*Consolidated Financial Statements of*

# LONDON LIFE INSURANCE COMPANY

*December 31, 2017 and 2016*

Deloitte.

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# Independent Auditor's Report

To the Policyholders and the Shareholder of
London Life Insurance Company

We have audited the accompanying consolidated financial statements of London Life Insurance Company, which comprise the consolidated balance sheets as at December 31, 2017 and December 31, 2016, and the consolidated statements of earnings, consolidated statements of comprehensive income, consolidated statements of changes in equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

**Management's Responsibility for the Consolidated Financial Statements**
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

**Opinion**
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of London Life Insurance Company as at December 31, 2017 and December 31, 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

/s/ Deloitte LLP
Chartered Professional Accountants
February 8, 2018
Winnipeg, Manitoba

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# CONSOLIDATED STATEMENTS OF EARNINGS

*(in Canadian $ millions)*

| | For the years ended December 31 | |
|---|---|---|
| | **2017** | 2016 |
| **Income** | | |
| Premium income | | |
| Gross premiums written | **$ 14,670** | $ 13,771 |
| Ceded premiums | **(143)** | (136) |
| Total net premiums | **14,527** | 13,635 |
| Net investment income (note 4) | | |
| Regular net investment income | **1,128** | 1,144 |
| Changes in fair value through profit or loss | **145** | 412 |
| Total net investment income | **1,273** | 1,556 |
| Fee and other income | **1,142** | 1,049 |
| | **16,942** | 16,240 |
| **Benefits and expenses** | | |
| Policyholder benefits | | |
| Gross | **14,182** | 12,078 |
| Ceded | **(130)** | (149) |
| Total net policyholder benefits | **14,052** | 11,929 |
| Policyholder dividends and experience refunds | **837** | 788 |
| Changes in insurance and investment contract liabilities | **135** | 1,499 |
| Total paid or credited to policyholders | **15,024** | 14,216 |
| Commissions | **701** | 733 |
| Operating and administrative expenses (note 22) | **562** | 604 |
| Premium taxes | **65** | 63 |
| Financing charges | **7** | 8 |
| Amortization of finite life intangible assets (note 7) | **22** | 20 |
| Restructuring expenses (note 21) | **79** | — |
| **Earnings before income taxes** | **482** | 596 |
| Income taxes (note 20) | **58** | 55 |
| **Net earnings** | **424** | 541 |
| Net earnings - participating account (note 13) | **33** | 40 |
| **Net earnings - common shareholder** | **$ 391** | $ 501 |

# CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

*(in Canadian $ millions)*

| | For the years ended December 31 | |
|---|---|---|
| | **2017** | 2016 |
| **Net earnings** | **$ 424** | $ 541 |
| **Other comprehensive income (loss)** | | |
| **Items that may be reclassified subsequently to Consolidated Statements of Earnings** | | |
| Unrealized foreign exchange gains (losses) on translation of foreign operations | **(44)** | (40) |
| Unrealized gains (losses) on available-for-sale assets | **(41)** | (23) |
| Income tax benefit (expense) | **10** | 6 |
| Realized (gains) losses on available-for-sale assets | **1** | (6) |
| Income tax expense | **—** | 1 |
| **Total items that may be reclassified** | **(74)** | (62) |
| **Items that will not be reclassified to Consolidated Statements of Earnings** | | |
| Re-measurements on defined benefit pension and other post-employment benefit plans (note 17) | **(35)** | (14) |
| Income tax benefit (expense) | **10** | 4 |
| **Total items that will not be reclassified** | **(25)** | (10) |
| **Total other comprehensive income (loss)** | **(99)** | (72) |
| **Comprehensive income** | **$ 325** | $ 469 |

# CONSOLIDATED BALANCE SHEETS

*(in Canadian $ millions)*

| | December 31 | |
|---|---|---|
| | 2017 | 2016 (note 27) |
| **Assets** | | |
| Cash and cash equivalents (note 3) | $ 466 | $ 392 |
| Bonds (note 4) | 18,341 | 18,192 |
| Mortgage loans (note 4) | 7,550 | 7,702 |
| Stocks (note 4) | 3,921 | 3,871 |
| Investment properties (note 4) | 1,394 | 1,143 |
| Loans to policyholders | 1,952 | 1,887 |
| | 33,624 | 33,187 |
| Funds held by ceding insurers | 2,378 | 2,615 |
| Goodwill (note 7) | 3 | 3 |
| Intangible assets (note 7) | 86 | 101 |
| Derivative financial instruments (note 23) | 88 | 95 |
| Owner occupied properties (note 8) | 138 | 139 |
| Fixed assets (note 8) | 30 | 35 |
| Other assets (note 9) | 133 | 136 |
| Premiums in course of collection, accounts and interest receivable | 373 | 355 |
| Reinsurance assets (note 10) | 1,118 | 1,149 |
| Current income taxes | 55 | 67 |
| Deferred tax assets (note 20) | 6 | 2 |
| Investments on account of segregated fund policyholders (note 11) | 60,446 | 55,575 |
| **Total assets** | $ 98,478 | $ 93,459 |
| **Liabilities** | | |
| Insurance contract liabilities (note 10) | $ 32,082 | $ 32,227 |
| Investment contract liabilities (note 10) | 43 | 42 |
| Funds held under reinsurance contracts | 23 | 20 |
| Derivative financial instruments (note 23) | 248 | 335 |
| Accounts payable | 133 | 127 |
| Other liabilities (note 12) | 1,110 | 948 |
| Current income taxes | 7 | 3 |
| Deferred tax liabilities (note 20) | 340 | 370 |
| Investment and insurance contracts on account of segregated fund policyholders (note 11) | 60,446 | 55,575 |
| **Total liabilities** | 94,432 | 89,647 |
| **Equity** | | |
| Participating account surplus | | |
| Accumulated surplus | 1,818 | 1,785 |
| Accumulated other comprehensive income (loss) (note 18) | (22) | 13 |
| Share capital (note 14) | 1,124 | 1,124 |
| Shareholder surplus | | |
| Accumulated surplus | 1,100 | 800 |
| Accumulated other comprehensive income (loss) (note 18) | (30) | 34 |
| Contributed surplus | 56 | 56 |
| **Total equity** | 4,046 | 3,812 |
| **Total liabilities and equity** | $ 98,478 | $ 93,459 |

Approved by the Board of Directors:

Jeffrey Orr
Chair of the Board

Paul Mahon
President and Chief Executive Officer

# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

*(in Canadian $ millions)*

| | December 31, 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Share capital** | **Contributed surplus** | **Accumulated surplus** | **Accumulated other comprehensive income (loss)** | **Total shareholder equity** | **Participating account surplus** | **Total equity** |
| **Balance, beginning of year** | **$ 1,124** | **$ 56** | **$ 800** | **$ 34** | **$ 2,014** | **$ 1,798** | **$ 3,812** |
| Net earnings | **—** | **—** | **391** | **—** | **391** | **33** | **424** |
| Other comprehensive income (loss) | **—** | **—** | **—** | **(64)** | **(64)** | **(35)** | **(99)** |
| | **1,124** | **56** | **1,191** | **(30)** | **2,341** | **1,796** | **4,137** |
| Dividends to common shareholder | **—** | **—** | **(91)** | **—** | **(91)** | **—** | **(91)** |
| **Balance, end of year** | **$ 1,124** | **$ 56** | **$ 1,100** | **$ (30)** | **$ 2,250** | **$ 1,796** | **$ 4,046** |

| | December 31, 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital | Contributed surplus | Accumulated surplus | Accumulated other comprehensive income (loss) | Total shareholder equity | Participating account surplus | Total equity |
| Balance, beginning of year | $ 1,024 | $ 56 | $ 747 | $ 84 | $ 1,911 | $ 1,780 | $ 3,691 |
| Net earnings | — | — | 501 | — | 501 | 40 | 541 |
| Other comprehensive income (loss) | — | — | — | (50) | (50) | (22) | (72) |
| | 1,024 | 56 | 1,248 | 34 | 2,362 | 1,798 | 4,160 |
| Dividends to common shareholder | — | — | (448) | — | (448) | — | (448) |
| Issue of common shares to parent company (note 14) | 100 | — | — | — | 100 | — | 100 |
| Balance, end of year | $ 1,124 | $ 56 | $ 800 | $ 34 | $ 2,014 | $ 1,798 | $ 3,812 |

# CONSOLIDATED STATEMENTS OF CASH FLOWS

*(in Canadian $ millions)*

| | For the years ended December 31 | |
|---|---|---|
| | **2017** | 2016 |
| **Operations** | | |
| Earnings before income taxes | **$ 482** | $ 596 |
| Income taxes paid, net of refunds received | **(60)** | (99) |
| Adjustments: | | |
| Change in insurance and investment contract liabilities | **1,128** | 1,294 |
| Change in funds held by ceding insurers | **(80)** | (267) |
| Change in funds held under reinsurance contracts | **3** | — |
| Change in reinsurance assets | **24** | 32 |
| Changes in fair value through profit or loss | **(145)** | (412) |
| Other | **24** | 36 |
| | **1,376** | 1,180 |
| **Financing Activities** | | |
| Issue of common shares | **—** | 100 |
| Dividends paid on common shares | **(91)** | (448) |
| | **(91)** | (348) |
| **Investment Activities** | | |
| Bond sales and maturities | **4,516** | 4,634 |
| Mortgage loan repayments | **1,521** | 1,354 |
| Stock sales | **1,237** | 1,672 |
| Change in loans to policyholders | **(65)** | (39) |
| Investment in bonds | **(5,794)** | (5,240) |
| Investment in mortgage loans | **(1,393)** | (1,548) |
| Investment in stocks | **(1,040)** | (1,620) |
| Investment in investment properties | **(191)** | (48) |
| | **(1,209)** | (835) |
| Effect of changes in exchange rates on cash and cash equivalents | **(2)** | (10) |
| **Increase (decrease) in cash and cash equivalents** | **74** | (13) |
| **Cash and cash equivalents, beginning of year** | **392** | 405 |
| **Cash and cash equivalents, end of year** | **$ 466** | $ 392 |
| **Supplementary cash flow information** | | |
| Interest income received | **$ 785** | $ 838 |
| Interest paid | **7** | 7 |
| Dividend income received | **115** | 118 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(in Canadian $ millions)*

### 1. Corporate Information

The London Life Insurance Company (London Life or the Company) is a company incorporated and domiciled in Canada. The registered address of the Company is 255 Dufferin Avenue, London, Ontario, Canada, N6A 4K1. London Life is a wholly-owned subsidiary of London Insurance Group, Inc. (LIG), who's indirect parent is Great-West Lifeco Inc. (Lifeco). Lifeco is a member of the Power Corporation of Canada group of companies and its direct parent is Power Financial Corporation (Power Financial).

London Life is a Canadian insurer, with interests in the life and health insurance, investment, savings and retirement income and reinsurance businesses, primarily in Canada through its operating subsidiaries including London Reinsurance Group Inc. (LRG), Toronto College Park Ltd. and Quadrus Investment Services Ltd.

The consolidated financial statements (financial statements) of the Company as at and for the year ended December 31, 2017 were approved by the Board of Directors on February 8, 2018.

### 2. Basis of Presentation and Summary of Accounting Policies

The consolidated financial statements of the Company have been prepared in compliance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). Consistent accounting policies were applied in the preparation of the consolidated financial statements of the subsidiaries of the Company.

The Company adopted the narrow scope amendments to IFRS for IAS 7 *Statement of Cash Flows*, IAS 12 *Income Taxes and Annual Improvements 2014 - 2016 Cycle* for the amendment to IFRS 12 *Disclosure of Interest in Other Entities*, effective January 1, 2017. The adoption of these narrow scope amendments did not have a significant impact on the Company's consolidated financial statements.

Effective January 1, 2017, the Company has changed the accounting policy to classify the provision for tax uncertainties as current or deferred based on how a disallowance of the underlying uncertain tax treatment would impact the tax provision accrual as of the balance sheet date. Previously, tax uncertainties were booked as current. The accounting policy change presents more reliable and relevant information to financial statement users as it reflects the economic reality of settling the underlying tax issues.

The Company retroactively restated the classification of current taxes to deferred taxes on the Consolidated Balance Sheets. The change in accounting policy resulted in increases to deferred tax liabilities and current income tax assets of $11 at December 31, 2016. These adjustments and reclassifications had no impact on the total equity or net earnings of the Company (note 27).

Basis of Consolidation

The consolidated financial statements of the Company were prepared as at and for the year ended December 31, 2017 with comparative information for December 31, 2016. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated until the date that such control ceases. The Company has control when it has the power to direct the relevant activities, has significant exposure to variable returns from these activities and has the ability to use its power to affect the variable returns. All intercompany balances, transactions, income and expenses and profits or losses, including dividends resulting from intercompany transactions, are eliminated on consolidation.

Use of Significant Judgments, Estimates and Assumptions

In preparation of these consolidated financial statements, management is required to make significant judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, net earnings and related disclosures. Although some uncertainty is inherent in these judgments and estimates, management believes that the amounts recorded are reasonable. Key sources of estimation uncertainty and areas where significant judgments have been made are listed below and discussed throughout the notes to these consolidated financial statements including:

- Management uses independent qualified appraisal services to determine the fair value of investment properties, which utilize judgments and estimates. These appraisals are adjusted by applying management judgments and estimates for material changes in property cash flows, capital expenditures or general market conditions (note 4).
- In the determination of the fair value of financial instruments, the Company's management exercises judgment in the determination of fair value inputs, particularly those items categorized within level 3 of the fair value hierarchy (note 6).
- Management evaluates the future benefit for initial recognition and measurement of goodwill and intangible assets as well as testing the recoverable amounts. The determination of the carrying value and recoverable amounts of the cash generating unit groupings for goodwill and intangible assets relies upon the determination of fair value or value-in-use using valuation methodologies (note 7).
- Judgments are used by management in determining whether deferred acquisition costs can be recognized on the Consolidated Balance Sheets. Deferred acquisition costs are recognized if management determines the costs meet the definition of an asset and are incremental and related to the issuance of mutual funds (note 9).
- Management uses judgment to evaluate the classification of insurance and reinsurance contracts to determine whether these arrangements should be accounted for as insurance, investment or service contracts.
- The actuarial assumptions, such as interest rates, inflation, policyholder behaviour, mortality and morbidity of policyholders, used in the valuation of insurance and certain investment contract liabilities under the Canadian Asset Liability Method require significant judgment and estimation (note 10).
- The actuarial assumptions used in determining the expense and benefit obligations for the Company's defined benefit pension plans and other post-employment benefits requires significant judgment and estimation. Management reviews previous experience of its plan members and market conditions including interest rates and inflation rates in evaluating the assumptions used in determining the expense for the current year (note 17).
- The Company operates within various tax jurisdictions where significant management judgments and estimates are required when interpreting the relevant tax laws, regulations and legislation in the determination of the Company's tax provisions and the carrying amounts of its tax assets and liabilities (note 20).
- Management applies judgment in assessing the recoverability of the deferred income tax asset carrying values based on future years' taxable income projections (note 20).
- Legal and other provisions are recognized resulting from a past event which, in the judgment of management, has resulted in a probable outflow of economic resources which would be passed to a third-party to settle the obligation. Management uses judgment to evaluate the possible outcomes and risks in determining the best estimate of the provision at the balance sheet date (note 24).
- The operating segments of the Company, which are the segments reviewed by the Company's Chief Executive Officer to assess performance and allocate resources within the Company. Management applies judgment in the aggregation of the business units into the Company's operating segments (note 26).

