

## **REPORT ON E-L FINANCIAL CORPORATION LIMITED**

---

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, 2020 and 2019 for E-L Financial Corporation Limited ("E-L Financial" or the "Company"). This MD&A should be read in conjunction with the December 31, 2020 year end consolidated financial statements and the notes, which form part of the E-L Financial Corporation Limited 2020 Annual Report dated March 3, 2021. 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 this MD&A may differ or not sum 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 weighted 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 risk including equity risk, hedging risk, interest rate risk, foreign exchange rate risk; liquidity risk; credit risk including counterparty risk; insurance risk including mortality risk, policyholder behaviour risk, expense risk, morbidity risk, product design and pricing risk, underwriting and claims risk, reinsurance risk; operational risk, including legal and regulatory risk, model risk, human resources risk, third party risk, technology, information security and business continuity risk; and business risk and strategic, including risk with respect to competition, risk with respect to financial strength, capital adequacy risk, risk with respect to distribution channels, risk with respect to changes to applicable income tax legislation, risk with respect to litigation, risk with respect to reputation, risk with respect to risk management policies, risk with respect to intellectual property, risk 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 8. 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 10.

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. Quarterly and year to date returns are calculated on an annualized basis.

Sources of earnings breaks down Empire Life's 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 20 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>2020</b>      | <b>2019</b>      |
|--------------------------------------|------------------|------------------|
| General fund assets                  | \$ 10,259        | \$ 9,462         |
| Segregated fund assets               | <b>8,457</b>     | 8,499            |
| Total Empire Life assets             | <b>18,716</b>    | 17,961           |
| Mutual fund assets                   | <b>120</b>       | 139              |
| <b>Total assets under management</b> | <b>\$ 18,836</b> | <b>\$ 18,100</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 include 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 52.7% 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 includes a 37.4% interest in Algoma Central Corporation ("Algoma") and a 24.1% interest in Economic Investment Trust Limited ("Economic"). Algoma and Economic are accounted for using the equity method.

The Company's investment in Empire Life (99.4% 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<br>(millions of dollars) | Fourth quarter |               | Year          |               |
|---|----------------|---------------|---------------|---------------|
|   | 2020           | 2019          | 2020          | 2019          |
| <b>Contribution to net income</b>                   |                |               |               |               |
| E-L Corporate <sup>(1)</sup>                        | \$ 438         | \$ 217        | \$ 361        | \$ 572        |
| Empire Life <sup>(2)</sup>                          | 72             | 76            | 139           | 173           |
| <b>Net income</b>                                   | <b>510</b>     | <b>293</b>    | <b>500</b>    | <b>745</b>    |
| Other comprehensive income (loss) <sup>(2)</sup>    | 1              | (14)          | 32            | 41            |
| <b>Comprehensive income</b>                         | <b>\$ 511</b>  | <b>\$ 279</b> | <b>\$ 532</b> | <b>\$ 786</b> |

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

| E-L Corporate<br>(millions of dollars)                         | Fourth quarter |               | Year          |               |
|--|----------------|---------------|---------------|---------------|
|  | 2020           | 2019          | 2020          | 2019          |
| Revenue  |                |               |               |               |
| Net gain on investments <sup>(3)</sup>                         | \$ 527         | \$ 271        | \$ 453        | \$ 646        |
| Investment and other income                                    | 34             | 27            | 130           | 145           |
| Share of associates income (loss)                              | 27             | 10            | (29)          | 24            |
|  | <b>588</b>     | <b>308</b>    | <b>554</b>    | <b>815</b>    |
| Operating expenses   | 12             | 10            | 42            | 37            |
| Income taxes   | 71             | 40            | 66            | 107           |
| Non-controlling interests                                      | 67             | 41            | 85            | 99            |
|  | <b>150</b>     | <b>91</b>     | <b>193</b>    | <b>243</b>    |
| <b>Net income</b>  | <b>438</b>     | <b>217</b>    | <b>361</b>    | <b>572</b>    |
| Other comprehensive (loss) income, net of taxes <sup>(1)</sup> | (3)            | 2             | (8)           | (6)           |
| <b>Comprehensive income</b>                                    | <b>\$ 435</b>  | <b>\$ 219</b> | <b>\$ 353</b> | <b>\$ 566</b> |

| <b>Empire Life</b><br><i>(millions of dollars)</i>             | <b>Fourth quarter</b> |              | <b>Year</b>   |               |
|--|-----------------------|--------------|---------------|---------------|
|  | <b>2020</b>           | <b>2019</b>  | <b>2020</b>   | <b>2019</b>   |
| Revenue  |                       |              |               |               |
| Net premiums   | \$ 221                | \$ 229       | \$ 860        | \$ 910        |
| Net gain (loss) on investments <sup>(3)</sup>                  | 102                   | (131)        | 541           | 618           |
| Investment income  | 86                    | 85           | 330           | 325           |
| Fee income   | 66                    | 66           | 251           | 262           |
|  | <b>475</b>            | <b>249</b>   | <b>1,982</b>  | <b>2,115</b>  |
| Benefits and expenses  | 363                   | 122          | 1,762         | 1,847         |
| Income and other taxes   | 31                    | 39           | 63            | 77            |
| Non-controlling and participating policyholders' interests     | 9                     | 12           | 18            | 18            |
|  | <b>403</b>            | <b>173</b>   | <b>1,843</b>  | <b>1,942</b>  |
| <b>Net income</b>  | <b>72</b>             | <b>76</b>    | <b>139</b>    | <b>173</b>    |
| Other comprehensive income (loss), net of taxes <sup>(2)</sup> | 4                     | (16)         | 40            | 47            |
| <b>Comprehensive income</b>                                    | <b>\$ 76</b>          | <b>\$ 60</b> | <b>\$ 179</b> | <b>\$ 220</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 in fair value through profit and loss ("FVTPL") investments and realized gain on available for sale ("AFS") investments

E-L Financial reported a consolidated 2020 net income of \$500 million or \$128.21 per common share compared to \$745 million or \$185.67 per common share in 2019. Despite the international emergence and spread of COVID-19 and the associated declines in global stock markets in the earlier part of 2020, the Company reported strong results in the business segments for the year.

E-L Corporate reported a net income of \$361 million for the year ended December 31, 2020 compared to net income of \$572 million in 2019. The decrease in earnings was primarily due to lower net gains on investments of \$453 million in 2020 compared to \$646 million in 2019. E-L Corporate's global investment portfolio had a pre-tax total return, including dividend income, of 10% in 2020 compared to a pre-tax total return of 17% in the prior year.

Empire Life reported net income of \$139 million in 2020 compared to \$173 million in 2019. The decrease in earnings from 2019 was due, in part, to a large one-time gain recognized in 2019 related to a reinsurance recapture initiative. In 2020, earnings from the Wealth Management line were lower due to reserve strengthening and assumption updates in the Wealth Management line, resulting from poor market returns earlier in the year. This was partially offset by increased earnings from the Individual Insurance line primarily as a result of asset trading gains from continued improvements in the Company's matching of assets and liabilities.

Consolidated comprehensive income for 2020 was \$532 million or \$136.75 per common share compared to \$786 million or \$196.32 per common share in 2019. Other comprehensive income ("OCI") was \$32 million in 2020 compared to \$41 million in 2019. The decrease in OCI relative to 2019 was primarily due to a higher loss from the re-measurement of post-employment liabilities partially offset by higher unrealized fair value gains on AFS assets in 2020 relative to 2019.

### **Normal course issuer bid**

On March 9, 2020, the Company obtained approval from the TSX to commence a normal course issuer bid ("NCIB") to purchase up to 200,970 Common Shares between March 9, 2020 and March 8, 2021. Daily purchases (other than pursuant to a block purchase exemption) on the TSX under the NCIB are limited to 1,000 Common Shares. The price that the Company pays for the Common Shares is the prevailing market price at the time of acquisition.

During the second quarter of 2020 the Company had purchased the maximum permitted shares under the NCIB totaling 200,970 Common Shares. The total consideration paid for the shares acquired was \$120 million with an average price of \$599.18 per share.

### Senior unsecured notes

In the second quarter of 2020, the Company issued \$200 million principal amount of 4.0% senior unsecured notes. The notes mature on June 22, 2050 and bear interest at an annual rate of 4.0% calculated and payable semi-annually in arrears on June 22 and December 22 of each year commencing December 22, 2020 and ending June 22, 2050.

