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Ratings

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Sun Life Financial Inc. And Its Operating Subsidiaries

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Sun Life Financial Inc. And Its Operating Subsidiaries

Major Rating Factors

Financial Strength Rating
Local Currency
NR/--/--

Strengths	Weaknesses
• Extremely strong competitive position built on leading market position in Canada, geographic diversity, strong operating performance, and positive brand strength • Very strong capital and earnings position • Strong financial flexibility reflecting access to diverse external sources of capital and liquidity • Strong enterprise risk management (ERM) program • Consistently exceptional liquidity	• Intermediate risk position arising from some sector and 'BBB' concentrations in the investment portfolio • Declining capital redundancy at 'AAA' largely due to successful growth

Rationale

In 2012, Sun Life Financial Inc. and its operating subsidiaries (collectively, SLF) announced its four pillar strategy to focus on its Canadian group and individual life, U.S. group, Asia, and asset management businesses. Over the past seven years, the group has grown these businesses profitably (including through acquisitions) while also divesting some of its noncore businesses, like its U.S. variable annuity business in 2013. The success of the strategy is apparent in Sun Life's improved return on equity (ROE; on a net income basis, including preferred shares) which has consistently been 10%-12% in the past few years--in the top quartile of similarly rated, globally diversified peers. Most of these peers have liabilities that are longer-tailed and more market-sensitive in nature, and we expect SLF's earnings will likely be more stable over time. The stability of its prospective earnings profile, top market positions, and strong brand in the oligopolistic Canadian life market, geographic diversity, and success in noninsurance businesses (asset management, which has consistently contributed more than 20% of earnings) lead to our overall assessment of its competitive position as extremely strong.

Factors specific to the holding company

Sun Life Financial Inc. is a publicly traded nonoperating holding company. We applied two notches to our rating between the lead operating subsidiary and the holding company, reflecting the Canadian regulatory regime and the group's structure.

Outlook

The outlook on SLF is stable, reflecting our expectation that the group will maintain its excellent business risk profile and very strong financial risk profile. We expect fixed-charge coverage above 8.0x with financial leverage below 30%. We also expect SLF to maintain its competitive position as a "big three" insurer in Canada with consistent earnings from the asset management and U.S. and Asia insurance segments.

Downside scenario

We could lower the ratings if SLF's competitive position deteriorates due to a longer-term decline in operating performance relative to peers; it loses its market position or experiences meaningful damage to its reputation in Canada; or sustained losses in its asset management businesses lead us to believe the group's diversification had weakened significantly.

Upside scenario

While unlikely in the next two years, we could raise the ratings if SLF's capital redundancy at 'AAA' were to rise significantly and we believe management remains committed to maintain capital at the 'AAA' level.

Macroeconomic Assumptions

- Real Canadian GDP growth of 1.7% in 2019 and 1.5% in 2020
- Consumer Price Index (CPI) at 2.0% in 2019 and 2.1% in 2020
- Canadian unemployment rate at 6.1% in 2019 and 6.2% in 2020
- Government of Canada three-month T-bill rates of 1.8% in 2019 and 2.4% in 2020
- Government of Canada 10-year bond rates of 2.3% in 2019 and 3.1% in 2020

Key Metrics

	--Year ended Dec. 31--				
(Mil. $)	**2020***	**2019***	**2018**	**2017**	**2016**
Net income	>2,950	>2,800	2,616.0	2,242.0	2,581.0
Fixed-charge coverage (x)	>8	>8	11.3	9.1	10.6
Financial leverage (%)	<25	<25	17.05*	18.7	19.7
S&P capital adequacy/redundancy	>AA	>AA	AAA	AAA	AAA
Return on revenue (%)	>12	>12	12.7	9.4	12.0
Return on assets (%)	>1.2	>1.2	1.3	1.1	1.4
Return on equity (%)	>10	>10	11.0	9.9	11.8

*Forecast data reflect S&P Global Ratings' base-case assumptions.