- The Company consolidates all subsidiaries and entities which management determines that the Company controls. Control is evaluated on the ability of the Company to direct the activities of the subsidiary or entity to derive variable returns and management uses judgment in determining whether control exists. Judgment is exercised in the evaluation of the variable returns and in determining the extent to which the Company has the ability to exercise its power to generate variable returns.
- Management uses judgments, such as the determination of the risks and benefits associated with the transaction that are used in determining whether the Company retains the primary obligation with a client in sub-advisor arrangements. Where the Company retains the risks and benefits, revenue and expenses are recorded on a gross basis.
- Within the Consolidated Statements of Cash Flows, purchases and sales of portfolio investments are recorded within investment activities due to management's judgment that these investing activities are long-term in nature.
- The results of the Company reflect management's judgments regarding the impact of prevailing global credit, equity and foreign exchange market conditions. The provision for future credit losses within the Company's insurance contract liabilities relies upon investment credit ratings. The Company's practice is to use third-party independent credit ratings where available. Management judgment is required when setting credit ratings for instruments that do not have a third-party rating.

The significant accounting policies are as follows:

**(a) Portfolio Investments**

Portfolio investments include bonds, mortgage loans, stocks and investment properties. Portfolio investments are classified as fair value through profit or loss, available-for-sale, held-to-maturity, loans and receivables, equity-method investments or as non-financial instruments based on management's intention relating to the purpose and nature of the instrument or characteristics of the investment. The Company has not classified any investments as held-to-maturity.

Investments in bonds and stocks normally actively traded on a public market or where fair value can be reliably measured are either designated or classified as fair value through profit or loss or classified as available-for-sale on a trade date basis. A financial asset is designated as fair value through profit or loss on initial recognition if it eliminates or significantly reduces an accounting mismatch. Changes in the fair value of financial assets designated as fair value through profit or loss are generally offset by changes in insurance contract liabilities, since the measurement of insurance contract liabilities is determined with reference to the assets supporting the liabilities. A financial asset is classified as fair value through profit or loss on initial recognition if it is part of a portfolio that is actively traded for the purpose of earning investment income. Fair value through profit or loss investments are recognized at fair value on the Consolidated Balance Sheets with realized and unrealized gains and losses reported in the Consolidated Statements of Earnings. Available-for-sale investments are recognized at fair value on the Consolidated Balance Sheets with unrealized gains and losses recorded in other comprehensive income. Realized gains and losses on available-for-sale investments are reclassified from other comprehensive income and recorded in the Consolidated Statements of Earnings when the investment is sold. Interest income earned on both fair value through profit or loss and available-for-sale bonds is recorded as net investment income in the Consolidated Statements of Earnings.

Investments in stocks where a fair value cannot be measured reliably are classified as available-for-sale and carried at cost. Investments in stocks for which the Company exerts significant influence over but does not control are accounted for using the equity method of accounting.

Investments in mortgages and bonds not normally actively traded on a public market are classified as loans and receivables and are carried at amortized cost net of any allowance for credit losses. Interest income earned and realized gains and losses on the sale of investments classified as loans and receivables are recorded in the Consolidated Statements of Earnings and included in net investment income.

Investment properties are real estate held to earn rental income or for capital appreciation. Investment properties are initially measured at cost and subsequently carried at fair value on the Consolidated Balance Sheets. All changes in fair value are recorded as net investment income in the Consolidated Statements of Earnings. Properties held to earn rental income or for capital appreciation that have an insignificant portion that is owner occupied or where there is no intent to occupy on a long-term basis are classified as investment properties. Properties that do not meet these criteria are classified as owner occupied properties. Property that is leased that would otherwise be classified as investment property if owned by the Company is also included within investment properties.

Fair Value Measurement

Financial instrument carrying values necessarily reflect the prevailing market liquidity and the liquidity premiums embedded within the market pricing methods that the Company relies upon.

Fair value movement on the assets supporting insurance contract liabilities is a major factor in the movement of insurance contract liabilities. Changes in the fair value of bonds designated or classified as fair value through profit or loss that support insurance and investment contract liabilities are largely offset by corresponding changes in the fair value of liabilities except when the bond has been deemed impaired.

The following is a description of the methodologies used to value instruments carried at fair value:

*Bonds - Fair Value Through Profit or Loss and Available-for-Sale*

Fair values for bonds classified and designated as fair value through profit or loss or available-for-sale are determined with reference to quoted market bid prices primarily provided by third-party independent pricing sources. Where prices are not quoted in a normally active market, fair values are determined by valuation models. The Company maximizes the use of observable inputs when measuring fair value. The Company obtains quoted prices in active markets, when available, for identical assets at the balance sheet date to measure bonds at fair value in its fair value through profit or loss and available-for-sale portfolios.

The Company estimates the fair value of bonds not traded in active markets by referring to actively traded securities with similar attributes, dealer quotations, matrix pricing methodology, discounted cash flow analyses and/or internal valuation models. This methodology considers such factors as the issuer's industry, the security's rating, term, coupon rate and position in the capital structure of the issuer, as well as, yield curves, credit curves, prepayment rates and other relevant factors. For bonds that are not traded in active markets, valuations are adjusted to reflect illiquidity, and such adjustments generally are based on available market evidence. In the absence of such evidence, management's best estimate is used.

*Bonds and Mortgages - Loans and Receivables*

For disclosure purposes only, fair values for bonds and mortgages classified as loans and receivables are determined by discounting expected future cash flows using current market rates for similar instruments. Valuation inputs typically include benchmark yields and risk-adjusted spreads based on current lending activities and market activity.

*Stocks - Fair Value Through Profit or Loss and Available-for-Sale*

Fair values for stocks traded on an active market are generally determined by the last bid price for the security from the exchange where it is principally traded. Fair values for stocks for which there is no active market is typically based upon alternative valuation techniques such as discounted cash flow analysis, review of price movement relative to the market and utilization of information provided by the underlying investment manager. The Company maximizes the use of observable inputs when measuring fair value. The Company obtains quoted prices in active markets, when available, for identical assets at the balance sheet date to measure stocks at fair value in its fair value through profit or loss and available-for-sale portfolios.

*Investment Properties*

Fair values for investment properties are determined using independent qualified appraisal services and include management adjustments for material changes in property cash flows, capital expenditures or general market conditions in the interim period between appraisals. The determination of the fair value of investment property requires the use of estimates including future cash flows (such as future leasing assumptions, rental rates, capital and operating expenditures) and discount, reversionary and overall capitalization rates applicable to the asset based on current market conditions. Investment property under construction is valued at fair value if such values can be reliably determined; otherwise they are recorded at cost.

Impairment

Investments are reviewed regularly on an individual basis to determine impairment status. The Company considers various factors in the impairment evaluation process, including, but not limited to, the financial condition of the issuer, specific adverse conditions affecting an industry or region, decline in fair value not related to interest rates, bankruptcy or defaults, and delinquency in payments of interest or principal.

Investments are deemed to be impaired when there is objective evidence that timely collection of future cash flows can no longer be reliably estimated. The fair value of an investment is not a definitive indicator of impairment, as it may be significantly influenced by other factors including the remaining term to maturity and liquidity of the asset; however, market price is taken into consideration when evaluating impairment.

For impaired mortgages and bonds classified as loans and receivables, provisions are established or write-offs made to adjust the carrying value to the net realizable amount. Wherever possible the fair value of collateral underlying the loans or observable market price is used to establish net realizable value. For impaired available-for-sale bonds recorded at fair value, the accumulated loss recorded in accumulated other comprehensive income is reclassified to net investment income. Impairments on available-for-sale debt instruments are reversed if there is objective evidence that a permanent recovery has occurred. All gains and losses on bonds classified or designated as fair value through profit or loss are already recorded in net investment income; therefore a reduction due to impairment of these assets will be recorded in net investment income.

Securities Lending

The Company engages in securities lending through its securities custodians as lending agents. Loaned securities are not derecognized, and continue to be reported within invested assets, as the Company retains substantial risks and rewards and economic benefits related to the loaned securities.

**(b) Transaction Costs**

Transaction costs are expensed as incurred for financial instruments classified as fair value through profit or loss. Transaction costs for financial assets classified as available-for-sale or loans and receivables are added to the value of the instrument at acquisition and taken into net earnings using the effective interest method. Transaction costs for financial liabilities classified as other than fair value through profit or loss are included in the value of the instrument issued and taken into net earnings using the effective interest method.

**(c) Cash and Cash Equivalents**

Cash and cash equivalents comprise cash, current operating accounts, overnight bank and term deposits with maturities of three months or less held for the purpose of meeting short-term cash requirements. Net payments in transit and overdraft bank balances are included in other liabilities.

**(d) Other Assets and Other Liabilities**

Other assets, which include prepaid expenses, deferred acquisition costs, and miscellaneous other assets, are measured at cost or amortized cost. Other liabilities, including bank overdraft, and other miscellaneous liabilities are measured at cost or amortized cost.

Provisions are recognized within other liabilities when the Company has a present obligation, either legal or constructive, as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount to settle the obligation. The amounts recognized for provisions are management's best estimates of the expenditures required to settle the obligation at the balance sheet date. The Company recognizes a provision for restructuring when a detailed formal plan for the restructuring has been established and that the plan has raised a valid expectation in those affected that the restructuring will occur.

Pension and other post-employment benefits also included within other assets and other liabilities are measured in accordance with note 2(t).

**(e) Participating Account**

The shareholder portion of participating earnings represents, as restricted by law, a portion of net earnings before policyholder dividends of the participating account. The actual payment of the shareholder portion of participating earnings is legally determined as a percentage of policyholder dividends paid.

**(f) Derivative Financial Instruments**

The Company uses derivative products as risk management instruments to hedge or manage asset, liability and capital positions, including fee and investment income. The Company's policy guidelines prohibit the use of derivative instruments for speculative trading purposes.

The Company includes disclosure of the maximum credit risk, future credit exposure, credit risk equivalent and risk weighted equivalent in note 23 as prescribed by the Office of the Superintendent of Financial Institutions in Canada (OSFI).

All derivatives including those that are embedded in financial and non-financial contracts that are not closely related to the host contracts are recorded at fair value on the Consolidated Balance Sheets. The method of recognizing unrealized and realized fair value gains and losses depends on whether the derivatives are designated as hedging instruments. For derivatives that are not designated as hedging instruments, unrealized and realized gains and losses are recorded in net investment income in the Consolidated Statements of Earnings. For derivatives designated as hedging instruments, unrealized and realized gains and losses are recognized according to the nature of the hedged item.

Derivatives are valued using market transactions and other market evidence whenever possible, including market based inputs to models, broker or dealer quotations or alternative pricing sources with reasonable levels of price transparency. When models are used, the selection of a particular model to value a derivative depends on the contractual terms of, and specific risks inherent in, the instrument, as well as the availability of pricing information in the market. The Company generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices and rates, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs.

To qualify for hedge accounting, the relationship between the hedged item and the hedging instrument must meet several strict conditions on documentation, probability of occurrence, hedge effectiveness and reliability of measurement. If these conditions are not met, the relationship does not qualify for hedge accounting treatment and both the hedged item and the hedging instrument are reported independently as if there was no hedging relationship.

Where a hedging relationship exists, the Company documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking derivatives that are used in hedging transactions to specific assets and liabilities on the Consolidated Balance Sheets or to specific firm commitments or forecasted transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Hedge effectiveness is reviewed quarterly through correlation testing. Hedge accounting is discontinued when the hedging no longer qualifies for hedge accounting.

Derivatives not designated as hedges for accounting purposes
For derivative investments not designated as accounting hedges, changes in fair value are recorded in net investment income.

Fair value hedges
For fair value hedges, changes in fair value of both the hedging instrument and the hedged risk are recorded in net investment income and consequently any ineffective portion of the hedge is recorded immediately in net investment income.

The Company currently has no instruments designated as fair value hedges.

Cash flow hedges
For cash flow hedges, the effective portion of the changes in fair value of the hedging instrument is recorded in the same manner as the hedged item while the ineffective portion is recognized immediately in net investment income. Gains and losses that accumulate in other comprehensive income are recorded in net investment income in the same period the hedged item affects net earnings. Gains and losses on cash flow hedges are immediately reclassified from other comprehensive income to net investment income if and when it is probable that a forecasted transaction is no longer expected to occur.

The Company currently has no derivatives designated as cash flow hedges.

Net investment hedges
For net investment hedges, the effective portion of changes in the fair value of the hedging instrument are recorded in other comprehensive income while the ineffective portion is recognized immediately in net investment income. The unrealized foreign exchange gains (losses) on the instruments are recorded within accumulated other comprehensive income and will be reclassified into net earnings when the Company disposes of the foreign operation.

The Company does not currently have net investment hedges.

**(g) Embedded Derivatives**

An embedded derivative is a component of a host contract that modifies the cash flows of the host contract in a manner similar to a derivative, according to a specified interest rate, financial instrument price, foreign exchange rate, underlying index or other variable. Embedded derivatives are treated as separate contracts and are recorded at fair value if their economic characteristics and risks are not closely related to those of the host contract and the host contract is not itself recorded at fair value through the Consolidated Statements of Earnings. Embedded derivatives that meet the definition of an insurance contract are accounted for and measured as an insurance contract.

**(h) Foreign Currency Translation**

The Company operates with multiple functional currencies. The Company's consolidated financial statements are presented in Canadian dollars as this presentation is most meaningful to financial statement users. For those subsidiaries with different functional currencies, exchange rate differences arising from the translation of monetary items that form part of the net investment in the foreign operation are recorded in unrealized foreign exchange gains (losses) on translation of foreign operations in other comprehensive income.

For the purpose of presenting consolidated financial statements, assets and liabilities are translated into Canadian dollars at the rate of exchange prevailing at the balance sheet dates and all income and expense items are translated at an average of daily rates. Unrealized foreign currency translation gains and losses on translation of the Company's net investment in its foreign operations are presented separately as a component of other comprehensive income. Unrealized gains and losses will be recognized proportionately in net investment income in the Consolidated Statements of Earnings when there has been a disposal of the investment in the foreign operations.

Foreign currency translation gains and losses on foreign currency transactions of the Company are included in net investment income.

**(i) Loans to Policyholders**

Loans to policyholders are classified as loans and receivables and measured at amortized cost. Loans to policyholders are shown at their unpaid principal balance and are fully secured by the cash surrender values of the policies. Carrying value of loans to policyholders approximates their fair value.

**(j) Reinsurance Contracts**

The Company, in the normal course of business, is a user of reinsurance in order to limit the potential for losses arising from certain exposures and a provider of reinsurance. Assumed reinsurance refers to the acceptance of certain insurance risks by the Company underwritten by another company. Ceded reinsurance refers to the transfer of insurance risk, along with the respective premiums, to one or more reinsurers who will share the risks. To the extent that assuming reinsurers are unable to meet their obligations, the Company remains liable to its policyholders for the portion reinsured. Consequently, allowances are made for reinsurance contracts which are deemed uncollectible.