### Substantial issuer bid

On November 9, 2020 the Company announced its intention to commence a substantial issuer bid ("SIB") pursuant to which the Company offered to purchase up to \$100 million of its outstanding Common Shares for cash. The SIB proceeded by way of a "modified Dutch auction".

As of December 17, 2020 the Company had taken up and paid for 109,863 Common Shares (the "Shares") at a price of \$750.00 per share. The Shares purchased under the SIB represent an aggregate purchase price of approximately \$82 million and represented 2.9% of the total number of the Company's issued and outstanding Common Shares at the expiry date of the SIB. After giving effect to the SIB, the Company had 3,708,576 Common Shares issued and outstanding.

### 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>2020</b>        | 2019        |
|--|--------------------|-------------|
| E-L Financial shareholders' equity                                   | \$ <b>6,474</b>    | \$ 6,275    |
| Less: First preference shares  | <b>(300)</b>       | (300)       |
|  | <b>6,174</b>       | 5,975       |
| Adjustments for investments in associates not carried at fair value: |                    |             |
| Carrying value   | <b>(245)</b>       | (332)       |
| Fair value <sup>(1)</sup>  | <b>344</b>         | 331         |
|  | <b>99</b>          | (1)         |
| Non-controlling interest and deferred tax                            | <b>(23)</b>        | —           |
|  | <b>76</b>          | (1)         |
| Net equity value   | <b>\$ 6,250</b>    | \$ 5,974    |
| Common Shares <sup>(2)</sup> outstanding at year end                 | <b>3,708,834</b>   | 4,019,667   |
| <b>Net equity value per common share<sup>(2) (3)</sup></b>           | <b>\$ 1,684.93</b> | \$ 1,486.19 |

<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

The Common Shares outstanding for 2020 are lower compared to the prior year amounts due to shares acquired as part of the Company's SIB and NCIB.

### 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* |
|--------|-------------------|---------|
|        | \$                | %       |
| 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)   |
| 2019   | 1,486.19          | 15.1    |
| 2020   | 1,684.93          | 15.4    |

#### Compounded annual growth in net equity value\*

|                               |      |
|-------------------------------|------|
| 2011 - 2020 - 10 years        | 9.3  |
| 1969 - 2020 - Since inception | 12.8 |

\* 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> | 2020      |          |           |             | 2019     |          |         |          |
|--|-----------|----------|-----------|-------------|----------|----------|---------|----------|
|  | Q4        | Q3       | Q2        | Q1          | Q4       | Q3       | Q2      | Q1       |
| Revenue  |           |          |           |             |          |          |         |          |
| Net gain (loss) on investments <sup>(1)</sup>          | \$ 629    | \$ 221   | \$ 1,273  | \$ (1,129)  | \$ 139   | \$ 163   | \$ 209  | \$ 753   |
| Net premium income                                     | 221       | 221      | 202       | 216         | 229      | 218      | 225     | 238      |
| Investment and other income                            | 185       | 173      | 177       | 176         | 178      | 186      | 200     | 168      |
| Associates <sup>(2)</sup>                              | 28        | 6        | 29        | (92)        | 10       | 4        | 7       | 3        |
| Total  | \$ 1,063  | \$ 621   | \$ 1,681  | \$ (829)    | \$ 556   | \$ 571   | \$ 641  | \$ 1,162 |
| Net income (loss) <sup>(3)</sup>                       | \$ 510    | \$ 201   | \$ 452    | \$ (663)    | \$ 293   | \$ 101   | \$ 42   | \$ 309   |
| Earnings (loss) per common share                       |           |          |           |             |          |          |         |          |
| - basic  | \$ 136.42 | \$ 52.88 | \$ 119.36 | \$ (170.26) | \$ 73.68 | \$ 24.61 | \$ 9.70 | \$ 77.68 |
| - diluted  | \$ 124.11 | \$ 48.71 | \$ 108.83 | \$ (170.26) | \$ 67.58 | \$ 23.26 | \$ 9.70 | \$ 71.45 |

<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 2020 increased compared to the prior quarter and fourth quarter of 2019, with the fluctuation mainly due to the impact of net investment gains. The fair value change in FVTPL investments increased in the fourth quarter of 2020, reflecting strong equity markets experience during the quarter.

Net premiums for the fourth quarter of 2020 were consistent with the prior quarter but lower relative to the fourth quarter of 2019. The decrease from the prior year is due to lower sales of fixed annuity products in the Wealth Management line partially offset by higher net premiums in the Individual Insurance line, resulting from strong sales of Empire Life's term life products.

#### Fourth quarter results

E-L Financial reported a consolidated net income of \$510 million or \$136.42 per common share for the fourth quarter of 2020 compared to \$293 million or \$73.68 per common share in 2019.

The increase in net income for the fourth quarter of 2020 is primarily due to a net gain on investments within the E-L Corporate segment of \$527 million compared to \$271 million in 2019 reflecting the strong global equity experience during the fourth quarter of 2020. The pre-tax total return on E-L Corporate's global investment portfolio for the fourth quarter of 2020 was 10% compared to 7% in the prior year.

Empire Life reported net income of \$72 million for the fourth quarter of 2020 compared to \$76 million for the fourth quarter of 2019.

Consolidated comprehensive income for the fourth quarter of 2020 was \$511 million or \$136.75 per common share compared to \$279 million or \$70.01 per common share for the fourth quarter of 2019. OCI for the fourth quarter of 2020 was \$1 million compared to other comprehensive loss ("OCL") of \$14 million in 2019. OCI increased in the fourth quarter of 2020, primarily due to unrealized fair value gains on AFS investments compared to unrealized fair value losses on these assets in 2019. The 2019 losses were partially offset by a gain on re-measurement of post-employment benefit liabilities in the fourth quarter of the year.

#### Liquidity and cash flows

##### Consolidated cash flows

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

| Year ended December 31<br>(millions of dollars)     | E-L Financial<br>(non-<br>consolidated) | United | Empire Life | Consolidation<br>adjustments | E-L Financial Consolidated |        |
|---|---|--------|-------------|------------------------------|----------------------------|--------|
|   |   |        |             |                              | 2020                       | 2019   |
| Cash flows from:                                    |   |        |             |                              |                            |        |
| Operating activities                                | \$ 247                                  | \$ 16  | \$ 273      | \$ (207)                     | \$ 329                     | \$ 417 |
| Financing activities                                | (199)                                   | (36)   | (205)       | 196                          | (244)                      | (101)  |
| Investing activities                                | (2)                                     | 50     | (19)        | 11                           | 40                         | (346)  |
| Increase (decrease) in cash and<br>cash equivalents | 46                                      | 30     | 49          | —                            | 125                        | (30)   |
| Cash and cash equivalents,<br>beginning of the year | 125                                     | 38     | 140         | —                            | 303                        | 333    |
| Cash and cash equivalents, end of<br>the year       | \$ 171                                  | \$ 68  | \$ 189      | \$ —                         | \$ 428                     | \$ 303 |

The decrease in cash provided from operating activities in 2020 relative to 2019, reflects the decrease in cash earnings during 2020 compared to the prior year, along with changes in working capital levels.

The increase in cash used for financing activities in 2020 relative to 2019 was due to the payment of a special cash dividend of \$25.00 per common share in the second quarter of 2020, purchases of the Company's Common Shares under the NCIB and SIB, a \$60 million repayment of the margin loan, and partly offset by the issuance of 30 year, 4% senior unsecured notes.

Cash used for investing activities declined in 2020 relative to 2019. In 2019 Empire Life deployed excess cash into higher yielding investments in order to enhance investment income.

