliated could have financial or reputational impacts.

We maintain an environmental risk management program to help protect investment assets (primarily real estate, mortgage and certain private fixed income assets) from losses due to environmental issues and to help ensure compliance with applicable laws. An important aspect of the program is an assessment of new investment assets for existing and potential environmental risks. Additionally, all

employees who are involved in underwriting and asset management investments in real estate and private debt secured by real estate complete environmental training and provide annual sign-off on compliance with the Company's environmental guidelines. We have programs in place across our real estate portfolio to identify and mitigate environmental risks, to conserve energy and to reduce waste. Environmental factors are incorporated into initial and ongoing reviews and assessments of public fixed income, private fixed income, real estate and commercial mortgage investments. Our cross-functional North American Investments Environmental Committee works to identify and assess environmental risks across our investment assets. Our International Sustainability Council convenes on broader environmental and sustainability issues. We report on environmental management annually in our Sustainability Report reviewed by the Governance, Nomination & Investment Committee.

Additional information on operational risk can be found in the Risk Factors section in our AIF.

## Liquidity Risk

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### Risk Description

Liquidity risk is the possibility that we will not be able to fund all cash outflow commitments and collateral requirements as they fall due. This includes the risk of being forced to sell assets at depressed prices resulting in realized losses on sale. This risk also includes restrictions on our ability to efficiently allocate capital among our subsidiaries due to various market and regulatory constraints on the movement of funds. Our funding obligations arise in connection with the payment of policyholder benefits, expenses, asset purchases, investment commitments, interest on debt, and dividends on capital stock. Sources of available cash flow include general fund premiums and deposits, investment related inflows (such as maturities, principal repayments, investment income and proceeds of asset sales), proceeds generated from financing activities in normal markets, and dividends and interest payments from subsidiaries. We have various financing transactions and derivative contracts under which we may be required to pledge collateral or to make payments to our counterparties for the decline in market value of specified assets. The amount of collateral or payments required may increase under certain circumstances (such as changes to interest rates, credit spreads, equity markets or foreign exchange rates), which could adversely affect our liquidity.

### Liquidity Risk Management Governance and Control

We generally maintain a conservative liquidity position and employ a wide range of liquidity risk management practices and controls, which are described below:

- Liquidity risk governance practices are in place, including independent monitoring and review and reporting to senior management and the Risk Review Committee.
- Liquidity is managed in accordance with our Asset Liability Management Policy and operating guidelines.
- Liquidity contingency plans are maintained for the management of liquidity in the event of a liquidity crisis.
- Stress testing is performed by comparing liquidity coverage ratios under a one-month stress scenario to our policy thresholds. These liquidity ratios are measured and managed at the enterprise and legal entity levels.
- Stress testing of our collateral is performed by comparing collateral coverage ratios to our policy threshold.
- Cash Management and asset-liability management programs support our ability to maintain our financial position by ensuring that sufficient cash flow and liquid assets are available to cover potential funding requirements. We invest in various types of assets with a view of matching them to our liabilities of various durations.
- Internal capital targets are established at an enterprise level to cover all risks and are above minimum regulatory and supervisory levels. Actual capital levels are monitored to ensure they exceed internal targets.
- We actively manage and monitor our capital and asset levels, and the diversification and credit quality of our investments.
- Various credit facilities for general corporate purposes are maintained.

The following table summarizes the contractual maturities of our significant financial liabilities and contractual commitments as at December 31, 2016 and December 31, 2015:

#### Financial Liabilities and Contractual Obligations

<b>December 31, 2016</b> (\$ millions)	<b>Within 1 year</b>	<b>1 year to 3 years</b>	<b>3 years to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Insurance and investment contract liabilities <sup>(1)</sup>	10,249	8,393	8,363	226,117	253,122
Senior debentures and unsecured financing <sup>(2)</sup>	110	520	485	4,392	5,507
Subordinated debt <sup>(2)</sup>	150	299	299	4,696	5,444
Bond repurchase agreements	1,789	–	–	–	1,789
Accounts payable and accrued expenses	6,530	–	–	–	6,530
Secured borrowings from mortgage securitization	22	251	419	597	1,289
Borrowed funds <sup>(2)</sup>	97	49	53	132	331
<b>Total liabilities</b>	<b>18,947</b>	<b>9,512</b>	<b>9,619</b>	<b>235,934</b>	<b>274,012</b>
Contractual commitments <sup>(3)</sup>					
Contractual loans, equities and mortgages	987	461	30	908	2,386
Operating leases	109	212	152	471	944
<b>Total contractual commitments</b>	<b>1,096</b>	<b>673</b>	<b>182</b>	<b>1,379</b>	<b>3,330</b>
<b>December 31, 2015</b> (\$ millions)	<b>Within 1 year</b>	<b>1 year to 3 years</b>	<b>3 years to 5 years</b>	<b>Over 5 years</b>	<b>Total</b>
Insurance and investment contract liabilities <sup>(1)</sup>	11,520	8,268	8,422	207,810	236,020
Senior debentures and unsecured financing <sup>(2)</sup>	150	300	574	6,309	7,333
Subordinated debt <sup>(2)</sup>	108	217	217	3,208	3,750
Bond repurchase agreements	1,549	–	–	–	1,549
Accounts payable and accrued expenses	6,489	–	–	–	6,489
Secured borrowings from mortgage securitization	14	83	309	362	768
Borrowed funds <sup>(2)</sup>	160	629	54	132	975
<b>Total liabilities</b>	<b>19,990</b>	<b>9,497</b>	<b>9,576</b>	<b>217,821</b>	<b>256,884</b>
Contractual commitments <sup>(3)</sup>					
Contractual loans, equities and mortgages	711	290	83	789	1,873
Operating leases	93	178	149	502	922
<b>Total contractual commitments</b>	<b>804</b>	<b>468</b>	<b>232</b>	<b>1,291</b>	<b>2,795</b>

(1) These amounts represent the undiscounted estimated cash flows of insurance and investment contract liabilities on our Consolidated Statements of Financial Position. These cash flows include estimates related to the timing and payment of death and disability claims, policy surrenders, policy maturities, annuity payments, minimum guarantees on segregated fund products, policyholder dividends, amounts on deposit, commissions and premium taxes offset by contractual future premiums and fees on in-force contracts. These estimated cash flows are based on the best estimated assumptions used in the determination of insurance and investment contract liabilities. Due to the use of assumptions, actual cash flows will differ from these estimates.

(2) Payments due based on maturity dates and include expected interest payments. Actual redemption of certain securities may occur sooner as some include an option for the issuer to call the security at par at an earlier date.

(3) Contractual commitments and operating lease commitments are not reported on our Consolidated Statements of Financial Position. Additional information on these commitments is included in Note 23 of our 2016 Annual Consolidated Financial Statements.

Additional information on liquidity risk can be found in Note 6 to our 2016 Annual Consolidated Financial Statements and the Risk Factors section in our AIF.

## Capital and Liquidity Management

Our liquidity management practices allow us to maintain a strong financial position by ensuring that sufficient liquid assets are available to cover our anticipated payment obligations and funding requirements. We invest in various types of assets with a view to matching them with liabilities of various durations.

The regulatory environments in which we operate are expected to evolve as governments and regulators work to develop the appropriate level of financial regulation required to ensure that capital, liquidity and risk management practices are sufficient to withstand severe economic downturns.

On September 12, 2016, OSFI released its LICAT Guideline, a new capital adequacy guideline. When implemented in 2018, this guideline will establish new regulatory capital requirements for life insurance companies, which will replace the current MCCR Guideline. Similar to the MCCR Guideline, OSFI has indicated that it will regularly review the effectiveness of the LICAT Guideline and update it to keep abreast of developments in the life insurance industry and evolving risk measurement and management practices. We are currently assessing the impact of the adoption of this guideline on our business.

## Principal Sources and Uses of Funds

Our primary source of funds is cash provided by operating activities, including premiums, investment management fees and net investment income. These funds are used primarily to pay policy benefits, dividends to policyholders, claims, commissions, operating expenses, interest expenses and shareholder dividends. Excess cash flows generated from operating activities are generally invested to support future payment requirements. We also raise funds from time to time, through borrowing and issuing of securities, to finance growth, acquisitions or other needs.

As at December 31, 2016, we maintained net cash, cash equivalents and short-term securities totaling \$8.5 billion. In addition to providing for near-term funding commitments, cash, cash equivalents and short-term securities include amounts that support short-term payment obligations.

Net cash, cash equivalents and short-term securities decreased by \$364 million in 2016. Cash flows generated by operating activities were \$3,668 million in 2016, compared to \$4,461 million in 2015. Cash used in financing activities in 2016 increased by \$437 million from 2015. Investing activities decreased cash by \$1,893 million during 2016, compared to \$723 million in 2015 due to the acquisition of U.S. employee benefits business in 2016. The strengthening of the Canadian dollar against foreign currencies decreased cash balances by \$235 million in 2016, compared to an increase of \$516 million in 2015.

