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IAG.TO - Q3 2016 Industrial Alliance Insurance and Financial Services Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Industrial Alliance third-quarter earnings results conference call.

(Operator Instructions)

As a reminder, this conference is being recorded, Wednesday, November 2, 2016. I would now like to turn the conference over to Grace Pollock. Please go ahead, ma'am.

Grace Pollock - *Industrial Alliance Insurance and Financial Services Inc. - Director of IR*

Thank you. Good afternoon and welcome to our third-quarter conference call. All documents related to our results, including the press release, slides, MD&A and the supplementary information package are posted in the Investor Relations section of our website at ia.ca. This conference call is open to the financial community, the media and the general public. The question period is reserved for financial analysts. A recording of this call will be available for one week starting this evening. The archived webcast will be available for 90 days and a transcript will be available on our website in the next week.

I draw your attention to the forward-looking statements at the end of the slide package. A more detailed discussion of the Company's risks is provided in our 2015 MD&A that is available on SEDAR or the IA website. I will now turn the call over to Yvon Charest, President and CEO.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

Good afternoon, everyone, and thank you for joining us. I'm today with Normand Pepin, EVP and assistant to the President; Rene Chabot, EVP, CFO and Chief Actuary; Michel Tremblay, EVP and Chief Investment Officer; Denis Ricard, EVP responsible for Individual Life and Annuities and Dealer Services, and Rene Laflamme, EVP responsible for Group Pensions, Employee Benefits and Special Market Solutions. We also have Mike Stickney, President of iA American, and Carl Mustos, President of iA Clarington.

We are very pleased to announce another outstanding quarter, making this one, one of the best years for iA Financial Group. Retail insurance in Canada and in the US delivered another fine performance for the eighth quarter in a row with, overall sales growth of 18%. Sales in Canada were up 17% and in the US was up by 19%. Sales of our adjustable disability product were up by 35% as momentum continues to build across Canada.

In retail wealth, gross sales of seg fund were up over the same quarter of last year and we continued to hold first place for net sales. I'm especially pleased to note the continued improvement in our mutual fund business. Redemptions have been coming down recently and our gross sales are up this quarter. Fund performance is also improving and recent launches of our solution at iA distribution affiliates have been successful. If we look at net sales of mutual and seg funds, we had positive fund sales for the first time in seven quarters because of the improvement in mutual funds, so it looks like the tide is beginning to reverse.

Our group wealth business is also of worthy of particular note. Total sales were up 85%, reflecting the signing of new mandates, so an excellent quarter there as well. In our auto and home insurance business, written premiums grew by 12% again this quarter and the contribution from partnership put in place last year continues to grow. Sales by dealer services held steady this quarter despite the slowdown in western provinces because of the oil and gas situation. Special market solution delivered their usual growth. Overall, premium and deposits were up by 18% over last year, reflecting strong the growth in our wealth and retail insurance businesses.

Asset under administration and management benefited from good market growth this quarter and were up by 4%. Finally, the number that is the true measure of our long term value creation, book value per share, grew by another 3% this quarter because of the outstanding contribution from profit. Again, an outstanding quarter in what is proving to be an outstanding year. Rene will now comment on profitability and give you some color on year-end actuarial review.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Good afternoon, ladies and gentlemen. We are extremely pleased with the strength and the quality of our Q3 earnings. Once again, the results show that we are delivering on our 2016 plan. Earnings of CAD1.40 per share exceeded the top of the guidance for the quarter by CAD0.15 per share. Our estimate of core EPS is CAD1.37, which is 25% higher than last year. With this quarter we are well above our guidance for the ninth month of 2016, which is turning out to be one of our best years on record.

Experience gains for the quarter are detailed on slides 6 and 7. We have a market gain of CAD0.09 from our hedging program, UL policy and higher MERs. Policyholder experience was strong for a third consecutive quarter and add another CAD0.12 to our EPS as follows. Individual insurance report again of CAD0.07, mainly for mortality and morbidity. This is the sixth consecutive quarter of favorable policyholder experience for retail insurance.

Strain on new business came in at 12% and was lower than expected, which adds another CAD0.01 to earnings. Individual wealth had a gain of CAD0.04, CAD0.01 for favorable longevity and the rest for expenses. Group savings report a gain of CAD0.01 on investments. On the group side, employee plans report lower dental and health that add CAD0.03 per share this quarter. Dealer services had an experienced loss of CAD0.03, including CAD0.01 related to higher creditor insurance claims. The other CAD0.02 is attributed to our car loan portfolio.