Business Risk Profile

SLF has an extremely strong competitive position supported by its strong operating performance, leading market positions in group and individual businesses in Canada, and brand recognition, as well as geographic and business diversification. SLF has maintained a top three position among Canadian life insurers with an 18% market share. Other segments include U.S. group benefits; asset management, which includes its third-party asset management business, Sun Life Investment Management (SLIM), and its flagship Massachusetts-based manager MFS Investment Management; and its Asia business, which sells life insurance in Hong Kong, the Philippines, Indonesia, Malaysia, among other nations in the region. In 2018, its regional segments SLF Canada, SLF US, and SLF Asia contributed 33%, 16%, and 17% of net underlying income, respectively; individual insurance, asset management, and group insurance contributed 28%, 29%, and 19%, respectively. It also has a broad distribution platform that includes both career sales force and third-party agents.

Operating performance has been strong, with return on average assets averaging about 1.3% in 2014-2018 and ROE (on a net income basis, unadjusted for preferred shares) consistently at 10%-12%. We expect earnings to remain stable and in line with the past few years. SLF's asset management business, despite headwinds in net flows as a result of recent market trends (a shift to passive from active investing), has consistently contributed more than 20% of EBIT over the past few years, and we expect it to continue doing so.

Financial Risk Profile

As of year-end 2017, SLF had slight 'AAA' capital redundancy per our model. The Life Insurance Capital Adequacy Test (LICAT), a new regulatory ratio introduced in 2018, did not affect the company's capital management strategy, and it had a LICAT ratio of 144% on a consolidated basis (including the holding company, which is regulated by the Office of the Superintendent of Financial Institutions) as of Dec. 31, 2018. SLF's capital buffer at 'AAA' redundancy per our model has been declining over the years, largely as a result of successful organic and inorganic growth in its U.S. group businesses. In our assessment of capital, we include qualifying intermediate equity hybrids, as well as 50% of SLF's provisions for adverse deviations (PfADs) embedded in its reserves. PfADs are additional reserves held to insulate a company against negative deviations from pricing, including risk of default on fixed income assets, lower-than-anticipated returns, and conservative assumptions for insurance risks such as mortality and lapses. Combined PfADs and hybrids account for less than 50% of total adjusted capital in our assessment of capital.

SLF has an intermediate risk position benefitting from the diversity of its investments and risks. The investment portfolio has no significant sector or single-name investment concentration; at year-end 2017, the bond portfolio had an average rating of 'A'. Its stated investment policy calls for very tight asset-liability matching in terms of cash flow and duration, and the company fully hedges its interest rate risk. The portfolio is well balanced among primary asset classes. As of June 30, 2018, total consolidated investments included bonds (68.8%), mortgages (10.9%), cash and cash equivalents (5.5%), equities (3.8%), real estate (5.0%), policy loans (2.1%), derivatives (0.8%), and other (3.0%). Foreign exchange currency mismatch, exposure to employee benefits, investment leverage, and sector and obligor investment concentrations are all neutral, in our opinion.

SLF has strong financial flexibility, in our view, due to its strong and diverse operating cash flows, proven access to markets, and exceptional liquidity position. Its financial leverage ratio (including pension fund deficits) at year-end 2018 was about 17%, and we anticipate it will remain relatively stable. Fixed-charge coverage at year-end 2018 was 11.25x, and we expect it to remain well above 8.00x in the next two years.

Other Assessments

We consider SLF's ERM program strong, supported by positive scores for risk management culture, overall risk controls, risk models, and emerging and strategic risk management. We view ERM as of high importance to our financial strength rating because SLF has a complex risk profile stemming from its operations in multiple countries and business lines. We continue to view SLF's ERM culture as positive due to its well-staffed, independent ERM function; active board participation; formal risk appetite statement; and obvious ties between risk and compensation. We also view its risk controls as positive, with strength in most key risk controls.

