

## REPORT ON E-L FINANCIAL CORPORATION LIMITED

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This document has been prepared for the purpose of providing Management's Discussion and Analysis ("MD&A") of the financial condition and results of operations for the years ended December 31, 2018 and 2017 for E-L Financial Corporation Limited ("E-L Financial" or the "Company"). This MD&A should be read in conjunction with the December 31, 2018 year end consolidated financial statements and the notes, which form part of the E-L Financial Corporation Limited 2018 Annual Report dated March 5, 2019. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). Unless otherwise noted, both the consolidated financial statements and this MD&A are expressed in Canadian dollars. Figures in MD&A may differ due to rounding.

This MD&A contains certain forward-looking statements that are subject to risks and uncertainties that may cause the results or events mentioned in this discussion to differ materially from actual results or events. No assurance can be given that results, performance or achievement expressed in, or implied by, any forward-looking statements within this discussion will occur, or if they do, that any benefits may be derived from them.

Unless otherwise stated, all per share amounts are based on the average number of Common Shares and Series A Convertible Preference Shares outstanding for the period, adjusted for the Company's proportionate interest in its own common shares held indirectly through investments in associates.

Additional information relating to the Company, including its Annual Information Form, may be found at [www.sedar.com](http://www.sedar.com).

### Forward-looking statements and information

Certain statements in this MD&A about the Company's current and future plans, expectations and intentions, results, market share growth and profitability, strategic objectives or any other future events or developments constitute forward-looking statements and information within the meaning of applicable securities laws. The words "may", "will", "would", "should", "could", "expects", "plans", "intends", "trends", "indications", "anticipates", "believes", "estimates", "predicts", "likely" or "potential" or the negative or other variations of these words or other comparable words or phrases, are intended to identify forward-looking statements and information. Although management believes that the expectations and assumptions on which such forward-looking statements and information are based are reasonable, undue reliance should not be placed on the forward-looking statements and information because there can be no assurance that they will prove to be correct. By their nature, such forward-looking statements and information are subject to various risks and uncertainties, which could cause the actual results and expectations to differ materially from the anticipated results or expectations expressed. These risks and uncertainties include, but are not limited to, market risks including equity risks, hedging risks, interest rate risks, foreign exchange rate risks; liquidity risks; credit risks including counterparty risks; insurance risks including mortality risks, policyholder behaviour risks, expense risks, morbidity risks, product design and pricing risks, underwriting and claims risks, reinsurance risks; operational risks, including legal and regulatory risks, model risks, human resources risks, third party risks, technology, information security and business continuity risks; and business risks, including risks with respect to competition, risks with respect to financial strength, capital adequacy risks, risks with respect to distribution channels, risks with respect to changes to applicable income tax legislation, risks with respect to litigation, risks with respect to reputation, risks with respect to risk management policies, risks with respect to intellectual property, risks with respect to significant ownership of common shares. Please see the section titled "Description of the Business" in E-L Financial's Annual Information Form available at [www.sedar.com](http://www.sedar.com) for more details on these risks.

Material factors or assumptions that were applied in drawing a conclusion or making an estimate set out in the forward-looking statements and information include that the general economy remains stable; assumptions on interest rates, mortality rates and policy liabilities; and capital markets continue to provide access to capital. These factors are not intended to represent a complete list of the factors that could affect

the Company; however, these factors should be considered carefully, and readers should not place undue reliance on forward-looking statements made herein or in the documents reproduced herein.

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

The forward-looking information contained herein is expressly qualified in its entirety by this cautionary statement. When relying on the Company's forward-looking statements and information to make decisions, investors and others should carefully consider the foregoing factors, assumptions and other uncertainties and potential events. Readers are cautioned not to place undue reliance on this forward-looking information, which is given as of the date hereof or the date indicated, and to not use such forward-looking information for anything other than its intended purpose. The Company undertakes no obligation to update publicly or revise any forward-looking statements and information, whether as a result of new information, future events or otherwise after the date of this document, except as required by law.

### **Non-GAAP measures**

The MD&A contains information using non-GAAP measures. Current Canadian GAAP is IFRS for the Company's consolidated financial statements. The Company believes that these measures provide useful information to its shareholders in evaluating the Company's financial results. Where non-GAAP measures are used, descriptions have been provided as to the nature of the adjustments made.

The MD&A contains reference to net equity value, net equity value per common share and growth in net equity value per common share. Net equity value per common share is described and reconciled to shareholders' equity on page 9. These terms do not have any standardized meaning according to IFRS and therefore may not be comparable to similar measures presented by other companies.

The MD&A also contains non-consolidated cash flow information of E-L Financial which is a non-GAAP presentation. The information is useful as it separates the Company's cash flows from the cash flows of its subsidiaries. This information is reconciled to the consolidated cash flows on page 11.

Other non-GAAP measures are also used in The Empire Life Insurance Company ("Empire" or "Empire Life") section of the MD&A. These include references to return on common shareholders' equity, source of earnings, assets under management, annualized premium sales, gross and net sales for mutual funds, segregated funds and fixed annuities. These provide investors with supplemental measures of its operating performance and to highlight trends in its core business that may not otherwise be apparent when relying solely on GAAP financial measures. Empire Life also believes that securities analysts, investors and other interested parties frequently use non-GAAP measures in the evaluation of issuers. Empire Life's management also uses non-GAAP measures in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and to determine components of management compensation.

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

Sources of earnings break down Empire Life earnings into several categories which are useful to assess the performance of the business. These categories include expected profit from in-force business, impact of new business, experience gains and losses, management actions and changes in assumptions, and earnings on surplus. The sources of earnings components are reconciled to Empire Life's net income on page 21 of this report.

Annualized premium sales are used as a method of measuring sales volume. It is equal to the premium expected to be received in the first twelve months for all new individual insurance and employee benefit policies sold during the period. Mutual fund gross and net sales and segregated fund gross and net sales

are also used as measures of sales volume. Empire Life believes that these measures provide information useful to its shareholders and policyholders in evaluating Empire Life's underlying financial results.

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

The following table provides a reconciliation of assets under management to total assets in Empire Life's financial statements:

<i>(in millions of dollars)</i>	<b>2018</b>	<b>2017</b>
General fund assets	\$ 8,447	\$ 8,713
Segregated fund assets	7,823	8,682
Total Empire Life assets	16,270	17,395
Mutual fund assets	145	183
<b>Total assets under management</b>	<b>\$ 16,415</b>	<b>\$ 17,578</b>

## The Company

E-L Financial operates as an investment and insurance holding company. In managing its operations, the Company distinguishes between two operating segments, E-L Corporate and Empire Life.

E-L Corporate's operations includes the oversight of investments in global equities held through direct and indirect holdings of common shares, investment funds, closed-end investment companies and other private companies. E-L Financial holds a 52.2% interest in a closed-end investment corporation, United Corporations Limited ("United") which is listed on the Toronto Stock Exchange. United is an investment vehicle for long-term growth through investments in common equities. The invested assets and operations of United are consolidated and included in the E-L Corporate segment. In addition, E-L Corporate has two significant investments in associates which are a 36.8% interest in Algoma Central Corporation ("Algoma") and a 24.0% interest in Economic Investment Trust Limited ("Economic"). Algoma and Economic are accounted for using the equity method.

The Company's investment in Empire Life (99.3% interest) is consolidated by E-L Financial. The Empire Life operating segment underwrites life and health insurance policies and provides segregated funds, mutual funds and annuity products.

The Company's strategy is to accumulate shareholder value through long-term capital appreciation and dividend and interest income from its investments. E-L Financial oversees its investments through representation on the Boards of Directors of the subsidiaries and the other companies in which the Company has significant shareholdings.

**Overview of results attributable to shareholders of E-L Financial**

E-L Financial consolidated (millions of dollars)	Fourth quarter		Year	
	2018	2017	2018	2017
<b>Contribution to net (loss) income</b>				
E-L Corporate <sup>(1)</sup>	\$ (244)	\$ 209	\$ (105)	\$ 498
Empire Life <sup>(2)</sup>	6	48	136	170
<b>Net (loss) income</b>	<b>(238)</b>	<b>257</b>	<b>31</b>	<b>668</b>
Other comprehensive (loss) income <sup>(2)</sup>	(8)	18	(26)	(35)
<b>Comprehensive (loss) income</b>	<b>\$ (246)</b>	<b>\$ 275</b>	<b>\$ 5</b>	<b>\$ 633</b>

The following tables summarize the results of the Company's business segments:

E-L Corporate (millions of dollars)	Fourth quarter		Year	
	2018	2017	2018	2017
Revenue				
Net (loss) gain on investments <sup>(3)</sup>	\$ (324)	\$ 257	\$ (206)	\$ 544
Investment and other income	27	26	134	118
Share of associates (loss) income	(5)	14	10	36
	<b>(302)</b>	<b>297</b>	<b>(62)</b>	<b>698</b>
Operating	9	9	34	29
Income taxes	(41)	37	(6)	92
Non-controlling interests	(26)	42	15	79
	<b>(58)</b>	<b>88</b>	<b>43</b>	<b>200</b>
<b>Net (loss) income</b>	<b>(244)</b>	<b>209</b>	<b>(105)</b>	<b>498</b>
Other comprehensive (loss) income, net of taxes <sup>(1)</sup>	(1)	1	2	(42)
<b>Comprehensive (loss) income</b>	<b>\$ (245)</b>	<b>\$ 210</b>	<b>\$ (103)</b>	<b>\$ 456</b>

Empire Life (millions of dollars)	Fourth quarter		Year	
	2018	2017	2018	2017
Revenue				
Net premiums	\$ 237	\$ 210	\$ 874	\$ 834
Net (loss) gain on investments <sup>(3)</sup>	(95)	269	(308)	302
Investment income	83	78	307	281
Fee income	65	70	264	257
	<b>290</b>	<b>627</b>	<b>1,137</b>	<b>1,674</b>
Benefits and expenses	275	553	934	1,428
Income and other taxes	4	20	56	70
Non-controlling and participating policyholders' interests	5	6	11	6
	<b>284</b>	<b>579</b>	<b>1,001</b>	<b>1,504</b>
<b>Net income</b>	<b>6</b>	<b>48</b>	<b>136</b>	<b>170</b>
Other comprehensive (loss) gain, net of taxes <sup>(2)</sup>	(7)	17	(28)	7
<b>Comprehensive (loss) income</b>	<b>\$ (1)</b>	<b>\$ 65</b>	<b>\$ 108</b>	<b>\$ 177</b>

<sup>(1)</sup> Net of non-controlling interests

<sup>(2)</sup> Net of non-controlling interests and participating policyholders' amounts

<sup>(3)</sup> Includes fair value change on fair value through profit and loss ("FVTPL") investments and realized gains on available for sale ("AFS") investments

E-L Financial reported consolidated 2018 net income of \$31 million, or \$3.96 per common share compared with \$668 million, or \$166.17 per common share in 2017. The decrease in net income is primarily due to net losses on investments within the E-L Corporate segment. E-L Corporate reported a net loss on investments of \$206 million in 2018 compared to a net gain of \$544 million in 2017. E-L Corporate's global investment portfolio had a negative pre-tax total return of 2% in 2018 compared to a pre-tax return of 14% in the prior year.

The Empire Life segment reported net income of \$136 million in 2018 compared to \$170 million in 2017. The net income for 2018 decreased primarily due to the impacts of changes made in the assumptions used by Empire Life in the estimation of insurance contract liabilities. During 2018 and 2017 changes were made to the company's bond portfolios which improved the matching of these investments to the estimated duration of the insurance contract liabilities. These changes positively impacted net income and were more significant in the prior year. In addition fourth quarter equity market declines reduced net income compared to the prior year.