Interest income was lower because we are shifting our origination to loans with a lower risk profile while provision on older loans in the portfolio were slightly higher than expected. This quarter, we have added new disclosure to our rolling nine to help you track our car loan business. At the bottom of page 7, we provide information on loan origination and receivables and at the bottom of page 9, we provide provision for losses and average 12-month credit loss. The last element impacting profit this quarter was a loss of CAD0.02 from income on capital, mainly because of weather related event at iA Auto and Home.

Our solvency ratio at the end of the quarter was 218%, reflecting the debt issued in September, the strong profit for the quarter, and the review we did of the CTL earn out. These positive items were slightly offset by the decline in rates. If we take into account the debt buyback in December announced last week, our ratio would be 207%. Likewise, our leverage ratio would fall back to around 25%, giving us a flexible balance sheet.

My final comment is on the year-end actuarial review. If I were to stop the clock today, with Canadian long-term interest rate at 1.8%, my interest rate protection in the reserve would be as large as last year end, which is 43 basis points and I would decrease the URR by 20 BPS with no charge to Q4 income. Basically, we are following through on our plan disclosed at the Investor Day. Operator, we will now take questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Our first question comes from the line of Meny Grauman with Cormark Securities.

Meny Grauman - *Cormark Securities - Analyst*

Hi, good afternoon. The question is just about the write down of the earn out at CTL. Just if you could provide a little bit more color that would be appreciated. There's no earnings impact now, but just the implications for the business going forward from this change, if you could just elaborate, that would be helpful.

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Yes, Denis Ricard here. I think that we can see with hindsight, I would say that it is going as planned on what I'll call a more realistic scenario than the one that we've been using for what we booked in our balance sheet at the beginning of the year. In other words, I can see today with hindsight again that we paid up front for that business for what we think is the true value of that business and we would have been prepared to pay even more with the earn-out formula if they were going to, let's say, if the Company was able to produce what I would call the more ambitious or the more optimistic scenario. All-in-all, we are very satisfied where the business is right now. The Company, as I would say, shifted a bit, the profile of its portfolio to let's say better quality of the loan and as such we are very, very pleased with where this is heading.

Meny Grauman - *Cormark Securities - Analyst*

The origins -- let's say the gap between sort of the most optimistic scenario and where we are now, is it a function of just that, of sort of moving up or getting better credits and sort of losing a little bit of volume but getting a higher quality credit or are there other factors that haven't gone your way that you could elaborate on?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Well, in fact, to get the origination as planned, CTL needed to go a bit with better quality of its portfolio and that is why we move to that segment and that's why also the recognition of the revenue is lower. That's the first item. Also what I can say is that the credit loss has been a bit higher than expected. That's the second item. All-in, those are the two reasons.

Meny Grauman - *Cormark Securities - Analyst*

Thanks for that. If I could just ask a broader question here, it's the second quarter in a row where we've seen a very big beat relative to consensus and I guess I would ask the question that what's the street missing here, but if I look at your 2016 guidance, you're also handily beating that as well. I'm wondering what is the explanation for that, for these beats in the sense that they seem to have also taken you by surprise to some extent if I just look at the guidance that you've provided for 2016 for the beginning of the year?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

I wouldn't say that they take us by surprise. One of the big elements of the beat is the policyholder experience. If you remember when we shared with you the plan for 2016, there was three key elements in that plan. The first element was the strength and we deliver on that strength, almost slightly better but almost right on. We talk about improving group life and health profitability That was a second very important milestone in our plan and that one has been much better than what we expected, but it's the fact that we have worked so hard on the line of business for the last two years or so that we finally see the benefit of it, so we are pleased with it too. There was the CTL piece also that was on the plan and Denis just commented on that one.

Outside these three pieces, what was in addition to this was the fact that the individual life insurance produced better results in terms of policyholder experience. We may have been prudent in that segment because there could be fluctuation from one quarter to the other, but we were very pleased to see that for the first three quarters of this year, so we get these good benefit out there and that was the key element that helped us to basically beat our plan. Also, the market were very good. Almost every quarter we had positive element on the market side, so altogether that's the reason we beat our guidance right now.

Meny Grauman - *Cormark Securities - Analyst*

Thank you very much.