Reinsurance contracts are insurance contracts and undergo the classification as described within the Insurance and Investment Contract Liabilities section of this note. Assumed reinsurance premiums, commissions and claim settlements, as well as the reinsurance assets associated with insurance and investment contracts, are accounted for in accordance with the terms and conditions of the underlying reinsurance contract. Reinsurance assets are reviewed for impairment on a regular basis for any events that may trigger impairment. The Company considers various factors in the impairment evaluation process, including but not limited to, collectability of amounts due under the terms of the contract. The carrying amount of a reinsurance asset is adjusted through an allowance account with any impairment loss being recorded in the Consolidated Statements of Earnings.

Any gains or losses on buying reinsurance are recognized in the Consolidated Statements of Earnings immediately at the date of purchase in accordance with the Canadian Asset Liability Method.

Assets and liabilities related to reinsurance are reported on a gross basis on the Consolidated Balance Sheets. The amount of liabilities ceded to reinsurers is estimated in a manner consistent with the claim liability associated with reinsured risks.

**(k) Funds Held by Ceding Insurers/Funds Held Under Reinsurance Contracts**

On the asset side, funds held by ceding insurers are assets that would normally be paid to the Company but are withheld by the cedant to reduce potential credit risk. Under certain forms of reinsurance contracts it is customary for the cedant to retain amounts on a funds withheld basis supporting the insurance contract liabilities ceded. For the funds withheld assets where the underlying asset portfolio is managed by the Company, the credit risk is retained by the Company. The funds withheld balance where the Company assumes the credit risk is measured at the fair value of the underlying asset portfolio with the change in fair value recorded in net investment income. Other funds held by ceding insurers are general obligations of the cedant and serve as collateral for insurance contract liabilities assumed from cedants. Funds withheld assets on these contacts do not have fixed maturity dates, their release generally being dependent on the run-off of the corresponding insurance contract liabilities.

On the liability side, funds held under reinsurance contracts consist mainly of amounts retained by the Company from ceded business written on a funds withheld basis. The Company withholds assets related to ceded insurance contract liabilities in order to reduce credit risk.

**(l) Business Combinations, Goodwill and Intangible Assets**

Business combinations are accounted for using the acquisition method. The Company identifies and classifies, in accordance with the Company's accounting policies, all assets acquired and liabilities assumed as at the acquisition date. Goodwill represents the excess of purchase consideration over the fair value of net assets of the acquired subsidiaries of the Company. Following initial recognition, goodwill is measured at cost less accumulated impairment losses.

Intangible assets represent finite life intangible assets of acquired subsidiaries of the Company and software acquired or internally developed by the Company. Finite life intangible assets include the value of software and customer contracts. These finite life intangible assets are amortized over their estimated useful lives, typically ranging between 3 and 10 years.

Impairment Testing

Goodwill and intangible assets are tested for impairment annually or more frequently if events indicate that impairment may have occurred. Intangible assets that were previously impaired are reviewed at each reporting date for evidence of reversal. In the event that certain conditions have been met, the Company would be required to reverse the impairment loss or a portion thereof.

Goodwill has been allocated to cash generating unit groupings, representing the lowest level that the assets are monitored for internal reporting purposes. Goodwill is tested for impairment by comparing the carrying value of each cash generating unit grouping containing the assets to its recoverable amount. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount is the higher of the asset's fair value less costs of disposal and value-in-use.

Finite life intangible assets are reviewed annually to determine if there are indicators of impairment and assess whether the amortization periods and methods are appropriate. If indicators of impairment have been identified, a test for impairment is performed and then the amortization of these assets is adjusted or impairment is recognized as necessary.

**(m) Revenue Recognition**

Premiums for all types of insurance contracts, and contracts with limited mortality or morbidity risk, are generally recognized as revenue when due and collection is reasonably assured.

Interest income on bonds and mortgages is recognized and accrued using the effective yield method.

Dividend income is recognized when the right to receive payment is established. This is the ex-dividend date for listed stocks, and usually the notification date or date when the shareholders have approved the dividend for private equity instruments.

Investment property income includes rents earned from tenants under lease agreements and property tax and operating cost recoveries. Rental income leases with contractual rent increases and rent-free periods are recognized on a straight-line basis over the term of the lease.

Fee and other income primarily includes fees earned from management of segregated fund assets, proprietary mutual fund assets and fees earned from management services. Fee and other income is recognized when services are rendered and the amount can be reasonably estimated.

The Company has sub-advisor arrangements where the Company retains the primary obligation with the client; as a result, fee income earned is reported on a gross basis with the corresponding sub-advisor expense recorded in operating and administrative expenses.

**(n) Owner Occupied Properties and Fixed Assets**

Property held for own use and fixed assets are carried at cost less accumulated depreciation and impairments. Depreciation is expensed to write-off the cost of assets, over their estimated useful lives, using the straight-line method, on the following bases:

| | |
|---|---|
| Owner occupied properties | 15 - 20 years |
| Furniture and fixtures | 5 - 10 years |
| Other fixed assets | 3 - 10 years |

Depreciation methods, useful lives and residual values are reviewed at least annually and adjusted if necessary.

**(o) Deferred Acquisition Costs**

Included in other assets are deferred acquisition costs. These are recognized as assets if the costs are incremental and incurred due to the contract being issued and are primarily amortized on a straight-line basis over the policy term, not to exceed 20 years.

**(p) Segregated Funds**

Segregated funds assets and liabilities arise from contracts where all financial risks associated with the related assets are borne by policyholders and are presented separately on the Consolidated Balance Sheets. The assets and liabilities are set equal to the fair value of the underlying asset portfolio. Investment income and changes in fair value of the segregated fund assets are offset by a corresponding change in the segregated fund liabilities.

**(q) Insurance and Investment Contract Liabilities**

Contract Classification

When significant insurance risk exists, the Company's products are classified at contract inception as insurance contracts, in accordance with IFRS 4, *Insurance Contracts* (IFRS 4). Significant insurance risk exists when the Company agrees to compensate policyholders or beneficiaries of the contract for specified uncertain future events that adversely affect the policyholder and whose amount and timing is unknown. Refer to note 10 for discussion of insurance risk.

In the absence of significant insurance risk, the contract is classified as an investment contract. Investment contracts with discretionary participating features are accounted for in accordance with IFRS 4 and investment contracts without discretionary participating features are accounted for in accordance with IAS 39, *Financial Instruments: Recognition & Measurement.* The Company has not classified any contracts as investment contracts with discretionary participating features.

Investment contracts may be reclassified as insurance contracts after inception if insurance risk becomes significant. A contract that is classified as an insurance contract at contract inception remains as such until all rights and obligations under the contract are extinguished or expire.

Investment contracts are contracts that carry financial risk, which is the risk of a possible future change in one or more of the following: interest rate, commodity price, foreign exchange rate, or credit rating. Refer to note 5 for discussion of Financial Instruments Risk Management.

Measurement

Insurance contract liabilities represent the amounts required, in addition to future premiums and investment income, to provide for future benefit payments, policyholder dividends, commission and policy administrative expenses for all insurance and annuity policies in force with the Company. The Appointed Actuary of the Company is responsible for determining the amount of the liabilities to make appropriate provisions for the Company's obligations to policyholders. The Appointed Actuary determine the liabilities for insurance contracts using generally accepted actuarial practices, according to the standards established by the Canadian Institute of Actuaries. The valuation uses the Canadian Asset Liability Method. This method involves the projection of future events in order to determine the amount of assets that must be set aside currently to provide for all future obligations and involves a significant amount of judgment.

In the computation of insurance contract liabilities, valuation assumptions have been made regarding rates of mortality/morbidity, investment returns, levels of operating expenses, rates of policy termination and rates of utilization of elective policy options or provisions. The valuation assumptions use best estimates of future experience together with a margin for adverse deviation. These margins are necessary to provide for possibilities of mis-estimation and/for future deterioration in the best estimate assumptions and provide reasonable assurance that insurance contract liabilities cover a range of possible outcomes. Margins are reviewed periodically for continued appropriateness.

Investment contract liabilities are measured at fair value determined using discounted cash flows utilizing the yield curves of financial instruments with similar cash flow characteristics.

**(r) Income Taxes**

The income tax expense for the period represents the sum of current income tax and deferred income tax. Income tax is recognized as an expense or income in profit or loss except to the extent that it relates to items that are recognized outside profit or loss (whether in other comprehensive income or directly in equity), in which case the income tax is also recognized outside profit or loss.

Current Income Tax

Current income tax is based on taxable income for the year. Current income tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities using the tax rates that have been enacted or substantively enacted at the balance sheet date in each respective jurisdiction. Current income tax assets and current income tax liabilities are offset if a legally enforceable right exists to offset the recognized amounts and the entity intends either to settle on a net basis, or to realize the assets and settle the liabilities simultaneously.

A provision for tax uncertainties which meet the probable threshold for recognition is measured based on the probability weighted average approach. The provision for tax uncertainties will be classified as current or deferred based on how a disallowance of the underlying uncertain tax treatment would impact the tax provision accrual as of the balance sheet date.

Deferred Income Tax

Deferred income tax is the tax expected to be payable or recoverable on differences arising between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable income and is accounted for using the balance sheet liability method. Deferred income tax liabilities are generally recognized for all taxable temporary differences and deferred income tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences, unused tax losses and carryforwards can be utilized.

Recognition is based on the fact that it is probable that the entity will have taxable profits and/or tax planning opportunities available to allow the deferred income tax asset to be utilized. Changes in circumstances in future periods may adversely impact the assessment of the recoverability. The uncertainty of the recoverability is taken into account in establishing the deferred income tax assets. The Company's annual financial planning process provides a significant basis for the measurement of deferred income tax assets.

Deferred income tax assets and liabilities are measured at the tax rates expected to apply in the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. Deferred income tax assets and deferred income tax liabilities are offset if a legally enforceable right exists to net current income tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred income tax asset to be recovered.

Deferred income tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries and associates, except where the group controls the timing of the reversal of the temporary difference and it is probable that the temporary differences will not reverse in the foreseeable future.

**(s) Policyholder Benefits**

Policyholder benefits include benefits and claims on life insurance contracts, maturity payments, annuity payments and surrenders. Gross benefits and claims for life insurance contracts include the cost of all claims arising during the year and settlement of claims. Death claims and surrenders are recorded on the basis of notifications received. Maturities and annuity payments are recorded when due.

**(t) Pension Plans and Other Post-Employment Benefits**

The Company maintains contributory and non-contributory defined benefit pension plans for certain employees and advisors. The Company also provides post-employment health, dental and life insurance benefits to eligible employees, advisors and their dependents.

The present value of the defined benefit obligations and the related current service cost is determined using the projected unit credit method (note 17). Pension plan assets are recorded at fair value.

For the Company's defined benefit plans, service costs and net interest costs are recognized in the Consolidated Statements of Earnings. Service costs include current service cost, administration expenses, past service costs and the impact of curtailments and settlements. To determine the net interest costs (income) recognized in the Consolidated Statements of Earnings, the Company applies a discount rate to the net benefit liability (asset), where the discount rate is determined by reference to market yields at the beginning of the year on high quality corporate bonds.

For the Company's defined benefit plans, re-measurements of the net defined benefit liability (asset) due to asset returns less (greater) than interest income, actuarial losses (gains) and changes in the asset ceiling are recognized in the Consolidated Statements of Comprehensive Income.

The Company also maintains defined contribution pension plans for certain employees and advisors. For the Company's defined contribution plans, the current service costs are recognized in the Consolidated Statements of Earnings.

**(u) Equity**

Financial instruments issued by the Company are classified as share capital if they represent a residual interest in the assets of the Company. Preferred share capital is classified as equity if it is non-redeemable, or retractable only at the Company's option and any dividends are discretionary. Incremental costs that are directly attributable to the issue of share capital are recognized as a deduction from equity, net of income tax.

Accumulated other comprehensive income (loss) represents the total of the unrealized foreign exchange gains (losses) on translation of foreign operations, the unrealized gains (losses) on available-for-sale assets, the unrealized gains (losses) on cash flow hedges, and the re-measurements on defined benefit pension and other post-employment benefit plans net of tax, where applicable.

Participating account surplus represents the proportion of equity attributable to the participating account.

Contributed surplus represents contributions from the parent company.

**(v) Share-Based Payments**

Lifeco has a stock option plan (the Lifeco stock option plan) that provides for the granting of options on common shares of Lifeco to certain officers and employees of Lifeco and its affiliates.

The Company follows the fair value method of accounting for the valuation of compensation expense for shares and share options granted to employees under its stock option plans (note 16). Compensation expense is recognized as an increase to compensation expense in the Consolidated Statements of Earnings over the vesting period of the granted options.

The Company and certain of its affiliates have established Deferred Share Unit Plans (DSU Plans) in which Directors of the Company participate. Units issued under the DSU Plans vest when granted. The Company recognizes an increase in operating and administrative expenses for the units granted under the DSU Plans.

Certain employees of the Company are entitled to participate in the Performance Share Unit Plan (PSU Plan). Units issued under the PSU Plan vest over a three year period. The Company uses the fair value method to recognize compensation expense for the units granted under the plan over the vesting period with a corresponding increase in the liability based on the market value of Lifeco's common shares.

The Company has an Employee Share Ownership Program (ESOP) where, subject to certain conditions being met, the Company will match contributions up to a maximum amount to purchase Lifeco common shares. The Company's contributions are expensed within operating and administrative expenses as incurred.

**(w) Leases**

Leases that do not transfer substantially all the risks and rewards of ownership are classified as operating leases. Payments made under operating leases, where the Company is the lessee, are charged to net earnings over the period of use.

Where the Company is the lessor under an operating lease for its investment property, the assets subject to the lease arrangement are presented within the Consolidated Balance Sheets. Income from these leases is recognized in the Consolidated Statements of Earnings on a straight-line basis over the lease term.

### (x) Operating Segments

Operating segments have been identified based on internal reports that are regularly reviewed by the Company's Chief Executive Officer to allocate resources and assess performance of segments. The Company's reportable business segments are the participating and shareholder operations of the Company. Within these segments the major business units are Individual Customer & Group Customer, Reinsurance/ International and Corporate. The Corporate business unit represents activities and transactions that are not directly attributable to the measurement of the business unit of the Company.