(\$ millions)	2016	2015
Net cash provided by operating activities	3,668	4,461
Net cash provided by (used in) financing activities	(1,543)	(1,106)
Net cash provided by (used in) investing activities	(1,893)	(723)
Changes due to fluctuations in exchange rates	(235)	516
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(3)</b>	<b>3,148</b>
Net cash and cash equivalents, beginning of year	6,512	3,364
Net cash and cash equivalents, end of year	6,509	6,512
Short-term securities, end of year	1,944	2,305
<b>Net cash, cash equivalents and short-term securities, end of year</b>	<b>8,453</b>	<b>8,817</b>

## Liquidity

We generally maintain an overall asset liquidity profile that exceeds requirements to fund insurance contract liabilities under prescribed adverse liability demand scenarios. To strengthen our liquidity further, we actively manage and monitor our:

- capital levels
- asset levels
- matching position
- diversification and credit quality of investments
- cash forecasts and actual amounts against established targets

We are subject to various regulations in the jurisdictions in which we operate. The ability of SLF Inc.'s subsidiaries to pay dividends and transfer funds is regulated in certain jurisdictions and may require local regulatory approvals and the satisfaction of specific conditions in certain circumstances. Through effective cash management and capital planning, SLF Inc. ensures that its subsidiaries, as a whole and on a stand-alone basis, are properly funded and maintain adequate liquidity to meet obligations, both individually and in aggregate.

The legal entity, SLF Inc. (the ultimate parent company) and its wholly-owned holding companies had \$1,616 million in cash and other liquid assets as at December 31, 2016. Of this amount, \$1,390 million was held at SLF Inc. The remaining \$226 million of liquid assets were held by SLF Inc.'s wholly-owned holding companies, which are available to SLF Inc. without any regulatory restrictions. SLF Inc. and its wholly-owned holding companies had \$990 million in cash and other liquid assets as at December 31, 2015. The increase in cash and liquid assets in these holding companies in 2016 was primarily attributable to the issuance of \$1,350 million subordinated debt detailed below, which was partially offset by our investment in an additional equity interest in BSLI and other operational requirements. Liquid assets as noted above include cash and cash equivalents, short-term investments, and publicly traded securities.

We maintain various credit facilities for general corporate purposes, as set out in the table below. Unless otherwise noted, all amounts are in Canadian dollars.

(\$ millions)	December 31, 2016			December 31, 2015		
	Amount	Utilized	Expiry	Amount	Utilized	Expiry
<b>Credit Facility</b>						
Committed	US\$ 500	US\$ 77	2018	US\$ 500	US\$ 77	2018
Uncommitted	US n/a	US n/a	n/a	US\$ 400	US\$ 400	2017
Uncommitted	\$ 205	\$ 101	n/a	\$ 205	\$ 89	n/a
Uncommitted	US\$ 25	US\$ 12	n/a	US\$ 25	US\$ 12	n/a

The agreement relating to our committed credit facility contains typical covenants for investment grade companies regarding solvency, credit ratings and financial strength, all of which were met as at December 31, 2016. These covenants include, but are not limited to,

the maintenance of total equity by SLF Inc. of at least \$12 billion, tested as of the last day of each fiscal quarter. SLF Inc.'s total equity was \$22.4 billion as at December 31, 2016.

Our failure to comply with the covenants under the committed credit facility would, subject to grace periods in the case of certain covenants, result in an event of default. This could require us to repay any outstanding borrowings or to cash collateralize letters of credit under the facility. A failure by SLF Inc. (or any of its subsidiaries) to pay an obligation due for an amount exceeding \$250 million would also result in an event of default under the committed credit facility described above.

Based on our historical cash flows and liquidity management processes, we believe that the cash flows from our operating activities will continue to provide sufficient liquidity for us to satisfy debt service obligations and to pay other expenses as they fall due.

## Capital

We have a capital risk policy designed to maintain a strong capital position and to provide the flexibility necessary to take advantage of growth opportunities, to support the risk associated with our businesses and to optimize shareholder return. Our capital risk policy is also intended to provide an appropriate level of risk management over capital adequacy risk, which is defined as the risk that capital is not or will not be sufficient to withstand adverse economic conditions, to maintain financial strength, or to allow the Company and its subsidiaries to take advantage of opportunities for expansion. Our capital base is structured to exceed minimum regulatory and internal capital targets and to maintain strong credit and financial strength ratings, while maintaining a capital-efficient structure. Capital is managed both on a consolidated basis under principles that consider all the risks associated with the business as well as at the business group level under the principles appropriate to the jurisdictions in which we operate. The capital of our foreign subsidiaries is managed on a local statutory basis in a manner commensurate with their individual risk profiles.

Sun Life Financial, including all of its business groups, engages in a capital planning process annually in which capital deployment options, capital raising and dividend recommendations are presented to the Board of Directors. Capital reviews are regularly conducted which consider the potential impacts under various business, interest rate and equity market scenarios. Relevant components of these capital reviews, including dividend recommendations, are presented to the Risk Review Committee of the Board of Directors on a quarterly basis. The Board of Directors is responsible for the approval of our annual capital plan and quarterly shareholder dividends.

The Company's capital risk policy establishes policies, operating guidelines and procedures that govern the management of capital. The Board of Directors reviews and approves SLF Inc.'s capital risk policy annually. Our Corporate Treasury and Risk Management functions are responsible for the development and implementation of the capital risk policy.

The Company's capital base consists mainly of common shareholders' equity. Other sources of capital include preferred shareholders' equity and subordinated debt issued by SLF Inc. and Sun Life Assurance. For Canadian regulatory purposes, our capital also includes innovative capital instruments issued by Sun Life Capital Trust and Sun Life Capital Trust II.

The following table summarizes the sources of our capital and our capital position over the past two years. Notes 13, 14, 15 and 21 to our 2016 Annual Consolidated Financial Statements include additional details on our capital.

(\$ millions)	2016	2015
Subordinated debt	3,836	2,492
Innovative capital instruments <sup>(1)</sup>	698	697
Equity		
Participating policyholders' equity and non-controlling interest	412	168
Preferred shareholders' equity	2,257	2,257
Common shareholders' equity	19,699	18,993
<b>Total equity</b>	<b>22,368</b>	21,418
<b>Total capital</b>	<b>26,902</b>	24,607
Ratio of debt to total capital <sup>(2)</sup>	16.9%	13.0%
Ratio of debt plus preferred shares to total capital <sup>(2)</sup>	25.2%	22.1%

(1) Innovative capital instruments are presented net of associated transaction costs and consist of SLEECs, which were issued by Sun Life Capital Trust and Sun Life Capital Trust II. SLEECs qualify as capital for Canadian regulatory purposes. However, under IFRS they are reported as Senior debentures in our Annual and Interim Consolidated Financial Statements.

(2) Debt includes all capital qualifying debt obligations.

Our total capital consists of subordinated debt and other capital, participating policyholders' equity and total shareholders' equity which includes common shareholders' equity and preferred shareholders' equity. As at December 31, 2016, our total capital was \$26.9 billion, up from \$24.6 billion as at December 31, 2015. The increase in total capital was primarily the result of common shareholders' net income of \$2,485 million and the issuance of \$1,350 million of subordinated debentures detailed below, partially offset by the foreign currency translation impact included in other comprehensive income (loss) of a loss of \$806 million, and the payment of \$986 million of dividends on common shares.

Common shareholders' equity was \$19.7 billion as at December 31, 2016, compared with \$19.0 billion as at December 31, 2015. The \$0.7 billion increase was due to common shareholders' net income and OCI, partially offset by dividends on common shares.

We strive to achieve an optimal capital structure by balancing the use of debt and equity financing. The debt-to-capital ratio for SLF Inc., which includes the innovative capital instruments and preferred shares issued by SLF Inc. as part of debt for the purposes of this calculation, increased to 25.2% as at December 31, 2016, compared with 22.1% as at December 31, 2015.

On February 19, 2016, SLF Inc. issued \$350 million principal amount of Series 2016-1 Subordinated Unsecured 3.10% Fixed/Floating Debentures due 2026. The net proceeds were used to partially fund the acquisition of the U.S. employee benefits business in March 2016 and for general corporate purposes.

On September 19, 2016, SLF Inc. issued \$1,000 million principal amount of Series 2016-2 Subordinated Unsecured 3.05% Fixed/Floating Debentures due 2028. The net proceeds from this issue of debentures were raised for general corporate purposes, including investments in subsidiaries and repayment of indebtedness.

On September 30, 2016, 1.1 million Class A Non-Cumulative 5-Year Rate Reset Preferred Shares Series 10R ("Series 10R Shares") were converted into Class A Non-Cumulative Floating Rate Preferred Shares Series 11QR ("Series 11QR Shares") through a holder option, on a one-for-one basis. After the conversion, 6.9 million Series 10R Shares and 1.1 million Series 11QR Shares were outstanding. For additional information, refer to Note 15 of our Annual Consolidated Financial Statements.

On December 19, 2016, we announced that the number of Class A Non-Cumulative Rate Reset Preferred Shares Series 12R (the "Series 12R Shares") that were elected to be converted into Class A Non-Cumulative Floating Rate Preferred Shares Series 13QR (the "Series 13QR Shares") was less than the one million shares required to give effect to conversions into Series 13QR Shares and accordingly no Series 12R Shares were converted into Series 13QR Shares.

On January 4, 2017, SLF Inc. announced its intention to redeem on March 2, 2017 all of the outstanding \$800 million principal amount of Series 2012-1 Subordinated Unsecured 4.38% Fixed/Floating Debentures. The redemption will be funded from existing cash and liquid assets.

On June 1, 2016, SLF Inc. redeemed all of the outstanding \$950 million principal amount of the Series B Senior Debentures in accordance with the terms of the Series B Senior Debentures.