*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>2020</b>   | 2019   |
|--|---------------|--------|
| Cash flows from:                                 |               |        |
| Operating activities                             |               |        |
| Dividends from subsidiaries                      | \$ 190        | \$ 83  |
| Dividends and interest                           | 86            | 93     |
| Expenses and taxes, net of other income          | (29)          | (26)   |
|  | <b>247</b>    | 150    |
| Financing activities                             |               |        |
| Cash dividends                                   | (133)         | (36)   |
| Share purchases                                  | (203)         | —      |
| Issuance of 4% unsecured notes                   | 198           | —      |
| Repayment of margin loan                         | (60)          | (25)   |
| Interest paid on borrowings                      | (1)           | (2)    |
| Purchases of subsidiary shares                   | —             | (1)    |
|  | <b>(199)</b>  | (64)   |
| Investing activities                             |               |        |
| Purchases of investments                         | (458)         | (812)  |
| Proceeds from sales of investments               | 434           | 774    |
| Net sales of short-term investments              | 13            | (13)   |
| Dividends from associates                        | 9             | 15     |
|  | <b>(2)</b>    | (36)   |
| Increase in cash and cash equivalents            | <b>46</b>     | 50     |
| Cash and cash equivalents, beginning of the year | <b>125</b>    | 75     |
| Cash and cash equivalents, end of the year       | <b>\$ 171</b> | \$ 125 |

During 2020, the non-consolidated cash and cash equivalents of E-L Financial increased by \$46 million.

Operating cash flows for 2020 increased compared with the prior period due to an additional dividend received from Empire Life in 2020. The movement in financing cash flows are due to the reasons noted above.

Investment activities in 2019 showed increased investment trading activity compared to 2020 as E-L Financial repositioned the assets managed by one of the global investment managers resulting in higher investment portfolio turnover during that period. As well, dividends received from associates in 2019 included a special dividend paid by Algoma.

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, 2020, consisted of the Company's shareholders' equity of \$6,474 million, non-controlling interests in subsidiaries of \$1,132 million and participating policyholders' interests of \$44 million.

In the normal course of business, the Company is obligated to fund investment commitments which are not recognized in the consolidated financial statements. As of December 31, 2020, E-L Corporate has \$144,321 (2019 - \$86,401) in unfunded commitments for units in limited partnerships.

## Selected annual information

| (millions of dollars, except per share amounts) | 2020      | 2019      | 2018      |
|---|-----------|-----------|-----------|
| <b>Revenue</b>                                  | \$ 2,536  | \$ 2,930  | \$ 1,077  |
| <b>Shareholder net income (loss)</b>            |           |           |           |
| E-L Corporate                                   | \$ 361    | \$ 572    | \$ (105)  |
| Empire Life                                     | 139       | 173       | 136       |
| Total   | \$ 500    | \$ 745    | \$ 31     |
| <b>Earnings per share</b>                       |           |           |           |
| - basic   | \$ 128.21 | \$ 185.67 | \$ 3.96   |
| - diluted                                       | \$ 119.68 | \$ 171.64 | \$ 3.96   |
| <b>Assets</b>                                   |           |           |           |
| E-L Corporate                                   | \$ 6,229  | \$ 5,788  | \$ 5,077  |
| Empire Life                                     | 18,716    | 17,961    | 16,270    |
| Total assets                                    | \$ 24,945 | \$ 23,749 | \$ 21,347 |
| <b>Non-current financial liabilities</b>        |           |           |           |
| E-L Corporate - Senior unsecured notes          | \$ 198    | \$ —      | \$ —      |
| Empire Life - Subordinated debt                 | 399       | 399       | 399       |
| Total non-current financial liabilities         | \$ 597    | \$ 399    | \$ 399    |
| <b>Cash dividends declared per share</b>        |           |           |           |
| First Preference Shares, Series 1               | \$ 1.3250 | \$ 1.3250 | \$ 1.3250 |
| First Preference Shares, Series 2               | \$ 1.1875 | \$ 1.1875 | \$ 1.1875 |
| First Preference Shares, Series 3               | \$ 1.3750 | \$ 1.3750 | \$ 1.3750 |
| Common Shares                                   | \$ 30.00  | \$ 5.00   | \$ 5.00   |

Revenues and net income over the period have been significantly impacted by fluctuations in the global stock markets. In 2020 E-L Corporate reported a net gain on investments of \$453 million compared to \$646 million in 2019. E-L Corporate's global investment portfolio had a pre-tax total return of negative 10% in 2020 compared to a pre-tax total return of positive 17% in the prior year. In 2018 E-L Corporate reported a net loss on investments of \$206 million with pre-tax total return of negative 2%. 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.

Assets have increased over the three year period, which is mainly due to the growth in investment portfolios.

In 2020 Common Share dividends were \$30.00 per share, representing a quarterly dividend of \$1.25 and an additional special cash dividend of \$25.00 per common share declared in the second quarter of 2020. In 2019 and 2018 Common Share dividends remained constant at \$5.00 per common share.

### 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                     | 3,708,576              |

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, 2020. Based on that evaluation, management concluded that the Company's disclosure controls and procedures were effective as at December 31, 2020.

### 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, 2020. Based on that evaluation, management concluded that the Company's internal control over financial reporting was effective as at December 31, 2020. No changes were made in the Company's internal control over financial reporting during the year ended December 31, 2020, 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

#### 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 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 solutions for insurance companies relating to IFRS 9:

- 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, 2023, which allows continued application of IAS 39 instead of adopting IFRS 9, if the Company's activities are 'predominantly connected 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 Note 4 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, 2020 and December 31, 2019 include mortgages with fair values of \$13,200 and \$10,400, 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 on its consolidated financial statements.

### *IFRS 17 Insurance Contracts*

The IASB issued the final IFRS 17 Standard on June 25 2020. IFRS 17 provides a comprehensive principle-based framework for the recognition, measurement, presentation and disclosures of all insurance contracts.

The new standard will replace IFRS 4 Insurance contracts. IFRS 17 requires entities to measure insurance contract liabilities at their current fulfillment cash flows and for revenue to be recognized as the service is provided over the coverage period. This new standard is required to be adopted retrospectively, if this is impracticable, the modified retrospective or fair value method may be used.

The effective dates for IFRS 17 and IFRS 9 have been deferred to annual reporting periods beginning on or after January 1, 2023. The Company is currently assessing the impact of adopting this standard on its consolidated financial statements.

### **Novel Coronavirus (or COVID-19)**

The continued worldwide spread of novel coronavirus (or COVID-19) continues to impact international business operations, supply chains, travel, commodity prices, consumer confidence and business forecasts. This has created increased uncertainty and volatility which will impact the performance and expected returns of the investment portfolios.

The Company continues to adjust operations as government restrictions and measures evolve. As the impacts of the COVID-19 pandemic continue to materialize, management is monitoring the developments in equity markets generally, and in connection with the Company's investment portfolios in particular.

To date, the Company has taken proactive measures through business continuity plans, carefully planning the return to premises for some employees. Processes supporting ongoing systems availability, stability and security are operating effectively and the Company continues to monitor the threat landscape.

The duration and impacts of the COVID-19 outbreak cannot currently be determined. If the COVID-19 pandemic is prolonged, or further diseases emerge that give rise to similar effects, there may be further negative effects on economies as well as increased volatility in equity markets. Unexpected developments in financial markets, regulatory environments, may also have adverse impacts on the Company's financial results.

### **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, 2020, investments - corporate had aggregate investments of \$5.7 billion, comprised primarily of common shares and units of investment funds, compared to aggregate investments at December 31, 2019 of \$5.3 billion. The fair value of investments - corporate is summarized in the table below:

| <i>(millions of dollars)</i> | <b>2020</b>     | <b>2019</b>     |
|------------------------------|-----------------|-----------------|
| Short-term investments       | \$ —            | \$ 13           |
| Preferred shares             | 1               | 1               |
| Common shares and units      |                 |                 |
| Canada and U.S.              | 3,491           | 3,107           |
| Europe and United Kingdom    | 1,171           | 1,158           |
| Emerging Markets             | 501             | 454             |
| Japan                        | 488             | 468             |
| Other                        | 37              | 69              |
| Total                        | <b>5,688</b>    | 5,256           |
| <b>Total invested assets</b> | <b>\$ 5,689</b> | <b>\$ 5,270</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>2020</b>           | 2019   | <b>2020</b>   | 2019   |
| Revenue                           |                       |        |               |        |
| Net gain on investments           | \$ 527                | \$ 271 | \$ 453        | \$ 646 |
| Investment and other income       | 34                    | 27     | 130           | 145    |
| Share of associates income (loss) | 27                    | 10     | (29)          | 24     |
|                                   | <b>588</b>            | 308    | <b>554</b>    | 815    |
| Operating expenses                | 12                    | 10     | 42            | 37     |
| Income taxes                      | 71                    | 40     | 66            | 107    |
| Non-controlling interests         | 67                    | 41     | 85            | 99     |
|                                   | <b>150</b>            | 91     | <b>193</b>    | 243    |
| <b>Net income</b>                 | <b>438</b>            | 217    | <b>361</b>    | 572    |
| (OCL) OCI, net of taxes           | (3)                   | 2      | (8)           | (6)    |
| <b>Comprehensive income</b>       | <b>\$ 435</b>         | \$ 219 | <b>\$ 353</b> | \$ 566 |

E-L Corporate reported net income of \$438 million in the fourth quarter of 2020 compared to \$217 million in 2019. For the fourth quarter of 2020 there was a net gain on investments of \$527 million compared to \$271 million in 2019. The pre-tax total return on investments was 10% for the fourth quarter of 2020 compared to 7% in 2019.