### (y) Future Accounting Policies

| New Standard | Summary of Future Changes |
|---|---|
| IFRS 15 - *Revenue from Contracts with Customers* | In May 2014, the IASB issued IFRS 15, *Revenue from Contracts with Customers*, which replaces IAS 11, *Construction Contracts* and IAS 18, *Revenue*. The standard provides a single revenue recognition standard to align the financial reporting of revenue from contracts with customers and related costs. The Company will recognize revenue when it transfers goods or services to a customer in the amount of consideration the Company expects to receive from the customer. Revenue arising from insurance contracts, leases, and financial instruments are out of scope of the new standard.<br><br>The Company will be adopting the standard on its effective date of January 1, 2018. Adoption of this standard will not have a material impact on the Company's consolidated financial statements. |
| IFRS 16 - *Leases* | In January 2016, the IASB issued IFRS 16, *Leases,* which introduces new guidance for identifying leases as well as a new right-of-use accounting model for lessees, replacing the operating and finance lease accounting models that currently exist. The new accounting model will generally require all lessees to recognize lease assets and liabilities on the balance sheet, initially measured at the present value of unavoidable lease payments for all leases with a maximum possible term of more than 12 months.<br><br>In contrast to the significant changes for lessees, the new standard will retain many key aspects of the current lessor accounting model.<br><br>The standard is effective January 1, 2019. The Company is evaluating the impact of the adoption of this standard, however it is not yet possible to provide a reliable estimate of the impact on the Company's consolidated financial statements. |

*2. Basis of Presentation and Summary of Accounting Policies (cont'd)*

| New Standard | Summary of Future Changes |
|---|---|
| IFRS 17 - *Insurance Contracts* | In May 2017, the IASB issued IFRS 17, *Insurance Contracts*, which will replace IFRS 4, *Insurance Contracts*. IFRS 17 sets out the requirements for the recognition, measurement, presentation and disclosures of insurance contracts a company issues and reinsurance contracts it holds. IFRS 17 introduces new measurement models depending on the nature of the insurance contracts. IFRS 17 requires entities to measure insurance contract liabilities on the balance sheet as the total of:<br><br>(a) the fulfilment cash flows - the current estimates of amounts that the company expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those amounts; and<br><br>(b) the contractual service margin - the future profit for providing insurance coverage.<br><br>The future profit for providing insurance coverage is recognized in profit or loss over time as the insurance coverage is provided. IFRS 17 also requires the Company to distinguish between groups of contracts expected to be profit making and groups of contracts expected to be onerous. The Company is required to update the fulfilment cash flows at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and discount rates.<br><br>The Company is currently in the planning phase of its project which includes assessing the financial statement impact of adopting IFRS 17, identifying potential business impacts, developing a detailed project plan, assessing resource requirements, and providing training to staff. The adoption of IFRS 17 is a significant initiative for the Company supported by a formal governance framework, for which substantial resources are being dedicated to ensure proper implementation.<br><br>The new standard is effective for annual periods beginning on or after January 1, 2021. IFRS 17 will affect how the Company accounts for its insurance contracts and how it reports financial performance in the Consolidated Statement of Earnings. The Company is currently assessing the impact that IFRS 17 will have on its consolidated financial statements. The Company expects this standard to have a significant impact on the timing of earnings recognition for its insurance contracts and a significant impact on how insurance contract results are presented and disclosed in the consolidated financial statements. |

*2. Basis of Presentation and Summary of Accounting Policies (cont'd)*

| New Standard | Summary of Future Changes |
|---|---|
| IFRS 9 - *Financial Instruments* | In July 2014, the IASB issued a final version of IFRS 9, *Financial Instruments* (IFRS 9) to replace IAS 39, *Financial Instruments: Recognition and Measurement*. The standard provides changes to financial instruments accounting for the following:<br>• classification and measurement of financial instruments based on a business model approach for managing financial assets and the contractual cash flow characteristics of the financial asset;<br>• impairment based on an expected loss model; and<br>• hedge accounting that incorporates the risk management practices of an entity.<br><br>In September 2016, the IASB issued an amendment to IFRS 4, *Insurance Contracts* (IFRS 4). The amendment "Applying IFRS 9, *Financial Instruments* with IFRS 4, *Insurance Contracts*" provides qualifying insurance companies with two options to address the potential volatility associated with implementing the IFRS 9 standard before the new proposed insurance contract standard is effective. The two options are as follows:<br>• *Deferral Approach* - provides the option to defer implementation of IFRS 9 until the year 2021 or the effective date of the new insurance contract standard, whichever is earlier; or<br>• *Overlay Approach* - provides the option to recognize the volatility that could arise when IFRS 9 is applied within other comprehensive income, rather than profit or loss.<br><br>The Company qualifies for the amendment and will be applying the deferral approach to allow adoption of both IFRS 9 and IFRS 17, *Insurance Contracts* simultaneously on January 1, 2021.<br><br>In October 2017, the IASB issued an amendment to IFRS 9 that certain prepayable financial assets with negative compensation can be measured at amortized cost or fair value through other comprehensive income instead of fair value through profit or loss under a certain condition.<br><br>The Company continues to evaluate the impact for the adoption of this standard with the adoption of IFRS 17, *Insurance Contracts*. |
| *Annual Improvements 2014 - 2016 Cycle* | In December 2016, the IASB issued *Annual Improvements 2014 - 2016 Cycle* as part of its ongoing process to efficiently deal with non-urgent narrow scope amendments to IFRS. Three amendments were included in this issue relating to IFRS 12, *Disclosure of Interests in Other Entities*, IFRS 1, *First-time Adoption of International Financial Reporting Standards* and IAS 28 *Investments in Associates and Joint Ventures.*<br><br>The amendments to IFRS 12 were effective January 1, 2017, and did not have significant impact on the Company's consolidated financial statements. The amendments to IFRS 1 and IAS 28 are effective January 1, 2018. Adoption of these amendments will not have an impact on the Company's consolidated financial statements. |

*2. Basis of Presentation and Summary of Accounting Policies (cont'd)*

| New Standard | Summary of Future Changes |
|---|---|
| IAS 40 - *Investment Property* | In December 2016, the IASB issued an amendment to IAS 40, *Investment Property* to clarify the requirements on transfers to, or from, investment property.<br><br>The amendment is effective January 1, 2018. The Company does not anticipate a significant impact of the adoption of this standard. |
| IFRS 2 - *Share-based Payment* | In June 2016, the IASB issued narrow scope amendments to IFRS 2, *Share-based Payment* clarifying how to account for certain types of share-based payment transactions.<br><br>The amendment is effective January 1, 2018. The Company does not anticipate a significant impact of the adoption of this standard. |
| IFRIC 22 - *Foreign Currency Transactions and Advance Consideration* | In December 2016, the IASB issued IFRIC Interpretation 22, *Foreign Currency Transactions and Advance Consideration* that provides requirements about which exchange rate to use in reporting foreign currency transactions when payment is made or received in advance.<br><br>The interpretation is effective January 1, 2018. The Company does not anticipate a significant impact of the adoption of this standard. |
| *Annual Improvements 2015 - 2017 Cycle* | In December 2017, the IASB issued *Annual Improvements 2015 - 2017 Cycle* as part of its ongoing process to efficiently deal with non-urgent narrow scope amendments to IFRS. Four amendments were included in this issue relating to IFRS 3, *Business Combinations*, IFRS 11, *Joint Arrangements*, IAS 12, *Income Taxes* and IAS 23 *Borrowing Costs.*<br><br>The amendments are effective January 1, 2019. The Company is evaluating the impact of the adoption of these amendments. |
| IAS 28 - *Investments in Associates and Joint Ventures* | In October 2017, the IASB issued amendments to IAS 28, *Investments in Associates and Joint Ventures*. The amendments clarify that a company is to account for long-term interests in an associate or joint venture using IFRS 9, Financial Instruments when the equity method is not applied.<br><br>The amendments are effective January 1, 2019. The Company is evaluating the impact of the adoption of these amendments. |
| IFRIC 23 - *Uncertainty over Income Tax Treatments* | In June 2017, the IASB issued IFRIC 23, *Uncertainty over Income Tax Treatments*. The interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 Income Taxes, when there is uncertainty over income tax treatments.<br><br>The interpretation is effective for periods beginning on or after January 1, 2019. The Company does not anticipate a significant impact from the adoption of this standard. |

## 3. Cash and Cash Equivalents

| | 2017 | 2016 |
|---|---|---|
| Cash | $ 257 | $ 246 |
| Short-term deposits | 209 | 146 |
| **Total** | $ 466 | $ 392 |

At December 31, 2017 cash of $4 was restricted for use by the Company ($10 at December 31, 2016) in respect of cash held in trust for reinsurance agreements or with regulatory authorities, client monies held by brokers and cash held in escrow.

## 4. Portfolio Investments

### (a) Carrying values and estimated fair values of portfolio investments are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Carrying value | Fair value | Carrying value | Fair value |
| **Bonds** | | | | |
| Designated fair value through profit or loss [1] | $ 11,042 | $ 11,042 | $ 11,178 | $ 11,178 |
| Classified fair value through profit or loss [1] | 1,714 | 1,714 | 1,742 | 1,742 |
| Available-for-sale | 2,455 | 2,455 | 2,234 | 2,234 |
| Loans and receivables | 3,130 | 3,214 | 3,038 | 3,145 |
| | 18,341 | 18,425 | 18,192 | 18,299 |
| **Mortgage loans** | | | | |
| Residential | 3,656 | 3,682 | 3,506 | 3,565 |
| Commercial | 3,894 | 3,938 | 4,196 | 4,309 |
| | 7,550 | 7,620 | 7,702 | 7,874 |
| **Stocks** | | | | |
| Designated fair value through profit or loss [1] | 3,908 | 3,908 | 3,854 | 3,854 |
| Available-for-sale, at cost [2] | 13 | 13 | 17 | 17 |
| | 3,921 | 3,921 | 3,871 | 3,871 |
| **Investment properties** | 1,394 | 1,394 | 1,143 | 1,143 |
| **Total** | $ 31,206 | $ 31,360 | $ 30,908 | $ 31,187 |

[1] A financial asset is designated as fair value through profit or loss on initial recognition if it eliminates or significantly reduces an accounting mismatch. Changes in the fair value of financial assets designated as fair value through profit or loss are generally offset by changes in insurance contract liabilities, since the measurement of insurance contract liabilities is determined with reference to the assets supporting the liabilities.

A financial asset is classified as fair value through profit or loss on initial recognition if it is part of a portfolio that is actively traded for the purpose of earning investment income.

[2] Fair value cannot be reliably measured, therefore the investments are held at cost.

**(b) Carrying value of bonds and mortgages by term to maturity are as follows:**

| | 2017 | | | |
|---|---|---|---|---|
| | Term to maturity | | | |
| | 1 year or less | 1 - 5 years | Over 5 years | Total |
| Bonds | $ 2,223 | $ 7,073 | $ 9,041 | $ 18,337 |
| Mortgage loans | 908 | 3,170 | 3,470 | 7,548 |
| **Total** | $ 3,131 | $ 10,243 | $ 12,511 | $ 25,885 |

| | 2016 | | | |
|---|---|---|---|---|
| | Term to maturity | | | |
| | 1 year or less | 1 - 5 years | Over 5 years | Total |
| Bonds | $ 2,305 | $ 6,999 | $ 8,882 | $ 18,186 |
| Mortgage loans | 789 | 3,423 | 3,489 | 7,701 |
| Total | $ 3,094 | $ 10,422 | $ 12,371 | $ 25,887 |

The above excludes the carrying value of impaired bonds and mortgage loans, as the ultimate timing of collectability is uncertain.

**(c) Included in portfolio investments are the following:**

(i) Carrying amount of impaired investments

| | 2017 | 2016 |
|---|---|---|
| Impaired amounts by classification | | |
| Fair value through profit or loss | $ 3 | $ 4 |
| Available-for-sale | 1 | 2 |
| Loans and receivables | 2 | 1 |
| **Total** | $ 6 | $ 7 |

The carrying amount of impaired investments includes $4 bonds and $2 mortgage loans at December 31, 2017 ($6 bonds and $1 mortgage loans at December 31, 2016).

(ii) At December 31, 2017 and December 31, 2016 the Company held no allowance for credit losses against its investments. A provision for future credit losses is included in insurance contract liabilities.

*4. Portfolio Investments (cont'd)*

**(d) Net investment income comprises the following:**

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | **Bonds** | **Mortgage loans** | **Stocks** | **Investment properties** | **Other** | **Total** |
| Regular net investment income: | | | | | | |
| Investment income earned | **$ 546** | **$ 279** | **$ 116** | **$ 113** | **$ 147** | **$ 1,201** |
| Net realized gains (losses) | | | | | | |
| Available-for-sale | **(1)** | **—** | **—** | **—** | **—** | **(1)** |
| Other classifications | **1** | **8** | **—** | **—** | **—** | **9** |
| Other income and expenses | **—** | **—** | **—** | **(56)** | **(25)** | **(81)** |
| | **546** | **287** | **116** | **57** | **122** | **1,128** |
| Changes in fair value on fair value through profit or loss assets: | | | | | | |
| Classified fair value through profit or loss | **(16)** | **—** | **—** | **—** | **—** | **(16)** |
| Designated fair value through profit or loss | **(46)** | **—** | **256** | **—** | **(109)** | **101** |
| Recorded at fair value through profit or loss | **—** | **—** | **—** | **60** | **—** | **60** |
| | **(62)** | **—** | **256** | **60** | **(109)** | **145** |
| **Total** | **$ 484** | **$ 287** | **$ 372** | **$ 117** | **$ 13** | **$ 1,273** |

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Bonds | Mortgage loans | Stocks | Investment properties | Other | Total |
| Regular net investment income: | | | | | | |
| Investment income earned | $ 554 | $ 297 | $ 117 | $ 103 | $ 137 | $ 1,208 |
| Net realized gains (losses) | | | | | | |
| Available-for-sale | 6 | — | — | — | — | 6 |
| Other classifications | (1) | 11 | — | — | — | 10 |
| Other income and expenses | — | — | — | (54) | (26) | (80) |
| | 559 | 308 | 117 | 49 | 111 | 1,144 |
| Changes in fair value on fair value through profit or loss assets: | | | | | | |
| Classified fair value through profit or loss | (9) | — | — | — | — | (9) |
| Designated fair value through profit or loss | (92) | — | 518 | — | (30) | 396 |
| Recorded at fair value through profit or loss | — | — | — | 25 | — | 25 |
| | (101) | — | 518 | 25 | (30) | 412 |
| Total | $ 458 | $ 308 | $ 635 | $ 74 | $ 81 | $ 1,556 |

Investment income earned comprises income from investments that are classified as available-for-sale, loans and receivables and investments classified or designated as fair value through profit or loss. Investment income from bonds and mortgages includes interest income and premium and discount amortization. Income from stocks includes dividends. Investment properties income includes rental income earned on investment properties, ground rent income earned on leased and sub-leased land, fee recoveries, lease cancellation income, and interest and other investment income earned on investment properties. Other income includes policyholder loan income, foreign exchange gains and losses, income earned from derivative financial instruments and other miscellaneous income.

**(e) The carrying value of investment properties and changes in the carrying value of investment properties are as follows:**

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning of year** | **$ 1,143** | $ 1,070 |
| Additions | **191** | 48 |
| Change in fair value through profit or loss | **60** | 25 |
| **Balance, end of year** | **$ 1,394** | $ 1,143 |

**(f) Transferred Financial Assets**

The Company engages in securities lending to generate additional income. The Company's securities custodians are used as lending agents. Collateral, which exceeds the fair value of the loaned securities, is deposited by the borrower with the Company's lending agent and maintained by the lending agent until the underlying security has been returned. The fair value of the loaned securities is monitored on a daily basis by the lending agent who obtains or refunds additional collateral as the fair value of the loaned securities fluctuates. In addition, the securities lending agent indemnifies the Company against borrower risk, meaning that the lending agent agrees contractually to replace securities not returned due to a borrower default. As at December 31, 2017, the Company had loaned securities (which are included in invested assets) with a fair value of $1,764 ($1,887 at December 31, 2016).

## 5. Financial Instruments Risk Management

The Company has policies relating to the identification, measurement, management, monitoring and reporting of risks associated with financial instruments. The key risks related to financial instruments are credit risk, liquidity risk and market risk (currency, interest rate and equity). The Risk Committee of the Board of Directors is responsible for the oversight of the Company's key risks.