As at December 31, 2016, our debt capital consisted of \$3,836 million in subordinated debentures and \$698 million of innovative capital instruments. The maturity dates of our long-term debt are well distributed over the medium- to long-term horizon to maximize our financial flexibility and to minimize refinancing requirements within a given year.

The table below provides the earliest par call and maturity dates for our subordinated debt, innovative capital instruments and preferred shares outstanding as at December 31, 2016.

Description	Interest Rate	Earliest Par Call Date/Redemption Date <sup>(1)</sup>	Maturity	Principal/Face Amount (\$ millions)
<b>Subordinated Debt Issued by Sun Life Assurance</b>				
6.30% Debentures, Series 2	6.30%	n/a	2028	150
<b>Subordinated Debt Issued by SLF Inc.</b>				
Series 2007-1	5.40%	May 29, 2037	2042	400
Series 2008-1	5.59%	January 30, 2018	2023	400
Series 2012-1	4.38%	March 2, 2017	2022	800
Series 2014-1	2.77%	May 13, 2019	2024	250
Series 2015-1	2.60%	September 25, 2020	2025	500
Series 2016-1	3.10%	February 19, 2021	2026	350
Series 2016-2	3.05%	September 19, 2023	2028	1,000
<b>Trust Units Issued by Sun Life Capital Trust</b>				
SLEECs – Series B	7.09%	June 30, 2032	Perpetual	200
<b>Debt Securities Issued by Sun Life Capital Trust II</b>				
SLEECs – Series 2009-1	5.86%	December 31, 2019	2108	500
<b>Class A Preferred Shares Issued by SLF Inc.</b>				
Series 1	4.75%	Any time	Perpetual	400
Series 2	4.80%	Any time	Perpetual	325
Series 3	4.45%	Any time	Perpetual	250
Series 4	4.45%	Any time	Perpetual	300
Series 5	4.50%	Any time	Perpetual	250
Series 8R <sup>(2)</sup>	2.275%	June 30, 2020	Perpetual	130
Series 9QR <sup>(3)</sup>	Floating	June 30, 2020 <sup>(5)</sup>	Perpetual	150
Series 10R <sup>(2)</sup>	2.842%	September 30, 2021	Perpetual	173
Series 11QR <sup>(4)</sup>	Floating	September 30, 2021 <sup>(5)</sup>	Perpetual	27
Series 12R <sup>(2)</sup>	3.806%	December 31, 2021	Perpetual	300

(1) The earliest date on which the Company has the option, but not the obligation, to call securities for redemption at their par value.

(2) On the earliest redemption date and every five years thereafter, the dividend rate will reset to an annual rate equal to the 5-year Government of Canada bond yield plus a spread specified for each series. The specified spread for Class A shares is: Series 8R – 1.41%, Series 10R – 2.17% and Series 12R – 2.73%. On the earliest redemption date and every five years thereafter, holders will have the right, at their option, to convert their shares into the series that is one number higher than their existing series.

(3) Holders of Series 9QR Shares will be entitled to receive quarterly floating rate non-cumulative dividends at an annual rate equal to the then 3-month Government of Canada treasury bill yield plus 1.41%. Holders of the Series 9QR Shares will have the right, at their option, to convert their Series 9QR Shares into Series 8R Shares on June 30, 2020, and on June 30 every five years thereafter.

(4) Holders of Series 11QR Shares will be entitled to receive quarterly floating rate non-cumulative dividends at an annual rate equal to the then 3-month Government of Canada treasury bill yield plus 2.17%. Holders of the Series 11QR Shares will have the right, at their option, to convert their Series 11QR Shares into Series 10R Shares on September 30, 2021, and on September 30 every five years thereafter.

(5) Redeemable on the redemption date and every five years thereafter, in whole or in part, at par, and on any other date at \$25.50 per share.

The following table shows the number of common shares and stock options outstanding of SLF Inc. for the last two years.

### Number of Common Shares Outstanding

(in millions)	2016	2015
Balance, beginning of year	612.3	613.1
Stock options exercised	1.3	1.6
Common shares repurchased	–	(5.3)
Canadian Dividend Reinvestment and Share Purchase Plan	–	2.0
Shares issued as consideration for business acquisition	–	0.9
Balance, end of year	613.6	612.3

### Number of Stock Options Outstanding

(in millions)	2016	2015
Balance, beginning of year	4.8	6.4
Options issued	0.4	0.4
Options exercised, cancelled or expired	(1.8)	(2.0)
Balance, end of year	3.4	4.8

Under our Canadian Dividend Reinvestment and Share Purchase Plan (the “Plan”), Canadian-resident common and preferred shareholders may choose to have their dividends automatically reinvested in common shares of SLF Inc. and may also purchase common shares through the Plan with cash. For dividend reinvestments, we may, at our option, issue common shares from treasury at a discount of up to 5% to the volume weighted average trading price or direct that common shares be purchased on behalf of participants on the open market through the Toronto Stock Exchange (“TSX”) and alternative Canadian trading platforms (the “Exchanges”) at the market price. Common shares of SLF Inc. acquired by participants through optional cash purchases may also be issued from treasury or purchased through the Exchanges at SLF Inc.’s option, in either case at no discount. The common shares issued from treasury for dividend reinvestments during 2016 were issued with no discount. Commencing with the dividends payable on March 31, 2016 and until further notice, common shares purchased under the Plan were purchased on the open market. There are no applicable discounts because the common shares are being purchased on the open market and are not being issued from treasury.

SLF Inc. grants stock options to certain employees. These options are granted at the closing price of SLF Inc.’s common shares on the TSX on the grant date.

As at February 3, 2017, 3,365,326 options to acquire SLF Inc. common shares and 613,611,965 common shares of SLF Inc. were outstanding.

In 2016, SLF Inc. had no share repurchase programs. During 2015, SLF Inc. purchased and cancelled 5.3 million common shares at a total cost of \$212 million as a part of a normal course issuer bid under which it was authorized to purchase up to 9 million common shares between November 10, 2014 and November 9, 2015. The purchases in 2015 were made through the facilities of the Exchanges, at prevailing market rates and all common shares purchased by SLF Inc. were cancelled.

## Shareholder Dividends

The declaration, amount and payment of dividends by SLF Inc. is subject to the approval of our Board of Directors and is dependent on our results of operations, our reported net income, financial condition, cash requirements and contractual restrictions. Capital management activities, as well as regulatory considerations and macro-economic factors including the economic outlook for the jurisdictions in which we do business, are also considered along with other factors. The Board of Directors reviews the level of dividends on a quarterly basis.

A regular and appropriate level of dividend payout and growth provides a stable source of return to common shareholders.

We target a dividend payout ratio of between 40% and 50% based on underlying income, except where circumstances and the factors noted above would suggest a different ratio.

During 2016, our dividend payout ratio to common shareholders based on our reported net income was 40% and on an underlying net income basis was 43%.

SLF Inc. increased its common shareholders’ dividend for the fourth quarter of 2016 to \$0.42. Total common shareholder dividends declared in 2016 were \$1.62 per share, compared to \$1.51 in 2015.

<b>Dividends declared</b> Amount per share	<b>2016</b>	2015	2014
Common shares	\$ 1.62	\$ 1.51	\$ 1.44
Class A preferred shares			
Series 1	\$1.187500	\$1.187500	\$1.187500
Series 2	\$1.200000	\$1.200000	\$1.200000
Series 3	\$1.112500	\$1.112500	\$1.112500
Series 4	\$1.112500	\$1.112500	\$1.112500
Series 5	\$1.125000	\$1.125000	\$1.125000
Series 6R <sup>(1)</sup>	\$ –	\$ –	\$0.750000
Series 8R <sup>(2)(3)</sup>	\$0.568800	\$0.828100	\$1.087500
Series 9QR <sup>(4)</sup>	\$0.476000	\$0.243300	\$ –
Series 10R <sup>(2)(5)</sup>	\$0.908900	\$0.975000	\$0.975000
Series 11QR <sup>(6)</sup>	\$0.169000	\$ –	\$ –
Series 12R <sup>(2)(7)</sup>	\$1.062500	\$1.062500	\$1.062500

(1) Class A Non-Cumulative 5-Year Rate Reset Preferred Shares Series 6R shares were redeemed in full on June 30, 2014.

(2) On the redemption date and every five years thereafter, the dividend rate will reset to an annual rate equal to the 5-year Government of Canada bond yield plus a yield specified for each series. The specified yield for Class A shares is: Series 8R – 1.41%, Series 10R – 2.17% and Series 12R – 2.73%. On the earliest redemption date and every five years thereafter, holders will have the right, at their option, to convert their shares into the series that is one number higher than their existing series.

(3) The dividend rate was reset on June 30, 2015 to a fixed annual dividend rate of 2.275% until the redemption date June 30, 2020.

(4) Holders of the Series 9QR Shares are entitled to receive quarterly floating rate non-cumulative dividends at an annual rate equal to the then 3-month Government of Canada treasury bill yield plus 1.41%. Holders of the Series 9QR Shares will have the right, at their option, to convert their Series 9QR Shares into Series 8R Shares on June 30, 2020 and on June 30 every five years thereafter.

(5) The dividend rate was reset on September 30, 2016 to a fixed annual dividend rate of 2.842% until the redemption date September 30, 2021.