Operator

Our next question comes from the line of Gabriel Dechaine, Canaccord Genuity.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Yes, just keeping on that EPS topic there, if we look at your guidance for Q4 that you laid out at the start of the year and -- is that still a realistic range or should we anticipate a big step down from the level of earnings we've seen the last two quarters, anyway? Or do you think these policyholder gains are going to persist?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

You know, it's difficult to predict, Gabriel. The only thing I could tell you is that the first three quarters of this year were all positive. Will that get a negative quarter in Q4 or will that continue to have a positive quarter in Q4? My impression at this moment if I will have to bet on this because I really don't know. I would say that I would expect to continue to see some policyholder, positive policyholder experience in Q4.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. If that's the case and we're looking at the very least, these are my words, not yours, but that the very least we'll end up at the high end of your [420-460] range. Is that the level, if I'm looking into next year, do you look at it in a very simplistic way and say off of that base we look for 8% to 10% growth in line with the plans we laid out at the Investor Day a few months ago?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Gabriel, you're anticipating our next quarter result disclosure, basically. It is next quarter that we're going to give you more insight about what's going to be our expectation for 2017 and on. There was a bit two part of your question in the sense that do I feel that I'm going to be this year at the high end of my guidance? I feel very comfortable about that. Very comfortable about that. The second piece was about 2017. Let's just pass the next quarter. Let's see what's going to be all of these discussions with all of the business heads about 2017 and we'll give you some highlight next quarter as we are used to doing.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

Okay. The 20 basis URR reduction that you're going to take next quarter, if I understand that correctly, at your Investor Day it looked like it would have been 10, 10, 10 or kind of a 20 over a two-year time frame 2016 and 2017. Is there any reason why you're doing all of the 20 at once in Q4 of this year?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

I gave you a preview of what I would have done if I closed the book today. That would be my choice today and why would it be my choice today is because I prefer to set this issue and put it back behind my back, basically -- behind my back. I know that there is something coming on the URR side. I prefer to eliminate it from the turf and move on to other elements.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

My last one for you, Rene or Yvon, where are we on the M&A front, specifically in the US, if you're any closer to consummating a transaction there?

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

It's Yvon Charest. All I can say is that we work actively on acquisitions, either in Canada or in the US. It's part of our plan to continue growing the organization. That's what we have been doing for awhile and that which we continue to work on. I'm afraid I could not provide anymore color there.

Gabriel Dechaine - *Canaccord Genuity - Analyst*

All right. Thought I'd try, thank you.

Operator

Our next question comes from the line of Peter Routledge with National Bank Financial.

Peter Routledge - *National Bank Financial - Analyst*

Hi. Wanted to ask a question just about the growth in required capital. Looks like it's up year over year 16% and its been ticking up fairly healthily all year. Is this something we should just -- this kind of expansion in the required capital, is that something we should come to expect just given your balance sheet and where the interest rate environment is?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

You know, Peter that the formula is very pro-cyclical and when these interest rate went down, then there is pressure on these capital increases. This year, you have seen these rates going down and I'm sure that you see that pressure that happens on our capital requirements. You also know that there is new regime coming in had in 2018 and plus and in that new regime, we haven't demonstrated yet and we haven't lay it totally yet but we expect that, that procyclicity will be less present than in the current framework. That's probably the two color I could give you on this.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

It's Yvon Charest if I may Peter . It's certainly not on the automatic pilot because the long-term rates, Canada long term rates, went down 50 BPS between the first three quarters but then so far in the fourth quarter, it's plus 18 points. Unless you believe that long-term rates will go down 50 BPS every three quarters, you should not extrapolate what happened to us lately without saying there will be a new regime soon for companies hedging their seg fund guarantees, so those are two critical information that you should use before doing a simple extrapolation of what happened to us lately.

Peter Routledge - *National Bank Financial - Analyst*

If rates start rising, or continue to rise, do you get the same -- does it work in reverse, i.e., do we start to see required capital under the current regime decline?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

The answer is yes.

Peter Routledge - *National Bank Financial - Analyst*

Okay. Just on CTL, huge growth in receivables. I presume that's them or perhaps better put, Industrial Alliance shifting the mix of that portfolio, so all your new originations have a different credit risk and you're growing that quite quickly. Is that a fair characterization?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Yes but one thing you also need to understand is the number that is being shown in our documents, it's a combined origination from both the prime business and the non-prime business. But you're right, on the non-prime business there's a shift right now going into a better quality.

Peter Routledge - *National Bank Financial - Analyst*

Okay. That 3.5% charge off seemed high. Assuming you continue to originate higher quality prime and non-prime loans, do you see that trending down?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

It should go down, yes.