Consolidated comprehensive income for 2018 was \$5 million, or a net loss of \$2.72 per common share compared to \$633 million, or \$157.33 per common share in 2017.

### Net equity value per common share

Investments in Algoma and Economic are accounted for using the equity method and are not carried at fair value. Therefore, to provide an indication of the accumulated shareholder value, the following table adjusts shareholders' equity to reflect investments in associates at fair value:

<i>(millions of dollars, except per share amounts)</i>	<b>2018</b>	2017
E-L Financial shareholders' equity	\$ 5,523	\$ 5,553
Less: First preference shares	(300)	(300)
	<b>5,223</b>	5,253
Adjustments for investments in associates not carried at fair value:		
Carrying value	(335)	(330)
Fair value <sup>(1)</sup>	315	381
	(20)	51
Non-controlling interest and deferred tax	5	(11)
	(15)	40
Net equity value	\$ 5,208	\$ 5,293
Common Shares <sup>(2)</sup> outstanding at year end	4,019,667	4,019,667
<b>Net equity value per common share<sup>(2) (3)</sup></b>	<b>\$ 1,295.65</b>	<b>\$ 1,316.64</b>

<sup>(1)</sup> Based on quoted market prices

<sup>(2)</sup> Common Shares includes Series A Convertible Preference Shares

<sup>(3)</sup> See non-GAAP measures

## Growth in net equity value

The Company's objective is to build long-term shareholder value by compounding growth in net equity value per common share over the long term. Set out below is a table that shows the net equity value per common share and growth for the respective fiscal periods. The growth in net equity value includes dividends paid to common shareholders.

Annual	Net equity value*		Growth*
		\$	%
2009		681.51	23.6
2010		747.28	9.7
2011		642.98	(13.9)
2012		740.49	15.2
2013		872.45	28.0
2014		970.65	11.3
2015		1,089.23	12.3
2016		1,159.26	6.8
2017		1,316.64	14.0
2018		1,295.65	(1.2)
<b>Compounded annual growth in net equity value*</b>			
2009 - 2018 - 10 years			9.7
1969 - 2018 - Since inception			12.4

\* This chart was drawn from the individual annual reports and has not been restated for any subsequent changes in accounting policies.

## Summary of quarterly results

The following table summarizes the quarterly results:

<i>(millions of dollars, except per share amounts)</i>	2018								2017
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	
Revenue									
Net (loss) gain on investments <sup>(1)</sup>	\$ (419)	\$ (112)	\$ 75	\$ (58)	\$ 527	\$ (240)	\$ 209	\$ 351	
Net premium income	237	221	205	211	210	217	204	203	
Investment and other income	175	175	199	158	173	158	175	150	
Associates <sup>(2)</sup>	(5)	10	7	(3)	14	9	12	1	
Total	\$ (12)	\$ 294	\$ 486	\$ 308	\$ 924	\$ 144	\$ 600	\$ 705	
Net (loss) income <sup>(3)</sup>	\$ (238)	\$ 96	\$ 108	\$ 66	\$ 257	\$ 49	\$ 98	\$ 264	
Earnings per common share									
- basic	\$ (61.62)	\$ 23.33	\$ 26.56	\$ 15.69	\$ 64.47	\$ 11.60	\$ 23.84	\$ 66.26	
- diluted	\$ (61.62)	\$ 22.08	\$ 24.12	\$ 15.15	\$ 58.80	\$ 11.31	\$ 22.30	\$ 60.41	

<sup>(1)</sup> Fair value change on FVTPL investments and realized gain (loss) on AFS investments

<sup>(2)</sup> Share of income (loss) of associates

<sup>(3)</sup> Attributable to shareholders

## Quarterly trend analysis

The consolidated revenue and consolidated net income of the Company are expected to fluctuate on a quarterly basis given its two segments. In particular, equity market movements, changes in interest rates, underwriting results, policy liability discount rates and policy reserve adjustments are likely to cause fluctuations. Investment income includes dividend income earned by the Company. In general, dividends earned on investments outside North America peak in the second and fourth quarters of the year.

Revenue for the fourth quarter of 2018 decreased from the third quarter of 2018 and the fourth quarter of 2017 primarily due to the declines in global equity markets during the fourth quarter of 2018.

Net premiums for the fourth quarter and the full year 2018 were higher relative to the same period in 2017 due to growth in all product lines.

#### Fourth quarter results

E-L Financial reported a consolidated net loss of \$238 million, or \$61.62 per common share for the fourth quarter of 2018 compared to income of \$257 million, or \$64.47 per common share in 2017. The loss was attributable to the E-L Corporate fourth quarter net loss of \$244 million compared to a net income of \$209 million for the comparable period in 2017. The fourth quarter E-L Corporate loss for 2018 was due to a net loss on investments of \$324 million. This compared to a net gain of \$257 million for the same period in 2017. The pre-tax total return on E-L Corporate's investments was negative 6% in 2018 compared to a positive return of 6% in the prior year.

Empire Life reported a net income of \$6 million in the fourth quarter of 2018 compared to \$48 million for the comparable period in 2017. The decrease in earnings for the fourth quarter of 2018 was primarily a result of changes in assumptions used by Empire Life in the estimation of insurance contract liabilities and the impact of equity market declines.

Consolidated comprehensive loss for the fourth quarter of 2018 was \$246 million, or \$63.51 per common share compared to comprehensive income of \$275 million, or \$69.16 per common share in 2017.

#### Liquidity and cash flows

##### Consolidated cash flows

The condensed cash flow of United and Empire Life, as well as E-L Financial non-consolidated and consolidated are presented below:

Year ended December 31 (millions of dollars)	E-L Financial (non- consolidated)	United	Empire Life	Consolidation adjustments	E-L Financial	
					2018	2017
Cash flows from:						
Operating activities	\$ 86	\$ 14	\$ 346	\$(58)	\$ 388	\$ 347
Financing activities	(50)	(25)	(367)	57	(385)	227
Investing activities	14	44	(68)	1	(9)	(655)
Increase (decrease) in cash and cash equivalents	50	33	(89)	—	(6)	(81)
Cash and cash equivalents, beginning of the year	25	20	294	—	339	420
Cash and cash equivalents, end of the year	\$ 75	\$ 53	\$ 205	—	\$ 333	\$ 339

The increase in cash provided from operating activities in 2018 relative to 2017, reflects the increase in cash earnings during 2018 compared to the prior year along with changes in working capital levels.

The decrease in financing activity cash flows during 2018 relative to 2017 was mainly due to Empire Life's redemption of \$300 million subordinated debt on May 31, 2018. In 2017, Empire Life issued \$200 million of subordinated debentures.

The change in cash from investing activities during 2018 relative to 2017 was primarily driven by the timing of portfolio investment transactions and the investment of proceeds from Empire Life's issuance of \$200 million of subordinated debt in 2017. In addition, during the fourth quarter of 2018 United completed an investment manager change contributing to higher investment turnover.

## Non-consolidated cash flows of E-L Financial

E-L Financial's corporate cash flows from operating activities, before payment of dividends, are primarily comprised of dividends and interest received, less operating expenses and income taxes.

The following table details the non-consolidated cash flows of the Company on a direct basis, excluding the cash flows of the subsidiaries. This table has been prepared to assist the reader in isolating the cash flows of E-L Financial (non-consolidated).

<i>(millions of dollars)</i>	<b>2018</b>	2017
Cash flows from:		
Operating activities		
Dividends from subsidiaries	\$ 52	\$ 14
Dividends and interest	85	67
Expenses and taxes, net of other income	(51)	(24)
	<b>86</b>	57
Financing activities		
Cash dividends	(36)	(36)
Margin loan	(10)	100
Interest paid on borrowings	(1)	(1)
Purchases of subsidiary shares	(3)	(103)
	<b>(50)</b>	(40)
Investing activities		
Purchases of investments	(554)	(1,132)
Proceeds from sales of investments	540	1,057
Net sales of short-term investments	21	44
Dividends from associates	7	7
	<b>14</b>	(24)
Increase (decrease) in cash and cash equivalents	<b>50</b>	(7)
Cash and cash equivalents, beginning of the year	<b>25</b>	32
Cash and cash equivalents, end of the year	<b>\$ 75</b>	\$ 25

For the year ended December 31, 2018, the non-consolidated cash flows of E-L Financial increased by \$50 million.

Operating cash flows for 2018 increased \$29 million over the prior year. E-L Financial receives dividends from its subsidiaries Empire Life and United. A large contributor to the increase was \$40 million common shareholder dividends received from Empire Life during 2018. Common shareholder dividends paid by Empire Life are reviewed on a quarterly basis and will depend upon various factors including the results of operations, the economic environment and the company's financial condition taking into account regulatory restrictions and other factors relevant to Empire Life's Board of Directors. E-L Financial received \$13 million of dividends from United during the year. United's dividend policy is to distribute annual net investment income in the form of dividends which consists of quarterly dividends with an additional dividend representing the balance of net investment income for the previous fiscal.

Dividends and interest increased by \$18 million. Dividends received are impacted by changes in the composition of the investment portfolio, variability in foreign exchange rates and dividend yields.

During the first quarter of 2017, for diversification reasons, E-L Financial reallocated the assets managed from one of the global investment managers. This caused higher investment portfolio turnover in 2017 compared to the current year resulting in higher income taxes paid during 2018.

During 2017, the Company drew on a margin loan facility to purchase \$100 million of Series 3 Preferred Shares from Empire Life. As of December 31, 2018 the margin facility is pledged with \$147 million of investments. Under the facility the Company is able to borrow funds in an amount up to 80% of the fair value of investments pledged.

E-L Financial maintains sufficient liquidity through holding cash equivalents and a sufficient amount of marketable investments that may be sold, if necessary, to fund new investment opportunities and to meet any operating cash flow requirements.

### Capital resources

The Company's capital management process is designed to protect capital and build shareholder value over the long-term. Effective capital management includes maintaining sufficient liquidity to be able to pay dividends to the Company's preferred shareholders, satisfy issuer credit ratings requirements, as well as providing flexibility to pursue strategic opportunities. Total capital on a consolidated basis at December 31, 2018, consisted of the Company's shareholders' equity of \$5,523 million, non-controlling interests in subsidiaries of \$979 million and participating policyholders' interests of \$36 million.

In the normal course of business, the Company is obligated to fund investment commitments which are not recognized in the consolidated financial statements. During 2017, E-L Financial subscribed for units in a Canadian limited partnership with an aggregate capital commitment of U.S. \$40 million. As of December 31, 2018, the remaining unfunded commitment was U.S. \$38 million. Empire Life had \$13 million of outstanding investment commitments as at December 31, 2018.

### Selected annual information

(millions of dollars, except per share amounts)	2018	2017	2016
<b>Revenue</b>	<b>1,077</b>	2,373	1,660
<b>Shareholder net (loss) income</b>			
E-L Corporate	<b>(105)</b>	498	181
Empire Life	<b>136</b>	170	152
Total	<b>31</b>	668	333
<b>Earnings per share</b>			
- basic	<b>3.96</b>	166.17	80.88
- diluted	<b>3.96</b>	152.83	75.80
<b>Assets</b>			
E-L Corporate	<b>5,078</b>	5,245	4,722
Empire Life	<b>16,270</b>	17,395	15,862
Total assets	<b>21,347</b>	22,640	20,584
<b>Cash dividends declared per share</b>			
First Preference Shares, Series 1	<b>\$ 1.3250</b>	\$ 1.3250	\$ 1.3250
First Preference Shares, Series 2	<b>\$ 1.1875</b>	\$ 1.1875	\$ 1.1875
First Preference Shares, Series 3	<b>\$ 1.3750</b>	\$ 1.3750	\$ 1.3750
Common Shares	<b>\$ 5.00</b>	\$ 5.00	\$ 5.00

Revenues and net income over the period have been significantly impacted by fluctuations in the global stock markets. E-L Corporate reported net gains on investments of \$156 million and \$544 million for 2016 and 2017. In 2016 investment returns in local currencies improved but were partially offset by the strengthening of the Canadian dollar relative to the U.S. dollar and Euro. In 2017 equity market returns in local currency were significantly higher than 2016 but were partially offset by foreign currency movements.