For the year ended December 31, 2020, E-L Corporate had a net gain on investments of \$453 million compared to \$646 million in 2019. The international emergence and spread of COVID-19 in 2020 negatively impacted global stock markets in the earlier part of 2020. Despite these events the Company's year to date pre-tax total return on investments including dividend income was 10% compared to 17% in the prior year. For the year ended December 31, 2020 the portfolio earned investment returns of 15% in Canada and the U.S., 8% in Europe and 11% in other geographic regions, which includes investments in Japan and emerging markets.

E-L Corporate's investment and other income decreased by \$15 million on year-to-date basis. This decline is primarily attributable to the impact of lower foreign dividends as certain companies within the investment portfolio have suspended or reduced dividends during the year.

### Share of associates income

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

| <i>(millions of dollars)</i> | Fourth quarter |       | Year <sup>(1)</sup> |       |
|------------------------------|----------------|-------|---------------------|-------|
|                              | 2020           | 2019  | 2020                | 2019  |
| Algoma                       | \$ 11          | \$ 2  | \$ (33)             | \$ 9  |
| Economic                     | 16             | 8     | 4                   | 15    |
|                              | \$ 27          | \$ 10 | \$ (29)             | \$ 24 |

<sup>(1)</sup> Year includes a \$58 million impairment loss (2019 - \$6 million).

During the first quarter of 2020 the stock market prices for Algoma and Economic declined significantly resulting in a \$63 million impairment write down. Although equity markets have continued to recover during the remainder of 2020, on a year to date basis the Company's investments in associates has been negatively impacted by the impairment write down.

Algoma's net income for the fourth quarter of 2020 increased over 2019 mainly due to strong results in the Domestic Dry-Bulk segment. Excluding the impairment write down in the first quarter of 2020, Algoma on a year to date basis reported strong results with increased earnings from their three marine segments, improved results from their joint ventures, and a gain on the sale of a real estate property.

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 8% in the fourth quarter 2020 compared to a 5% return in the fourth quarter of 2019. On a year to date basis, Economic's global investment portfolio had a pre-tax total return, gross of fees, of 7% during 2020 compared to an 18% return in 2019.

The ownership interests, carrying value and fair value of E-L Corporate's investment in associates is summarized in the table below:

|          | 2020      |                |            | 2019      |                |            |
|----------|-----------|----------------|------------|-----------|----------------|------------|
|          | Ownership | Carrying value | Fair value | Ownership | Carrying value | Fair value |
| Algoma   | 37.4 %    | \$ 98          | \$ 197     | 37.0 %    | \$ 185         | \$ 184     |
| Economic | 24.1 %    | \$ 147         | \$ 147     | 24.0 %    | \$ 147         | \$ 147     |
| Total    |           | \$ 245         | \$ 344     |           | \$ 332         | \$ 331     |

Algoma and Economic are Canadian public companies for which further information is publicly available.

### 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, 2020, 52% (2019 - 49%) of the investment - corporate including cash and cash equivalents was denominated in U.S. dollars, 10% (2019 - 10%) in Euros and 8% (2019 - 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’s net income attributable to the owners of E-L Financial, after adjustment for non-controlling interests, is shown in the following table:

| <i>(millions of dollars)</i>                     | Fourth quarter |              | Year          |               |
|--|----------------|--------------|---------------|---------------|
|  | 2020           | 2019         | 2020          | 2019          |
| Empire Life common shareholders’ net income      | \$ 72          | \$ 76        | \$ 140        | \$ 174        |
| Non-controlling interests                        | —              | —            | 1             | 1             |
| <b>Net income, contribution to E-L Financial</b> | <b>\$ 72</b>   | <b>\$ 76</b> | <b>\$ 139</b> | <b>\$ 173</b> |

|   |               |               |              |               |
|---|---------------|---------------|--------------|---------------|
| <b>Empire Life return on common shareholders’ equity (quarterly annualized)</b> | <b>17.8 %</b> | <b>18.7 %</b> | <b>8.5 %</b> | <b>11.1 %</b> |
|---|---------------|---------------|--------------|---------------|

Empire Life reported fourth quarter common shareholders’ net income of \$72 million for 2020, compared to \$76 million for 2019. Full year common shareholders’ net income was \$140 million compared to \$174 million in 2019. The decrease in earnings from 2019 was due, in part, to a large one-time gain recognized in 2019 related to a reinsurance recapture initiative. In 2020, earnings from the Wealth Management line were lower due to reserve strengthening and assumption updates in the Wealth Management line due to poor market returns early in the year, partially offset by increased earnings from the Individual Insurance line primarily as a result of asset trading gains from continued improvements in Empire Life’s matching of assets and liabilities.

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

| <b>Sources of Earnings</b><br><i>(millions of dollars)</i> | Fourth quarter |              | Year          |               |
|--|----------------|--------------|---------------|---------------|
|  | 2020           | 2019         | 2020          | 2019          |
| Expected profit on in-force business                       | \$ 55          | \$ 47        | \$ 215        | \$ 190        |
| Impact of new business                                     | (1)            | (7)          | (16)          | (28)          |
| Experience gains (losses)                                  | 61             | 5            | (81)          | (6)           |
| Management actions and changes in assumptions              | (22)           | 48           | 13            | 37            |
| Earnings on operations before income taxes                 | 92             | 94           | 130           | 194           |
| Earnings on surplus  | 8              | 16           | 70            | 54            |
| Income before income tax                                   | 101            | 110          | 200           | 247           |
| Income taxes   | 25             | 30           | 47            | 60            |
| Empire Life’s shareholders’ net income                     | 76             | 79           | 153           | 187           |
| Dividends on preferred shares                              | (3)            | (3)          | (13)          | (13)          |
| <b>Empire Life common shareholders’ net income</b>         | <b>\$ 72</b>   | <b>\$ 76</b> | <b>\$ 140</b> | <b>\$ 174</b> |

The expected profit on in-force business for the fourth quarter and for the year increased by 16% and 13% respectively, due to higher levels of business inforce at the start of the year for all three business lines.

The improvement in impact of new business for the fourth quarter and the year was primarily driven by favourable new business profits at issue in the Individual Insurance line, combined with lower strain in the Employee Benefits line. For the year, the impact of new business improved over 2019 partially due to the

Employee Benefits line where several new specialty partners were added in 2019 causing significant new business strain in that period. The Individual Insurance line also contributed to improved impact of new business as sales of term products, which generally contribute a positive impact of new business value were strong in the fourth quarter. The impact of new business in the Individual Insurance line is positive when the present value of future profits from new business exceeds the sum of the margins in the initial policy liabilities plus the expenses incurred at the point of sale.

The improvement in experience gains for the fourth quarter of 2020 is primarily attributable to the Wealth Management line as strong equity returns contributed to a partial reversal of provisions recorded for segregated fund benefit guarantees earlier in 2020. For the year, the increase in experience losses was primarily driven by the overall strengthening of policy liabilities supporting segregated fund benefit guarantees.

The effect of management actions and changes in assumptions in the fourth quarter of 2020 was lower than 2019 primarily due to unfavourable assumption updates in the Wealth Management line in 2020 and the favourable impact of a reinsurance recapture initiative in 2019, partially offset by favourable assumption updates in the Individual Insurance line. For the year, the effect of management actions and changes in assumptions was lower than 2019 primarily due to overall assumption updates which were less favourable than 2019, and due to the positive effect of a reinsurance recapture initiative which was recorded in 2019. This was partially offset by improved asset trading gains in the Individual Insurance line in 2020.