Peter Routledge - *National Bank Financial - Analyst*

It's so high because the legacy book credit quality wasn't very strong, is that--

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Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Well it is high because it's a combined ratio of both prime and non-prime, so it will never go as low as what you see on the prime side, which is around 50 BPS, or 0.5%, but it will stay higher, obviously, but it should trend down a bit here.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

It's probably low on the prime side.

Peter Routledge - *National Bank Financial - Analyst*

Got it. Okay. Thanks very much.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

The non-prime side, excuse me.

Operator

Our next question comes from the line of Paul Holden with CIBC World Markets.

Paul Holden - *CIBC World Markets - Analyst*

Thank you. Good afternoon. First question again is related to CTL. With your Investor Day, you introduced a longer term target of growing dealer services by a CAGR of 15%, so I'm wondering with the change in underwriting approach and slower volumes, if that expected growth rate over the next few years changes at all?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

In fact, it should decrease a bit. I don't have the number with me, but one thing that you have to keep in mind is that the we expect the portfolio to grow as much as was expected in the Investor Day but you could probably find a bit less of a margin at the end of the day than what was expected in the projection, but I don't have the number with me right now.

Paul Holden - *CIBC World Markets - Analyst*

I understand. So more of an impact on bottom-line growth versus top-line, is what you're suggesting?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

That's what I'm suggesting, yes.

Paul Holden - *CIBC World Markets - Analyst*

Okay, good. Next question is with respect to the improvement in mutual fund flows. A very good result in what wasn't the best quarter for the industry. Not a terrible quarter, but not a great quarter for the industry. Wondering where you're able to pick up those incremental gross flows on a distribution basis. Is that mostly coming through affiliated distribution or is that third party?

Carl Mustos - *Industrial Alliance Insurance and Financial Services Inc. - President of iA Clarington*

Thanks for the question. We're really encouraged by our redemptions declining significantly over the quarter but our pick up in gross was mostly with the affiliates and the managed solutions new products that we talked about at Investor Day as well. We're very encouraged by the results so far.

Paul Holden - *CIBC World Markets - Analyst*

Okay. Those managed solutions in terms of that picking up, that's independent of the affiliate? It's like you're selling that more into independent MFDA or IIROC?

Carl Mustos - *Industrial Alliance Insurance and Financial Services Inc. - President of iA Clarington*

It available for sale everywhere and we are selling it beyond our own affiliates, but the bulk of the purchases of late have been with our affiliates. Our growth has been quite strong in our affiliates of late.

Paul Holden - *CIBC World Markets - Analyst*

Thank you, thank you. Final question is with respect to regulatory capital. Now, recognizing that you're regulated by AMF, not OSFI, but under the new LICAT, one of the proposals is an additional capital requirement for lines of businesses growing in excess of 20%. You'd have a few lines of businesses that might grow in excess of that rate. Would that also a apply to you under AMF regulations? Does that, is that enough of a capital charge to alter your approach to growing in niche lines of business?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

It would apply to us, too, because it's the same formula, AMF and OSFI. That piece of the formula didn't attract too much of my attention so I suspect that it should not be a huge amount of money for us.

Paul Holden - *CIBC World Markets - Analyst*

Okay, thank you. That's all the questions I had.

Operator

Our next question comes from the line of Sumit Malhotra with Scotiabank.

Sumit Malhotra - *Scotiabank - Analyst*

Thanks, good afternoon. First, for Rene, on the actuarial reserves review for Q4. Now you specifically mentioned the 20 basis point reduction in URR and the fact that there should be no income statement impact if I heard you correctly there. Are there any other areas of your portfolio as you undertake the review in Q4 that you're expecting may have a bottom-line impact for the Company?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

No, Sumit, it was an all-inclusive statement.

Sumit Malhotra - *Scotiabank - Analyst*

All-inclusive, okay. So the review for Q4 non-issue from at least a bottom-line perspective?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

This is currently the preview that I'm sending to investors. This is where we are at at this moment and with the caveats that I mentioned to you, Canadian long-term rate at 1.8%.

Sumit Malhotra - *Scotiabank - Analyst*

Got it, thank you. The second part is around the policyholder experience gains that you've benefited from for, it feels like a number of quarters now. I'm looking back at individual insurance in particular. The mortality and morbidity bucket has contributed to about CAD0.40 to earnings over the last five quarters.