The 2018 period was affected by the declines in global equity markets. The Canadian dollar depreciated against most major portfolio currencies which partially offset the net investment loss for the year.

The fluctuation in Empire Life's revenue for the three year period is primarily driven by the impact of market interest rate movements on Empire Life's FVTPL investments.

During 2016 and 2017, assets continued to increase due to the growth in the investment portfolio combined with positive investment returns. In 2018 assets declined in both E-L Corporate and Empire Life primarily due to the stock market decline during the year.

### Outstanding share data

The following summarizes the issued and outstanding shares of the Company:

	Issued and outstanding
Preferred shares	
Series A Preference Shares	258
First Preference Shares, Series 1	4,000,000
First Preference Shares, Series 2	4,000,000
First Preference Shares, Series 3	4,000,000
Common Shares	4,019,409

The Series A Preference Shares are convertible, at the shareholder's option, into Common Shares on a share for share basis. The Series A Preference Shares and Common Shares are each entitled to one vote per share.

The First Preference Shares are convertible at the option of the Company, into that number of Common Shares determined by dividing by the then applicable redemption price, together with all declared and unpaid dividends to the date of conversion, by the greater of \$1.00 and 95% of the weighted average trading price of the Common Shares on the Toronto Stock Exchange for the 20 consecutive trading days ending on the fourth day prior to the conversion date.

### Disclosure controls and procedures

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company under Canadian securities laws is recorded, processed, summarized and reported within the specified time periods, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management on a timely basis to allow appropriate decisions regarding public disclosure. Under the supervision of management, an evaluation was carried out on the effectiveness of the Company's disclosure controls and procedures as of December 31, 2018. Based on that evaluation, management concluded that the Company's disclosure controls and procedures were effective as at December 31, 2018.

### Internal control over financial reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes in accordance with IFRS. Under the supervision of management, an evaluation of the Company's internal control over financial reporting was carried out as at December 31, 2018. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2018. No changes were made in the Company's internal control over financial reporting during the year ended December 31, 2018, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

### **Critical accounting estimates**

The consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada which require estimates and assumptions in determining amounts reported in the financial statements. Note 2 to the consolidated financial statements describes the significant accounting policies. The Company considers the following items to be particularly susceptible to changes in estimates and judgments:

#### **Insurance contract liabilities**

The determination of policy liabilities requires best estimate assumptions that cover the remaining life of the policies for mortality, morbidity, investment returns, persistency, expenses, inflation and taxes and include consideration of related reinsurance effects. Due to the long-term risks and measurement uncertainties inherent in the life insurance business, a margin for adverse deviation from best estimates is included in each assumption. These margins allow for possible deterioration in future experience and provide for greater confidence that policy liabilities are adequate to pay future benefits. The resulting provisions for adverse deviations have the effect of increasing policy liabilities and decreasing the income that otherwise would have been recognized at policy inception. A range of allowable margins is prescribed by the Canadian Institute of Actuaries. Assumptions are reviewed and updated at least annually and the impact of changes in those assumptions is reflected in earnings in the year of the change. Empire Life's sensitivity to risks related to policy liabilities are included in notes 22 and 23 to the consolidated financial statements.

#### **Impairment**

The Company maintains a prudent policy in setting the provision for impaired investments. When there is no longer reasonable assurance of full collection of loan principal and loan interest related to a mortgage or policy contract loan, management establishes a specific provision for loan impairment and charges the corresponding reduction in carrying value to income in the period the impairment is identified. In determining the estimated realizable value of the investment, management considers a number of events and conditions. These include the value of the security underlying the loan, geographic location, industry classification of the borrower, an assessment of the financial stability of the borrower, repayment history and an assessment of the impact of current economic conditions. Changes in these circumstances may cause subsequent changes in the estimated realizable amount of the investment and changes in the specific provision for impairment.

AFS securities are subject to a regular review for losses that are significant or prolonged. Objective evidence of impairment exists if there has been a significant or prolonged decline in the fair value of the investment below its cost or if there is a significant adverse change in the technological, market, economic or legal environment in which the issuer operates or the issuer is experiencing financial difficulties.

Investments in associates recognize an impairment loss if the investment in associates' recoverable amount is determined to be lower than the investment's carrying amount at the reporting date. Recoverable amount is equal to the higher of the investment's fair value less costs of disposal and value in use. Impairment losses are recognized in the consolidated statements of income. Previously recognized impairment losses are reversed if the investment's recoverable amount subsequently increases and there is a significant indication that the circumstances that led to the initial recognition of the impairment loss have improved or recovered completely.

#### **Consolidation**

There could be judgment involved in assessing control or significant influence of certain of the Company's interests in other entities. The Company has applied judgment to assess which party has power or influence over the relevant activities of these entities. When assessing decision making power, the Company has considered voting rights, contractual agreements, relative share holdings, and other facts and circumstances. The initial assessment of control or influence is reassessed when there are changes in facts and circumstances.

## Fair value estimates

In measuring the fair value of financial instruments, management exercises judgment in the selection of fair value inputs and in determining their significance to the fair value estimate. Judgment is also required in the classification of fair value measurements within the levels of the fair value hierarchy, in particular those items categorized within Level 3 of the hierarchy.

## Accounting changes

### i) New accounting pronouncements adopted in 2018

#### *IFRS 15 Revenue from Contracts with Customers*

The IASB has issued a new standard for the recognition of revenue which was effective on January 1, 2018. The new standard replaces IAS 18 *Revenue* which covers contracts for goods and services and IAS 11 *Construction Contracts* which covers construction contracts and is based on the principle that revenue is recognized when control of a good or service transfers to a customer. The Company adopted IFRS 15 using the modified retrospective approach with no restatement of comparative information. The adoption of IFRS 15 on January 1, 2018 did not result in any changes to the Company's accounting policies for revenue recognition and therefore, did not result in any transitional adjustments to the Company's consolidated financial statements.

### ii) New accounting pronouncements issued but not yet effective

#### *IFRS 9 Financial Instruments*

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

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

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

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

The Company has evaluated the criteria and will apply the temporary exemption for periods beginning before January 1, 2022, which allows continued application of IAS 39 instead of adopting IFRS 9, if the Company's activities are 'predominantly connected with insurance'. To assess whether activities are 'predominantly connected with insurance' two criteria were satisfied:

- Carrying amount of liabilities arising from contracts within IFRS 17's scope is significant, compared to the total carrying amount of liabilities; and
- Comparison of total carrying amount of liabilities connected with insurance with the total carrying amount of all of its liabilities. Liabilities connected with insurance include segregated fund liabilities measured at FVTPL applying IAS 39, and liabilities that arise because the insurer issues or fulfills obligations arising from those insurance and segregated fund contracts. The second test is passed

if the resulting percentage is either: greater than 90%; or if it is less than or equal to 90% but greater than 80% and the insurer is not engaged in a significant activity unconnected with insurance.

Per the amendments to IFRS 4 *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts*, companies applying the temporary exemption are required to disclose fair value information with respect to their investments in financial assets whose contractual cash flows reflect solely payments of principal and interest on the principal amount outstanding ("SPPI"), to enable users of financial statements to compare insurers applying the temporary exemption with entities applying IFRS 9. The Company's fixed income invested assets presented in Notes 5 and 8 include cash equivalents, short-term investments, bonds, mortgages, loans on policies and policy contract loans and primarily have cash flows that qualify as SPPI. Fixed income invested assets which do not have SPPI qualifying cash flows as at December 31, 2018 include bonds and mortgages with fair values of \$20.2 million and \$11.5 million, respectively.

The Company has considered the total insurance liabilities, which include segregated fund liabilities, against total liabilities and have concluded that the Company meets both criteria noted above.

The Company is currently evaluating the impact of IFRS 9 and related amendment to IFRS 17 on its consolidated financial statements.

#### *IFRS 16 Leases*

In January 2016, the IASB published IFRS 16 which is effective January 1, 2019. The new standard requires the capitalization of all leases by recognizing the present value of the lease payments and showing them as lease assets, and recognizing a financial liability representing an obligation to make future lease payments. The Company has evaluated the impact of IFRS 16 on its consolidated financial statements as not significant.

#### *IFRS 17 Insurance Contracts*

IFRS 17 was issued in May 2017 as replacement for IFRS 4 *Insurance Contracts*. The IFRS 17 standard has an objective to ensure that an entity provides relevant information that faithfully represents those contracts and gives a basis for users of financial statements to assess the effect that insurance contracts have on the financial position, income statement and cash flow statement. The standard establishes the principles for recognition, measurement, presentation and disclosure. It defines a general measurement model and a variable fee approach applicable to all insurance contracts and reinsurance contracts to measure the insurance contract liabilities, and it defines a specific model for contracts of one year or less.

The provisions of this new standard will apply retrospectively to each group of insurance contracts and, if and only if impracticable, an entity shall apply the modified retrospective or fair value approach to financial statements.

IFRS 17 is tentatively effective (subject to IASB due process for the approval of a 1 year deferral) for reporting periods beginning on or after January 1, 2022, with comparative figures required to be restated. The Company is currently evaluating the impact on presentation, disclosure and measurement of the insurance contracts that this standard will have on its consolidated financial statements.

#### **Analysis of business segments**

The remainder of this MD&A discusses the individual results of operations and financial condition of the Company's business segments: E-L Corporate and Empire Life.

**E-L CORPORATE**

E-L Corporate's operations includes the oversight of investments in global equities held through direct and indirect holdings of common shares, investment funds, closed-end investment companies, a limited partnership and other private companies.

Investments in Economic and Algoma are reported as investments in associates and are discussed below. Investments in equities and fixed income securities held directly by E-L Financial and through United are combined to form "Investments – corporate".

**Investments - corporate**

Investments - corporate includes investments in equities and short-term fixed-income investments. At December 31, 2018, investments - corporate had aggregate investments of \$4.6 billion, comprised primarily of common shares and units of investment funds, compared to aggregate investments at December 31, 2017 of \$4.9 billion. The fair value of investments - corporate is summarized in the table below:

<i>(millions of dollars)</i>	<b>2018</b>	<b>2017</b>
Short-term investments	\$ —	\$ 21
Preferred shares	3	1
Common shares and units		
Canadian and U.S.	2,464	2,784
Europe and United Kingdom	1,078	1,055
Emerging Markets	469	460
Japan	463	422
Other	119	110
Total	<b>4,593</b>	4,831
<b>Total invested assets</b>	<b>\$ 4,596</b>	<b>\$ 4,853</b>

The following table provides a summary of E-L Corporate's results:

<i>(millions of dollars)</i>	<b>Fourth quarter</b>		<b>Year</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Revenue				
Net (loss) gain on investments	\$ (324)	\$ 257	\$ (206)	\$ 544
Investment and other income	27	26	134	118
Share of associates (loss) income	(5)	14	10	36
	<b>(302)</b>	297	<b>(62)</b>	698
Operating	9	9	34	29
Income taxes	(41)	37	(6)	92
Non-controlling interests	(26)	42	15	79
	<b>(58)</b>	88	<b>43</b>	200
<b>Net (loss) income</b>	<b>(244)</b>	209	<b>(105)</b>	498
Other comprehensive (loss) income, net of taxes	(1)	1	2	(42)
<b>Comprehensive (loss) income</b>	<b>\$ (245)</b>	\$ 210	<b>\$ (103)</b>	\$ 456

The decrease in E-L Corporate's net income for the fourth quarter of 2018 compared to the prior year is primarily due to a net loss on investments of \$324 million compared to a net gain of \$257 million for the same period in 2017. The pre-tax total return on investments was negative 6% in 2018 compared to a pre-tax total return of 6% in the prior year. Investments in Canada and U.S. were the largest contributor to the 2018 fourth quarter investment performance with a negative return of approximately 7%.