Earnings on surplus were lower in the fourth quarter of 2020 primarily due to lower realized gains on AFS assets. For the year, earnings on surplus were higher primarily due to realized gains on AFS bonds recorded earlier in the year and lower realized and unrealized losses on FVTPL assets in this segment.

### 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 2020 and 2019. A discussion of results is provided in the Product Line section of the MD&A.

| Three months ended December 31<br>(millions of dollars) | Wealth Management |             | Employee Benefits |             | Individual Insurance |              | Capital & Surplus |              | Total        |              |
|---|-------------------|-------------|-------------------|-------------|----------------------|--------------|-------------------|--------------|--------------|--------------|
|   | 2020              | 2019        | 2020              | 2019        | 2020                 | 2019         | 2020              | 2019         | 2020         | 2019         |
| <b>Revenue</b>  |                   |             |                   |             |                      |              |                   |              |              |              |
| Net premiums  | \$ 21             | \$ 35       | \$ 94             | \$ 94       | \$ 108               | \$ 101       | \$ —              | \$ —         | \$ 223       | \$ 231       |
| Fee income  | 63                | 63          | 3                 | 3           | —                    | —            | —                 | —            | 66           | 66           |
| Investment income                                       | 9                 | 9           | 1                 | 1           | 59                   | 57           | 16                | 17           | 85           | 84           |
| Net gains (losses) on investments <sup>(1)</sup>        | 14                | (5)         | 1                 | —           | 90                   | (134)        | (3)               | 8            | 101          | (131)        |
|   | 107               | 102         | 99                | 97          | 257                  | 24           | 12                | 25           | 475          | 249          |
| <b>Expenses</b>   |                   |             |                   |             |                      |              |                   |              |              |              |
| Benefits and expenses                                   | 74                | 92          | 95                | 94          | 189                  | (68)         | 4                 | 4            | 362          | 122          |
| Income and other taxes                                  | 8                 | 2           | 3                 | 3           | 19                   | 27           | 2                 | 8            | 33           | 40           |
|   | 82                | 94          | 98                | 97          | 208                  | (42)         | 6                 | 12           | 394          | 162          |
| <b>Net income after tax</b>                             | <b>\$ 25</b>      | <b>\$ 8</b> | <b>\$ 1</b>       | <b>\$ —</b> | <b>\$ 49</b>         | <b>\$ 67</b> | <b>\$ 6</b>       | <b>\$ 13</b> | <b>\$ 81</b> | <b>\$ 87</b> |
| Participating policyholders' portion                    |                   |             |                   |             |                      |              |                   |              | 5            | 8            |
| Dividends on preferred shares                           |                   |             |                   |             |                      |              |                   |              | 3            | 3            |
| Empire Life's common shareholders' net income           |                   |             |                   |             |                      |              |                   |              | 72           | 76           |
| Non-controlling interests in net income                 |                   |             |                   |             |                      |              |                   |              | —            | —            |
| Net income attributable to owners of E-L Financial      |                   |             |                   |             |                      |              |                   |              | \$ 72        | \$ 76        |

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

| For the years ended December 31<br>(millions of dollars) | Wealth Management |              | Employee Benefits |             | Individual Insurance |              | Capital & Surplus |              | Total         |               |
|--|-------------------|--------------|-------------------|-------------|----------------------|--------------|-------------------|--------------|---------------|---------------|
|  | 2020              | 2019         | 2020              | 2019        | 2020                 | 2019         | 2020              | 2019         | 2020          | 2019          |
| <b>Revenue</b>   |                   |              |                   |             |                      |              |                   |              |               |               |
| Net premium  | \$ 95             | \$ 159       | \$ 357            | \$ 360      | \$ 409               | \$ 390       | \$ —              | \$ —         | \$ 860        | \$ 910        |
| Fee income   | 238               | 249          | 13                | 13          | —                    | —            | —                 | —            | 251           | 262           |
| Investment income  | 38                | 40           | 4                 | 5           | 222                  | 215          | 65                | 65           | 329           | 326           |
| Net gains on investments <sup>(1)</sup>                  | 34                | 19           | 8                 | 4           | 478                  | 585          | 21                | 9            | 541           | 617           |
|  | 405               | 467          | 382               | 382         | 1,109                | 1,190        | 86                | 76           | 1,982         | 2,115         |
| <b>Expenses</b>  |                   |              |                   |             |                      |              |                   |              |               |               |
| Benefits and expenses                                    | 447               | 368          | 353               | 365         | 940                  | 1,094        | 16                | 16           | 1,757         | 1,843         |
| Income and other taxes                                   | (13)              | 24           | 14                | 11          | 50                   | 31           | 17                | 16           | 67            | 81            |
|  | 434               | 393          | 368               | 375         | 990                  | 1,125        | 33                | 32           | 1,825         | 1,924         |
| <b>Net (loss) income after tax</b>                       | <b>\$ (29)</b>    | <b>\$ 74</b> | <b>\$ 14</b>      | <b>\$ 7</b> | <b>\$ 119</b>        | <b>\$ 65</b> | <b>\$ 53</b>      | <b>\$ 43</b> | <b>\$ 157</b> | <b>\$ 191</b> |
| Participating policyholders' portion                     |                   |              |                   |             |                      |              |                   |              | 4             | 3             |
| Dividends on preferred shares                            |                   |              |                   |             |                      |              |                   |              | 13            | 13            |
| Empire Life's common shareholders' net income            |                   |              |                   |             |                      |              |                   |              | 140           | 174           |
| Non-controlling interests in net income                  |                   |              |                   |             |                      |              |                   |              | 1             | 1             |
| Net income attributable to owners of E-L Financial       |                   |              |                   |             |                      |              |                   |              | \$ 139        | \$ 173        |

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

### Product line results - Wealth Management

| Key Operating Results<br>(millions of dollars) | Fourth quarter |             |                |              |
|--|----------------|-------------|----------------|--------------|
|  | 2020           |             | 2019           |              |
|  | 2020           | 2019        | 2020           | 2019         |
| <b>Fixed Annuities</b>                         |                |             |                |              |
| Assets under management                        | \$ 950         | \$ 958      | \$ 950         | \$ 958       |
| Gross sales                                    | 21             | 35          | 95             | 159          |
| Net sales                                      | (9)            | —           | (19)           | 13           |
| <b>Segregated Funds</b>                        |                |             |                |              |
| Assets under management                        | 8,439          | 8,480       | 8,439          | 8,480        |
| Gross sales                                    | 234            | 243         | 759            | 856          |
| Net sales                                      | (58)           | (83)        | (236)          | (329)        |
| Fee income                                     | 62             | 62          | 235            | 246          |
| <b>Mutual Funds</b>                            |                |             |                |              |
| Assets under management                        | 120            | 139         | 120            | 139          |
| Gross sales                                    | 1              | 2           | 8              | 8            |
| Net sales                                      | (8)            | (7)         | (23)           | (28)         |
| Fee income                                     | 1              | —           | 2              | 2            |
| <b>Net income (loss) after tax</b>             | <b>\$ 25</b>   | <b>\$ 8</b> | <b>\$ (29)</b> | <b>\$ 74</b> |

Fixed annuity assets under management decreased by 1% during the last 12 months. Gross sales in the fourth quarter and for the year were 40% lower as customers shifted away from fixed income products.

Segregated fund assets under management at the end of the period were unchanged from their levels at the beginning of the year. Gross sales in the fourth quarter of 2020 were 4% lower than the same period in 2019. For the year, gross sales were 11% lower than 2019 levels, reflecting the challenging sales

environment experienced in 2020 and the effects of turbulent equity markets in the first half of the year. On October 23, 2019, Empire Life launched six new Multi-Strategy GIF segregated funds to offer customers a mix of investment management styles and greater diversification. Empire Life also launched a new Short Term High Income GIF and reopened the Global Dividend Growth GIF.

Segregated fund fee income for the fourth quarter was consistent with the same period in 2019. For the year, fee income from segregated funds was 4% lower than 2019 primarily due to lower average assets relative to 2019.

Mutual fund assets under management decreased during the last 12 months due to lower mutual fund sales. Empire Life continues to explore various strategic alternatives with respect to its mutual fund business.