Maybe a two-parter here. First one I know not completely fair but is, do you look at this and say this is something that we've been fortunate to benefit from or is it something in the way that you have established reserves that you think the conservatism is allowing for these gains to come through? If it's the second part, as you review numbers at the end of the year, are we going to get a shift such that the individual insurance line benefits from a higher expected profit in 2017 as you bake some of this into more of a normal course expectation? Not sure if I explained that perfectly, but hopefully you understand where I'm coming from.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

I will try to answer correctly. If you look at the policyholder slide 7 you see that in 2015, we had CAD28 million of policyholder gains in the individual insurance and they were definitely on the high side, so we were a bit skeptical that it could came back. Then you'll see that in 2016 we are at 13 at that moment. It's more related to the positioning of the expected profit than the reserve in my point of view, Sumit. Even if there is interconnection between the two, it's more the positioning of the expected profit.

It's always a difficult judgment call here to what extent you try to push the envelope on the expected and then you get a loss or you try to be as accurate as possible to see what's happening. That's going to be the difficult task that we will have to do in the fourth quarter. To what extent we do believe that these policyholder experiences are there, they are there for the long term and then we push a bit more the envelope on the expected profit side.

Sumit Malhotra - *Scotiabank - Analyst*

Based on your answer to a previous question that you expected the gains to continue in Q4 it sounds to me like you're indicating that you feel some of these are going to have staying power and as such, it's reasonable to expect them to move into the expected profit bucket going forward.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

We are in a very difficult area here. We are in a very difficult area in the sense that when I said that, I think they are going to continue because I have three quarters in a row they are there so I'm expecting a fourth quarter in a row and I see that since 2015 they are there, so I feel positive about it. But you know what? I don't know what is going to happen in Q4. Something different could happen. I invite you to wait and see what Q4 is going to deliver and wait and see what we are going to provide you as guidance when we are going to put deeper thought on this in the next quarter.

Sumit Malhotra - *Scotiabank - Analyst*

Fair enough. Last one for Denis or Yvon, back to CTL. I don't want to over play this because it's not that large a part of your business, but I will say it's strange to see an acquisition closed three quarters ago and in relatively short order, you're writing off a decent amount of the goodwill. Is this a reflection of just the way that the earn out was set up it, that it was very reliant on the CTL almost delivering short-term performance or should we look at this to say there was elements of this business that maybe the risk profile wasn't fully appreciated by IAG?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Well, let me answer that you got it right because in terms of the formula that we set at the beginning, obviously this is a business that I mean, we decided to go with that business a couple of years ago and we wanted to protect ourselves. We had this earn-out formula that was really focused on providing short-term results. After a year, because it has been a year, after a year we looked at it and really we decided that it was time to review our old projections on that business. Obviously, it became clear that the earn out would not be payable so we had the agreement with the previous shareholders on that. Then after that, we went through -- that was the decision on the earn-out part. I'll leave it to Rene to explain what we did on the goodwill side.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

On the goodwill side, Sumit, that's two different decision. On the one side you do it on the earn out, on the goodwill then you look at what is now the business model. Basically, the business model changed a little bit. We shift toward a less riskier profile in terms of portfolio. We have new financial projection so we put all this into the calculation and we just apply it.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

It's Yvon Charest, if I may, because, I don't want people to leave this room and saying oh, my God, it's going tough with CTL. The mere fact is two things. First the CTL guys, we're extremely optimistic and second, based on their optimism, we made the decision at iA in the balance sheet to put the most optimistic view of the earn out. We could have taken another decision but we made that decision.

Today what we are telling you, we say you know what? The most optimistic scenario we don't see it. We see the realistic scenario and this is why we felt that we had to adjust the balance sheet. Had we decided to, in the balance sheet to book for another earn out, let's say the realistic view, you would say business is going as expected, everything is fine and blah, blah, blah. I don't want people to draw conclusions just because of our decision a year ago to book for a very optimistic view of the business.

Sumit Malhotra - *Scotiabank - Analyst*

Understood. Thank you all for your time.

Operator

Our next question comes from the line of Doug Young with Desjardins Capital Markets.

Doug Young - *Desjardins Securities - Analyst*

I apologize up front but I have another CTL question. Just what I want to understand is, have you written down all of the goodwill related to that and is all of the intangibles related to -- or all the earn out, out of that as well? Or is there still some assumptions of earn outs in there?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

The earn out is totally written down and the goodwill is partially written down because we still have goodwill related to the realistic scenario as Yvon mentioned.

Doug Young - *Desjardins Securities - Analyst*

Is there any issue, and maybe this is a question for Yvon or Denis, but is there anything issue with the retention of the people around the earn out being gone?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Well it's a very interesting question because some of the Management were also shareholders, but I mean, we've had an agreement with the shareholders, all the shareholders, the ones that are with Management and the ones that are not, to we terminated the earn out agreement and we settled that and I can tell you that all of the Management are staying on board.