For the year ended December 31, 2018, E-L Corporate had net loss on investments of \$206 million compared with a net gain of \$544 million in 2017. The pre-tax total return on investments was negative 2% in 2018 compared to a pre-tax total return of 14% in the prior year. The pre-tax total return for investments in Canada and U.S. was approximately nil for the year with negative returns in other significant geographic regions. Investments in emerging markets and European countries including the United Kingdom were detractors to these investment returns for 2018.

The net loss on investments for the fourth quarter and year were partly offset by foreign currency movements mostly impacted by a weaker Canadian dollar.

### Share of associates income

The details of E-L Corporate's share of income of associates are as follows:

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
Algoma	\$ 9	\$ 5	\$ 20	\$ 21
Economic *	(14)	9	(10)	15
	\$ (5)	\$ 14	\$ 10	\$ 36

\* Net of a \$6.4 million impairment loss booked in the fourth quarter of 2018 (2017 - \$nil).

Algoma's earnings for 2017 included net gains on the sale of investment properties that were sold within the discontinued real estate segment. Excluding these gains, Algoma's 2018 net earnings increased over the prior year. Algoma continued to grow earnings within its global short sea shipping segment that was introduced in 2016, along with improved earnings within the domestic dry bulk segment partly due to improved margins. 2018 also benefited from the gains associated with the cancellation of four ship building contracts.

Economic owns, directly and indirectly, long-term investments in the common shares of some publicly-traded Canadian companies, and a managed global investment portfolio of common shares of publicly-traded global companies.

Economic's global investment portfolio had a quarterly pre-tax total return, gross of fees, of negative 6% in the fourth quarter of 2018 versus a comparative return of 7% in the fourth quarter of 2017. On a year to date basis, Economic's global investment portfolio had a pre-tax total return, gross of fees, of 1% during 2018 compared to 12% return in 2017.

<i>(millions of dollars)</i>	2018			2017		
	Ownership	Carrying value	Fair value	Ownership	Carrying value	Fair value
Algoma	36.8%	\$ 199	\$ 179	36.7%	\$ 182	\$ 227
Economic	24.0%	136	136	24.0%	148	154
Total		\$ 335	\$ 315		\$ 330	\$ 381

Additional information relating to Algoma and Economic may be found on their respective profiles at [www.sedar.com](http://www.sedar.com).

### Risk management

The objective of the Company's risk management process is to ensure that the operations of the Company encompassing risk are consistent with the Company's objectives and risk tolerance, while maintaining an appropriate risk/reward balance.

### Market risk

Market risk is the most significant risk impacting E-L Corporate as its investing activities are influenced by market price, foreign currency and interest rate risk. As the Company's investment portfolio is represented by Canadian and global equities, the value of its investments will vary from day to day depending on a number of market factors including economic conditions, global events, market news, and on the performance of the issuers of the securities in which the Company invests. Changes in foreign currency exchange rates will also affect the value of investments of non-Canadian dollar securities. As of December 31, 2018, 42% (2017 - 44%) of the investment - corporate including cash and cash equivalents was denominated in U.S. dollars, 11% (2017 - 11%) in Euros and 10% (2017 - 9%) in the Japanese Yen representing the largest foreign currency exposures. The Company also holds investments within emerging markets. Investments in emerging markets are more likely to experience political, economic and social instability, which may result in higher levels of market value volatility.

### Credit risk

In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact the Company is included in the Annual Information Form which is available at [www.sedar.com](http://www.sedar.com). Disclosures regarding E-L Corporate's financial instruments, including financial risk management, are included in Notes 4, 6 and 22 to the consolidated financial statements.

### Outlook

The Company's future earning prospects are dependent on the successful management of its E-L Corporate portfolio and on the continued profitability of its insurance company subsidiary. The performance of the E-L Corporate portfolio is impacted by global securities markets and the selection of equity and fixed income investments. The Company continues to maintain its strategy of accumulating shareholder value through long-term capital appreciation and dividend and interest income.

## REPORT ON EMPIRE LIFE

Empire Life provides a broad range of life insurance and wealth management products, employee benefit plans and financial services to meet the needs of individuals, professionals and businesses through a network of Independent Financial Advisors (“IFA”), Managing General Agents (“MGA”), National Account firms, Mutual Fund Dealers and Employee Benefits brokers and representatives.

Empire Life reported fourth quarter common shareholders’ net income of \$6 million for 2018, compared to \$48 million for 2017. The decrease in earnings was primarily a result of unfavourable assumption updates and lower fee income in the Wealth Management product line. Full year common shareholders’ net income was \$137 million compared to \$171 million in 2017 primarily due to unfavourable assumption updates.

Empire Life’s net income attributable to the owners of E-L Financial, after adjustment for non-controlling interests, is shown in the following table:

	Fourth quarter		Year	
	2018	2017	2018	2017
<i>(millions of dollars)</i>				
Empire Life common shareholders’ net income	\$ 6	\$ 48	\$ 137	\$ 171
Non-controlling interests	—	—	1	1
<b>Net income, contribution to E-L Financial</b>	<b>\$ 6</b>	<b>\$ 48</b>	<b>\$ 136</b>	<b>\$ 170</b>

<b>Empire Life return on common shareholders’ equity (quarterly annualized)</b>	<b>1.7%</b>	<b>13.8%</b>	<b>9.4%</b>	<b>12.8%</b>
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The following table provides a breakdown of the sources of earnings for the fourth quarter and year:

Sources of Earnings	Fourth quarter		Year	
	2018	2017	2018	2017
<i>(millions of dollars)</i>				
Expected profit on in-force business	\$ 51	\$ 53	\$ 194	\$ 183
Impact of new business	(12)	(8)	(16)	(22)
Experience (losses) gains	(26)	8	(3)	16
Management actions and changes in assumptions	(22)	4	(20)	32
(Loss) earnings on operations before income taxes	(9)	58	154	209
Earnings on surplus	15	9	37	28
Income before income tax	7	66	191	236
Income taxes	(3)	15	40	56
Empire Life’s shareholders’ net income	10	52	151	181
Dividends on preferred shares <sup>(1)</sup>	3	3	13	10
<b>Empire Life common shareholders’ net income</b>	<b>\$ 6</b>	<b>\$ 48</b>	<b>\$ 137</b>	<b>\$ 171</b>

<sup>(1)</sup> 2018 year includes \$5 million (2017 - \$1 million) preference share dividends to E-L Financial

The expected profit on in-force business for the fourth quarter decreased by 4% due to a decline in the Wealth Management product line, partially offset by growth in the Individual Insurance product line. For the year, expected profit increased by 6% primarily due to growth in the Individual Insurance and Wealth Management product lines.

The impact of new business for the fourth quarter was primarily driven by higher new business strain related to the Individual Insurance product line, and higher sales for fixed annuities in the Wealth Management product line relative to 2017. For the year, overall lower new business strain was related to lower overall sales in the Wealth Management product line, primarily due to lower segregated fund sales.

The experience losses for the fourth quarter were mainly driven by higher investment losses in the Individual Insurance and Wealth Management product lines. For the year, lower experience gains relative to 2017 were mainly driven by higher investment losses in the Wealth Management and Individual Insurance product lines, partially offset by improved health and long-term disability claims results in the Employee Benefits product line and improved surrender and lapse experience in the Individual Insurance product line.

Management actions in the fourth quarter and the year for each of 2018 and 2017 included improved matching of assets and liabilities in the Individual Insurance product line. During the first and second quarters of 2018 and first quarter of 2017, there was an increase in investment in real estate limited partnership units which resulted in a gain from updating insurance contract liabilities.

Changes in assumptions refers to the impact on actuarial reserves of changing projected assumptions related to policyholder behaviour, mortality, investment returns, expenses and other factors. Empire Life regularly reviews assumptions and updates them to reflect current company and industry experience. For the fourth quarter and the year, the change was mainly due to the increase in insurance contract liabilities to reflect the impact of changing assumptions related to policyholder behaviour on inforce universal life policies and renewable term policies.

Earnings on surplus increased for the fourth quarter and the year primarily due to gains on Empire Life's hedging program and lower interest expense as a result of a lower level of subordinated debt, partially offset by fair value losses on FVTPL.

### Results by Major Product Line

The following tables provide a summary of Empire Life results by major product line for the three months ended December 31 and year for 2018 and 2017. A discussion of results is provided in the Product Line section of the MD&A.

Three months ended December 31 <i>(millions of dollars)</i>	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
<b>Revenue</b>										
Net premium	\$ 53	\$ 33	\$ 86	\$ 82	\$ 99	\$ 95	\$ —	\$ —	\$ 237	\$ 210
Fee income	62	67	3	3	—	—	—	—	65	70
Investment income	10	10	1	1	53	49	18	17	82	77
Net (losses) gains on investments <sup>(1)</sup>	(18)	14	1	1	(76)	253	(1)	1	(94)	270
	106	125	91	87	76	397	17	19	289	627
<b>Expenses</b>										
Benefits and expenses	93	97	85	75	95	373	1	7	274	552
Income and other taxes	3	7	3	4	(4)	7	3	3	5	21
	96	104	88	80	91	380	4	10	278	573
<b>Net income (loss) after tax</b>	\$ 11	\$ 21	\$ 3	\$ 7	\$ (15)	\$ 17	\$ 13	\$ 9	\$ 11	\$ 54
Participating policyholders' portion									1	2
Dividends on preferred shares									3	3
Empire Life's common shareholders' net income									6	48
Non-controlling interests in net income									—	—
Net income attributable to owners of E-L Financial									\$ 6	\$ 48

Twelve months ended December 31 <i>(millions of dollars)</i>	Wealth Management		Employee Benefits		Individual Insurance		Capital & Surplus		Total	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
<b>Revenue</b>										
Net premium	\$ 155	\$ 136	\$ 340	\$ 331	\$ 379	\$ 368	\$ —	\$ —	\$ 874	\$ 834
Fee income	253	246	11	10	—	—	—	—	264	257
Investment income	39	39	4	4	199	183	66	55	308	281
Net (losses) gains on investments <sup>(1)</sup>	(34)	21	(1)	—	(264)	282	(9)	(2)	(308)	301
	412	443	354	344	314	833	58	54	1,138	1,675
<b>Expenses</b>										
Benefits and expenses	315	332	313	308	282	763	20	20	931	1,423
Income and other taxes	24	27	17	16	12	23	7	8	60	74
	339	360	330	324	295	787	27	28	991	1,499
<b>Net income after tax</b>	<b>\$ 73</b>	<b>\$ 83</b>	<b>\$ 24</b>	<b>\$ 20</b>	<b>\$ 19</b>	<b>\$ 46</b>	<b>\$ 31</b>	<b>\$ 27</b>	<b>\$ 148</b>	<b>\$ 176</b>
Participating policyholders' portion									(3)	(5)
Dividends on preferred shares									13	10
Empire Life's common shareholders' net income									137	171
Non-controlling interests in net income									1	1
Net income attributable to owners of E-L Financial									\$ 137	\$ 170

<sup>(1)</sup> Includes fair value change on FVTPL investments and realized gains on AFS investments

### Product Line Results - Wealth Management

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
<b>Fixed Annuities</b>				
Assets under management	\$ 944	\$ 972	\$ 944	\$ 972
Gross sales	53	33	155	136
Net sales	23	7	32	3
<b>Segregated Funds</b>				
Assets under management	7,806	8,661	7,806	8,661
Gross sales	244	309	908	1,112
Net sales	(18)	56	(118)	140
Fee income	61	66	249	242
<b>Mutual Funds</b>				
Assets under management	145	184	145	184
Gross sales	2	9	16	27
Net sales	(8)	(4)	(27)	(21)
Fee income	1	1	3	3
<b>Net income after tax</b>	<b>\$ 11</b>	<b>\$ 21</b>	<b>\$ 73</b>	<b>\$ 83</b>

Fixed annuities assets under management decreased by 3% during the last 12 months. Despite aggressive competitive rates in the market, gross sales increased by 61% for the fourth quarter of 2018 and 14% for the full year.