(6) Holders of the Series 11QR Shares are entitled to receive quarterly floating rate non-cumulative dividends at an annual rate equal to the then 3-month Government of Canada treasury bill yield plus 2.17%. Holders of the Series 11QR Shares will have the right, at their option, to convert their Series 11QR Shares into Series 10R Shares on September 30, 2021 and on September 30 every five years thereafter.

(7) The dividend rate was reset on December 31, 2016 to a fixed annual dividend rate of 3.806% until the redemption date December 31, 2021.

## Capital Adequacy

### SLF Inc.

SLF Inc. is a non-operating insurance company and is subject to OSFI's MCCSR capital rules. In accordance with this guideline, SLF Inc. manages its capital in a manner commensurate with its risk profile and control environment, and SLF Inc.'s regulated subsidiaries comply with the capital adequacy requirements imposed in the jurisdictions in which they operate. SLF Inc.'s consolidated capital position is above its internal target. Effective January 1, 2016, regulated insurance holding companies and non-operating insurance companies (collectively, "Insurance Holding Companies") were subject to the MCCSR capital rules which have been established by OSFI.

As at December 31, 2016, SLF Inc.'s MCCSR ratio was 253%. The primary difference between the MCCSR ratio of SLF Inc. and the MCCSR ratio of Sun Life Assurance as discussed below relates to cash and liquid assets held at the holding company level of \$1,616 million as discussed above and capital related to certain insurance subsidiaries held directly by SLF Inc.

### Sun Life Assurance

Sun Life Assurance, SLF Inc.'s principal operating life insurance subsidiary in Canada, is also subject to OSFI's MCCSR capital rules. The Company expects to maintain an MCCSR ratio for Sun Life Assurance at or above 200%. With an MCCSR ratio of 226% as at December 31, 2016, Sun Life Assurance's capital ratio is well above OSFI's supervisory ratio of 150% and regulatory minimum ratio of 120%. The MCCSR calculation involves using qualifying models or applying quantitative factors to specific assets and liabilities based on a number of risk components to arrive at required capital and comparing this requirement to available capital to assess capital adequacy. Certain of these risk components, along with available capital, are sensitive to changes in equity markets and interest rates as outlined in the Risk Management section of this MD&A.

The following table shows the components of Sun Life Assurance's MCCR ratio for the last two years.

<b>Sun Life Assurance MCCR</b> (\$ millions)	<b>2016</b>	2015
Capital available		
Retained earnings and contributed surplus	<b>11,871</b>	10,831
Accumulated other comprehensive income	<b>1,509</b>	2,194
Common and preferred shares	<b>5,946</b>	5,596
Innovative capital instruments and subordinated debt	<b>1,048</b>	1,047
Other	<b>46</b>	152
Less:		
Goodwill	<b>2,242</b>	1,553
Non-life investments and other	<b>2,225</b>	1,880
Total capital available	<b>15,953</b>	16,387
Required capital		
Asset default and market risks	<b>4,109</b>	4,078
Insurance risks	<b>1,797</b>	1,646
Interest rate risks	<b>1,156</b>	1,095
Total capital required	<b>7,062</b>	6,819
MCCR ratio	<b>226%</b>	240%

As at December 31, 2016, Sun Life Assurance's MCCR ratio was 226%, compared to 240% as at December 31, 2015. The decrease to Sun Life Assurance's MCCR ratio over 2016 primarily resulted from the acquisition of the U.S. employee benefits business, partially offset by the contribution of earnings net of dividends. Additional details concerning the calculation of available capital and MCCR are included in SLF Inc.'s 2016 AIF under the heading Regulatory Matters.

OSFI has released the 2016 MCCR Guideline, which is effective for reporting periods commencing January 1, 2016. No new guideline was released for 2017. As noted above, the 2016 MCCR Guideline was applicable to Insurance Holding Companies effective January 1, 2016.

### Foreign Life Insurance Companies

Foreign subsidiaries and foreign operations of SLF Inc. must comply with local capital or solvency requirements in the jurisdictions in which they operate. Our operations maintained capital levels above the minimum local regulatory requirements during 2016. Additional information on capital and regulatory requirements for our foreign subsidiaries and foreign operations is provided in SLF Inc.'s AIF under the heading Regulatory Matters.

In the U.S., as at December 31, 2016, we have two internal reinsurance arrangements with affiliated reinsurance companies, in Delaware and Vermont, relating to our closed block of individual universal life insurance products with no-lapse guarantee benefits issued in the U.S. The Delaware reinsurance structure was established in 2013 and finances excess U.S. statutory reserves for certain universal life policies issued between January 2000 and February 2006. The financing of U.S. statutory reserve requirements in excess of those required under IFRS for the Delaware reinsurance company is supported by a guarantee from SLF Inc. The Vermont reinsurance structure was established in 2007 for certain policies issued between March 2006 and December 2008. Under the Vermont reinsurance structure, the related excess U.S. statutory reserve requirements are funded through a long-term financing arrangement established with an unrelated financial institution.

## Financial Strength Ratings

Independent rating agencies assign credit ratings to securities issued by companies and assign financial strength ratings to financial institutions such as Sun Life Assurance.

The financial strength ratings assigned by rating agencies are intended to provide an independent view of the creditworthiness and financial strength of a financial institution. Each rating agency has developed its own methodology for the assessment and subsequent rating of life insurance companies.

Rating agencies do not assign a financial strength rating for SLF Inc., however, credit ratings are assigned to the securities issued by SLF Inc. and its subsidiaries and are described in SLF Inc.'s AIF under the heading Security Ratings.

The following table summarizes the financial strength ratings for Sun Life Assurance as at January 31, 2017 and December 31, 2015.

	<b>A.M. Best</b>	<b>DBRS</b>	<b>Moody's</b>	<b>Standard &amp; Poor's</b>
<b>January 31, 2017</b>	<b>A+</b>	<b>AA(low)</b>	<b>Aa3</b>	<b>AA-</b>
December 31, 2015	A+	AA(low)	Aa3	AA-

All rating agencies currently have stable outlooks on Sun Life Assurance's financial strength ratings. Rating agencies took the following actions on the financial strength rating of Sun Life Assurance throughout 2016:

- April 15, 2016 – Standard & Poor's affirmed the financial strength rating with a stable outlook.
- July 22, 2016 – Moody's affirmed the financial strength rating with a stable outlook.
- November 24, 2016 – DBRS affirmed the financial strength rating with a stable outlook
- December 2, 2016 – A.M. Best affirmed the financial strength rating with a stable outlook.

## Off-Balance Sheet Arrangements

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In the normal course of business, we are engaged in a variety of financial arrangements. The principal purposes of these arrangements are to earn management fees and additional spread on a matched book of business and to reduce financing costs.

While most of these activities are reflected on our balance sheet with respect to assets and liabilities, certain of them are either not recorded on our balance sheet or are recorded on our balance sheet in amounts that differ from the full contract or notional amounts. The types of off-balance sheet activities we undertake primarily include asset securitizations and securities lending.

### **Asset Securitizations**

In the past, we sold mortgage or bond assets to non-consolidated structured entities, which may also purchase investment assets from third parties. Our securitized AUM held by these non-consolidated structured entities were \$2 million as at December 31, 2016, compared to \$7 million as at December 31, 2015.

However, the majority of our securitization activities are recorded on our Consolidated Statements of Financial Position. We securitize multi-residential mortgages under the National Housing Act Mortgage-Backed Securities program sponsored by the CMHC. The securitization of the multi-residential mortgages with the CMHC does not qualify for de-recognition and remains on our Consolidated Statements of Financial Position. Additional information on this program can be found in Note 5 to our 2016 Annual Consolidated Financial Statements.

### **Securities Lending**

We lend securities in our investment portfolio to other institutions for short periods to generate additional fee income. We conduct our program only with well-established, reputable banking institutions that carry a minimum credit rating of "AA". Collateral, which exceeds the fair value of the loaned securities, is deposited by the borrower with a lending agent, usually a securities custodian, and maintained by the lending agent until the underlying security has been returned to us. We monitor the fair value of the loaned securities on a daily basis with additional collateral obtained or refunded as the fair value fluctuates. Certain arrangements allow us to invest the cash collateral received for the securities loaned. Loaned securities are recognized in our Consolidated Statements of Financial Position as Invested Assets. As at December 31, 2016, we loaned securities with a carrying value of \$1.5 billion for which the collateral held was \$1.6 billion. This compares to loaned securities of \$1.4 billion, with collateral of \$1.5 billion as at December 31, 2015.

## Commitments, Guarantees, Contingencies and Reinsurance Matters

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In the normal course of business, we enter into leasing agreements, outsourcing arrangements and agreements involving indemnities to third parties. We are also engaged in arbitration proceedings from time to time with certain companies that have contracts to provide reinsurance to the Company. Information regarding our commitments, guarantees and contingencies are summarized in Note 23 to our 2016 Annual Consolidated Financial Statements. A table summarizing our significant financial liabilities and contractual obligations can be found in this MD&A in the section under the heading Risk Management – Liquidity Risk.

## Accounting and Control Matters

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### **Critical Accounting Policies and Estimates**

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Our significant accounting and actuarial policies are described in Notes 1, 2, 3, 5, 6, 7 and 10 of our 2016 Annual Consolidated Financial Statements. Management must make judgments involving assumptions and estimates, some of which may relate to matters that are inherently uncertain, under these policies. The estimates described below are considered particularly significant to understanding our financial performance. As part of our financial control and reporting, judgments involving assumptions and estimates are reviewed by the independent auditor and by other independent advisors on a periodic basis. Accounting policies requiring estimates are applied consistently in the determination of our financial results.