### Product line results - Employee Benefits

| Key Operating Results<br>(millions of dollars) | Fourth quarter |             | Year         |             |
|--|----------------|-------------|--------------|-------------|
|  | 2020           | 2019        | 2020         | 2019        |
| Annualized premium sales                       | \$ 24          | \$ 21       | \$ 85        | \$ 104      |
| Net premiums                                   | 93             | 93          | 357          | 360         |
| <b>Net income after tax</b>                    | <b>\$ 1</b>    | <b>\$ —</b> | <b>\$ 14</b> | <b>\$ 7</b> |

For the fourth quarter, annualized premium sales for Employee Benefits increased by 12% relative to 2019, primarily related to strong sales in core group benefit products and specialty arrangements, partially offset by lower block transfers from strategic partners. For the year, annualized premium sales were 18% lower than 2019, primarily due to lower overall sales in the core group benefit products, partially offset by an overall increase in sales from the strategic distribution partner arrangements early in the year. Over the last several years, Empire Life has entered into a number of strategic arrangements to expand market share in this space.

Net premiums for the fourth quarter and year decreased by less than 1% compared to the same periods in 2019, primarily due to premium rebates offered to customers in the spring to reflect lower health claims experience as a result of COVID-19 regional lockdowns and limited capacity offered by many health care providers. Empire Life continues to focus on profitable sales in the employee benefits market where price competition continues for all major product lines.

Net income increased in 2020 and relative to 2019 primarily due to experience gains on dental and extended health care benefits.

### Product line results - Individual Insurance

| Key Operating Results<br>(millions of dollars) | Fourth quarter |              | Year          |              |
|--|----------------|--------------|---------------|--------------|
|  | 2020           | 2019         | 2020          | 2019         |
| <b>Shareholders'</b>                           |                |              |               |              |
| Annualized premium sales                       | \$ 9           | \$ 5         | \$ 25         | \$ 21        |
| Net premiums                                   | 73             | 69           | 280           | 274          |
| Net income after tax                           | 43             | 62           | 115           | 67           |
| <b>Policyholders'</b>                          |                |              |               |              |
| Annualized premium sales                       | 4              | 5            | 13            | 18           |
| Net premiums                                   | 35             | 32           | 128           | 116          |
| Net income (loss) after tax                    | 5              | 4            | 4             | (1)          |
| <b>Net income after tax</b>                    | <b>\$ 49</b>   | <b>\$ 66</b> | <b>\$ 119</b> | <b>\$ 65</b> |

Shareholders' annualized premium sales increased for the fourth quarter and the year compared to 2019 primarily due to increased sales of Empire Life's term life products. Policyholders' annualized premium sales declined compared to the fourth quarter of the prior year and were 25% lower for the full year as COVID-19 lockdowns and restrictions made underwriting of sales more challenging. Shareholders' total net premiums increased by 6% in the quarter and 2% for the year, primarily from stronger sales of term life products over the period. Policyholders' net premiums were 9% and 10% higher for the fourth quarter and full year respectively compared to 2019, primarily due to the effect of strong sales of Empire Life's participating life products in the last half of 2019.

Shareholders' net income was lower for the fourth quarter, primarily due to the impact of a reinsurance recapture initiative and the impact of a mortality table update on insurance contract liabilities recorded in the fourth quarter 2019 results. For the year, Shareholders' net income increased, primarily due to improved mortality experience, reduced losses on interest rate movements and improved matching of assets and liabilities, which offset the lower gain from the update of policy liability assumptions described in the following table and subsequent paragraphs.

| <i>(millions of dollars)</i>   | <b>2020</b>  | 2019         |
|--|--------------|--------------|
| <b>Components of pre-tax income increase from update of policy liability assumptions</b>         |              |              |
| Lapse/premium assumptions  | \$ (98)      | \$ (27)      |
| Net investment assumptions   | (49)         | (120)        |
| Mortality experience   | (45)         | 12           |
| Mortality table update   | 76           | 155          |
| Reinsurance recapture  | 19           | 107          |
| Deferred tax liability   | 117          | —            |
| Other  | 12           | (69)         |
| <b>Total gain from update of policy liability assumptions (excluding policyholders' portion)</b> | <b>\$ 32</b> | <b>\$ 57</b> |

In 2020 the lapse/premium assumption change is related to updates of assumed lapse rates on renewable term, non-par whole life and universal life policies. The refinements to the lapse/premium assumptions for 2019 were primarily related to the adjustment of the lapse assumption on renewable term products.

The primary driver of the net investment assumptions change for 2020 is a decrease to the initial reinvestment rate ("IRR") used in the valuation of liabilities. The primary drivers of the net investment assumptions change for 2019 were decreases to the IRR and ultimate reinvestment rate ("URR") used in the valuation of liabilities. Updates were also made to the equity investment return assumption, the planned level of equities matching policy liabilities, and to the maturity assumptions for preferred shares. However, these items had a less significant impact when compared with the IRR and URR updates.

Updates to the mortality experience in 2020 are primarily related to revised projected assumptions related to renewable term business and to the partial recognition of the change described in the next paragraph.

In 2019 the individual insurance mortality tables were replaced by more recent industry tables. The updated tables provide a more appropriate mortality projection, specifically at older ages. Actual/expected ratios were updated based on a combination of Empire Life and industry experience. Partial credit was taken for this change in 2019 with the remainder being recognized in 2020.

In 2019, Empire Life enacted significant changes to its reinsurance programs. Specifically, the reinsurers of Empire Life's individual life policies were notified that in 2020 Empire Life would increase its individual life retention from \$500 to \$1,500 and the recapture provisions of all eligible reinsurance treaties would be enacted. The recapture resulted in a substantial net liability decrease on both the universal life and non-participating blocks of business as the present value of future reinsurance premiums was greater than the

estimated future claims. An additional amount was recognized in 2020 as provisions from the actuarial liabilities were released.

Actuarial standards allow for a wide range of practice with respect to capitalization of the preferred tax treatment of dividends on Canadian equities that are supporting actuarial liabilities. In 2020, Empire Life updated its projections to be more consistent with industry practice, which resulted in a significant reduction in insurance contract liabilities.

## Results - Capital and Surplus

| <i>(millions of dollars)</i>                | Fourth quarter |              | Year         |              |
|---|----------------|--------------|--------------|--------------|
|   | 2020           | 2019         | 2020         | 2019         |
| Net income after tax                        |                |              |              |              |
| Net income after tax shareholders' portion  | \$ 7           | \$ 10        | \$ 54        | \$ 39        |
| Net income after tax policyholders' portion | —              | 4            | —            | 5            |
| <b>Net income after tax</b>                 | <b>\$ 7</b>    | <b>\$ 13</b> | <b>\$ 54</b> | <b>\$ 44</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.

Net income from the shareholders' portion of Capital & Surplus was lower than the fourth quarter of 2019, primarily due to lower realized gains on AFS assets in this portfolio. For the year, shareholders' net income was higher than 2019 primarily due to higher realized gains on AFS assets, partially offset by realized losses on FVTPL assets. Policyholders net income was lower than the comparable periods in 2019 primarily due to lower realized gains on AFS assets.

On February 17, 2021, Empire Life completed an offering of \$200 million aggregate principal 3.625% Limited Recourse Capital Notes Series 1 ("Notes"). In connection with the issuance of the Notes, Empire Life issued Non-Cumulative 5-Year Fixed Rate Reset Preferred Shares, Series 5 ("Preferred Shares Series 5") to be held by a trustee for a newly formed trust. In case of non-payment of interest on or principal of the Notes when due, the recourse of each Note holder will be limited to that holder's proportionate share of the Limited Recourse Trust's assets, which will consist of the Preferred Shares Series 5 except in limited circumstances. The purpose of the sale of the Notes is to enlarge the Company's Tier 1 capital base with a view to optimizing Empire Life's capital structure within the parameters prescribed by the Superintendent of Financial Institutions for regulatory capital requirements.