Doug Young - *Desjardins Securities - Analyst*

Okay. Rene, just if I can go through some math with you here, you talk about a 20 basis point reduction in the URR, and I can get to the math on what that would impact would be. The IRR, can you talk and I don't have the numbers in front of me, but if it's a 1.8%, how far are you reducing your IRR at year end?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

My IRR is moving basically from 217 to 180, to answer your question, Doug.

Doug Young - *Desjardins Securities - Analyst*

Okay. Those two items, when you add them together, you think you have or you're clearly comfortable that you've got offsets elsewhere in terms of reserve releases to be able to mitigate the impact.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

That's the reason I mentioned that statement, Doug.

Doug Young - *Desjardins Securities - Analyst*

I just want to be crystal clear on that. Can you talk a bit about what are some of the big -- I know you've talked about different items in the past, but what are some of the bigger drivers that help mitigate the earnings impact?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

It's all the same. The one we talked with you last quarter as well as at the Investor Day. It's all the some thematics, always the same. I would just repeat myself on that. The idea here, Doug, was to give to the people the time, basically, and not necessarily to demonstrate how the the clock works. If you like to have further granular information, I could take it off line with you.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

When you say all of the same you mentioned all of the Management actions we have done at every single quarter, including in Q3 to try to have the URR issue behind us

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Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

It's always active portfolio management, the investment gains that you create in that active portfolio management,, the fact that we have better assets yielding rates, the fact that we have mortality gains and the fact that we review our expenses, the fact that review all of our other assumptions. We put all of this into our basket and then take the initiative.

Doug Young - *Desjardins Securities - Analyst*

Perfect. Okay. Lastly, you have talked historically about seg fund hedging. I apologize if there's been an update on this. I haven't seen anything. Is there any update in terms of getting credit for hedging seg fund risk and can you talk a little bit more about that file?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

There was a period where we could provide comments to AMF on this. It was October 16 so we provided our comments on this and we are waiting for the final decision on that one.

Doug Young - *Desjardins Securities - Analyst*

Okay, perfect. Thank you very much.

Operator

Our next question comes from the line of Mario Mendonca with TD Securities.

Mario Mendonca - *TD Securities - Analyst*

Good afternoon. Rene, I do want to make sure I get these numbers right, though. The 20 basis point decline in the URR would imply something like CAD132 million after tax. The URR would be perhaps as much as CAD90 million, so you're talking about CAD220 million, CAD230 million after tax of reserve strengthening related to rates. Now, you made -- first of all, does that number close enough?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Yes, it is.

Mario Mendonca - *TD Securities - Analyst*

So the way to address that, you talked about the management actions and you're right, we're familiar with that. You've gone through that several times now. The question is you clearly have a lot of excess reserves related to mortality or wouldn't be seeing all of these experience gains over the last little while. Is there room to release mortality, morbidity or other reserves like equity markets, for example, to help offset that CAD220 million I referred or so I referred to or is it all just the management actions?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

It's mostly management action, investment gains related to management action, Mario, and I did not release any mortality improvement reserve, for example, that I could have done. I did not touch that. It's still there, except that as you know every year, perhaps mortality gains related to my five-year rolling average that I'm using in that process too. Investment gain to management action, most of the time plus the usual mortality gains plus other small mortality elements on other elements that I'd pick altogether.

Mario Mendonca - *TD Securities - Analyst*

And you're offering this all prospectively. Nothing has been done, this is just what contemplate for the end of the year?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Yes, I didn't try to change the earnings power path of the organization.

Mario Mendonca - *TD Securities - Analyst*

That's where I'm getting at. Now back to CTL, and Yvon, your point a moment ago you don't want us walking away thinking that something is wrong. From the nature of the questions, that's precisely what we're all thinking, so if I could just pursue this a little further, what is the net investment on Industrial Alliance's balance sheet today, broken out between just the net investment and then the goodwill for CTL today?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

It's Denis Ricard here. It would be around CAD31 million.

Mario Mendonca - *TD Securities - Analyst*

CAD31 million would be the investment in CTL today. What portion of that is goodwill?

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

It's Yvon Charest. The guys are checking the numbers, so we'll tell you within 10 seconds if we can answer or if it's going to be after the call.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

We'd prefer to send you--

Mario Mendonca - *TD Securities - Analyst*

To be clear, so the entire investment on the books today is CAD31 million, goodwill plus everything else? Is that right?