The following sections describe how the Company manages each of these risks.

**(a) Credit Risk**

Credit risk is the risk of loss resulting from an obliger's potential inability or unwillingness to fully meet its contractual obligations to the Company.

The following policies and procedures are in place to manage this risk:

- Investment policies are in place that minimize undue concentration within issuers, connected companies, industries or individual geographies.
- Investment limits specify minimum and maximum limits for each asset class.
- Identification of credit risk through an internal credit risk rating system which includes a detailed assessment of an obligor's creditworthiness. Internal credit risk ratings cannot be higher than the highest rating provided by certain independent ratings companies.
- Portfolios are monitored continuously, and reviewed regularly with the Risk Committee and the Investment Committee of the Board of Directors.

- Credit risk associated with derivative instruments is evaluated quarterly based on conditions that existed at the balance sheet date, using practices that are at least as conservative as those recommended by regulators. The Company seeks to mitigate derivative credit risk by setting rating based counterparty limits in investment policies and through collateral arrangements where possible.
- Counterparties providing reinsurance to the Company are reviewed for financial soundness as part of an ongoing monitoring process. The minimum financial strength of reinsurers is outlined in the Reinsurance Risk Management Policy. The Company seeks to minimize reinsurance credit risk by setting rating based limits on net ceded exposure by counterparty as well as seeking protection in the form of collateral or funds withheld arrangements where possible.
- Investment guidelines also specify collateral requirements.

(i) Maximum Exposure to Credit Risk

The following summarizes the Company's maximum exposure to credit risk related to financial instruments. The maximum credit exposure is the carrying value of the asset net of any allowances for losses.

| | **2017** | 2016 (note 27) |
|---|---|---|
| Cash and cash equivalents | **$ 466** | $ 392 |
| Bonds | | |
| Fair value through profit or loss | **12,756** | 12,920 |
| Available-for-sale | **2,455** | 2,234 |
| Loans and receivables | **3,130** | 3,038 |
| Mortgage loans | **7,550** | 7,702 |
| Loans to policyholders | **1,952** | 1,887 |
| Funds held by ceding reinsurers | **2,378** | 2,615 |
| Reinsurance assets | **1,118** | 1,149 |
| Interest due and accrued | **195** | 190 |
| Accounts receivable | **61** | 70 |
| Premiums in course of collection | **117** | 95 |
| Other assets [(1)] | **154** | 160 |
| Derivative assets | **88** | 95 |
| **Total[(2)]** | **$ 32,420** | $ 32,547 |

[(1)] Includes items such as current income taxes receivable and miscellaneous other assets of the Company (note 9).

Credit risk is also mitigated by entering into collateral agreements. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are implemented regarding the acceptability of types of collateral and the valuation parameters. Management monitors the value of the collateral, requests additional collateral when needed and performs an impairment valuation when applicable. The Company has $25 of collateral received from counterparties as at December 31, 2017 ($10 at December 31, 2016) relating to derivative assets.

(ii) Concentration of Credit Risk

Concentrations of credit risk arise from exposures to a single debtor, a group of related debtors or groups of debtors that have similar credit risk characteristics in that they operate in the same geographic region or in similar industries. The characteristics are similar in that changes in economic or political environments may impact their ability to meet obligations as they come due.

The following provides details of the carrying value of bonds by issuer, industry sector and geographic distribution:

| | 2017 | | |
|---|---|---|---|
| | **Canada** | **Reinsurance/ International** | **Total** |
| Bonds issued or guaranteed by: | | | |
| Treasuries | **$ 61** | **$ 228** | **$ 289** |
| Government related | **6,204** | **65** | **6,269** |
| Agency securitized | **—** | **13** | **13** |
| Non-agency securitized | **1,188** | **48** | **1,236** |
| Financials | **2,979** | **198** | **3,177** |
| Communications | **350** | **36** | **386** |
| Consumer products | **1,179** | **257** | **1,436** |
| Energy | **789** | **53** | **842** |
| Industrials | **659** | **110** | **769** |
| Technology | **225** | **77** | **302** |
| Transportation | **736** | **45** | **781** |
| Utilities | **1,585** | **80** | **1,665** |
| Total long-term bonds | **15,955** | **1,210** | **17,165** |
| Short-term bonds | **1,145** | **31** | **1,176** |
| **Total** | **$ 17,100** | **$ 1,241** | **$ 18,341** |

| | 2016 | | |
|---|---|---|---|
| | Canada | Reinsurance/ International | Total |
| Bonds issued or guaranteed by: | | | |
| Treasuries | $ 290 | $ 263 | $ 553 |
| Government related | 6,390 | 56 | 6,446 |
| Agency securitized | — | 24 | 24 |
| Non-agency securitized | 1,427 | 51 | 1,478 |
| Financials | 2,798 | 211 | 3,009 |
| Communications | 306 | 30 | 336 |
| Consumer products | 1,122 | 194 | 1,316 |
| Energy | 753 | 72 | 825 |
| Industrials | 574 | 90 | 664 |
| Technology | 209 | 51 | 260 |
| Transportation | 712 | 36 | 748 |
| Utilities | 1,336 | 77 | 1,413 |
| Total long-term bonds | 15,917 | 1,155 | 17,072 |
| Short-term bonds | 1,116 | 4 | 1,120 |
| Total | $ 17,033 | $ 1,159 | $ 18,192 |

The following provides details of the carrying value of mortgage loans, all in Canada, by type:

| | 2017 | 2016 |
|---|---|---|
| Single family residential | $ **1,166** | $ 1,135 |
| Multi-family residential | **2,490** | 2,371 |
| Commercial | **3,894** | 4,196 |
| **Total** | $ **7,550** | $ 7,702 |

(iii) Asset Quality

Bond Portfolio By Credit Rating

| | 2017 | 2016 |
|---|---|---|
| AAA | $ **6,007** | $ 6,901 |
| AA | **4,298** | 3,678 |
| A | **4,483** | 4,581 |
| BBB | **3,516** | 2,983 |
| BB and lower | **37** | 49 |
| **Total** | $ **18,341** | $ 18,192 |

Derivative Portfolio by Credit Rating

| | 2017 | 2016 |
|---|---|---|
| Over-the-counter contracts (counterparty ratings): | | |
| AA | $ **20** | $ 28 |
| A | **68** | 65 |
| Exchange-traded | **—** | 2 |
| **Total** | $ **88** | $ 95 |

(iv) Loans Past Due, But Not Impaired

Loans that are past due but not considered impaired are loans for which scheduled payments have not been received, but management has reasonable assurance of collection of the full amount of principal and interest due. The following provides carrying values of the loans past due, but not impaired:

| | 2017 | 2016 |
|---|---|---|
| Less than 30 days | $ **1** | $ 52 |
| 30 - 90 days | **—** | — |
| Greater than 90 days | **—** | 1 |
| **Total** | $ **1** | $ 53 |

(v) The following outlines the future asset credit losses provided for in insurance contract liabilities. These amounts are in addition to the allowance for asset losses included with assets:

| | **2017** | 2016 |
|---|---|---|
| Participating | **$ 745** | $ 691 |
| Non-participating | **28** | 37 |
| **Total** | **$ 773** | $ 728 |

**(b) Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet all cash outflow obligations as they come due. The following policies and procedures are in place to manage this risk:

- The Company closely manages operating liquidity through cash flow matching of assets and liabilities and forecasting earned and required yields, to ensure consistency between policyholder requirements and the yield of assets. Approximately 28% (approximately 32% in 2016) of insurance and investment contract liabilities are non-cashable prior to maturity or subject to fair value adjustments.
- Management closely monitors the solvency and capital positions of the Company and its principal subsidiaries opposite liquidity requirements. Additional liquidity is available through established lines of credit or the capital markets.

In the normal course of business the Company enters into contracts that give rise to commitments of future minimum payments that impact short-term and long-term liquidity.

**(c) Market Risk**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market factors which include three types: currency risk, interest rate (including related inflation) risk and equity risk.

Caution Related to Risk Sensitivities

These consolidated financial statements include estimates of sensitivities and risk exposure measures for certain risks, such as the sensitivity due to specific changes in interest rate levels projected and market prices as at the valuation date. Actual results can differ significantly from these estimates for a variety of reasons including:

- Assessment of the circumstances that led to the scenario may lead to changes in (re)investment approaches and interest rate scenarios considered,
- Changes in actuarial, investment return and future investment activity assumptions,
- Actual experience differing from the assumptions,
- Changes in business mix, effective income tax rates and other market factors,
- Interactions among these factors and assumptions when more than one changes, and
- The general limitations of the Company's internal models.

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 above. Given the nature of these calculations, the Company cannot provide assurance that the actual impact on net earnings attributed to shareholders will be as indicated.

(i) Currency Risk

Currency risk relates to the Company operating and holding financial instruments in different currencies. For the assets backing insurance and investment contract liabilities that are not matched by currency, changes in foreign exchange rates can expose the Company to the risk of foreign exchange losses not offset by liability decreases. The Company has net investments in foreign operations. The Company's debt obligations are denominated in Canadian dollars, euros, and U.S. dollars. In accordance with IFRS, foreign currency translation gains and losses from net investments in foreign operations, net of related hedging activities and tax effects, are recorded in accumulated other comprehensive income. Strengthening or weakening of the Canadian dollar spot rate compared to the U.S. dollar, British pound and euro spot rates impacts the Company's total equity. Correspondingly, the Company's book value per share and capital ratios monitored by rating agencies are also impacted. The following policies and procedures are in place to mitigate the Company's exposure to currency risk:

- The Company uses financial measures such as constant currency calculations to monitor the effect of currency translation fluctuations.
- Investments are normally made in the same currency as the liabilities supported by those investments. Segmented Investment Guidelines include maximum tolerances for unhedged currency mismatch exposures.
- For assets backing liabilities not matched by currency, the Company would normally convert the assets back to the currency of the liability using foreign exchange contracts.
- A 10% weakening of the Canadian dollar against foreign currencies would be expected to increase non-participating insurance and investment contract liabilities and their supporting assets by approximately the same amount resulting in an immaterial change to net earnings. A 10% strengthening of the Canadian dollar against foreign currencies would be expected to decrease non-participating insurance and investment contract liabilities and their supporting assets by approximately the same amount resulting in an immaterial change in net earnings.

(ii) Interest Rate Risk

Interest rate risk exists if asset and liability cash flows are not closely matched and interest rates change causing a difference in value between the asset and liability. The following policies and procedures are in place to mitigate the Company's exposure to interest rate risk:

- The Company utilizes a formal process for managing the matching of assets and liabilities. This involves grouping general fund assets and liabilities into segments. Assets in each segment are managed in relation to the liabilities in the segment.
- Interest rate risk is managed by investing in assets that are suitable for the products sold.
- Where these products have benefit or expense payments that are dependent on inflation (inflation-indexed annuities, pensions and disability claims) the Company generally invests in real return instruments to hedge its real dollar liability cash flows. Some protection against changes in the inflation index is achieved as any related change in the fair value of the assets will be largely offset by a similar change in the fair value of the liabilities.
- For products with fixed and highly predictable benefit payments, investments are made in fixed income assets or real estate whose cash flows closely match the liability product cash flows. Where assets are not available to match certain period cash flows, such as long-tail cash flows, a portion of these are invested in equities and the rest are duration matched. Hedging instruments are employed where necessary when there is a lack of suitable permanent investments to minimize loss exposure to interest rate changes. To the extent these cash flows are matched, protection against interest rate change is achieved and any change in the fair value of the assets will be offset by a similar change in the fair value of the liabilities.

- For products with less predictable timing of benefit payments, investments are made in fixed income assets with cash flows of a shorter duration than the anticipated timing of benefit payments, or equities as described below.
- The risk associated with the mismatch in portfolio duration and cash flow, asset prepayment exposure and the pace of asset acquisition are quantified and reviewed regularly.

Projected cash flows from the current assets and liabilities are used in the Canadian Asset Liability Method to determine insurance contract liabilities. Valuation assumptions have been made regarding rates of returns on supporting assets, fixed income, equity and inflation. The valuation assumptions use best estimates of future reinvestment rates and inflation assumptions with an assumed correlation together with margins for adverse deviation set in accordance with professional standards. These margins are necessary to provide for possibilities of misestimation and/or future deterioration in the best estimate assumptions and provide reasonable assurance that insurance contract liabilities cover a range of possible outcomes. Margins are reviewed periodically for continued appropriateness.

Projected cash flows from fixed income assets used in actuarial calculations are reduced to provide for potential asset default losses. The net effective yield rate reduction averaged 0.11% (0.11% in 2016). The calculation for future credit losses on assets is based on the credit quality of the underlying asset portfolio.

Testing under a number of interest rate scenarios (including increasing, decreasing and fluctuating rates) is done to assess reinvestment risk. The total provision for interest rates is sufficient to cover a broader or more severe set of risks than the minimum arising from the current Canadian Institute of Actuaries prescribed scenarios.

The range of interest rates covered by these provisions is set in consideration of long-term historical results and is monitored quarterly with a full review annually. An immediate 1% parallel shift in the yield curve would not have a material impact on the Company's view of the range of interest rates to be covered by the provisions. If sustained however, the parallel shift could impact the Company's range of scenarios covered.

The total provision for interest rates also considers the impact of the Canadian Institute of Actuaries prescribed scenarios.

- At December 31, 2017 and December 31, 2016, the effect of an immediate 1% parallel increase in the yield curve on the prescribed scenarios results in interest rate changes to assets and liabilities that will offset each other with no impact to net earnings.
- At December 31, 2017 and December 31, 2016, the effect of an immediate 1% parallel decrease in the yield curve on the prescribed scenarios results in interest rate changes to assets and liabilities that will offset each other with no impact to net earnings.

Another way of measuring the interest rate risk associated with this assumption is to determine the effect on the insurance and investment contract liabilities impacting the shareholder net earnings of the Company of a 1% change in the Company's view of the range of interest rates to be covered by these provisions. The following provides information on the effect of an immediate 1% increase or 1% decrease in the interest rates at both the low and high end of the range of interest rates recognized in the provisions:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **1% increase** | **1% decrease** | 1% increase | 1% decrease |
| **Change in interest rates** | | | | |
| Increase (decrease) in non-participating insurance and investment contract liabilities | **$ (40)** | **$ 75** | $ (37) | $ 77 |
| Increase (decrease) in net earnings | **$ 31** | **$ (57)** | $ 29 | $ (59) |

(iii) Equity Risk

Equity risk is the uncertainty associated with the valuation of assets and liabilities arising from changes in equity markets and other pricing risk. To mitigate pricing risk, the Company has investment policy guidelines in place that provide for prudent investment in equity markets within clearly defined limits. The risks associated with segregated fund guarantees have been mitigated through internal reinsurance treaties and a hedging program for lifetime Guaranteed Minimum Withdrawal Benefit guarantees using equity futures, currency forwards, and interest rate derivatives. For policies with segregated fund guarantees, the Company generally determines insurance contract liabilities at a conditional tail expectation of 75 (CTE75) level.