#### **Benefits to Policyholders**

##### **General**

The liabilities for insurance contracts represent the estimated amounts which, together with estimated future premiums and net investment income, will provide for outstanding claims, estimated future benefits, policyholders' dividends, taxes (other than income taxes), and expenses on in-force insurance contracts.

In determining our liabilities for insurance contracts, assumptions must be made about mortality and morbidity rates, lapse and other policyholder behaviour, interest rates, equity market performance, asset default, inflation, expenses, and other factors over the life of our products. Most of these assumptions relate to events that are anticipated to occur many years in the future. Assumptions require significant judgment and regular review and, where appropriate, revision.

We use best estimate assumptions for expected future experience and apply margins for adverse deviations to provide for uncertainty in the choice of the best estimate assumptions. The amount of insurance contract liabilities related to the application of margins for adverse deviations to best estimate assumptions is called a provision for adverse deviations.

### **Best Estimate Assumptions**

Best estimate assumptions are intended to be current, neutral estimates of the expected outcome as guided by Canadian actuarial standards of practice. The choice of best estimate assumptions takes into account current circumstances, past experience data (Company and/or industry), the relationship of past to expected future experience, anti-selection, the relationship among assumptions, and other relevant factors. For assumptions on economic matters, the assets supporting the liabilities and the expected policy for asset-liability management are relevant factors.

### **Margins for Adverse Deviations**

The appropriate level of margin for adverse deviations on an assumption is guided by Canadian actuarial standards of practice. For most assumptions, the standard range of margins for adverse deviations is 5% to 20% of the best estimate assumption, and the actuary chooses from within that range based on a number of considerations related to the uncertainty in the determination of the best estimate assumption. The level of uncertainty, and hence the margin chosen, will vary by assumption and by line of business and other factors. Considerations that would tend to indicate a choice of margin at the high end of the range include:

- The statistical credibility of the Company's experience is too low to be the primary source of data for choosing the best estimate assumption
- Future experience is difficult to estimate
- The cohort of risks lacks homogeneity
- Operational risks adversely impact the ability to estimate the best estimate assumption
- Past experience may not be representative of future experience and the experience may deteriorate

Provisions for adverse deviations in future interest rates are included by testing a number of scenarios of future interest rates, some of which are prescribed by Canadian actuarial standards of practice, and determining the liability based on the range of possible outcomes. A scenario of future interest rates includes, for each forecast period between the statement of financial position date and the last liability cash flow, interest rates for risk-free assets, premiums for asset default, rates of inflation, and an investment strategy consistent with the Company's investment policy. The starting point for all future interest rate scenarios is consistent with the current market environment. If few scenarios are tested, the liability would be at least as great as the largest of the outcomes. If many scenarios are tested, the liability would be within a range defined by the average of the outcomes that are above the 60th percentile of the range of outcomes and the corresponding average for the 80th percentile.

Provisions for adverse deviations in future equity returns are included by scenario testing or by applying margins for adverse deviations. In blocks of business where the valuation of liabilities uses scenario testing of future equity returns, the liability would be within a range defined by the average of the outcomes that are above the 60th percentile of the range of outcomes and the corresponding average for the 80th percentile. In blocks of business where the valuation of liabilities does not use scenario testing of future equity returns, the margin for adverse deviations on common share dividends is between 5% and 20%, and the margin for adverse deviations on capital gains would be 20% plus an assumption that those assets reduce in value by 20% to 50% at the time when the reduction is most adverse. A 30% reduction is appropriate for a diversified portfolio of North American common shares and, for other portfolios, the appropriate reduction depends on the volatility of the portfolio relative to a diversified portfolio of North American common shares.

In choosing margins, we ensure that, when taken one at a time, each margin is reasonable with respect to the underlying best estimate assumption and the extent of uncertainty present in making that assumption, and also that, in aggregate, the cumulative impact of the margins for adverse deviations is considered reasonable with respect to the total amount of our insurance contract liabilities. Our margins are generally stable over time and are generally only revised to reflect changes in the level of uncertainty in the best estimate assumptions. Our margins tend to be at the high end of the range for expenses and in the mid-range or higher for other assumptions. When considering the aggregate impact of margins, the actuary assesses the consistency of margins for each assumption across each block of business to ensure there is no double counting or omission and to avoid choosing margins that might be mutually exclusive. In particular, the actuary chooses similar margins for blocks of business with similar characteristics, and also chooses margins that are consistent with other assumptions, including assumptions about economic factors. The actuary is guided by Canadian actuarial standards of practice in making these professional judgments about the reasonableness of margins for adverse deviations.

The best estimate assumptions and margins for adverse deviations are reviewed at least annually and revisions are made when appropriate. The choice of assumptions underlying the valuation of insurance contract liabilities is subject to external actuarial peer review.

### **Critical Accounting Estimates Key Risk Factors**

Significant factors affecting the determination of policyholders' benefits, the methodology by which they are determined, their significance to the Company's financial condition and results of operations are described below.

#### **Non-fixed Income Market Movements**

We are exposed to equity markets through our segregated fund products (including variable annuities) that provide guarantees linked to underlying fund performance and through insurance products where the insurance contract liabilities are supported by non-fixed income assets.

For segregated fund products (including variable annuities), we have implemented hedging programs involving the use of derivative instruments to mitigate a large portion of the equity market risk associated with the guarantees. The cost of these hedging programs is reflected in the liabilities. The equity market risk associated with anticipated future fee income is not hedged.

The majority of non-fixed income assets which are designated as FVTPL support our participating and universal life products where investment returns are passed through to policyholders through routine changes in the amount of dividends declared or in the rate of interest credited. In these cases, changes in non-fixed income asset values are largely offset by changes in insurance contract liabilities.

### **Interest Rates**

We generally maintain distinct asset portfolios for each major line of business. In the valuation of insurance contract liabilities, the future cash flows from insurance contracts and the assets that support them are projected under a number of interest rate scenarios, some of which are prescribed by Canadian actuarial standards of practice. Reinvestments and disinvestments take place according to the specifications of each scenario, and the liability is set based on the range of possible outcomes.

For certain products, including participating insurance and certain forms of universal life policies and annuities, policyholders share investment performance through routine changes in the amount of dividends declared or in the rate of interest credited. These products generally have minimum interest rate guarantees.

Hedging programs are in place to help mitigate the impact of interest rate movements.

### **Mortality**

Mortality refers to the rates at which death occurs for defined groups of people. Life insurance mortality assumptions are generally based on the past five to ten years of experience. Our experience is combined with industry experience where our own experience is insufficient to be statistically valid. Assumed mortality rates for life insurance and annuity contracts include assumptions about future mortality improvement based on recent trends in population mortality and our outlook for future trends.

### **Morbidity**

Morbidity refers to both the rates of accident or sickness and the rates of recovery therefrom. Most of our disability insurance is marketed on a group basis. We offer critical illness policies on an individual basis in Canada and Asia, long-term care on an individual basis in Canada, and medical stop-loss insurance is offered on a group basis in the U.S. In Canada, group morbidity assumptions are based on our five-year average experience, modified to reflect any emerging trend in recovery rates. For long-term care and critical illness insurance, assumptions are developed in collaboration with our reinsurers and are largely based on their experience. In the United States, our experience is used for both medical stop-loss and disability assumptions, with some consideration of industry experience.

### **Policy Termination Rates**

Policyholders may allow their policies to lapse prior to the end of the contractual coverage period by choosing not to continue to pay premiums or by surrendering their policy for the cash surrender value. Assumptions for lapse experience on life insurance are generally based on our five-year average experience. Lapse rates vary by plan, age at issue, method of premium payment, and policy duration.

### **Premium Payment Patterns**

For universal life contracts, it is necessary to set assumptions about premium payment patterns. Studies prepared by industry or the actuarial profession are used for products where our experience is insufficient to be statistically valid. Premium payment patterns usually vary by plan, age at issue, method of premium payment, and policy duration.

### **Expense**

Future policy-related expenses include the costs of premium collection, claims adjudication and processing, actuarial calculations, preparation and mailing of policy statements, and related indirect expenses and overheads. Expense assumptions are mainly based on our recent experience using an internal expense allocation methodology. Inflationary increases assumed in future expenses are consistent with the future interest rates used in scenario testing.

### **Asset Default**

As required by Canadian actuarial standards of practice, insurance contract liabilities include a provision for possible future default of the assets supporting those liabilities. The amount of the provision for asset default included in the insurance contract liabilities is based on possible reductions in future investment yield that vary by factors such as type of asset, asset credit quality (rating), duration, and country of origin. The asset default assumptions are comprised of a best estimate plus a margin for adverse deviations, and are intended to provide for loss of both principal and income. Best estimate asset default assumptions by asset category and geography are derived from long-term studies of industry experience and the Company's experience. Margins for adverse deviation are chosen from the standard range (of 25% to 100%) as recommended by Canadian actuarial standards of practice based on the amount of uncertainty in the choice of best estimate assumption. The credit quality of an asset is based on external ratings if available (public bonds) and internal ratings if not (mortgages and loans). Any assets without ratings are treated as if they are rated below investment grade.