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

Yes, it's quite in the ballpark. It might not be the precise number, but it's in the ballpark.

Mario Mendonca - *TD Securities - Analyst*

So we are not talking about a huge number here, so even if you wrote off the whole thing tomorrow, the entire net investment we're looking at CAD31 million?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

For sure, Mario, it's a small amount. For sure it's a small amount. It's just that I don't get the exact amount in my head, but for sure it's a small amount.

Mario Mendonca - *TD Securities - Analyst*

That's okay. That's what I'm trying to get at. The final question, on the write-off of the -- or write down of the earn out, I see that it benefited the MCCSR. Why would that not have gone through your earnings as well, or was this entirely a capital entry?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Mario, you have to separate P&L from capital. In the capital, you know the goodwill is already written down. What do you have here? You have a benefit, an additional profit coming from the fact that I'm writing down the earn out. It's like having additional profit from capital purposes, but it has no additional profit from P&L purposes because I do write down the goodwill in my P&L.

Mario Mendonca - *TD Securities - Analyst*

I see. The two offset each other from the P&L. So there's no--

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Yes, from a P&L, from a capital point of view since goodwill was already written down.

Mario Mendonca - *TD Securities - Analyst*

Totally get it. To be clear, the one thing I'll want to be confident on that there's no benefit to earnings related to the write down because the goodwill write-off offset that?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

You're right.

Mario Mendonca - *TD Securities - Analyst*

Got it. Thank you.

Operator

Our next question comes from the line of Tom MacKinnon with BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Just a couple questions, one other CTL. I think you said it would be CAD0.04 accretive when you got CTL. How should we be looking at that in light of what you've done here? Is there any change to that or is there any change to what you think you should be getting out of CTL going forward? How much is it in that expected profit of your group insurance business?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

It's Denis here. If we look forward, like I said before, there could be a significant -- not a significant, sorry, a minor decrease in the contribution to the profit of the Company in the future, but it's not going to be that material. We still believe that the business model of CTL is relevant, is going to be there. Obviously we're learning that business right now with all of the management over there, but when we look long term we still believe that it's going to continue to provide for the EPS growth.

Tom MacKinnon - *BMO Capital Markets - Analyst*

If I look at expected profit in group insurance, it was running in the 12, 13-ish range and then the last two quarters it was up 17 and then 20.9. What's driving that there? How much of CTL is in those numbers?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

CTL are in these numbers and CTL are in the SAL numbers (i.e. Dealer Services) of that group insurance line of business. What was driving the growth of that segment was mostly employer/employee plan. That was a key element of the growth out there. You remember that we told you that we were working on improving the situation of that line of business, so we have increased our expected profit from that line of business year over year as well as the fact that CTL was also providing some increasing number on the SAL business (i.e. Dealer Services). As an indication, you could probably use the fact that the growth in CTL was easily -- the growth of SAL (i.e. Dealer Services) was easily CTL driven.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay. What percentage is CTL of the group business? Is it less than 25%?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

I would say it's about 10%.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay. Great. Finally, with respect to the MCCSR, the TSX was up nicely in the quarter, maybe about 4.5% to 5%. Why didn't that help your MCCSR at all in the quarter?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Probably because the benefit we had from the seg fund business was compensated by the fact that when these market goes up we have more capital in the life insurance side, so that's the net of the two. That didn't create too much of an impact.

Yvon Charest - *Industrial Alliance Insurance and Financial Services Inc. - President and CEO*

Yes, a lot of people would say the equity market has improved, it's great. Yes, it's great for the income statement. It's even better for the reserve buffer on stock because you know that buffer has increased, but unfortunately, over the short-term for capital, it's a bit more expensive because the capital requirement is a percentage of the investment, so when the market goes up, it does something. This is the tradeoff between income and capital.

Tom MacKinnon - *BMO Capital Markets - Analyst*

All right, because I know that when you put out your grid describing the sensitivity of the solvency ratio it shows the solvency ratio potentially could go down as equity markets go down, but what you're telling me is the solvency ratio doesn't go up as equity markets go up?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

When equity goes up, you have more capital involved because of your holding of the stock and you have benefit from the seg fund because the equity goes up and it's the net of the two. Next time when we're going to publish the capital matrix, we'll make sure that we give you one or two notches so that you could see when the market goes up what's happening.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, that's great. Then finally, the expense gains you got in the quarter. What was driving that and how sustainable do you think that could be?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