We have a positive score for SLF's risk models, reflecting its ability to perform both stochastic and deterministic analyses, formal approach to model governance, and extensive use of models in risk-informed decision-making. We view its emerging risk as positive since its practices influence management action. SLF has well-established processes for identifying, assessing, quantifying (where possible), and mitigating emerging risks as shown by its key risk report and frequent scenario analyses. We also view SLF's strategic risk management positively due to its use of risk metrics to inform decision-making, as well as its successful track record of execution.

We also have a strong view of SLF's management and governance. Management has a track record of converting strategic decisions into action and meeting its financial and operational goals. Its four-pillar business strategy centers on achieving scale, diversification, generating higher-quality earnings, and operational excellence across its four major business units. SLF's diverse sources of earnings (regionally and by product line), in addition to its positive operating performance (by ROE), show the success of this strategy. The group sold its U.S. annuities and certain life insurance businesses to Delaware Life Holdings in 2013; expanded into less-capital-intensive businesses; launched a Canadian mutual fund company and SLIM; and improved financial flexibility by reduced leverage.

SLF has maintained exceptional liquidity, and we believe it has well-established policies to ensure that it has sufficient cash to meet its liquidity requirements, including those well above general expectations. At year-end 2017, its liquidity ratio per our model was 398%--well above our thresholds for a positive assessment. Collateral-posting obligations (associated with hedging derivatives) were minimal relative to liquid assets. Confidence-sensitive liability coverage is positive. SLF has a total equity covenant in its committed credit facility, and it kept well above this covenant as of Dec. 31, 2018.

Rating Score Snapshot

	To:	**From:**
Holding company rating	A+/-/A-1+	A/-/A-1
Financial strength rating	AA/Stable/--	AA-/Positive/--
Anchor	aa	aa-
Business risk profile	Excellent	Very strong
IICRA	Very low	Very low
Competitive position	Extremely strong	Very strong
Financial risk profile	Very strong	Very strong
Capital and earnings	Very strong	Very strong
Risk position	Intermediate	Intermediate
Financial flexibility	Strong	Strong
Modifiers	0	0
ERM and management	0	0
Enterprise risk management	Strong	Strong
Management and governance	Strong	Strong
Holistic analysis	0	0
Liquidity	Exceptional	Exceptional
Support	0	0
Group support	0	0
Government support	0	0

IICRA--Insurance industry and country risk assessment. Note: Support does not consider ratings above sovereign criteria.

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria | Insurance | General: Enterprise Risk Management, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Criteria | Insurance | General: Methodology For Assessing Capital Charges For Commercial Mortgage Loans Held By U.S. Insurance Companies, May 31, 2012
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008
- Criteria - Insurance - Life: Liquidity Model For U.S. And Canadian Life Insurers, April 22, 2004

Ratings Detail (As Of April 2, 2019)	
Sun Life Financial Inc.	
Financial Strength Rating	
Local Currency	NR/--/--
Issuer Credit Rating	A+/Stable/A-1+
Preferred Stock *Canada National Scale Preferred Share*	P-1(Low)
Preferred Stock	A-
Senior Unsecured	A+
Subordinated	A
Related Entities	
Sun Life and Health Insurance Co. (U.S.)	
Financial Strength Rating	
Local Currency	AA/Stable/--
Issuer Credit Rating	
Local Currency	AA/Stable/--
Sun Life Assurance Co. of Canada	
Financial Strength Rating	
Local Currency	AA/Stable/--
Issuer Credit Rating	AA/Stable/A-1+
Subordinated	A+
Subordinated	AA-
Sun Life Assurance Co. of Canada (U.S. branch)	
Financial Strength Rating	
Local Currency	AA/Stable/--

Ratings Detail (As Of April 2, 2019) (cont.)	
Issuer Credit Rating	
Local Currency	AA/Stable/--
Sun Life Capital Trust	
Preferred Stock *Canada National Scale Preferred Share*	P-1
Preferred Stock	A+
Sun Life Capital Trust II	
Preferred Stock *Canada National Scale Preferred Share*	P-1
Preferred Stock	A+
Domicile	Canada

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.