Some insurance and investment contract liabilities are supported by investment properties, common stocks and private equities, for example segregated fund products and products with long-tail cash flows. Generally these liabilities will fluctuate in line with equity values. There will be additional impacts on these liabilities as equity values fluctuate. The following provides information on the expected impacts of a 10% increase or 10% decrease in equity values:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **10% increase** | **10% decrease** | 10% increase | 10% decrease |
| **Change in equity values** | | | | |
| Increase (decrease) in non-participating insurance and investment contract liabilities | **$ (1)** | **$ 10** | $ (1) | $ 1 |
| Increase (decrease) in net earnings | **$ 1** | **$ (7)** | $ 1 | $ (1) |

The best estimate return assumptions for equities are primarily based on long-term historical averages. Changes in the current market could result in changes to these assumptions and will impact both asset and liability cash flows. The following provides information on the impacts of a 1% increase or 1% decrease in the best estimate assumptions:

| | **2017** | | 2016 | |
|---|---|---|---|---|
| | **1% increase** | **1% decrease** | 1% increase | 1% decrease |
| **Change in best estimate return assumptions for equities** | | | | |
| Increase (decrease) in non-participating insurance contract liabilities | **$ (27)** | **$ 36** | $ (28) | $ 36 |
| Increase (decrease) in net earnings | **$ 20** | **$ (26)** | $ 20 | $ (26) |

**(d) Enforceable Master Netting Arrangements or Similar Agreements**

The Company enters into International Swaps and Derivative Association's (ISDA's) master agreements for transacting over-the-counter derivatives. The Company receives and pledges collateral according to the related ISDA's Credit Support Annexes. The ISDA's master agreements do not meet the criteria for offsetting on the Consolidated Balance Sheets because they create a right of set-off that is enforceable only in the event of default, insolvency, or bankruptcy.

For exchange-traded derivatives subject to derivative clearing agreements with the exchanges and clearinghouses, there is no provision for set-off at default. Initial margin is excluded from the table within this disclosure as it would become part of a pooled settlement process.

*5. Financial Instruments Risk Management (cont'd)*

The Company's reverse repurchase agreements are also subject to right of set-off in the event of default. These transactions and agreements include master netting arrangements which provide for the netting of payment obligations between the Company and its counterparties in the event of default.

The table sets out the potential effect on the Company's Consolidated Balance Sheets on financial instruments that have been shown in a gross position where right of set-off exists under certain circumstances that do not qualify for netting on the Consolidated Balance Sheets.

| | 2017 | | | |
|---|---|---|---|---|
| | | Related amounts not set-off in the Balance Sheet | | |
| | **Gross amount of financial instruments presented in the Balance Sheet** | **Offsetting counterparty position [1]** | **Financial collateral received/ pledged [2]** | **Net exposure** |
| **Financial instruments - assets** | | | | |
| Derivative financial instruments | **$ 88** | **$ (74)** | **$ (12)** | **$ 2** |
| **Total financial instruments - assets** | **$ 88** | **$ (74)** | **$ (12)** | **$ 2** |
| **Financial instruments - liabilities** | | | | |
| Derivative financial instruments | **$ 248** | **$ (74)** | **$ (66)** | **$ 108** |
| **Total financial instruments - liabilities** | **$ 248** | **$ (74)** | **$ (66)** | **$ 108** |

| | 2016 | | | |
|---|---|---|---|---|
| | | Related amounts not set-off in the Balance Sheet | | |
| | Gross amount of financial instruments presented in the Balance Sheet | Offsetting counterparty position [1] | Financial collateral received/ pledged [2] | Net exposure |
| Financial instruments - assets | | | | |
| Derivative financial instruments | $ 95 | $ (89) | $ (5) | $ 1 |
| Total financial instruments - assets | $ 95 | $ (89) | $ (5) | $ 1 |
| Financial instruments - liabilities | | | | |
| Derivative financial instruments | $ 335 | $ (89) | $ (83) | $ 163 |
| Total financial instruments - liabilities | $ 335 | $ (89) | $ (83) | $ 163 |

(1) Includes counterparty amounts recognized on the Consolidated Balance Sheets where the Company has a potential offsetting position (as described above) but does not meet the criteria for offsetting on the balance sheet, excluding collateral.

(2) Financial collateral presented above excludes overcollateralization and, for exchange-traded derivatives, initial margin. Total financial collateral, including initial margin and overcollateralization, received on derivative assets was $25 ($10 at December 31, 2016), and pledged on derivative liabilities was $93 ($112 at December 31, 2016).

## 6. Fair Value Measurement

The Company's assets and liabilities recorded at fair value have been categorized based upon the following fair value hierarchy:

Level 1: Fair value measurements utilize observable, quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Assets and liabilities utilizing Level 1 inputs include actively exchange-traded equity securities, exchange-traded futures, and mutual and segregated funds which have available prices in an active market with no redemption restrictions.

Level 2: Fair value measurements utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals. The fair values for some Level 2 securities were obtained from a pricing service. The pricing service inputs include, but are not limited to, benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, offers and reference data. Level 2 assets and liabilities include those priced using a matrix which is based on credit quality and average life, government and agency securities, some private bonds, most investment-grade and high-yield corporate bonds, most asset-backed securities, most over-the-counter derivatives, and mortgage loans. Investment contracts that are measured at fair value through profit or loss are mostly included in the Level 2 category.

Level 3: Fair value measurements utilize one or more significant inputs that are not based on observable market inputs and include situations where there is little, if any, market activity for the asset or liability. The values of the majority of Level 3 securities were obtained from single broker quotes, internal pricing models, or external appraisers. Assets and liabilities utilizing Level 3 inputs generally include certain bonds, certain asset-backed securities, some private equities, investments in mutual and segregated funds where there are redemption restrictions, certain over-the-counter derivatives, and investment properties.

*6. Fair Value Measurement (cont'd)*

The following presents the Company's assets and liabilities measured at fair value on a recurring basis by hierarchy level:

| | 2017 | | | |
|---|---|---|---|---|
| **Assets measured at fair value** | **Level 1** | **Level 2** | **Level 3** | **Total** |
| Cash and cash equivalents | $ 466 | $ — | $ — | $ 466 |
| Financial assets at fair value through profit or loss | | | | |
| Bonds | — | 12,756 | — | 12,756 |
| Stocks | 3,841 | — | 67 | 3,908 |
| Total financial assets at fair value through profit or loss | 3,841 | 12,756 | 67 | 16,664 |
| Available-for-sale financial assets | | | | |
| Bonds | — | 2,455 | — | 2,455 |
| Investment properties | — | — | 1,394 | 1,394 |
| Derivatives [1] | — | 88 | — | 88 |
| **Total assets measured at fair value** | $ 4,307 | $ 15,299 | $ 1,461 | $ 21,067 |
| **Liabilities measured at fair value** | | | | |
| Derivatives [2] | $ — | $ 248 | $ — | $ 248 |
| Investment contract liabilities | — | 43 | — | 43 |
| **Total liabilities measured at fair value** | $ — | $ 291 | $ — | $ 291 |

(1) Excludes collateral received from counterparties of $25.
(2) Excludes collateral pledged to counterparties of $66.

There were no transfers of the Company's assets and liabilities between Level 1 and Level 2 in the year.

*6. Fair Value Measurement (cont'd)*

| Assets measured at fair value | 2016 Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Cash and cash equivalents | $ 392 | $ — | $ — | $ 392 |
| Financial assets at fair value through profit or loss | | | | |
| Bonds | — | 12,920 | — | 12,920 |
| Stocks | 3,816 | 4 | 34 | 3,854 |
| Total financial assets at fair value through profit or loss | 3,816 | 12,924 | 34 | 16,774 |
| Available-for-sale financial assets | | | | |
| Bonds | — | 2,234 | — | 2,234 |
| Investment properties | — | — | 1,143 | 1,143 |
| Derivatives [1] | 2 | 93 | — | 95 |
| Total assets measured at fair value | $ 4,210 | $ 15,251 | $ 1,177 | $ 20,638 |
| Liabilities measured at fair value | | | | |
| Derivatives [2] | $ — | $ 335 | $ — | $ 335 |
| Investment contract liabilities | — | 42 | — | 42 |
| Total liabilities measured at fair value | $ — | $ 377 | $ — | $ 377 |

(1) Excludes collateral received from counterparties of $10.
(2) Excludes collateral pledged to counterparties of $86.

There were no transfers of the Company's assets and liabilities between Level 1 and Level 2 in the year.

*6. Fair Value Measurement (cont'd)*

The following presents additional information about assets measured at fair value on a recurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Fair value through profit or loss bonds | Available-for-sale bonds | Fair value through profit or loss stocks [2] | Investment properties | Total Level 3 assets |
| **Balance, beginning of year** | $ — | $ — | $ 34 | $ 1,143 | $ 1,177 |
| Total gains | | | | | |
| Included in net earnings | — | — | 1 | 60 | 61 |
| Purchases | — | — | 42 | 191 | 233 |
| Sales | — | — | (14) | — | (14) |
| Transfers into Level 3 [1] | — | — | 4 | — | 4 |
| Transfers out of Level 3 [1] | — | — | — | — | — |
| **Balance, end of year** | $ — | $ — | $ 67 | $ 1,394 | $ 1,461 |
| **Total gains for the year included in net investment income** | $ — | $ — | $ 1 | $ 60 | $ 61 |
| **Change in unrealized gains for the year included in earnings for assets held at December 31, 2017** | $ — | $ — | $ 1 | $ 60 | $ 61 |

(1) Transfers into Level 3 are due primarily to decreased observability of inputs in valuation methodologies. Transfers out of Level 3 are due primarily to increased observability of inputs in valuation methodologies as evidenced by corroboration of market prices with multiple pricing vendors or the lifting of redemption restrictions on investments in mutual and segregated funds.

(2) Includes investments in mutual and segregated funds where there are redemption restrictions. The fair value is based on observable, quoted prices.

*6. Fair Value Measurement (cont'd)*

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Fair value through profit or loss bonds | Available-for-sale bonds | Fair value through profit or loss stocks [2] | Investment properties | Total Level 3 assets |
| Balance, beginning of year | $ — | $ — | $ 29 | $ 1,070 | $ 1,099 |
| Total gains | | | | | |
| Included in net earnings | — | — | 1 | 25 | 26 |
| Purchases | — | — | 25 | 48 | 73 |
| Sales | — | — | (21) | — | (21) |
| Transfers into Level 3 [1] | — | — | — | — | — |
| Transfers out of Level 3 [1] | — | — | — | — | — |
| Balance, end of year | $ — | $ — | $ 34 | $ 1,143 | $ 1,177 |
| Total gains for the year included in net investment income | $ — | $ — | $ 1 | $ 25 | $ 26 |
| Change in unrealized gains for the year included in earnings for assets held at December 31, 2016 | $ — | $ — | $ 1 | $ 25 | $ 26 |

(1) Transfers into Level 3 are due primarily to decreased observability of inputs in valuation methodologies. Transfers out of Level 3 are due primarily to increased observability of inputs in valuation methodologies as evidenced by corroboration of market prices with multiple pricing vendors or the lifting of redemption restrictions on investments in mutual and segregated funds.

(2) Includes investments in mutual and segregated funds where there are redemption restrictions. The fair value is based on observable, quoted prices.

The following sets out information about significant unobservable inputs used at year-end in measuring assets and liabilities categorized as Level 3 in the fair value hierarchy:

| **Type of asset** | **Valuation approach** | **Significant unobservable input** | **Input value** | **Inter-relationship between key unobservable inputs and fair value measurement** |
|---|---|---|---|---|
| Investment properties | Investment property valuations are generally determined using property valuation models based on expected capitalization rates and models that discount expected future net cash flows. The determination of the fair value of investment property requires the use of estimates such as future cash flows (such as future leasing assumptions, rental rates, capital and operating expenditures) and discount, reversionary and overall capitalization rates applicable to the asset based on current market rates. | Discount rate | Range of 5.0% - 7.5% | A decrease in the discount rate would result in an increase in fair value. An increase in the discount rate would result in a decrease in fair value. |
| | | Reversionary rate | Range of 4.3% - 7.0% | A decrease in the reversionary rate would result in an increase in fair value. An increase in the reversionary rate would result in a decrease in fair value. |
| | | Vacancy rate | Weighted average of 4.9% | A decrease in the expected vacancy rate would generally result in an increase in fair value. An increase in the expected vacancy rate would generally result in a decrease in fair value. |

*6. Fair Value Measurement (cont'd)*

The following presents the Company's assets disclosed at fair value on a recurring basis by hierarchy level:

| | 2017 | | | | |
|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Other assets not held at fair value** | **Total** |
| **Assets disclosed at fair value** | | | | | |
| Loans and receivables financial assets | | | | | |
| Bonds | **$ — $** | **2,314 $** | **19 $** | **881 $** | **3,214** |
| Mortgage loans | **—** | **7,620** | **—** | **—** | **7,620** |
| Loans to policyholders | **—** | **1,952** | **—** | **—** | **1,952** |
| Total loans and receivables financial assets | **—** | **11,886** | **19** | **881** | **12,786** |
| Available-for-sale financial assets | | | | | |
| Stocks [1] | **—** | **—** | **—** | **13** | **13** |
| **Total assets disclosed at fair value** | **$ — $** | **11,886 $** | **19 $** | **894 $** | **12,799** |

(1) Fair value of certain stocks available for sale cannot be reliably measured, therefore these investments are recorded at cost.

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Other assets not held at fair value | Total |
| Assets disclosed at fair value | | | | | |
| Loans and receivables financial assets | | | | | |
| Bonds | $ — $ | 2,261 $ | 7 $ | 877 $ | 3,145 |
| Mortgage loans | — | 7,874 | — | — | 7,874 |
| Loans to policyholders | — | 1,887 | — | — | 1,887 |
| Total loans and receivables financial assets | — | 12,022 | 7 | 877 | 12,906 |
| Available-for-sale financial assets | | | | | |
| Stocks [1] | — | — | — | 17 | 17 |
| Total assets disclosed at fair value | $ — $ | 12,022 $ | 7 $ | 894 $ | 12,923 |

(1) Fair value of certain stocks available for sale cannot be reliably measured, therefore these investments are recorded at cost.

## 7. Goodwill and Intangible Assets

### (a) Goodwill

The carrying value of goodwill, all in the shareholder segment, and changes in the carrying value of goodwill are as follows:

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning and end of year** | $ 3 | $ 3 |

The Company has no accumulated impairment losses on goodwill at December 31, 2017 and 2016.

### (b) Intangible Assets

The carrying value and changes in the carrying value of finite life intangible assets are as follows:

| | 2017 | | |
|---|---|---|---|
| | **Customer contract related** | **Technology/ Software** | **Total** |
| Amortization period range | **10 years** | **3-10 years** | |
| Amortization method | **Straight-line** | **Straight-line** | |
| Cost | | | |
| **Balance, beginning of year** | $ **54** | $ **157** | $ **211** |
| Additions | **—** | **12** | **12** |
| Disposals | **—** | **(7)** | **(7)** |
| **Balance, end of year** | $ **54** | $ **162** | $ **216** |
| Accumulated amortization and impairment | | | |
| **Balance, beginning of year** | $ **(38)** | $ **(72)** | $ **(110)** |
| Disposals | **—** | **2** | **2** |
| Amortization | **(6)** | **(16)** | **(22)** |
| **Balance, end of year** | $ **(44)** | $ **(86)** | $ **(130)** |
| **Net carrying amount** | $ **10** | $ **76** | $ **86** |

| | 2016 | | |
|---|---|---|---|
| | Customer contract related | Technology/ Software | Total |
| Amortization period range | 10 years | 3 - 10 years | |
| Amortization method | Straight-line | Straight-line | |
| Cost | | | |
| Balance, beginning of year | $ 54 | $ 140 | $ 194 |
| Additions | — | 17 | 17 |
| Balance, end of year | $ 54 | $ 157 | $ 211 |
| Accumulated amortization and impairment | | | |
| Balance, beginning of year | $ (32) | $ (58) | $ (90) |
| Amortization | (6) | (14) | (20) |
| Balance, end of year | $ (38) | $ (72) | $ (110) |
| Net carrying amount | $ 16 | $ 85 | $ 101 |

The weighted average remaining amortization period of the customer contract related channels is 2 years (3 years at December 31, 2016).