In contrast to asset impairment provisions and changes in FVTPL assets arising from impairments, both of which arise from known credit events, the asset default provision in the insurance contract liabilities covers losses related to possible future (unknown) credit events. Canadian actuarial standards of practice require the asset default provision to be determined taking into account known impairments that are recognized elsewhere on the statement of financial position. The asset default provision included in the insurance contract liabilities is reassessed each reporting period in light of impairments, changes in asset quality ratings, and other events that occurred during the period.

### **Sensitivities to Best Estimate Assumptions**

Our sensitivities relative to our best estimate assumptions are included in the table below. The sensitivities presented below are forward-looking statements. They are measures of our estimated net income sensitivity to changes in the best estimate assumptions in our insurance contract liabilities based on a starting point and business mix as of December 31, 2016 and as at December 31, 2015. They reflect the update of actuarial method and assumption changes described in this MD&A under the heading Assumption Changes and Management Actions. Where appropriate, these sensitivities take into account hedging programs in place as at December 31, 2016 and December 31, 2015. A description of these hedging programs can be found in this MD&A under the heading Market Risk. The sensitivity to changes in our accounting estimates in the table below represents the Company's estimate of changes in market conditions or best estimate assumptions that are reasonably likely based on the Company's and/or the industry's historical experience and industry standards and best practices as at December 31, 2016 and December 31, 2015. We have also disclosed the impact of a 100 basis point change in interest rates and a 25% change in equity markets to illustrate that significant changes in interest rates and equity market levels may result in other than proportionate impacts on our sensitivities at more significant market movements.

Changes to the starting point for interest rates, equity market prices and business mix will result in different estimated sensitivities. Additional information regarding equity and interest rate sensitivities, including key assumptions, can be found in the Risk Management section of this MD&A under the heading Market Risk Sensitivities. The following table summarizes the impact these sensitivities would have on our net income.

Critical Accounting Estimate	Sensitivity	2016	2015
(\$ millions, after-tax)			
Interest Rates	100 basis point parallel decrease in interest rates across the entire yield curve	(200)	(300)
	50 basis point parallel decrease in interest rates across the entire yield curve	(100)	(100)
	50 basis point parallel increase in interest rates across the entire yield curve	50	50
	100 basis point parallel increase in interest rates across the entire yield curve	50	50
Equity Markets	25% decrease across all equity markets	(300)	(350)
	10% decrease across all equity markets	(100)	(100)
	10% increase across all equity markets	100	100
	25% increase across all equity markets	250	300
	1% reduction in assumed future equity and real estate returns	(445)	(420)
Mortality	2% increase in the best estimate assumption for insurance products – where higher mortality would be financially adverse	(35)	(35)
	2% decrease in the best estimate assumption for annuity products – where lower mortality would be financially adverse	(120)	(115)
Morbidity	5% adverse change in the best estimate assumption	(150)	(140)
Policy Termination Rates	10% decrease in the termination rate – where fewer terminations would be financially adverse	(235)	(245)
	10% increase in the termination rate – where more terminations would be financially adverse	(130)	(120)
Operating Expenses and Inflation	5% increase in unit maintenance expenses	(170)	(180)

### Fair Value of Assets and Liabilities

Debt securities, equity securities and certain other invested assets are designated as FVTPL or AFS and are recorded at fair value in our Consolidated Statements of Financial Position. Changes in fair value of assets designated as FVTPL, and realized gains and losses on sale of FVTPL assets are recorded in income. Changes in fair value of AFS assets are recorded in OCI. For foreign currency translation, exchange differences calculated on the amortized cost of AFS debt securities are recognized in income and other changes in carrying amount are recognized in OCI. The exchange differences from the translation of AFS equity securities and other invested assets are recognized in OCI. Net impairment losses and realized gains and losses on sale of AFS assets are reclassified from OCI to income.

The fair value of government and corporate debt securities is determined using quoted prices in active markets for identical or similar securities. When quoted prices in active markets are not available, fair value is determined using market standard valuation methodologies, which include discounted cash flow analysis, consensus pricing from various broker dealers that are typically the market makers, or other similar techniques. The assumptions and valuation inputs in applying these market standard valuation methodologies are determined primarily using observable market inputs, which include, but are not limited to, benchmark yields, reported trades of identical or similar instruments, broker-dealer quotes, issuer spreads, bid prices, and reference data including market research publications. In limited circumstances, non-binding broker quotes are used.

The fair value of asset-backed securities is determined using quoted prices in active markets for identical or similar securities, when available, or valuation methodologies and valuation inputs similar to those used for government and corporate debt securities. Additional valuation inputs include structural characteristics of the securities, and the underlying collateral performance, such as prepayment speeds and delinquencies. Expected prepayment speeds are based primarily on those previously experienced in the market at projected future interest rate levels. In instances where there is a lack of sufficient observable market data to value the securities, non-binding broker quotes are used.

The fair value of equity securities is determined using quoted prices in active markets for identical securities or similar securities. When quoted prices in active markets are not available, fair value is determined using equity valuation models, which include discounted cash flow analysis and other techniques that involve benchmark comparison. Valuation inputs primarily include projected future operating cash flows and earnings, dividends, market discount rates, and earnings multiples of comparable companies.

Mortgages and loans are generally carried at amortized cost. The fair value of mortgages and loans, for disclosure purposes, is determined by discounting the expected future cash flows using a current market interest rate applicable to financial instruments with a similar yield, credit quality and maturity characteristics. Valuation inputs typically include benchmark yields and risk-adjusted spreads from current lending activities or loan issuances. The risk-adjusted spreads are determined based on the borrower's credit and liquidity, as well as term and other loan-specific features. Long-term mortgages and loans are generally categorized in Level 3 of the fair value hierarchy. The significant unobservable input is a portion of these risk adjusted spreads at or beyond the 20 year point for mortgages and at or beyond the 10 year point for loans.

Derivative financial instruments are recorded at fair value with changes in fair value recorded in income unless the derivative is part of a qualifying hedging relationship for accounting purposes. The fair value of derivative financial instruments depends upon derivative types. The fair value of exchange-traded futures and options is determined using quoted prices in active markets, while the fair value

of OTC derivatives is determined using pricing models, such as discounted cash flow analysis or other market standard valuation techniques, with primarily observable market inputs. Valuation inputs used to price OTC derivatives may include swap interest rate curves, foreign exchange spot and forward rates, index prices, the value of underlying securities, projected dividends, volatility surfaces, and in limited circumstances, counterparty quotes.

The fair value of OTC derivative financial instruments also includes credit valuation adjustments to reflect the credit risk of both the derivative counterparty and ourselves as well as the impact of contractual factors designed to reduce our credit exposure, such as collateral and legal rights of offset under master netting agreements. Inputs into determining the appropriate credit valuation adjustments are typically obtained from publicly available information and include credit default swap spreads when available, credit spreads derived from specific bond yields, or published cumulative default experience data adjusted for current trends when credit default swap spreads are not available.

The fair value of other invested assets is determined using quoted prices in active markets for identical securities or similar securities. When quoted prices in active markets are not available, fair value is determined using equity valuation models, which include discounted cash flow analysis and other techniques that involve benchmark comparison. Valuation inputs primarily include projected future operating cash flows and earnings, dividends, market discount rates, and earnings multiples of comparable companies.

Investment properties are recorded at fair value with changes in fair value recorded in income. The fair value of investment properties is generally determined using property valuation models that are based on expected capitalization rates and models that discount expected future net cash flows at current market interest rates reflective of the characteristics, location, and market of each property. Expected future net cash flows include contractual and projected cash flows and forecasted operating expenses, and take into account interest, rental and occupancy rates derived from market surveys. The estimates of future cash inflows, in addition to expected rental income from current leases, include projected income from future leases based on significant assumptions that are consistent with current market conditions. The future rental rates are estimated based on the location, type and quality of the properties, and take into account market data and projections at the valuation date. The fair values are typically compared to market-based information for reasonability, including recent transactions involving comparable assets. The methodologies and inputs used in these models are in accordance with real estate industry valuation standards. Valuations are prepared externally or internally by professionally accredited real estate appraisers.

The fair value of short-term securities is approximated by their carrying amount adjusted for credit risk where appropriate.

Due to their nature, the fair value of policy loans and cash are assumed to be equal to their carrying values, which is the amount these assets are recorded at in our Consolidated Statements of Financial Position.

Investments for accounts of segregated fund holders are recorded at fair value with changes in fair value recorded in net realized and unrealized gains (losses) within the segregated fund and are not recorded in our Consolidated Statements of Operations. The fair value of investments for accounts of segregated fund holders is determined using quoted prices in active markets or independent valuation information provided by investment managers. The fair value of direct investments within investments for accounts of segregated fund holders, such as short-term securities and government and corporate debt securities, is determined according to valuation methodologies and inputs described above in the respective asset type sections.

The fair value of the secured borrowings from mortgage securitization is based on the methodologies and assumptions as described above for asset-backed securities.

The methodologies and assumptions for determining the fair values of investment contract liabilities are included in Note 10.B of our 2016 Annual Consolidated Financial Statements.

We categorize our assets and liabilities carried at fair value, based on the priority of the inputs to the valuation techniques used to measure fair value, into a three-level fair value hierarchy as follows:

Level 1: Fair value is based on the unadjusted quoted prices for identical assets or liabilities in an active market. The types of assets and liabilities classified as Level 1 generally include cash and cash equivalents, certain U.S. government and agency securities, exchange-traded equity securities, and certain segregated and mutual fund units held for account of segregated fund holders.