Segregated fund assets under management decreased by 10% during the last 12 months primarily due to the stock market decline for the period. For the fourth quarter and year, gross sales decreased compared to 2017 primarily due to lower sales for the Guaranteed Minimum Withdrawal Benefit ("GMWB") product. On November 12, 2018, Empire Life launched a new No Load purchase option within the GIF and Class Plus 3.0 product lines, and added four global fund options to Class Plus 3.0. The No Load option gives clients full access to their investments without any surrender charges. On May 28, 2018, Empire Life introduced seven new global funds, a fee for service option and a preferred pricing program to provide clients with more global and lower cost investment options within the GIF product line of segregated funds. On October 23, 2017, Empire Life launched a new version of its GMWB product which is more capital-efficient than the previous product, resulting in overall lower costs for the consumer. The industry segregated fund sales in 2018 were down approximately 8% from 2017, while Empire Life's sales have decreased 18% over the same period.

Segregated fund fee income decreased by 8% for the fourth quarter of 2018 and increased by 3% for the full year primarily due to variations in average assets under management relative to the same periods in 2017.

Mutual fund assets under management decreased during the last 12 months due to lower mutual fund sales combined with the closure of three mutual funds in the third quarter of 2017. Empire Life continues to explore various strategic alternatives with respect to its mutual fund business.

The following table provides a breakdown of the sources of earnings for the fourth quarter and year for Wealth Management:

<b>Sources of Earnings - Wealth Management</b> <i>(millions of dollars)</i>	<b>Fourth quarter</b>		<b>Year</b>	
	<b>2018</b>	<b>2017</b>	<b>2018</b>	<b>2017</b>
Expected profit on in-force business	\$ 33	\$ 36	\$ 121	\$ 118
Impact of new business	(6)	(2)	(11)	(9)
Experience (losses) gains	(9)	1	(9)	9
Management actions and changes in assumptions	(5)	(7)	(5)	(7)
Earnings on operations before income taxes	13	28	97	111
Income taxes	3	7	24	28
<b>Empire Life's shareholders' net income</b>	<b>\$ 11</b>	<b>\$ 21</b>	<b>\$ 73</b>	<b>\$ 83</b>

The expected profit on in-force business for the fourth quarter of 2018 decreased primarily due to lower fee income on lower segregated fund assets under management compared to the same period in 2017. The impact of new business was primarily driven by higher sales of fixed annuities partially offset by lower segregated fund and mutual fund sales. Experience losses for the fourth quarter and full year 2018 relative to experience gains in the same period in 2017 primarily related to an increase in policy liabilities for segregated fund guarantees and unfavourable investment experience on the assets matching fixed interest annuities relative to the corresponding periods in 2017. Losses in management actions and changes in assumptions for the fourth quarter and full year 2018 were primarily driven by unfavourable assumption updates in the fixed annuities business.

**Product Line Results - Employee Benefits**

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
<b>Selected financial information</b>				
Annualized premium sales	\$ 12	\$ 16	\$ 59	\$ 43
Net premium	86	82	340	331
<b>Net income after tax</b>	<b>\$ 3</b>	<b>\$ 7</b>	<b>\$ 24</b>	<b>\$ 20</b>

For the fourth quarter and year, annualized premium sales for Employee Benefits decreased by 25% and increased by 37% respectively relative to 2017. This is primarily due to a large block transfer from a new strategic distribution partner in the first quarter of 2018, in addition to continued growth of the small to medium-sized business owner market. Over the last two years, Empire Life has entered into a number of strategic partnerships to expand market share.

Net premiums for the fourth quarter and year increased by 5% and 3% respectively compared to the same period in 2017. Empire Life continues to focus on profitable sales in the employee benefits market where price competition continues for all major product lines.

The following table provides a breakdown of the sources of earnings for the fourth quarter and year for Employee Benefits:

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
Expected profit on in-force business	\$ 6	\$ 5	\$ 22	\$ 22
Impact of new business	(8)	(3)	(13)	(10)
Experience gains	2	4	19	12
Management actions and changes in assumptions	4	3	4	3
Earnings on operations before income taxes	4	9	32	27
Income taxes	1	2	8	7
<b>Empire Life's shareholders' net income</b>	<b>\$ 3</b>	<b>\$ 7</b>	<b>\$ 24</b>	<b>\$ 20</b>

Expected profit for the fourth quarter and 2018 was relatively unchanged compared to the same period in 2017. The impact of new business relates primarily to the cost of acquiring new business. Experience gains for the fourth quarter were lower mainly due to less favourable claims experience relative to the fourth quarter of 2017. Experience gains for the year were higher compared to 2017 due to continued improvements in health and long-term disability claims, offset by higher expenses related to business development activities. As Empire Life balances claims management with customer experience, it cannot predict whether claims improvement will continue.

In both 2018 and 2017, management actions and changes in assumptions was favourable primarily due to assumption updates for group long-term disability policy liabilities in the fourth quarter.

**Product Line Results - Individual Insurance**

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
<b>Selected financial information</b>				
Shareholders' annualized premium sales	\$ 6	\$ 5	\$ 23	22
Policyholders' annualized premium sales	5	3	16	10
Shareholders' net premiums	69	71	278	281
Policyholders' net premiums	29	24	101	87
<b>Net income after tax</b>				
Net (loss) income after tax shareholders' portion	\$ (16)	\$ 17	\$ 24	56
Net income (loss) after tax policyholders' portion	1	—	(4)	(10)
<b>Net (loss) income after tax</b>	<b>\$ (15)</b>	<b>\$ 17</b>	<b>\$ 19</b>	<b>46</b>

For the fourth quarter and the year, both shareholders' and policyholders' annualized premium sales were higher than the comparable period in 2017. Shareholders' net premiums decreased whereas Policyholders' net premiums increased for the fourth quarter and the year compared to the same period in 2017 primarily due to changes in inforce business. In November 2018, Empire Life introduced Guaranteed Life Protect, which offer customers guaranteed, lifetime coverage with no health or lifestyle questions asked. Empire Life has continued to modify its EstateMax® participating policy since it was launched in 2015. In February 2017, EstateMax® 8 Pay and Optimax Wealth™ 8 Pay were introduced to provide new payment options to allow clients to pay for their participating policy in as few as eight years.

The following table provides a breakdown of the sources of earnings for the fourth quarter and year for Individual Insurance (excludes policyholders' portion):

**Sources of Earnings - Individual Insurance (excludes policyholders' portion)**

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
Expected profit on in-force business	\$ 13	\$ 11	\$ 50	43
Impact of new business	2	(2)	7	(4)
Experience (losses) gains	(19)	4	(14)	(4)
Management actions and changes in assumptions	(21)	8	(19)	36
(Loss) earnings on operations before income taxes	(25)	21	24	71
Income taxes	(9)	4	1	15
<b>Empire Life's shareholders' net (loss) income</b>	<b>\$ (16)</b>	<b>\$ 17</b>	<b>\$ 24</b>	<b>56</b>

Expected profit for the fourth quarter and the year was mainly driven by overall growth in the in-force business. The impact of new business in the fourth quarter were primarily related to investment losses on the equity assets backing long term insurance liabilities. Experience losses for the year were primarily related to equity investment losses and unfavourable surrender and lapse experience compared to the same period in 2017, partially offset by investment gains on the fixed income and real estate assets backing insurance liabilities.

Gains from management actions to improve asset/liability matching during the fourth quarter and the year were overshadowed by net unfavourable updates to policy liability assumptions. Management will continue to make changes to the asset portfolios to reduce the mismatch between the liability and asset portfolio.

The following table provides a breakdown of the policy liability assumption updates:

<i>(millions of dollars)</i>	2018	2017
<b>Components of pretax income increase from update of policy liability assumptions</b>		
Lapse/premium assumptions	\$ (59)	\$ (19)
Net investment assumptions	(3)	(33)
Mortality	28	16
Other	(3)	35
Total loss from update of policy liability assumptions (excluding policyholders' portion)	\$ (38)	(1)

The refinements to lapse/premium assumptions for 2018 were primarily related to the adjustment of lapse assumptions of non-participating 10-year renewable term products and the enhancement of universal life lapse assumptions by funding levels. Empire Life recorded \$20 million of this assumption update in the third quarter of 2018 and the remainder was included in the fourth quarter. The refinements to lapse/premium assumptions for 2017 were primarily related to universal life projected premiums and lapse rates.

The primary change in the net investment assumptions for 2018 was minimal, whereas 2017 resulted in lower overall future yields and greater policy liabilities.

Mortality assumption changes include updates due to mortality experience and a revised mortality improvement scale which is in line with the Canadian Institute of Actuaries promulgated mortality improvement scale.

Other policy liability assumption updates for 2018 and 2017 were primarily related to refinements to the modeling of reinsurance treaties.

### Results - Capital and Surplus

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
Net income after tax shareholders' portion	\$ 12	\$ 7	\$ 30	\$ 21
Net income after tax policyholders' portion	—	3	1	5
<b>Net income after tax</b>	<b>\$ 13</b>	<b>\$ 9</b>	<b>\$ 31</b>	<b>\$ 27</b>

In addition to the three major lines of business, Empire Life maintains distinct accounts for the investment income attributable to Shareholders' Capital and Surplus and to Policyholders' Surplus.

The following table provides a breakdown of the sources of earnings for the fourth quarter and year for Capital and Surplus (excludes policyholders' portion).

### Sources of Earnings - Capital and Surplus (excludes policyholders' portion)

<i>(millions of dollars)</i>	Fourth quarter		Year	
	2018	2017	2018	2017
Income from investments	\$ 9	\$ 19	\$ 54	\$ 56
Gains (losses) on hedging instruments	8	(4)	3	(9)
Interest and other expenses	(1)	(7)	(20)	(20)
Earnings before income taxes	15	9	37	28
Income taxes	3	2	7	6
<b>Empire Life's shareholders' net income</b>	<b>\$ 12</b>	<b>\$ 7</b>	<b>\$ 30</b>	<b>\$ 21</b>

Income from investments decreased in the fourth quarter and the year compared to 2017 primarily due to fair value losses on invested assets due to the decline in the market value of preferred shares. During the

fourth quarter and year, Empire Life incurred a gain on its hedging program primarily due to the decline of Canadian stock indices in 2018 compared to an increase in 2017 (discussed in the Risk Management section). Interest expense for the quarter decreased primarily as a result of a lower level of subordinated debt due to a redemption in May 2018. For the year of 2018, the interest and other expenses was relatively unchanged as a lower level of subordinated debt is offset by a higher interest rate for subordinated debt issued in 2017.