## 8. Owner Occupied Properties and Fixed Assets

The carrying value of owner occupied properties and the changes in the carrying value of owner occupied properties is as follows:

| | 2017 | 2016 |
|---|---|---|
| **Carrying value, beginning of year** | **$ 166** | $ 164 |
| Less: accumulated depreciation/impairments | **(27)** | (22) |
| **Net carrying value, beginning of year** | **139** | 142 |
| Additions | **4** | 2 |
| Depreciation | **(5)** | (5) |
| **Net carrying value, end of year** | **$ 138** | $ 139 |

The net carrying value of fixed assets is $30 at December 31, 2017 ($35 at December 31, 2016).

There are no restrictions on the title of the owner occupied properties and fixed assets, nor are they pledged as security for debt.

## 9. Other Assets

| | 2017 | 2016 |
|---|---|---|
| Deferred acquisition costs | **$ 33** | $ 36 |
| Prepaid expenses | **1** | 7 |
| Miscellaneous other assets | **99** | 93 |
| **Total** | **$ 133** | $ 136 |

Total other assets of $100 ($100 at December 31, 2016) are expected to be realized within 12 months from the reporting date. This amount excludes deferred acquisition costs, the changes in which are noted below.

**Deferred acquisition costs**

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning of year** | **$ 36** | $ 40 |
| Additions | **10** | 10 |
| Amortization | **(11)** | (11) |
| Disposals | **(2)** | (3) |
| **Balance, end of year** | **$ 33** | $ 36 |

## 10. Insurance and Investment Contract Liabilities

### (a) Insurance and investment contract liabilities

| | 2017 | | |
|---|---|---|---|
| | **Gross liability** | **Reinsurance assets** | **Net** |
| Insurance contract liabilities | **$ 32,082** | **$ 1,118** | **$ 30,964** |
| Investment contract liabilities | **43** | **—** | **43** |
| **Total** | **$ 32,125** | **$ 1,118** | **$ 31,007** |

| | 2016 | | |
|---|---|---|---|
| | Gross liability | Reinsurance assets | Net |
| Insurance contract liabilities | $ 32,227 | $ 1,149 | $ 31,078 |
| Investment contract liabilities | 42 | — | 42 |
| Total | $ 32,269 | $ 1,149 | $ 31,120 |

### (b) Composition of insurance and investment contract liabilities and related supporting assets

(i) The composition of insurance and investment contract liabilities is as follows:

| | 2017 | | |
|---|---|---|---|
| | **Gross liability** | **Reinsurance assets** | **Net** |
| Participating | | | |
| Individual Customer | **$ 24,713** | **$ 61** | **$ 24,652** |
| Non-Participating | | | |
| Individual Customer | **2,216** | **944** | **1,272** |
| Group Customer | **2,662** | **—** | **2,662** |
| Reinsurance | **2,534** | **113** | **2,421** |
| **Total** | **$ 32,125** | **$ 1,118** | **$ 31,007** |

| | 2016 | | |
|---|---|---|---|
| | Gross liability | Reinsurance assets | Net |
| Participating | | | |
| Individual Customer | $ 23,388 | $ (57) | $ 23,445 |
| Non-Participating | | | |
| Individual Customer | 2,405 | 1,077 | 1,328 |
| Group Customer | 3,706 | — | 3,706 |
| Reinsurance | 2,770 | 129 | 2,641 |
| Total | $ 32,269 | $ 1,149 | $ 31,120 |

*10. Insurance and Investment Contract Liabilities (cont'd)*

(ii) The composition of the assets supporting liabilities and equity is as follows:

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | **Bonds** | **Mortgage loans** | **Stocks** | **Investment properties** | **Other** | **Total** |
| **Carrying value** | | | | | | |
| Participating liabilities | **$ 10,875** | **$ 5,970** | **$ 3,559** | **$ 1,255** | **$ 3,054** | **$ 24,713** |
| Non-participating liabilities | | | | | | |
| Individual Customer | **1,379** | **209** | **158** | **86** | **384** | **2,216** |
| Group Customer | **754** | **997** | **2** | **—** | **909** | **2,662** |
| Reinsurance | **356** | **—** | **3** | **—** | **2,175** | **2,534** |
| Other | **2,393** | **280** | **135** | **48** | **59,451** | **62,307** |
| Total equity | **2,584** | **94** | **64** | **5** | **1,299** | **4,046** |
| **Total carrying value** | **$ 18,341** | **$ 7,550** | **$ 3,921** | **$ 1,394** | **$ 67,272** | **$ 98,478** |
| **Fair value** | **$ 18,425** | **$ 7,620** | **$ 3,921** | **$ 1,394** | **$ 67,272** | **$ 98,632** |

| | 2016 (note 27) | | | | | |
|---|---|---|---|---|---|---|
| | Bonds | Mortgage loans | Stocks | Investment properties | Other | Total |
| Carrying value | | | | | | |
| Participating liabilities | $ 10,394 | $ 5,934 | $ 3,476 | $ 1,042 | $ 2,542 | $ 23,388 |
| Non-participating liabilities[1] | | | | | | |
| Individual Customer | 1,222 | 284 | 205 | 13 | 681 | 2,405 |
| Group Customer | 1,463 | 1,096 | 3 | — | 1,144 | 3,706 |
| Reinsurance | 378 | — | 4 | — | 2,388 | 2,770 |
| Other | 2,330 | 289 | 149 | 40 | 54,570 | 57,378 |
| Total equity | 2,405 | 99 | 34 | 48 | 1,226 | 3,812 |
| Total carrying value | $ 18,192 | $ 7,702 | $ 3,871 | $ 1,143 | $ 62,551 | $ 93,459 |
| Fair value | $ 18,299 | $ 7,874 | $ 3,871 | $ 1,143 | $ 62,551 | $ 93,738 |

[1] Effective January 1, 2017, the Company realigned its presentation for Individual Insurance, Wealth Management and Group Insurance into two units: Individual Customer and Group Customer. The realignment resulted in a change to comparative figures within non-participating liabilities.

Cash flows of assets supporting insurance and investment contract liabilities are matched within reasonable limits. Changes in the fair values of these assets are essentially offset by changes in the fair value of insurance and investment contract liabilities.

Changes in the fair values of assets backing capital and surplus, less related income taxes, would result in a corresponding change in surplus over time in accordance with investment accounting policies.

### (c) Changes in insurance contract liabilities

The change in insurance contract liabilities during the year was the result of the following business activities and changes in actuarial estimates:

| | 2017 | | | |
|---|---|---|---|---|
| | Participating | | | |
| | Gross liability | Reinsurance assets | Net | |
| **Balance, beginning of year** | $ 23,388 | $ (57) | $ 23,445 | |
| Impact of new business | 78 | — | 78 | |
| Normal change in force | 1,250 | 16 | 1,234 | |
| Management action and changes in assumptions | (3) | 102 | (105) | |
| **Balance, end of year** | $ 24,713 | $ 61 | $ 24,652 | |

| | Non-participating | | | |
|---|---|---|---|---|
| | Gross liability | Reinsurance assets | Net | Total Net |
| **Balance, beginning of year** | $ 8,839 | $ 1,206 | $ 7,633 | $ 31,078 |
| Impact of new business | 526 | 8 | 518 | 596 |
| Normal change in force | (318) | 21 | (339) | 895 |
| Management action and changes in assumptions | (228) | (171) | (57) | (162) |
| Business movement from/to external parties | (293) | — | (293) | (293) |
| Business movement from/to affiliates | (976) | — | (976) | (976) |
| Impact of foreign exchange rate changes | (181) | (7) | (174) | (174) |
| **Balance, end of year** | $ 7,369 | $ 1,057 | $ 6,312 | $ 30,964 |

| | 2016 | | |
|---|---|---|---|
| | Participating | | |
| | Gross liability | Reinsurance assets | Net |
| Balance, beginning of year | $ 22,086 | $ (69) | $ 22,155 |
| Impact of new business | 161 | — | 161 |
| Normal change in force | 1,274 | 9 | 1,265 |
| Management action and changes in assumptions | (133) | 3 | (136) |
| Balance, end of year | $ 23,388 | $ (57) | $ 23,445 |

*10. Insurance and Investment Contract Liabilities (cont'd)*

| | Non-participating | | | |
|---|---|---|---|---|
| | Gross liability | Reinsurance assets | Net | Total Net |
| Balance, beginning of year | $ 8,178 | $ 1,254 | $ 6,924 | $ 29,079 |
| Impact of new business | 828 | 15 | 813 | 974 |
| Normal change in force | (560) | 26 | (586) | 679 |
| Management action and changes in assumptions | (56) | (85) | 29 | (107) |
| Business movement from/to external parties | (109) | — | (109) | (109) |
| Business movement from/to affiliates | 603 | — | 603 | 603 |
| Impact of foreign exchange rate changes | (45) | (4) | (41) | (41) |
| Balance, end of year | $ 8,839 | $ 1,206 | $ 7,633 | $ 31,078 |

Under fair value accounting, movement in the fair value of the supporting assets is a major factor in the movement of insurance contract liabilities. Changes in the fair value of assets are largely offset by corresponding changes in the fair value of liabilities. The change in the value of the insurance contract liabilities associated with the change in the value of the supporting assets is included in the normal change in force above.

In 2017, the major contributors to the decrease in net insurance contract liabilities were the impact of business to/from affiliates of $976, business to/from external parties of $293, foreign exchange rate changes of $174 and management actions and changes of assumptions of $162, which was partially offset by increases due to the normal change of in force business of $895 and the impact of new business of $596.

Net non-participating insurance contract liabilities decreased by $57 in 2017 due to management actions and assumption changes. The decrease was primarily due to updated life mortality assumptions of $58 and policyholder behaviour assumptions of $12, partially offset by increases due to updated economic assumptions of $6 and modeling refinements of $5.

Net participating insurance contract liabilities decreased $105 in 2017 due to management actions and assumption changes. The decrease was primarily due to a reduction of provisions for future policyholder dividends of $2,416 and updated expense and tax assumptions of $261, partially offset by increases due to lower investment returns of $2,041, updated life mortality assumptions of $289, modeling refinements of $237 and updated policyholder behaviour assumptions of $5.

In 2016, the major contributors to the increase in net insurance contract liabilities were the impact of new business of $974, normal change in force of $679 and the business movement from/to affiliates of $603, which was partially offset by decreases due to the management action and changes in assumptions of $107.

Net non-participating insurance contract liabilities increased by $29 in 2016 due to management actions and assumption changes. The increase was primarily due to updated life mortality assumptions of $36 and economic assumptions of $13, partially offset by increases due updated expense and tax assumptions of $14, updated provision for claims and experience rating refunds of $3, updated morbidity assumptions of $2 and updated policyholder behaviour assumptions of $2.

Net participating insurance contract liabilities decreased $136 in 2016 due to management actions and assumption changes. The decrease was primarily due to updated expense and tax assumptions of $141, updated life mortality assumptions of $7 and provisions for future policyholder dividends of $3, partially offset by increases due to updated policyholder behaviour assumptions of $14.

**(d) Change in investment contract liabilities measured at fair value**

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning of year** | **$ 42** | $ 38 |
| Normal change in force business | **(1)** | 1 |
| Investment experience | **2** | 3 |
| **Balance, end of year** | **$ 43** | $ 42 |

The carrying value of investment contract liabilities approximates their fair value. No investment contract liabilities have been reinsured.

**(e) Gross premiums written and gross policyholder benefits**

(i) Premium Income

| | 2017 | 2016 |
|---|---|---|
| Direct premiums | **$ 3,298** | $ 3,121 |
| Assumed reinsurance premiums | **11,372** | 10,650 |
| **Total** | **$ 14,670** | $ 13,771 |

(ii) Policyholder Benefits

| | 2017 | 2016 |
|---|---|---|
| Direct | **$ 1,815** | $ 1,900 |
| Assumed reinsurance | **12,367** | 10,178 |
| **Total** | **$ 14,182** | $ 12,078 |

**(f) Actuarial Assumptions**

In the computation of insurance contract liabilities, valuation assumptions have been made regarding rates of mortality/morbidity, investment returns, levels of operating expenses, rates of policy termination and rates of utilization of elective policy options or provisions. The valuation assumptions use best estimates of future experience together with a margin for adverse deviation. These margins are necessary to provide for possibilities of misestimation and/or future deterioration in the best estimate assumptions and provide reasonable assurance that insurance contract liabilities cover a range of possible outcomes. Margins are reviewed periodically for continued appropriateness.

The methods for arriving at these valuation assumptions are outlined below:

Mortality

A life insurance mortality study is carried out annually for each major block of insurance business. The results of each study are used to update the Company's experience valuation mortality tables for that business. When there is insufficient data, use is made of the latest industry experience to derive an appropriate valuation mortality assumption. Improvement scales for life insurance and annuitant mortality are updated periodically based on population and industry studies, product specific considerations, as well as professional guidance. In addition, appropriate provisions have been made for future mortality deterioration on term insurance.

Annuitant mortality is also studied regularly and the results used to modify established industry experience annuitant mortality tables.

Morbidity

The Company uses industry developed experience tables modified to reflect emerging Company experience. Both claim incidence and termination are monitored regularly and emerging experience is factored into the current valuation.

Property and casualty reinsurance

Insurance contract liabilities for property and casualty reinsurance written by LRG are determined using accepted actuarial practices for property and casualty insurers in Canada. The insurance contract liabilities have been established using cash flow valuation techniques including discounting. The insurance contract liabilities are based on cession statements provided by ceding companies. In addition, insurance contract liabilities also include an amount for incurred but not reported losses which may differ significantly from the ultimate loss development. The estimates and underlying methodology are continually reviewed and updated, and adjustments to estimates are reflected in earnings. LRG analyzes the emergence of claims experience against expected assumptions for each reinsurance contract separately and at the portfolio level. If necessary, a more in-depth analysis is undertaken of the cedant experience.

Investment returns

The assets which correspond to the different liability categories are segmented. For each segment, projected cash flows from the current assets and liabilities are used in Canadian Asset Liability Method to determine insurance contract liabilities. Cash flows from assets are reduced to provide for asset default losses. Testing under several interest rate and equity scenarios (including increasing and decreasing rates) is done to provide for reinvestment risk (note 5 (c)).

Expenses

Contractual policy expenses (e.g. sales commissions) and tax expenses are reflected on a best estimate basis. Expense studies for indirect operating expenses are updated regularly to determine an appropriate estimate of future operating expenses for the liability type being valued. Improvements in unit operating expenses are not projected. An inflation assumption is incorporated in the estimate of future operating expenses consistent with the interest rate scenarios projected under Canadian Asset Liability Method as inflation is assumed to be correlated with new money interest rates.