Level 2: Fair value is based on quoted prices for similar assets or liabilities traded in active markets, or prices from valuation techniques that use significant observable inputs, or inputs that are derived principally from or corroborated with observable market data through correlation or other means. The types of assets and liabilities classified as Level 2 generally include Canadian federal, provincial and municipal government, other foreign government and corporate debt securities, certain asset-backed securities, OTC derivatives, and certain segregated and mutual fund units held for account of segregated fund holders.

Level 3: Fair value is based on valuation techniques that require one or more significant inputs that are not based on observable market inputs. These unobservable inputs reflect our expectations about the assumptions market participants would use in pricing the asset or liability. The types of assets and liabilities classified as Level 3 generally include certain corporate bonds, certain other invested assets, and investment properties.

As pricing inputs become more or less observable, assets are transferred between levels in the hierarchy. Total gains and losses in income and OCI are calculated assuming transfers into or out of Level 3 occur at the beginning of the period. For a financial instrument that transfers into Level 3 during the reporting period, the entire change in fair value for the period is included in the Level 3 reconciliation schedule in Note 5 to our 2016 Annual Consolidated Financial Statements. For transfers out of Level 3 during the reporting period, the change in fair value for the period is excluded from the Level 3 reconciliation schedule in Note 5 to our 2016 Annual Consolidated Financial Statements. Transfers into Level 3 occur when the inputs used to price the financial instrument lack observable market data and as a result, no longer meet the Level 1 or 2 criteria at the reporting date. Transfers out of Level 3 occur when the pricing inputs become more transparent and satisfy the Level 1 or 2 criteria at the reporting date.

Transfers into and out of Level 3 for financial assets were \$88 million and \$375 million for the year ended December 31, 2016, respectively, compared to \$142 million and \$1,097 million, respectively, for the year ended December 31, 2015. The total amount of the net realized/unrealized gains/(losses) related to financial instruments transferred out of Level 3 during the period, which were

excluded from the Level 3 reconciliation, was a loss of \$4 million as at December 31, 2016 compared to a loss of \$13 million as at December 31, 2015.

Additional information on the fair value measurement of investments can be found in Note 5 of our 2016 Annual Consolidated Financial Statements.

### **Impairment**

Management assesses debt and equity securities, mortgages and loans and other invested assets for objective evidence of impairment at each reporting date. Financial assets are impaired and impairment losses are incurred if there is objective evidence of impairment as a result of one or more loss events that have an impact on the estimated future cash flows that can be reliably estimated. Objective evidence of impairment generally includes significant financial difficulty of the issuer, including actual or anticipated bankruptcy or defaults and delinquency in payments of interest or principal or disappearance of an active market for the financial assets. All equity instruments in an unrealized loss position are reviewed to determine if objective evidence of impairment exists. Objective evidence of impairment for an investment in an equity instrument or other invested asset also includes, but is not limited to, the financial condition and near-term prospects of the issuer, including information about significant changes with adverse effects that have taken place in the technological, market, economic or legal environment in which the issuer operates, and a significant or prolonged decline in the fair value of an equity instrument or other invested asset below its cost.

Additional information on the impairment of financial assets can be found in Notes 1 and 6 of our 2016 Annual Consolidated Financial Statements.

### **Goodwill**

Goodwill represents the excess of the cost of an acquisition over the fair value of the net identifiable tangible and intangible assets of the acquired businesses. Goodwill is carried at original cost less any impairment subsequently incurred. Goodwill is assessed for impairment annually or more frequently if events or circumstances occur that may result in the recoverable amount of a CGU falling below its carrying value. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of cash inflows from other groups of assets. The goodwill balances are allocated to either individual or groups of CGUs that are expected to benefit from the synergies of the business combination. Goodwill impairment is quantified by comparing a CGU's or a group of CGU's carrying value to its recoverable amount, which is the higher of fair value less cost to sell and value in use. Impairment losses are recognized immediately and may not be reversed in future periods.

No impairment charges were recognized in 2016. We had a carrying value of \$5.3 billion in goodwill as at December 31, 2016. Additional information on goodwill can be found in Note 9 of our 2016 Annual Consolidated Financial Statements.

### **Intangible Assets**

Intangible assets consist of finite life and indefinite life intangible assets. Finite life intangible assets are amortized on a straight-line basis over varying periods of up to 40 years, and are charged through operating expenses. The useful lives of finite life intangible assets are reviewed annually, and the amortization is adjusted as necessary. Indefinite life intangibles are not amortized, and are assessed for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. Impairment is assessed by comparing the carrying values of the indefinite life intangible assets to their recoverable amounts. If the carrying values of the indefinite life intangibles exceed their recoverable amounts, these assets are considered impaired, and a charge for impairment is recognized in our Consolidated Statements of Operations. The recoverable amount of intangible assets is determined using various valuation models, which require management to make certain judgments and assumptions that could affect the estimates of the recoverable amount. There were no impairment charges in 2016. Impairment charges of \$4 million were recognized in 2015.

As at December 31, 2016 our finite life intangible assets had a carrying value of \$1,046 million, which reflected the value of the field force, asset administration contracts, and Client relationships acquired as part of the Clarica, CMG Asia, Genworth EBG, Ryan Labs, Prime Advisors, and Bentall Kennedy acquisitions, as well as software costs. Our indefinite life intangible assets had a carrying value of \$657 million as at December 31, 2016. The value of the indefinite life intangible assets reflected fund management contracts of MFS and Bentall Kennedy.

### **Income Taxes**

Income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. Deferred income tax is provided using the liability method. Our provision for income taxes is calculated based on the tax rates and tax laws that have been enacted or substantially enacted by the end of the reporting period.

As a multinational organization, we are subject to taxation in numerous jurisdictions. We seek to operate in a tax efficient manner while ensuring that we are in compliance with all laws and regulations. The determination of the required provision for current and deferred income taxes requires that we interpret tax legislation in the jurisdictions in which we operate and that we make assumptions about the expected timing of realization of deferred income tax assets and liabilities. Tax laws are complex and their interpretation requires significant judgment. The provision for income taxes reflects management's interpretation of the relevant tax laws and its best estimate of the income tax implications of the transactions and events during the period. We believe that our provisions for uncertain tax positions appropriately reflect the risk of tax positions that are under audit, dispute or appeal with tax authorities, or which are otherwise considered to involve uncertainty. The adequacy of our tax provision is reviewed at the end of each reporting period. To the extent that our interpretations differ from those of tax authorities or the timing of realization is not as expected, the provision for income taxes may increase or decrease in future periods to reflect actual experience. The amount of any increase or decrease cannot be reasonably estimated.

Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax losses and unused tax credits to the extent that it is probable that taxable profit will be available against which the temporary differences, unused tax losses and unused tax credits can be utilized. At each reporting period, we assess all available evidence, both positive and negative, to determine the amount of deferred income tax assets to be recorded. If it is probable that the benefit of tax losses and tax deductions will not be realized, a deferred income tax asset is not recognized. The assessment requires significant estimates and judgment about future events based on the information available at the reporting date.

From time to time, local governments in countries in which we operate enact changes to statutory corporate income tax rates. These changes require us to review and re-measure our deferred tax assets and liabilities as of the date of enactment. As of December 31, 2016, our net deferred tax asset in the Consolidated Statements of Financial Position was \$761 million, primarily in Canada. Any future tax rate reductions in jurisdictions where we carry a net deferred tax asset, could result in a reduction in the carrying value of the deferred tax asset and a corresponding income tax expense at the time of substantial enactment of a rate reduction.

### **Pension Plans and Other Post-Retirement Benefits**

The Company sponsors defined benefit pension plans and defined contribution plans for eligible employees. All of our material defined benefit plans worldwide are closed to new entrants with new hires participating in defined contribution plans. Our defined benefit pension plans offer benefits based on length of service and final average earnings and certain plans offer some indexation of benefits. We maintain certain supplementary non-contributory defined benefit pension arrangements for eligible employees, which are primarily for benefits which are in excess of local tax limits. In addition to these plans, in some countries the Company sponsors certain post-retirement benefit plans (for medical, dental and/or life insurance benefits) for eligible qualifying employees and their dependents who meet certain requirements.

In Canada, since January 1, 2009, all new employees participate in a defined contribution plan, while existing employees continue to accrue future benefits in the prior plan which provides a defined benefit plan and an optional contributory defined contribution plan.

With the closure of the Canadian defined benefit plans to new entrants, the volatility associated with future service accruals for active members has been limited and will decline over time. As at December 31, 2016, there are no active members in the U.K. and no active employees accruing future service benefits in the U.S. defined benefit plans.

The major risks remaining in relation to past service obligations are increases in liabilities due to a decline in discount rates, greater life expectancy than assumed and adverse asset returns. We continue to implement our plan to de-risk our material defined benefit pension plans Company-wide by systematically shifting the pension asset mix towards liability matching investments over the next few years. The target for our significant plans is to minimize volatility in funded status arising from changes in discount rates and exposure to equity markets.

Due to the long-term nature of these defined benefit plans, the calculation of benefit expenses and accrued benefit obligations depends on various assumptions, including discount rates, rates of compensation increases, health care cost trend rates, retirement ages, mortality rates and termination rates. Based upon consultation with external pension actuaries, management determines the assumptions used for these plans on an annual basis. The discount rate used is based on market yields of high-quality corporate bonds that are denominated in the same currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related obligation.