### Sources of capital

Empire Life has issued private and public securities to strengthen its capital position and fund new business growth. Details of the Empire Life's outstanding preferred shares and subordinated debt are as follows:

Preferred Shares				Face amounts as at	
(millions of dollars)	Date Issued	Earliest redemption date	Yield	December 31 2018	December 31 2017
Preferred shares	January 2016	April 17, 2021	5.75%	\$ 150	\$ 150
Preferred shares	November 2017	January 17, 2023	4.90%	100	100

  

Subordinated debentures				Principal amounts as at	
(millions of dollars)	Date Issued	Earliest redemption date	Interest rate	December 31 2018	December 31 2017
Series 2013-1	May 2013	May 31, 2018	2.870%	\$ —	\$ 300
Series 2016-1 <sup>(1)</sup>	Dec. 2016	December 16, 2021	3.383%	200	200
Series 2017-1 <sup>(2)</sup>	Sept. 2017	March 15, 2023	3.664%	200	200

<sup>(1)</sup> Unsecured Debentures due 2026. From December 16, 2021, interest is payable at 1.95% over the 3-month Canadian Deposit Offering Rate ("CDOR").

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

Empire Life's debentures and preferred shares are rated by DBRS Limited ("DBRS") and A.M. Best Company, Inc. ("A.M. Best"). Empire Life's DBRS issuer rating is "A" (sixth highest of 20 categories), its subordinated debt rating is "A (low)" (seventh highest of 20 categories), its financial strength rating is "A" (sixth highest of 22 categories) and its Preferred Share rating is Pfd-2 (fifth highest of 18 categories). All ratings have a stable trend.

A.M. Best ratings of Empire Life are "A Excellent" financial strength rating (third highest of 16 categories), "a" long-term issuer credit rating (sixth highest of 21 categories), "bbb+" Subordinated Debt rating (eighth highest of 21 categories), and "bbb" Preferred Share rating (ninth highest of 21 categories). All ratings have a stable trend.

### Regulatory Capital

Effective January 1, 2018, Minimum Continuing Capital and Surplus Requirements ("MCCSR") was replaced by the Life Insurance Capital Adequacy Test ("LICAT"). The LICAT is intended to improve the measurement of the life insurer's solvency position by recognizing the long-term economics of the life insurance business. Empire Life had a strong capital position under MCCSR and continues to have a strong capital position under the LICAT framework. Empire Life is required to maintain a minimum Core Ratio of 55% and a Total Ratio of 90%. OSFI has established supervisory target levels of 70% for Core and 100% for Total capital.

<b>LICAT</b> (millions of dollars)	<b>December 31</b> <b>2018</b>	September 30 2018	June 30 2018	March 31 2018
<b>Available capital</b>				
Tier 1	\$ 1,476	\$ 1,526	\$ 1,513	\$ 1,480
Tier 2	653	608	614	915
<b>Total</b>	<b>\$ 2,129</b>	<b>\$ 2,134</b>	<b>\$ 2,127</b>	<b>\$ 2,395</b>
<b>Surplus allowance and eligible deposits</b>	<b>\$ 887</b>	<b>\$ 1,001</b>	<b>\$ 1,005</b>	<b>\$ 996</b>
<b>Base solvency buffer</b>	<b>\$ 2,029</b>	<b>\$ 1,908</b>	<b>\$ 1,949</b>	<b>\$ 1,910</b>
<b>LICAT Total Ratio</b>	<b>149%</b>	164%	161%	178%
<b>LICAT Core Ratio</b>	<b>103%</b>	117%	114%	114%

<b>MCCSR</b> (millions of dollars)	December 31 2017
<b>Available regulatory capital</b>	
Tier 1	\$ 1,409
Tier 2	932
<b>Total</b>	<b>\$ 2,341</b>
<b>Required regulatory capital</b>	<b>\$ 831</b>
<b>MCCSR Ratio</b>	<b>282%</b>

### Industry Dynamics and Management's Strategy

Empire Life's operations are organized by product line with each line of business having responsibility for product development, product pricing, marketing, distribution and customer service within their particular markets. This structure recognizes that there are distinct marketplace dynamics in each of the three major product lines. Management believes this structure enables each line of business to develop strategies to achieve the enterprise-wide objectives of business growth and expense management while recognizing the unique business environment in which each operates. The lines of business are supported by corporate units that provide administrative and technology services to the lines of business, manage invested assets, and oversee enterprise risk management policies.

Based on general fund and segregated fund assets, Empire Life is among the 10 largest life insurance companies in Canada. Empire Life has approximately 7% market share of Segregated Funds, 1% market share for employee benefits and 3% market share for new life insurance premiums. To be priced competitively in the marketplace while simultaneously providing acceptable long-term financial contribution to shareholders, Empire Life, as a mid-sized company, must find a way to continue to be cost competitive with the larger companies that have some natural economy of scale advantages. In order to improve its unit expenses, management's enterprise-wide strategic focus has been on achieving profitable growth in its selected markets and on expense management. Empire Life has focused exclusively on the Canadian marketplace and, within it, on particular market segments where management feels there are opportunities to build solid, long-term relationships with its distribution partners by offering competitive products and more personal service. By focusing on particular market segments and by being seen by these independent advisors as a viable alternative to broadly focused competitors, management believes these solid relationships will enable profitable growth.

The Wealth Management product line at Empire Life is comprised of segregated fund products, guaranteed interest products and mutual funds. These products compete against products offered by a variety of financial institutions. A key element of any competitive strategy in this market is providing a competitive rate of return to clients. The value-oriented equity investment strategy used by Empire Life has focused on developing long-term performance in the fund marketplace. Management will continue to improve competitiveness by focusing on long-term performance, providing low cost products to customers along with broadened

distribution reach. Empire Life continued to achieve strong growth in assets under management from its segregated fund business as a result of net new sales and equity market appreciation. Empire Life is continuing to monitor and manage GMWB risk exposure and the competitive landscape for this product. The fourth quarter 2017 Empire Life launched a new version of its GMWB product which is more capital efficient and reduces the amount of risk to Empire Life while still offering a competitive guaranteed income solution to customers at lower fees.

Within the broader employee benefits marketplace in Canada, Empire Life continues to focus on the small group employer market with fewer than 200 employees representing the majority of Canadian companies. This niche strategy coupled with an ongoing focus on balancing growth and profit has enabled Empire Life to be cost competitive within this market segment and is expected to enable this product line to grow its market share while generating acceptable returns.

Individual Insurance products are very long-term in nature and consequently can be subject to new business strain. New business strain occurs when the provision for adverse deviation included in the actuarial policy liabilities exceeds the profit margin in the product pricing. At current reinsurance price levels in the Canadian market place, a company may reduce new business strain and improve profitability in the short term by opting to increase the amount of insurance risk reinsured to third parties. Mortality trends continue to be favourable for life insurance products. Rather than give up the future earnings that would emerge if the trend in mortality improvement witnessed in recent decades continues, Empire Life continues to utilize lower than average levels of reinsurance with the resultant negative impact on short-term earnings. Low long-term interest rates continue to have an unfavourable impact on this product line. In the past few years, industry prices for longer term life insurance products have increased. Empire Life has also increased prices for these products and has focused its growth efforts on shorter term products, such as 10 year renewable term life insurance. Because of the reasonable long-term returns of this product line, management continues to focus on steady growth, technology development and process improvement in order to continue to have a cost structure that allows us to compete while generating an acceptable long-term financial contribution. Empire Life is continuously reviewing its Individual Insurance product mix to improve profitability, reduce interest rate risk, reduce required regulatory capital, develop web-based products and processes, and improve the customer and advisor experience.

### **Risk Management**

Empire Life is a financial institution offering Wealth Management, Employee Benefits and Individual Insurance products. Empire Life is exposed to a number of risks as a result of its business activities. The goal of Empire Life's risk management process is to ensure that the operations that expose it to risk are consistent with its strategy, business objectives and risk philosophy, while maintaining an appropriate risk/reward balance and enhancing stakeholder value. When making decisions about risk taking and risk management, Empire Life considers:

- The need to meet the expectations of its customers, shareholders and creditors and to protect the commitments that have been made to them;
- The need to be adequately compensated for the capital it deploys to support business activities and strategic objectives;
- The need to protect its brand; and
- The need to maintain its targeted financial strength rating.

Empire Life's risk appetite defines the aggregate level of risk Empire Life is willing to take to achieve its business strategies. The risk appetite supports the pursuit of shareholder value but does not compromise the Company's ability to pay claims and fulfill policyholder commitments.

Empire Life's risk management framework is structured based on a number of guiding principles:

- Due to the long term nature of the majority of its commitments, Empire Life accepts capital market risk provided it is managed within specific risk tolerances and limits. Empire Life takes a low-risk,

value-oriented approach to managing its investments - it accepts credit and alternative asset risk provided it is rewarded through appropriately enhanced returns;

- Empire Life manages liquidity across the business to provide a high level of confidence that all obligations (to customers, creditors and shareholders) will be met when they fall due;
- Empire Life accepts insurance risks provided they are properly priced and managed in order to deliver value to its customers and shareholders;
- Empire Life is forward-looking in its business planning and takes a prudent approach to capital management. It strives to have a high level of confidence that capital is sufficient to support planned future activities;
- Management is active in industry committees and, through a network of oversight functions, monitors the landscape so that Empire Life is appropriately positioned to manage regulatory, tax, accounting and actuarial changes;
- Empire Life accepts that operational risks are a part of doing business and knows that risk management is a key part of decision-making. It protects its business and customers by engaging in cost-effective risk mitigation; and
- Empire Life expects ethical conduct by all of its employees and it acts with integrity at all times.

The Board of Directors oversees and monitors Empire Life's risk management framework, processes and practices, and reviews and approves Empire Life's Enterprise Risk Management Framework and overall risk appetite. Senior management shares responsibility and accountability for risk management across the organization. This enables a cross-functional perspective on risk management, enhanced by the frequency of contact across the management team. Empire Life has an Asset Management Committee with responsibility for overseeing the management of corporate policies established by both the Investment Committee and Risk and Capital Committee of the Board. More information related to governance can be found under the Corporate Governance over Risk Management section of Empire Life's 2018 Annual Report. Risk management policy development is centralized under the leadership of the Chief Risk Officer and applies to all business units. The Chief Risk Officer is a member of the Asset Management Committee and has Board reporting responsibility with respect to risk and capital management. All risk management policies and procedures are regularly reviewed for relevance and changes in the risk environment. Accountability, application, day-to-day management and procedural elements are the responsibility of area management, supported by business unit compliance officers and the risk management department. There is senior management representation and oversight on various interdisciplinary risk control committees. Empire Life formally establishes and documents its values and risk tolerances through several company-wide policies including a code of business conduct, corporate disclosure principles, enterprise risk management, capital management and whistleblower policies. Empire Life's strategic risk management policies (including those related to product design and pricing, investment and capital management) are also approved by its Board, or a Board committee.