The expense was widespread in many different wealth management businesses. It's within our seg fund businesses, iA Clarington businesses as well as distribution businesses. We think that it's just the fact that we have additional volume and we were just operating better in these segments.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay. The last one is as we move into the fourth quarter and we get maybe a bit of a push for insurance sales in light of some tax changes or potential IIT type changes, how is EquiBuild positioned there and what do you see happening for sales in the fourth quarter for that. What do you think that could do to strain?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

It's Denis here. Let me answer first that in terms of sales and I've been talking to some colleagues of other companies in Canada. Obviously the brokers are, I would say, they are quite intense in their activities right now, so I think for the whole industry you should expect an increase level of sales in Q4 compared to what you would otherwise see, so that's the basic thing that I would say. I don't know Rene if you want to add on strain.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Maybe on the strain side, it's sure that, that push, that push for level COI business, it's sure the product mix side is not very favorable for us. There is two elements at work here. The fact that if we are able to sell a whole bunch of policy or a good number of policy it's going to be beneficial but on the other side, probably in more strainful product and that's the net of the two. In this quarter, you have seen that was exactly the case. The strain is at 12%. We sell more but we had less favorable product mix, but the net was positive overall.

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Maybe one thing I would like to add is the question on EquiBuild. EquiBuild is getting traction. It's still under, let's say, our expectation at this point, but the trend is going upward, so my hope is that when ever all of the other products, prices going up that the product will become even more attractive and that all of the efforts that we've done will be rewarded at that point.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay. Thanks very much.

Operator

Our next question comes from the line of Darko Mihelic with RBC Capital Markets.

Darko Mihelic - *RBC Capital Markets - Analyst*

Hi, thank you. My question was also related to strain but I care more about next year. It sounds to me like you are not actually making any changes to the product lineup. It's just a pricing change for next year. Is that the way I should think about this?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Well, it's Denis again. No, I think you should think a bit differently here. Obviously the basis was to make sure we price correctly for the IIT changes. We did that, but at the same time, we tried to look at all our portfolio of products. Some products were removed, some that were quite strain intensive, by the way. We also took advantage of that for the level cost of insurance to increase more than necessary for the IIT costs, because obviously there were some downward trend in the interest rates. It's more than just offsetting the IIT impact.

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Darko, this is all good news with respect to strain anticipation for 2017.

Darko Mihelic - *RBC Capital Markets - Analyst*

Is it good news just because the -- first of all, is the expectation for 2017, now that you've had pull forward in 2016, is the expectation that 2017 should actually be a lighter year in terms of sales?

Denis Ricard - *Industrial Alliance Insurance and Financial Services Inc. - EVP of Individual Insurance & Annuities*

Denis again. Well hopefully it's not going to be a soft year. We don't know yet because obviously not all of the companies have disclosed what their changes will be, but I can tell you one thing. There's going to be a second round of changes in pricing because obviously we all look at each other and we don't know what the others are doing. Once we have more clarity as to what the other companies are doing, it is possible that we will go for a second round. It could be that we push too hard on prices or maybe we haven't pushed hard enough. We'll have to see.

Darko Mihelic - *RBC Capital Markets - Analyst*

Okay, understood. Thank you.

Operator

(Operator Instructions)

Our next question is a follow-up question from the line of Mario Mendonca with TD Securities.

Mario Mendonca - *TD Securities - Analyst*

Just a quick follow-up again on CTL. So 3.5% loss rate this quarter, that works out against the receivable to be, I think, we're looking at maybe CAD3 million loss or PCLs this quarter. Where in the sources of earnings for group insurance would that be recorded? Is that a net against the expected profit?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

No, it is in the gain and loss of group insurance.

Mario Mendonca - *TD Securities - Analyst*

Sorry, in experience then?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Yes, experience gain and loss of group insurance.

Mario Mendonca - *TD Securities - Analyst*

That number was small, so I guess there were just some positives that offset that, but the CAD3.5 million is about right, is that right?

Rene Chabot - *Industrial Alliance Insurance and Financial Services Inc. - EVP, CFO and Chief Actuary*

Yes, you're about right, and it's because of group life and health that deliver another good quarter.

Mario Mendonca - *TD Securities - Analyst*

Thanks again.

Operator

We are showing no further questions at this time. I'll turn the conference back over to you.

Grace Pollock - *Industrial Alliance Insurance and Financial Services Inc. - Director of IR*

That concludes our conference call today. If you have any further questions you can call us at 418-780-5945. Thanks for joining us today.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you kindly for your participation and ask that you please disconnect your lines.