## 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 subordinated debt and preferred shares are as follows:

| <i>(millions of dollars)</i> | Date Issued    | Earliest redemption date | Interest rate | Face amounts as at |                  |
|------------------------------|----------------|--------------------------|---------------|--------------------|------------------|
|                              |                |                          |               | December 31 2020   | December 31 2019 |
| Subordinated debentures      |                |                          |               |                    |                  |
| Series 2016-1 <sup>(1)</sup> | December 2016  | December 16, 2021        | 3.383 %       | \$ 200             | \$ 200           |
| Series 2017-1 <sup>(2)</sup> | September 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 the 3-month CDOR.

| (millions of dollars) | Date Issued   | Earliest redemption date | Yield  | Principal amounts as at |                  |
|-----------------------|---------------|--------------------------|--------|-------------------------|------------------|
|                       |               |                          |        | December 31 2020        | December 31 2019 |
| Preferred shares      | January 2016  | April 17, 2021           | 5.75 % | \$ 150                  | \$ 150           |
| Preferred shares      | November 2017 | January 17, 2023         | 4.90 % | \$ 100                  | \$ 100           |

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", its subordinated debt rating is "A (low)", its financial strength rating is "A" and its Preferred Share rating is Pfd-2. All ratings have a stable trend.

A.M. Best ratings of Empire Life are "A Excellent" financial strength rating, "a" long-term issuer credit rating, "bbb+" Subordinated Debt rating, and "bbb" Preferred Share rating. All ratings have a stable trend.

### Regulatory capital

The Life Insurance Capital Adequacy Test ("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 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.

| LICAT<br>(millions of dollars)                 | Dec 31<br>2020 | Sep 30<br>2020 | Jun 30<br>2020 | Mar 31<br>2020 | Dec 31<br>2019 |
|--|----------------|----------------|----------------|----------------|----------------|
| <b>Available capital</b>                       |                |                |                |                |                |
| Tier 1   | \$ 1,623       | \$ 1,544       | \$ 1,527       | \$ 1,435       | \$ 1,616       |
| Tier 2   | 677            | 703            | 710            | 671            | 669            |
| Total  | \$ 2,300       | \$ 2,247       | \$ 2,237       | \$ 2,106       | \$ 2,285       |
| <b>Surplus allowance and eligible deposits</b> | \$ 1,156       | \$ 1,111       | \$ 1,094       | \$ 1,029       | \$ 1,109       |
| <b>Base solvency buffer</b>                    | \$ 2,541       | \$ 2,542       | \$ 2,510       | \$ 2,371       | \$ 2,191       |
| <b>LICAT Total Ratio</b>                       | 136 %          | 132 %          | 133 %          | 132 %          | 155 %          |
| <b>LICAT Core Ratio</b>                        | 96 %           | 91 %           | 91 %           | 91 %           | 109 %          |

### 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 2% 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. In 2019, Empire Life acquired a minority interest in The Gryphin Advantage Inc. as part of its continuing commitment to ensuring consumers have the availability of independent advice in the marketplace.

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 broadening distribution reach. Empire Life continues 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 guaranteed minimum withdrawal benefit ("GMWB") risk exposure and the competitive landscape for this product.

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 provisions 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 Empire Life 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 (or improve) its external 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 Empire Life's ability to pay claims and fulfil 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, with specific focus on market, credit and liquidity risk including asset/liability management as well as capital management. The Product Management Review Committee is responsible for overseeing management of corporate policy established by the Risk and Capital Committee of the Board, with specific focus on insurance. Activities not delegated to one of these two committees remain under the oversight of senior management. More information related to governance can be found under the Corporate Governance over Risk Management section of Empire Life's 2019 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 Product Management Review 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.

### **Significant developments**

Commencing in the first quarter of 2020, the spread of the COVID-19 pandemic, given its severity and scale, continues to affect Empire Life's business, some of our clients and also continues to pose risks to the Canadian economy. Empire Life continues to adjust operations as government restrictions and measures evolve. As the impacts of the COVID-19 pandemic continue to materialize, management is monitoring the effects of the disruption on Empire Life's business strategies and initiatives and the effects on its financial results.

The COVID-19 pandemic has and may continue to result in disruptions to clients and the way in which business is conducted, including prolonged duration of employees working from home. To date, Empire Life has taken proactive measures through business continuity plans, carefully planning the return to premise for some employees, and management teams have increased their efforts to preserve the well-being of employees and our ability to serve clients. Processes supporting ongoing systems availability, stability and security are operating effectively and Empire Life continues to monitor the threat landscape.

The duration and impacts of the COVID-19 outbreak cannot currently be determined. If the COVID-19 pandemic is prolonged, or further diseases emerge that give rise to similar effects, there may be further negative effects on the Canadian economy as well as increased volatility in equity and fixed income markets. Unexpected developments in financial markets, regulatory environments, or consumer behaviour and confidence may also have adverse impacts on Empire Life's financial results and condition, and business.

### **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 objective of the hedging program is to partially protect Empire Life from future regulatory (LICAT) ratio declines that might result from adverse stock market price changes. 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 loss of \$5 million and \$3 million after tax respectively on its hedging program, primarily as Canadian equity markets experienced positive returns in the fourth quarter and for the year. This compares to a hedging program loss of \$2 million and \$11 million respectively for the comparable periods in 2019, primarily due to a rise in Canadian stock prices.

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, 2020, Empire Life had \$8.5 billion of segregated fund assets and liabilities. Of this amount, approximately \$8.2 billion have guarantees. The following table provides a percentage breakdown by type of guarantee.

|  | <b>December 31<br/>2020</b> | December 31<br>2019 |
|--|-----------------------------|---------------------|
| <b>Percentage of segregated fund liabilities with:</b>   |                             |                     |
| 75% maturity guarantee and a 75% death benefit guarantee   | <b>6 %</b>                  | 4 %                 |
| 75% maturity guarantee and a 100% death benefit guarantee  | <b>44 %</b>                 | 46 %                |
| 100% maturity and death benefit guarantee (with a minimum of 15 years between deposit and maturity date) | <b>7 %</b>                  | 7 %                 |
| Guaranteed minimum withdrawal benefit ("GMWB")   | <b>43 %</b>                 | 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.

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, 2020 and December 31, 2019, the sensitivity of Empire Life shareholders' net income and LICAT Total ratio resulting from stock market increases and decreases is provided in the following table.

| Sensitivity to equity risk<br>Impact on net income ( <i>millions of dollars after tax</i> ) | Increase      |               | Decrease       |                 |                 |
|---|---------------|---------------|----------------|-----------------|-----------------|
|   | 20%           | 10%           | 10%            | 20%             | 30%             |
| <b>As at December 31, 2020</b>  |               |               |                |                 |                 |
| Segregated fund guarantees  | \$ 108        | \$ 104        | \$ (13)        | \$ (86)         | \$ (220)        |
| Other equity risk   | 37            | 18            | (16)           | (29)            | (78)            |
| Equity hedge  | (8)           | (4)           | 5              | 12              | 20              |
| <b>Total</b>  | <b>\$ 136</b> | <b>\$ 117</b> | <b>\$ (23)</b> | <b>\$ (103)</b> | <b>\$ (278)</b> |
| <b>As at December 31, 2019</b>  |               |               |                |                 |                 |
| Segregated fund guarantees  | \$ —          | \$ —          | \$ (10)        | \$ (76)         | \$ (229)        |
| Other equity risk   | 33            | 15            | (12)           | (20)            | (65)            |
| Equity hedge  | (2)           | (1)           | 4              | 16              | 38              |
| <b>Total</b>  | <b>\$ 31</b>  | <b>\$ 14</b>  | <b>\$ (18)</b> | <b>\$ (80)</b>  | <b>\$ (256)</b> |

| Sensitivity to equity risk<br>Impact on LICAT | Increase    |             | Decrease    |              |              |
|---|-------------|-------------|-------------|--------------|--------------|
|   | 20%         | 10%         | 10%         | 20%          | 30%          |
| <b>As at December 31, 2020</b>                |             |             |             |              |              |
| Segregated fund guarantees                    | 6%          | 5%          | (1)%        | (8)%         | (16)%        |
| Other equity risk                             | —%          | —%          | —%          | —%           | (1)%         |
| Equity hedge                                  | (1)%        | —%          | —%          | 1%           | 1%           |
| <b>Total</b>                                  | <b>6%</b>   | <b>5%</b>   | <b>—%</b>   | <b>(7)%</b>  | <b>(16)%</b> |
| <b>As at December 31, 2019</b>                |             |             |             |              |              |
| Segregated fund guarantees                    | 3%          | —%          | (6)%        | (16)%        | (22)%        |
| Other equity risk                             | (1)%        | (1)%        | —%          | 1%           | 1%           |
| Equity hedge                                  | (3)%        | (2)%        | 1%          | 3%           | 3%           |
| <b>Total</b>                                  | <b>(1)%</b> | <b>(2)%</b> | <b>(4)%</b> | <b>(12)%</b> | <b>(18)%</b> |

In early 2020, Empire Life significantly increased the segregated fund guarantee liability because of market declines. This liability was further strengthened during the fourth quarter assumption update process, which offset most of the reduction in liability that arose from strong fourth quarter equity returns. These changes caused a significant increase in the potential positive net income impacts of a 10% and 20% increase in stock markets at the end of 2020 relative to the end of 2019.