## Caution Related to Sensitivities

In the sections that follow, Empire Life provides sensitivities and risk exposure measures for certain risks. These include sensitivities due to specific changes in market prices and interest rates, based on market prices, interest rates, assets, liabilities and business mix in place as at the calculation dates. The sensitivities are calculated independently for each risk factor, assuming that all other risk variables remain constant. Actual results can differ materially from these estimates for a variety of reasons, including the interaction among these factors when more than one factor changes; changes in actuarial and investment return and future investment activity assumptions; actual experience differing from the assumptions; changes in business mix, effective tax rates and other market factors; and the general limitations of Empire Life's internal models used for purposes of these calculations. Changes due to new sales or maturities, asset purchases/sales, or other management actions could also result in material changes to these reported sensitivities. For these reasons, the sensitivities should only be viewed as directional estimates of the underlying sensitivities for the respective factors based on the assumptions outlined, and should not be viewed as predictors for Empire Life's future net income, OCI, and capital sensitivities. Given the nature of these calculations, Empire Life cannot provide assurance that actual impact will be consistent with the estimates provided. Changes in risk variables in excess of the ranges illustrated may result in other than proportionate impacts.

## Market Risk

Empire Life has equity market risk related to its segregated fund products and from equity assets backing life insurance liabilities. Empire Life has a semi-static hedging program. The hedging program may employ derivatives positions including put options and futures. The extent of derivatives used is monitored and managed on an ongoing basis, giving consideration to equity risk and the level of available capital.

There is income statement volatility from this hedging program. Based on current equity market levels, Empire Life has required capital for LICAT purposes and policy liabilities on the statement of financial position related to segregated fund guarantees. Therefore a by-product of hedging LICAT exposure is net income volatility, as the gains or losses from hedging instruments are not necessarily offset by changes in policy liabilities related to segregated fund guarantee risk. During the fourth quarter and for the year, Empire Life experienced a gain of \$6 million and \$2 million after tax respectively on its hedging program primarily due to declining Canadian stock indices. This compares to a hedging program cost of \$3 million and \$7 million respectively for the comparable period in 2017 primarily due to stable Canadian stock prices in 2017.

Empire Life's LICAT ratio is also sensitive to stock market volatility, due primarily to liability and capital requirements related to segregated fund guarantees. As of December 31, 2018, Empire Life had \$7.8 billion of segregated fund assets and liabilities. Of this amount, approximately \$7.5 billion have guarantees. The following table provides a percentage breakdown by type of guarantee:

	December 31 2018	December 31 2017
<b>Percentage of segregated fund liabilities with:</b>		
75% maturity guarantee and a 75% death benefit guarantee	3%	2%
75% maturity guarantee and a 100% death benefit guarantee	47%	48%
100% maturity and death benefit guarantee (with a minimum of 15 years between deposit and maturity date)	7%	7%
100% maturity and death benefit guarantee (GMWB)	43%	43%

All Empire Life segregated fund guarantees are policy-based (not deposit-based), thereby generally lowering Empire Life's stock market sensitivity relative to products with deposit-based guarantees. Policy-based guarantees consider all of the deposits in the customer's policy (whether the fund value is below or above the guaranteed amount) to arrive at an overall net guarantee payment, whereas deposit-based guarantees consider only the deposits where the fund value is below the guaranteed amount and ignore all the deposits in the customer's policy where the fund value is above the guaranteed amount. Therefore, policy-based guarantees generally pay less than deposit-based guarantees. For segregated fund guarantee insurance

contract liabilities, the level of sensitivity is highly dependent on the level of the stock market at the time of performing the estimate. If period-end stock markets are high relative to market levels at the time that segregated fund policies are issued, the sensitivity is reduced. If period-end stock markets are low relative to market levels at the time that segregated fund policies are issued, the sensitivity is increased.

The segregated fund regulatory capital and liability framework includes the use of "zero floors" (i.e., negative liability amounts are not permitted so zero is used instead, as described below) and other regulatory constraints, and this often makes the sensitivity impacts non-linear. The liabilities are the greater of: (i) the average of the amounts determined by averaging the results from adverse economic scenarios; and (ii) zero. Based on stock market levels at December 31, 2018 and December 31, 2017, the sensitivity of Empire Life shareholders' net income to changes in segregated fund guarantee insurance contract liabilities resulting from stock market increases and decreases is as follows:

<b>Sensitivity to segregated fund guarantees</b> <i>(millions of dollars after tax)</i>	<b>Increase</b>		<b>Decrease</b>		
	<b>20%</b>	<b>10%</b>	<b>10%</b>	<b>20%</b>	<b>30%</b>
<b>December 31, 2018 Shareholders' net income</b>	\$ 3	\$ 3	\$ (11)	\$ (129)	\$ (269)
December 31, 2017 Shareholders' net income	\$ nil	\$ nil	\$ nil	\$ (34)	\$ (160)

Empire Life's equity market sensitivity for segregated fund guarantees has increased primarily as a result of a positive liability position as of Q4 2018. The segregated fund guarantee liability became positive after an equity market decline in the fourth quarter. This increases net income sensitivity as any changes to the liability when it is above the zero floor will flow through net income.

As noted earlier, Empire Life also has equity market risk related to its equity assets backing life insurance liabilities. Based on stock market levels as at December 31, 2018 and December 31, 2017, the sensitivity of Empire Life shareholders' net income (including changes in segregated fund guarantee insurance contract liabilities) and capital ratio resulting from stock market increases and decreases is as follows (excluding the effect of Empire Life's equity risk hedging program):

<b>Excluding equity risk hedge</b> <i>(millions of dollars after tax)</i>	<b>Increase</b>		<b>Decrease</b>		
	<b>20%</b>	<b>10%</b>	<b>10%</b>	<b>20%</b>	<b>30%</b>
<b>December 31, 2018 Shareholders' net income</b>	\$ 41	\$ 21	\$ (25)	\$ (176)	\$ (387)
<b>December 31, 2018 LICAT total ratio</b>	10 %	9 %	(10) %	(16) %	(24) %

<b>Excluding equity risk hedge</b> <i>(millions of dollars after tax)</i>	<b>Increase</b>		<b>Decrease</b>		
	<b>20%</b>	<b>10%</b>	<b>10%</b>	<b>20%</b>	<b>30%</b>
December 31, 2017 Shareholders' net income	\$ 49	\$ 24	\$ (24)	\$ (83)	\$ (236)
December 31, 2017 MCSR ratio	(1) %	— %	(19) %	(43) %	(59) %

The equity risk hedging program provides some relief in adverse scenarios, but may incur losses in positive scenarios. The December 31, 2018 and December 31, 2017 amounts in the following table include the effect of Empire Life's equity risk hedging program (described above):

Including equity risk hedge (millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
December 31, 2018 Shareholders' net income	\$ 35	\$ 16	\$ (16)	\$ (150)	\$ (337)
December 31, 2018 LICAT total ratio	8 %	8 %	(9) %	(14) %	(21) %

Including equity risk hedge (millions of dollars after tax)	Increase		Decrease		
	20%	10%	10%	20%	30%
December 31, 2017 Shareholders' net income	\$ 48	\$ 24	\$ (22)	\$ (74)	\$ (210)
December 31, 2017 MCCSR ratio	(5) %	(2) %	(18) %	(39) %	(50) %

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

The amount at risk related to segregated fund maturity guarantees and segregated fund death benefit guarantees and the resulting policy liabilities and LICAT base solvency buffer for December 31, 2018 for Empire Life's segregated funds is provided in the following table:

Segregated Funds (millions of dollars)	Withdrawal Benefit > Fund Value		Maturity Guarantee > Fund Value		Death Benefit > Fund Value		Policy Liabilities	LICAT Capital
	Fund Value	Amount at Risk	Fund Value	Amount at Risk	Fund Value	Amount at Risk		
December 31, 2018	\$ 2,689	\$ 1,057	\$ 301	\$ 24	\$ 3,789	\$ 165	\$ 4	\$ 433
December 31, 2017	\$ 2,708	\$ 689	\$ 31	\$ 1	\$ 409	\$ 3	nil	\$ N/A

The first six columns of the above table show all segregated fund policies where the future withdrawal benefit, future maturity guarantee, or future death benefit guarantee is greater than the fund value. The amount at risk represents the excess of the future withdrawal benefit, future maturity guarantee or future death benefit guarantee amount over the fund value for these policies. The withdrawal benefit amounts in the above table relate to GMWB products. The GMWB withdrawal benefit amount at risk represents the amount that could be paid by Empire Life to GMWB policyholders if the net return on each GMWB policyholder's assets is zero for the remainder of each GMWB policyholder's life, based on life expectancy. As at December 31, 2018, the aggregate amount at risk for all three categories of risk was \$1,246 million. At December 31, 2017, the aggregate amount at risk for these three categories of risk was \$692 million. For these three categories of risk, the amount at risk is not currently payable. Payment is contingent on future outcomes, including fund performance, deaths, deposits, withdrawals and maturity dates.

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

In addition, Empire Life considers the sensitivity of its LICAT ratio to changes in market interest rates. The impact of an immediate 50 basis point decrease in interest rates and a 50 basis point decrease in assumed initial reinvestment rate ("IRR") for non-participating insurance business and segregated fund guarantees for December 31, 2018 and December 31, 2017, is shown in the table below. This assumes no change in the ultimate reinvestment rate ("URR"). The first column below excludes the impact of market value changes in AFS bonds. The AFS bonds provide a natural economic offset to the interest rate risk attributable to Empire

Life's product liabilities. The second column below shows the impact if the AFS bonds were sold to realize the gains from a 50 basis point decrease in interest rates.

<b>Sensitivity to market interest rates LICAT/MCCSR:</b>	<b>Before the sale of AFS assets</b>	<b>After the sale of AFS assets</b>
	<b>50bps decrease</b>	<b>50bps decrease</b>
<b>December 31, 2018 LICAT Total ratio</b>	<b>(5)%</b>	<b>(5)%</b>
December 31, 2017 MCCSR ratio	(23)%	(17)%

## **Operational Risk**

Operational risk relates to the uncertainty arising from larger than expected losses or damages as a result of inadequate or failed internal processes, people and systems, or from external events. Operational risk is naturally present in all of Empire Life's business activities and encompasses a broad range of risks, including legal disputes, regulatory compliance failures, technology failures, business interruption, information security and privacy breaches, human resources management failures, processing errors, modeling errors, theft and fraud, and damage to physical assets. The following is a further description of key operational risks and their associated risk management strategies.

### *(1) Legal and Regulatory Compliance Risk*

Empire Life is governed by the Insurance Companies Act and supervised by OSFI and is also subject to various requirements imposed by legislation and regulation in each of the provinces and territories of Canada applicable to insurance companies and companies providing other financial services. Material changes in the regulatory framework could have an adverse effect on Empire Life. Failure to comply with regulatory requirements or public expectations could adversely impact Empire Life's reputation and ability to conduct business. Empire Life is subject to litigation from time to time, in the normal course of business, and currently has a number of outstanding lawsuits. There can be no assurance that the present or any future litigation will not have a material adverse effect on Empire Life.

Empire Life's corporate compliance department, headed by the Chief Compliance Officer, oversees the regulatory compliance framework. This framework promotes risk-based management of regulatory compliance risk and includes company-wide policies, operating guidelines, programs to promote awareness of laws and regulations impacting Empire Life, ongoing monitoring of emerging legal issues and regulatory changes and employee education programs that include anti-money laundering and anti-terrorist financing, privacy and information security risk management as well as reporting breaches and Empire Life's code of business conduct. The framework is supported by a network of business unit compliance officers as well as the corporate legal services department. The Chief Compliance Officer reports regularly to the Conduct Review Committee of the Board on the state of compliance, key compliance risks and emerging regulatory trends. The General Counsel reports regularly to the Audit Committee of the Board on litigation activity.