Actual experience may differ from that assumed, which would impact the valuation of defined benefit plans and the level of benefit expenses recognized in future years. Details of our pension and post-retirement benefit plans and the key assumptions used for the valuation these plans are included in Note 25 of our 2016 Annual Consolidated Financial Statements.

## **Changes in Accounting Policies**

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We have included in this section a summary of changes in accounting policies. Where there are references to Notes, these are part of our 2016 Annual Consolidated Financial Statements.

### **New and Amended International Financial Reporting Standards Adopted in 2016**

We adopted several amended IFRS, that were effective for annual periods beginning on or after January 1, 2016. These include amendments to *Disclosure Initiatives (Amendments to IAS 1: Presentation of Financial Statements)*, IFRS 11 *Joint Arrangements*, IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets*, the standards amended by *Annual Improvements to IFRSs 2012-2014 Cycle* and *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)*. Refer to Note 2 of our 2016 Annual Consolidated Financial Statements for details of these changes.

### **New and Amended International Financial Reporting Standards to be Adopted in 2017**

The following amended IFRS were issued by the IASB and are expected to be adopted by us in 2017.

In January 2016, the IASB issued narrow-scope amendments to IAS 12 *Income Taxes*. The amendments clarify how to account for deferred tax assets related to unrealized losses on debt instruments measured at fair value. The amendments are effective for annual periods beginning on or after January 1, 2017. The amendments are to be applied retrospectively, with certain relief available upon transition. We do not expect the adoption of these amendments to have a material impact on our Consolidated Financial Statements.

In January 2016, the IASB issued *Disclosure Initiative (Amendments to IAS 7)*, which amends IAS 7 *Statement of Cash Flows*. The amendments require entities to provide disclosure that enables users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments are effective for annual periods beginning on or after January 1, 2017, to be applied prospectively. We do not expect the adoption of these amendments to have a material impact on our Consolidated Financial Statements.

In December 2016, the IASB issued *Annual Improvements to IFRSs 2014-2016 Cycle*, which includes a minor amendment to IFRS 12 *Disclosure of Interests in Other Entities* that is effective for annual periods beginning on or after January 1, 2017. The amendment provides clarification guidance to the scope of IFRS 12. We do not expect the adoption of this amendment to have a material impact on our Consolidated Financial Statements.

## New and Amended International Financial Reporting Standards to be Adopted in 2018 or Later

The following new standards were issued by the IASB and are expected to be adopted by us in 2018 or later.

In May 2014, the IASB issued IFRS 15 *Revenue from Contracts with Customers* ("IFRS 15"), which replaces IAS 11 *Construction Contracts*, IAS 18 *Revenue* and various interpretations. IFRS 15 establishes principles about the nature, amount, timing, and uncertainty of revenue arising from contracts with customers. IFRS 15 requires entities to recognize revenue to reflect the transfer of goods or services to customers measured at the amounts an entity expects to be entitled to in exchange for those goods or services. In September 2015, the IASB deferred the effective date of IFRS 15 from January 1, 2017 to annual periods beginning on or after January 1, 2018. IFRS 15 is to be applied retrospectively, or on a modified retrospective basis. Insurance and investment contracts are not in the scope of this standard. In April 2016, the IASB issued *Clarifications to IFRS 15 Revenue from Contracts with Customers*, which provides additional guidance and relief on transition of IFRS 15. These amendments are effective for annual periods beginning on or after January 1, 2018. We are currently assessing the impact that IFRS 15, along with these amendments, will have on our Consolidated Financial Statements.

In July 2014, the IASB issued the final version of IFRS 9 *Financial Instruments* ("IFRS 9"), which replaces IAS 39 *Financial Instruments: Recognition and Measurement* ("IAS 39"). IFRS 9 includes guidance on the classification and measurement of financial instruments, impairment of financial assets, and hedge accounting. Financial asset classification is based on the cash flow characteristics and the business model in which an asset is held. The classification determines how a financial instrument is accounted for and measured. IFRS 9 also introduces an impairment model for financial instruments not measured at fair value through profit or loss that requires recognition of expected losses at initial recognition of a financial instrument and the recognition of full lifetime expected losses if certain criteria are met. In addition, a new model for hedge accounting was introduced to achieve better alignment with risk management activities. In September 2016, the IASB issued amendments to IFRS 4 *Insurance Contracts* ("IFRS 4"), to allow insurance entities whose predominant activities are to issue contracts within the scope of IFRS 4, an optional temporary exemption from applying IFRS 9 until 2021 (the "deferral approach"). We qualify and we will elect the deferral approach permitted under the amendments. Consequently, we will continue to apply IAS 39, the existing financial instrument standard until 2021.

In January 2016, the IASB issued IFRS 16 *Leases* ("IFRS 16"), which replaces IAS 17 *Leases*, and related interpretations. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both lessees and lessors. For lessees, IFRS 16 removes the classification of leases as either operating or financing and requires that all leases be recognized on the statement of financial position, with certain exemptions that include leases of 12 months or less. The accounting for lessors is substantially unchanged. The standard is effective for annual periods beginning on or after January 1, 2019, to be applied retrospectively, or on a modified retrospective basis. We are currently assessing the impact the adoption of this standard will have on our Consolidated Financial Statements.

In June 2016, the IASB issued *Classification and Measurement of Share-based Payment Transactions*, which amends IFRS 2 *Share-based Payment*, which clarifies how to account for certain types of share-based payment transactions, such as the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments. These amendments are effective for annual periods beginning on or after January 1, 2018, and are applicable to awards granted on or after that date and to unvested and vested but unexercised awards outstanding at that date. The amendments are to be applied prospectively, with retrospective application permitted. We are currently assessing the impact the adoption of these amendments will have on our Consolidated Financial Statements.

In December 2016, the IASB issued *Annual Improvements to IFRSs 2014-2016 Cycle*, which includes minor amendments to various IFRSs. These amendments are effective for annual periods beginning on or after January 1, 2018. We are currently assessing the impact the adoption of these amendments will have on our Consolidated Financial Statements.

In December 2016, the IASB issued *Transfers of Investment Property (Amendments to IAS 40)*. The amendments to IAS 40 *Investment Property* clarify that an entity shall transfer property to, or from, investment property when, and only when, there is evidence of a change in use. The amendments are effective for annual periods beginning on or after January 1, 2018. We are currently assessing the impact the adoption of these amendments will have on our Consolidated Financial Statements.

In December 2016, the IASB issued IFRIC 22 *Foreign Currency Transactions and Advance Consideration*, which was developed by the IFRS Interpretations Committee. IFRIC 22 clarifies that for purposes of determining the exchange rate in transactions which include the receipt or payment of advance consideration in a foreign currency, the date of the transaction is the date of initial recognition of the non-monetary prepayment asset or deferred income liability. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018. We are currently assessing the impact that IFRIC 22 will have on our Consolidated Financial Statements.

## Future Accounting Changes

In June 2013, the IASB issued its second exposure draft on *Insurance Contracts*, the replacement standard for IFRS 4 *Insurance Contracts*. The IASB continued its deliberations on the comments received on this exposure draft during 2016 and we continue to monitor the developments related to this new standard. The new IFRS standard, renamed IFRS 17 *Insurance Contracts*, is expected in the first half of 2017 with an expected effective date of 2021.

## Disclosure Controls and Procedures

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The Company has established disclosure controls and procedures that are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Company's President and CEO, Executive Vice-President and CFO, and Executive Vice-President, Chief Legal Officer and Public Affairs, on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of our disclosure controls and procedures, as defined under rules adopted by the Canadian securities regulatory authorities and the SEC, as of December 31, 2016, was carried out under the supervision of and with the participation of the Company's management, including the CEO and the CFO. Based on our evaluation, the CEO and the CFO concluded that the design and operation of these disclosure controls and procedures were effective as of December 31, 2016.

### **Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of our financial statements in accordance with IFRS.

Due to its inherent limitations, internal control over financial reporting may not prevent or detect misstatements on a timely basis. Projections of any evaluation of the effectiveness of internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

We conducted an assessment of the effectiveness of our internal control over financial reporting, as of December 31, 2016, based on the framework and criteria established in *Internal Control-Integrated Framework (2013)*, issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that assessment, we have concluded that our internal control over financial reporting was effective as of December 31, 2016.

Our internal control over financial reporting, as of December 31, 2016, has been audited by the Company's external auditor, Deloitte LLP, Independent Registered Public Accounting Firm, who also audited our Annual Consolidated Financial Statements for the year ended December 31, 2016. As stated in the Report of Independent Registered Public Accounting Firm, they have expressed an unqualified opinion on our internal control over financial reporting as of December 31, 2016.

### **Limitation on Disclosure Controls and Procedures and Internal Control over Financial Reporting**

Effective December 31, 2016, the Company's management no longer limits the scope of its design of the Company's disclosure controls and procedures and the Company's internal control over financial reporting to exclude controls, policies and procedures of the U.S. employee group benefits business we acquired in 2016.

### **Changes in Internal Control over Financial Reporting**

No changes were made in our internal control over financial reporting for the period which began on January 1, 2016 and ended December 31, 2016 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## **Legal and Regulatory Proceedings**

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We are regularly involved in legal actions, both as a defendant and as a plaintiff. Information on legal and regulatory proceedings can be found in Note 23 of our 2016 Annual Consolidated Financial Statements.