These changes also caused an increase in the potential positive LICAT ratio impacts of favourable equity shocks and a decrease in the potential negative LICAT ratio impacts of unfavourable equity shocks.

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 Empire Life's segregated funds is provided in the following table.

| Segregated Funds<br>( <i>millions of dollars</i> ) | Withdrawal Benefit ><br>Fund Value |                   | Maturity Guarantee ><br>Fund Value |                   | Death Benefit > Fund<br>Value |                   | Policy<br>Liabilities | LICAT<br>Capital |
|--|------------------------------------|-------------------|------------------------------------|-------------------|-------------------------------|-------------------|-----------------------|------------------|
|  | Fund<br>Value                      | Amount at<br>Risk | Fund<br>Value                      | Amount at<br>Risk | Fund<br>Value                 | Amount at<br>Risk |                       |                  |
| December 31, 2020                                  | \$ 2,687                           | \$ 931            | \$ 52                              | \$ 2              | \$ 654                        | \$ 12             | \$ 147                | \$ 682           |
| December 31, 2019                                  | \$ 2,701                           | \$ 882            | \$ 51                              | \$ 2              | \$ 650                        | \$ 6              | \$ —                  | \$ 465           |

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, 2020, the aggregate amount at risk for all three categories of risk was \$946 million. At December 31, 2019, the aggregate amount at risk for these three categories of risk was \$890 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 IRR for non-participating insurance business and segregated fund guarantees for December 31, 2020 and December 31, 2019, is shown in the table below. This assumes no change in the URR.

| <b>Sensitivity to market interest rates LICAT:</b> | <b>Impact of<br/>50 bps decrease</b> |
|--|--------------------------------------|
| <b>December 31, 2020 LICAT total ratio</b>         | <b>3%</b>                            |
| December 31, 2019 LICAT total ratio                | 1%                                   |

### **Operational risk**

Operational risk is broadly defined as the risk of loss resulting from human error, decisions, actions or failure to act, inadequate or failed internal processes and systems, or from external events that affect business operations. Operational risk is naturally present in all of Empire Life's business activities and is also embedded in the practices used to manage other risks. If not managed effectively, operational risk can impact Empire Life's ability to manage other risks. The following is a further description of some operational risks and their associated risk management strategies.

#### *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.

#### *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. The Chief Risk Officer reports regularly to the Risk and Capital Committee of the Board on model use and related oversight activities.

#### *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, and is unable to maintain and effectively deploy resources with the in-depth knowledge and necessary skills needed to support business activities, 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.

#### *Third-party risk*

Empire Life obtains many different types of services from a number of third-party service providers and has outsourced certain business functions or processes to third parties. Should these third parties fail to deliver systems and/or 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 contracting guidelines as well as 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.

#### *Technology and information security 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, criminal activity, fraud or the loss of certain software licensing agreements could have a material adverse impact on Empire Life.

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 Vice-President, Enterprise Services and Security, who reports at least annually to the Risk and Capital Committee of the Board. This program consists of a number of standards, procedures and guidelines focused on management of cybersecurity risk and

maintenance of the security and integrity of the data entrusted to Empire Life. 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 continuity risk*

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 of key business functions occur as a result of an event, including pandemic, impacting the availability of trained employees, physical locations to conduct operations and/or access to technology. 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 services and failover capability designed to minimize downtime and accelerate system recovery. The Business Continuity Planning Team Chair reports at least annually to the Risk and Capital Committee of the Board on business continuity preparedness and operational resiliency.

#### **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. As a long-term oriented underwriter and investor, Empire Life may be adversely affected if it does not adequately prepare for the direct or indirect negative impacts of environmental events and developments,

including those related to impacts of climate changes and the transition to a lower-carbon economy. These events and developments may include increased frequency and severity of natural or human-made environmental disasters, longer-term shifts in climate patterns, emerging regulatory and public policy developments and the impacts on Empire Life's operations, invested assets, suppliers and customers.

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 notes 22 and 23 to the 2020 consolidated financial statements.

## **Outlook**

The path and implications of COVID-19 on Canadian and international business operations, supply chains, travel, consumer confidence and business forecasts, and domestic and international securities markets, remains uncertain and is expected to continue into 2021. The progression of the virus, potential treatments and therapies, the availability of vaccines and actions taken by governments, businesses and individuals could vary by region and country and will impact economic recoveries. Empire Life continues to adjust operations as government restrictions and measures evolve. Our business continuity processes have been successful in ensuring that key business functions and normal operations continue through these unprecedented times. Processes supporting ongoing systems availability, stability and security are operating effectively and we continue to monitor the threat landscape. The majority of employees continue to work from home. Return to office activities have been carefully planned but remain appropriately flexible in response to government restrictions. Management remains focused on preserving the well-being of all employees and our ability to serve our customers.

The effects of the COVID-19 pandemic took a toll on the Canadian economy in 2020 as GDP contracted by an estimated 5.5% for the full year and, the Canadian dollar strengthened slightly to 1.29 (annual average) per U.S. dollar. Amid the backdrop of regional lockdowns and other restrictions, annual unemployment in Canada rose to 9.5%, the highest level in 25 years. The lingering effects of the pandemic will continue to weigh on 2021 and potentially beyond. The recovery of the Canadian and global economy will depend on the effectiveness of vaccine rollouts and limiting the effects of future waves of infections.

In response to the contracting economy, the Bank of Canada decreased the overnight rate to 0.25% in 2020 with the Bank of Canada indicating that the overnight rate is expected to remain low in the near-term. The Canadian Federal Bond yield curve shifted down with the 5-year rate decreasing from 1.68% to 0.39% in 2020 and the 30-year rate decreasing from 1.76% to 1.21% in 2020. While corporate and provincial bond spreads widened significantly in the first and second quarters and the effects of the pandemic took hold, spreads narrowed in the latter half of the year and ended 2020 near their opening levels. Interest rates have generally been lower than historic averages for several years.

Despite an uneven quarterly performance, global equity markets performed well in 2020 with the MSCI up over 16% for the year. The S&P 500 stock index was up 16.3% and the S&P/TSX composite index was up 2.2% 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 2021, the global economy is expected to have moderate growth. The Canadian economy is expected to rebound in 2021 and 2022 with forecast GDP of 4.0% and 4.8% respectively. The ability of economies to recover and grow in line with projections is highly dependent on the ability of governments to contain further spread of COVID-19 infection and achieve sufficient immunity through

vaccinations to ease the containment measures currently in place. Other threats to economic growth include the impact of the energy policy on the regional economies of the western provinces. Short-term interest rates may continue to stay at their historic low levels in the near-term. Overall, the Canadian economy is well-positioned to support continued growth of all Empire Life's product lines.

The individual insurance market continues to grow modestly even with the challenge of the persistent low long-term interest rate environment that followed the financial crisis and has remained low in the current COVID-19 pandemic. 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. The segregated fund product line saw a decline in net sales while experiencing uneven market returns in 2020; 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. Across all business lines, Empire Life is focused on growth and diversification of distribution as well digital enablement and adoption, all while maintaining personalized service.

As noted under the Regulatory Capital section, OSFI implemented its LICAT Guidelines on January 1, 2018. This Guideline established a new risk-based regulatory capital framework for life insurance companies and replaced the previous Minimum Continuing Capital and Surplus Requirements 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 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 guarantees 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 the final standard for IFRS 17 Insurance Contracts in June 2020. IFRS 17 includes 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 and has developed a plan to implement the changes required to be ready to report under the new standards when they take effect on January 1, 2023.

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.

The cost of managing regulation is a concern. The insurance industry is facing more aggressive consumer and financial solvency regulation than in the past and must also absorb the cost of implementing IFRS 17. The regulation load is increasing operating costs without offsetting revenue gains. Empire Life must continue to grow its business to absorb these rising costs.