### *(2) Model Risk*

Empire Life uses models to support many business functions including investment analysis, product development and pricing, valuation of policy liabilities, financial planning, asset/liability management, capital management, project management and risk management. The risk of inappropriate use or interpretation of Empire Life's models or their output, or the use of deficient models, data or assumptions could result in financial losses or inappropriate business decisions. Empire Life has developed management and mitigation processes related to model use and oversight of models to limit financial, operational and strategic impacts from an error or misinterpretation of model results. Senior management has overall responsibility and accountability for models in use to support activities within their business area. Management reports regularly to the Risk and Capital Committee of the Board on model use and related oversight activities.

### *(3) Human Resources Risk*

Competition for qualified employees, including executives, is intense both in the financial services industry and non-financial industries. If Empire Life is unable to retain and attract qualified employees and executives, the results of its operations and financial condition, including its competitive position, could be adversely affected. To mitigate this risk, Empire Life has a number of human resources policies, processes and practices in place. Management reports regularly to the Human Resources Committee of the Board on succession planning and employee development programs as well as compensation practices and programs, all of which are designed to attract, motivate and retain high-performing and high-potential employees.

### *(4) Third-Party Risk*

Empire Life obtains many different types of services from a number of third-party services providers and has outsourced certain business functions or processes to third parties. Should these third parties fail to deliver services in compliance with contractual or other service arrangements, Empire Life's business may be adversely impacted. To mitigate this risk, Empire Life has established a company-wide outsourcing risk management policy that provides guidance when considering, entering into or managing existing outsourcing arrangements commensurate with the risks associated with the service provider and the nature of the arrangement. Annually, management reports to the Conduct Review Committee of the Board on outsourcing activities including details on those arrangements deemed to be most material to Empire Life.

### *(5) Technology, Information Security and Business Continuity Risk*

Empire Life relies on technology in virtually all aspects of its business and operations including the creation and support of new products and services, and the nature of life insurance business necessitates a substantial investment in technology. Operational integrity, data integrity and security of information and systems infrastructure are all relied upon for normal business operations. Disruptions due to system failure, information security breaches, privacy breaches, cyber-attacks, human errors, natural disasters, criminal activity, fraud or the loss of certain software licensing agreements could have a material adverse impact on Empire Life.

Empire Life has an enterprise-wide business continuity and disaster recovery program overseen by the Business Continuity Planning Team and Senior Management. The program includes policies, plans and procedures designed so that, to the extent practically possible, key business functions can continue and normal operations can resume effectively and efficiently should a major disruption occur. Each business unit is accountable for preparing and maintaining detailed business continuity plans and processes. Empire Life establishes and regularly tests business continuity and disaster recovery plans and maintains off-site system facilities and other related services and failover capability designed to minimize downtime and accelerate system recovery.

Information security breaches, including various forms of cyber-attack, could occur and may result in inappropriate disclosure or use of personal or confidential information. To mitigate this risk, Empire Life has an information security program overseen by the Chief Technology Officer. This program consists of a number of standards, procedures and guidelines focused on protecting information and computer systems. An incident management process is in place for monitoring and managing security events.

Privacy breaches could occur and may result in unauthorized disclosure or use of private and confidential information. To manage this risk, Empire Life has a privacy program overseen by the Chief Privacy Officer. The program includes policies and standards, ongoing monitoring of emerging privacy legislation and a network of business unit privacy officers. Processes have been established to provide guidance to employees on the handling of personal information and the reporting of privacy incidents and issues to appropriate management for response and resolution. The Chief Privacy Officer reports regularly to the Conduct Review Committee of the Board on privacy and data security risks and emerging trends.

## Business and Strategic Risk

Business and strategic risk relates to the uncertainty in future earnings and capital related to the potential inability to implement appropriate business plans and strategies, make decisions, allocate resources, manage distribution or adapt to changes in business environment, such as the competitive landscape, regulatory and tax changes or changes in accounting and actuarial standards. Empire Life regularly reviews and adapts its business strategies and plans in consideration of changes in the external business environment, economic, political and regulatory environment. Empire Life's financial performance is dependent upon its ability to implement and execute business strategies and plans for growth.

Empire Life's business strategies and plans are designed to align with risk appetite, capital position and financial performance objectives. Empire Life periodically reassesses risk appetite taking into consideration the economic, regulatory and competitive environments in which it operates. The current environment requires Empire Life to adapt rapidly to new opportunities and challenges and to refine its strategies accordingly. If Empire Life fails to revise its strategies on a timely basis or adapt to the changing environment, it may not be able to achieve its growth objectives.

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

Successful execution of Empire Life's business strategies and plans depends on a number of factors including its ability to (i) generate sufficient earnings to maintain an adequate level of capital; (ii) generate sustained investment performance; (iii) meet regulatory requirements; (iv) manage risk exposures effectively; (v) attract and retain customers and distributors; (vi) have the right set of products; and (vii) reduce operating expenses while maintaining the ability to hire, retain and motivate key personnel. Empire Life's business and strategic plans are reviewed and discussed by its senior management team and are subject to approval by the Board of Directors, which also receives regular updates on implementation progress against key business plan objectives. The Board and its subcommittees receive regular updates on key risks.

In addition to the discussion of risks included in this MD&A, a comprehensive discussion of the material risks that impact Empire Life is included in Empire Life's Annual Information Form available at [www.sedar.com](http://www.sedar.com). Additional disclosures of Empire Life's sensitivity to risks are included in note 28 to the 2018 consolidated financial statements.

## Outlook

The Canadian economy performed largely as expected in 2018 with GDP growth estimated at 2% for the full year, the Canadian dollar remained relatively unchanged at 1.30 (annual average) per U.S. dollar and annual unemployment fell from 6.3% to 5.8%, the lowest it has been since the 1970's. Consumer spending has slowed down gradually throughout the year and business investment in machinery and equipment has slowed significantly after a strong first quarter in 2018. A number of uncertainties will continue in 2019 which may negatively impact the Canadian economy including Alberta's oil production cuts, slower global demand and GM's Oshawa plant closure, trade tensions, geopolitical concerns (e.g. North Korea, Iran, Brexit, Italy), Fed tightening.

The Bank of Canada raised rates three times during the year with the overnight rate up from 1.00% to 1.75%. The Canadian Federal Bond yield curve flattened with the 5-year increasing slightly from 1.86% to 1.88% in 2018 and the 30-year decreasing from 2.26% to 2.18% in 2018. Corporate and provincial bond spreads increased during 2018. Interest rates have generally been lower than typical levels for several years.

Global equity markets were weak in 2018 with the MSCI down over 10%, for the year. The S&P 500 stock index was down 6.2% and the S&P/TSX composite index was down 11.6% for the year. Stock market

conditions impact the in-force profit margins and new business growth for the segregated fund and mutual fund portions of Empire Life's Wealth Management product line.

Looking forward to 2019, the global economy is expected to have a moderate growth. The Canadian economy is expected to continue to grow at a slower pace than in 2018 with forecast GDP of 1.8% slightly below the estimated 2% in 2018. The western provinces are expected to continue to grow at about 2.5% with British Columbia benefiting from the LNG project. Provinces in central Canada are expected to experience slower growth with oil production cuts and pull back on capital spending plans. The Atlantic Provinces are expected to grow at a more moderate pace of about 1%. Short-term interest rates are expected to continue to rise in the U.S. as well as in Canada but much slower pace and likely in the second half of the year. Overall the Canadian economy is well positioned to support continued growth of all Empire Life's product lines.

The individual insurance market grew modestly in 2018 even with the challenge of the persistent low long-term interest rate environment that followed the financial crisis. Empire Life has decreased its emphasis on long-term life insurance products in favor of shorter term products, such as 10 year renewable term life insurance. Long-term interest rates, product mix and product pricing are expected to continue to be challenges for Empire Life's Individual Insurance product line in 2019. The segregated fund product line saw a decline after experiencing a strong growth in 2017; fees will likely be impacted by competition going forward. Empire Life will continue to develop low cost efficient products delivered digitally to satisfy consumer needs. Within the employee benefits product line, although highly concentrated Empire Life will continue to penetrate its niche market to grow the business.

As noted under the Regulatory Capital section, OSFI implemented its LICAT Guidelines on January 1, 2018. This new Guideline established a new risk based regulatory capital framework for life insurance companies and replaced the previous MCCSR Guideline. LICAT is intended to improve the quality of capital available and provide a better alignment of risk measures with the long-term economics of the insurance business. This new Guideline was developed in consultation with the Life Insurance Industry and OSFI. OSFI is also reviewing the overall approach for determining capital requirements for segregated fund guarantee risks. Changes to the capital required for products with guaranteed income may ultimately impact the industry's ability to offer these products at reasonable prices to the consumer. OSFI has indicated that the effective date for the Guideline for segregated fund guarantee will be implemented at the same time as IFRS 17. OSFI is continuing to review the application of Non-Viable Contingent Capital ("NVCC") for life insurance companies. If NVCC applied, new preferred shares and subordinated debentures issued after the transition date would have to be compliant with the new regime to qualify as capital.

The IASB issued IFRS 17, Accounting Standards for Insurance Contracts, in May 2017. IFRS 17 will include fundamental changes from the CALM method (equivalent to IFRS 4 Insurance Contracts) that Empire Life currently applies for the valuation of insurance contracts and revenue recognition. The IASB has also granted a temporary exemption from the application of IFRS 9 Financial Instruments to allow insurance companies the ability to implement both IFRS 17 and IFRS 9 concurrently. IFRS 9 applies to the measurement of financial assets, the expected credit loss model and hedge accounting. For insurance contracts and financial instruments accounting, the goal is global consistency under IFRS as opposed to the differing approaches in each country that exist today. Preparing for the adoption of IFRS 17 and IFRS 9 is a significant initiative for Empire Life and for the industry. Empire Life is currently assessing the impact that IFRS 17 and IFRS 9 will have on Empire Life's consolidated financial statements as well as developing a plan to implement the changes required to be ready to report under the new standards when they take effect.

The Canadian Securities Administrators ("CSA") has increased disclosure requirements for mutual fund companies, including point of sale requirements and customer relationship model initiatives. Mutual fund fees continue to be an area of interest for Canadian securities regulators. The CSA commissioned independent third-party research that will assess the impact of commissions and embedded (trailer) fees on mutual fund flows. This research will support CSA policy decisions concerning Canada's current mutual fund

fee structure. Empire Life continues to monitor these developments and assess the possible impact to the insurance industry at some future date.

The industry is also improving the oversight of MGAs and their advisors. Life insurance companies, including Empire Life, commonly contract with MGAs as a key component of the distribution chain for insurance and wealth management products. In 2013, the Canadian Life and Health Insurance Association ("CLHIA") developed a new Insurer-MGA Relationship guideline (effective January 1, 2015). The Guideline describes desired outcomes and related practices in five general areas, including, perform due diligence prior to entering into a contract with an MGA, clearly set out roles and responsibilities in the contract, commit to a culture of treating customers fairly, monitor the performance of the MGA and retain ultimate responsibility. The industry is also considering establishing a licensing regime for all distribution firms. The licensing of distribution firms would clarify the accountability for the distribution partners to adhere to the insurer's code of conduct and provide on-going monitoring of the advisors activities.

Government pension reform including the Federal Pooled Registration Pension Plan program and the proposed Ontario Registered Pension Plan are expected to reduce future demand for private sector retirement savings products, having an adverse impact on banks, mutual fund companies, life insurance companies and advisors.

In 2016 changes were made to the tax rules that deal with the exemption status of certain life insurance policies effective on January 1, 2017. The exemption test is aimed at distinguishing between (and tax differently) policies that are designed as protection versus those that are designed primarily as investments. The new exempt test represents a significant change to the tax regime that existed over the past 30 years. These changes required all life insurance companies to review the design and the pricing of their life insurance product offerings. Empire Life either modified or withdrew certain product offerings to comply with the new tax rules.