Policy termination

Studies to determine rates of policy termination are updated regularly to form the basis of this estimate. Industry data is also available and is useful where the Company has no experience with specific types of policies or its exposure is limited. The Company has significant exposures in respect of the T-100 and Level Cost of Insurance Universal Life products in Canada and policy renewal rates at the end of term for renewable term policies in Canada and Reinsurance. Industry experience has guided the Company's assumptions for these products as the Company's own experience is very limited.

Utilization of elective policy options

There are a wide range of elective options embedded in the policies issued by the Company. Examples include term renewals, conversion to whole life insurance (term insurance), settlement annuity purchase at guaranteed rates (deposit annuities) and guarantee re-sets (segregated fund maturity guarantees). The assumed rates of utilization are based on Company or industry experience when it exists and when not on judgment considering incentives to utilize the option. Generally, whenever it is clearly in the best interests of an informed policyholder to utilize an option, then it is assumed to be elected.

Policyholder dividends and adjustable policy features

Future policyholder dividends and other adjustable policy features are included in the determination of insurance contract liabilities with the assumption that policyholder dividends or adjustable benefits will change in the future in response to the relevant experience. The dividend and policy adjustments are determined consistent with policyholders' reasonable expectations, such expectations being influenced by the participating policyholder dividend policies and/or policyholder communications, marketing material and past practice. It is the Company's expectation that changes will occur in policyholder dividend scales or adjustable benefits for participating or adjustable business respectively, corresponding to changes in the best estimate assumptions, resulting in an immaterial net change in insurance contract liabilities. Where underlying guarantees may limit the ability to pass all of this experience back to the policyholder, the impact of this non-adjustability on shareholder earnings is reflected in the changes in best estimate assumptions above.

**(g) Risk management**

(i) Insurance risk

Insurance risk is the risk that the insured event occurs and that there are large deviations between expected and actual actuarial assumptions including mortality, persistency, longevity, morbidity, expense variations and investment returns.

As an insurance company, London Life is in the business of accepting risk associated with insurance contract liabilities. The objective of the Company is to mitigate its exposure to risk arising from these contracts through product design, product and geographical diversification, the implementation of the Company's underwriting strategy guidelines, and through the use of reinsurance arrangements.

The following provides information about the Company's insurance contract liabilities sensitivities to management's best estimate of the approximate impact as a result of changes in assumptions used to determine the Company's liability associated with these contracts.

| | Increase (decrease) in net earnings | |
|---|---|---|
| | **2017** | 2016 |
| Mortality - 2% increase | **$ (20)** | $ (21) |
| Annuitant mortality - 2% decrease | **$ (5)** | $ (5) |
| Morbidity - 5% adverse change | **$ (1)** | $ (9) |
| Investment returns | | |
| Parallel shift in yield curve | | |
| 1% increase | **$ —** | $ — |
| 1% decrease | **$ —** | $ — |
| Change in range of interest rates | | |
| 1% increase | **$ 31** | $ 29 |
| 1% decrease | **$ (57)** | $ (59) |
| Change in equity values | | |
| 10% increase | **$ 1** | $ 1 |
| 10% decrease | **$ (7)** | $ (1) |
| Change in best estimate return assumptions for equities | | |
| 1% increase | **$ 20** | $ 20 |
| 1% decrease | **$ (26)** | $ (26) |
| Expenses - 5% increase | **$ (7)** | $ (7) |
| Policy termination and renewal - 10% adverse change | **$ (115)** | $ (103) |

Concentration risk may arise from geographic regions, accumulation of risks and market risk. The concentration of insurance risk before and after reinsurance by geographic region is described below.

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | **Gross liability** | **Reinsurance assets** | **Net** | Gross liability | Reinsurance assets | Net |
| Canada | **$ 29,591** | **$ 1,005** | **$ 28,586** | $ 29,499 | $ 1,020 | $ 28,479 |
| International | **2,534** | **113** | **2,421** | 2,770 | 129 | 2,641 |
| **Total** | **$ 32,125** | **$ 1,118** | **$ 31,007** | $ 32,269 | $ 1,149 | $ 31,120 |

(ii) Reinsurance risk

Maximum limits per insured life benefit amount (which vary by line of business) are established for life and health insurance, and reinsurance is purchased for amounts in excess of those limits.

Reinsurance costs and recoveries as defined by the reinsurance agreement are reflected in the valuation with these costs and recoveries being appropriately calibrated to the direct assumptions.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honour their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

Certain of the reinsurance contracts are on a funds withheld basis where the Company retains the assets supporting the reinsured insurance contract liabilities, thus minimizing the exposure to significant losses from reinsurer insolvency on those contracts.

## 11. Segregated Funds and Other Structured Entities

The Company offers segregated fund products. These funds are contracts issued by insurers to segregated fund policyholders where the benefit is directly linked to the performance of the investments, the risks or rewards of the fair value movements and net investment income is realized by the segregated fund policyholders. The segregated fund policyholders are required to select the segregated funds that hold a range of underlying investments. While the Company has legal title to the investments, there is a contractual obligation to pass along the investment results to the segregated fund policyholder and the Company segregates these investments from those of the Company.

The segregated fund assets are legally separated from the general assets of the Company under the terms of the policyholder agreement and cannot be used to settle obligations of the Company. As a result of the legal and constructive arrangements of these funds, the assets and liabilities of these funds are presented as line items within the Consolidated Balance Sheets titled investments on account of segregated fund policyholders and with an equal liability titled investment and insurance contracts on account of segregated fund policyholders.

In circumstances where the segregated funds are invested in structured entities and are deemed to control the entity, the Company has presented the non-controlling ownership interest within the segregated funds for the risk of policyholders as equal and offsetting amounts in the assets and liabilities. The amounts presented within are $517 at December 31, 2017 ($487 at December 31, 2016).

Within the Consolidated Statements of Earnings, all segregated fund policyholders' income, including fair value changes and net investment income, is credited to the segregated fund policyholders and reflected in the assets and liabilities on account of segregated fund policyholders within the Consolidated Balance Sheets. As these amounts do not directly impact the revenues and expenses of the Company, these amounts are not included separately in the Consolidated Statements of Earnings.

Segregated Funds Guarantee Exposure

The Company offers retail segregated fund products that provide for certain guarantees that are tied to the market values of the investment funds. While these products are similar to mutual funds, there is a key difference from mutual funds as the segregated funds have certain guarantee features that protect the segregated fund policyholder from market declines in the underlying investments. These guarantees are the Company's primary exposure on these funds. The Company accounts for these guarantees within insurance and investment contract liabilities within the financial statements. In addition to the Company's exposure on the guarantees, the fees earned by the Company on these products are impacted by the fair value of these funds.

The Company also offers a guaranteed minimum withdrawal benefits product. The guaranteed minimum withdrawal benefits products offered by the Company offer levels of death and maturity guarantees. At December 31, 2017, the amount of guaranteed minimum withdrawal benefits product in-force was $1,916 ($1,954 at December 31, 2016).

The following presents further details of the investments, determined in accordance with the relevant statutory reporting requirements, on account of segregated fund policyholders:

**(a) Investments on account of segregated fund policyholders**

| | 2017 | 2016 |
|---|---|---|
| Cash and cash equivalents | $ **1,879** | $ 1,851 |
| Bonds | **9,798** | 9,222 |
| Mortgage loans | **1,985** | 2,000 |
| Stocks | **16,676** | 15,243 |
| Mutual funds | **27,660** | 24,760 |
| Investment properties | **2,526** | 2,380 |
| | **60,524** | 55,456 |
| Accrued income | **83** | 81 |
| Other liabilities | **(678)** | (449) |
| Non-controlling mutual fund interest | **517** | 487 |
| **Total** | $ **60,446** | $ 55,575 |

**(b) Investment and insurance contracts on account of segregated fund policyholders**

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning of year** | $ **55,575** | $ 51,811 |
| Additions (deductions): | | |
| Policyholder deposits | **7,731** | 6,816 |
| Net investment income | **960** | 926 |
| Net realized capital gains on investments | **1,510** | 1,168 |
| Net unrealized capital gains on investments | **1,212** | 1,703 |
| Policyholder withdrawals | **(6,568)** | (6,885) |
| Change in General Fund investment in Segregated Fund | **(4)** | (3) |
| Non-controlling mutual funds interest | **30** | 39 |
| **Total** | **4,871** | 3,764 |
| **Balance, end of year** | $ **60,446** | $ 55,575 |

**(c) Investment income on account of segregated fund policyholders**

| | 2017 | 2016 |
|---|---|---|
| Net investment income | **$ 960** | $ 926 |
| Net realized capital gains on investments | **1,510** | 1,168 |
| Net unrealized capital gains on investments | **1,212** | 1,703 |
| **Total** | **3,682** | 3,797 |
| Change in investment and insurance contracts liability on account of segregated fund policyholders | **3,682** | 3,797 |
| **Net** | **$ —** | $ — |

**(d) Investments on account of segregated fund policyholders by fair value hierarchy level (note 6)**

| | 2017 | | | |
|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Total** |
| **Investments on account of segregated fund policyholders** [1] | **$ 44,141** | **$ 14,373** | **$ 2,527** | **$ 61,041** |

[1] Excludes other liabilities, net of other assets, of $595.

| | 2016 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments on account of segregated fund policyholders [1] | $ 40,238 | $ 13,313 | $ 2,392 | $ 55,943 |

[1] Excludes other liabilities, net of other assets, of $368.

During 2017, certain foreign stock holdings valued at $498 have been transferred from Level 1 to Level 2 ($17 were transferred from Level 1 to Level 2 at December 31, 2016), primarily based on the Company utilizing inputs in addition to quoted prices in active markets for certain foreign stock holdings at year end. Level 2 assets include those assets where fair value is not available from normal market pricing sources, where inputs are utilized in addition to quoted prices in active markets and where the Company does not have visibility through to the underlying assets.

As at December 31, 2017, $5,208 ($3,591 at December 31, 2016) of the segregated funds were invested in funds managed by related parties Investors Group and Mackenzie Investments, members of the Power Financial group of companies (note 19).

The following presents additional information about the Company's investments on account of segregated fund policyholders for which the Company has utilized Level 3 inputs to determine fair value:

| | 2017 | 2016 |
|---|---|---|
| **Balance, beginning of year** | **$ 2,392** | $ 2,260 |
| Total gains included in segregated fund investment income | **20** | 22 |
| Purchases | **129** | 118 |
| Sales | **(3)** | (8) |
| Transfers out of Level 3 | **(11)** | — |
| **Balance, end of year** | **$ 2,527** | $ 2,392 |

Transfers into Level 3 are due primarily to decreased observability of inputs in valuation methodologies. Transfers out of Level 3 are due primarily to increased observability of inputs in valuation methodologies as evidenced by corroboration of market prices with multiple pricing vendors.

In addition to the segregated funds, the Company has interests in a number of structured unconsolidated entities including mutual funds and unit trusts. These entities are created as investment strategies for its unit-holders based on the directive of each individual fund.

Some of these funds are managed by related parties of the Company and the Company receives management fees related to these services. Management fees can be variable due to performance of factors – such as markets or industries – in which the fund invests. Fee income derived in connection with the management of investment funds generally increases or decreases in direct relationship with changes of assets under management which is affected by prevailing market conditions, and the inflow and outflow of client assets.

Factors that could cause assets under management and fees to decrease include declines in equity markets, changes in fixed income markets, changes in interest rates and defaults, redemptions and other withdrawals, political and other economic risks, changing investment trends and relative investment performance. The risk is that fees may vary but expenses and recovery of initial expenses are relatively fixed, and market conditions may cause a shift in asset mix potentially resulting in a change in revenue.

During 2017, fee and other income earned by the Company resulting from the Company's interests in these structured entities was $979 ($910 at December 31, 2016).

## 12. Other Liabilities

| | 2017 | 2016 |
|---|---|---|
| Pension and other post-employment benefits (note 17) | **$ 339** | $ 293 |
| Bank overdraft | **148** | 103 |
| Other | **623** | 552 |
| **Total** | **$ 1,110** | $ 948 |

Total other liabilities of $771 ($655 at December 31, 2016) are expected to be realized within 12 months from the reporting date.

## 13. Participating Account

Earnings attributable to the participating account recorded in the Consolidated Statements of Earnings is as follows:

| | 2017 | 2016 |
|---|---|---|
| Net earnings attributable to participating account before policyholder dividends | $ 847 | $ 843 |
| Policyholder dividends | (814) | (803) |
| **Net earnings - participating account** | $ 33 | $ 40 |

The shareholder portion of participating earnings represents, as restricted by law, a portion of net earnings before policyholder dividends of the participating account, $22 in 2017 ($22 in 2016). $46 of shareholder surplus ($45 in 2016) that has been recognized but not paid is dependent on future payment of dividends to participating policyholders.

## 14. Share Capital

Authorized

Unlimited Preferred Shares
Unlimited Common Shares

Issued and outstanding and fully paid

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Number | Carrying Value | Number | Carrying Value |
| **Common shares** | 670,943 | $ 1,124 | 670,943 | $ 1,124 |

## 15. Capital Management

### (a) Policies and Objectives

Managing capital is the continual process of establishing and maintaining the quantity and quality of capital appropriate for the Company and ensuring capital is deployed in a manner consistent with the expectations of the Company's stakeholders. For these purposes, the Board considers the key stakeholders to be the Company's shareholders, policyholders and holders of subordinated liabilities in addition to the relevant regulators in the various jurisdictions where the Company and its subsidiaries operate.

The Company manages its capital on both a consolidated basis as well as at the individual operating subsidiary level. The primary objectives of the Company's capital management strategy are:

- to maintain the capitalization of its regulated operating subsidiaries at a level that will exceed the relevant minimum regulatory capital requirements in the jurisdictions in which they operate;
- to maintain strong credit and financial strength ratings of the Company ensuring stable access to capital markets; and
- to provide an efficient capital structure to maximize shareholder value in the context of the Company's operational risks and strategic plans.

The Company has established policies and procedures designed to identify, measure and report all material risks. Management is responsible for establishing capital management procedures for monitoring capital adequacy. The Board of Directors reviews and approves all capital transactions undertaken by management and capital adequacy metrics to ensure it reflects the Company's strategic business plan.

The target level of capitalization for the Company and its subsidiaries is assessed by considering various factors such as the probability of falling below the minimum regulatory capital requirements in the relevant operating jurisdiction, the views expressed by various credit rating agencies that provide financial strength and other ratings to the Company, and the desire to hold sufficient capital to be able to honour all policyholder and other obligations of the Company with a high degree of confidence.

**(b) Regulatory Capital**

In Canada, OSFI has established a capital adequacy measurement for life insurance companies incorporated under the Insurance Companies Act (Canada) and their subsidiaries, known as the Minimum Continuing Capital and Surplus Requirements (MCCSR). For this purpose, various additions or deductions from capital are mandated by the guidelines issued by OSFI. The following provides a summary of the MCCSR information and ratios for London Life:

| | 2017 | 2016 |
|---|---|---|
| **Adjusted Net Tier 1 Capital** | **$ 3,677** | $ 3,465 |
| **Net Tier 2 Capital** | **176** | 126 |
| **Total Capital Available** | **$ 3,853** | $ 3,591 |
| **Total Capital Required** | **$ 1,712** | $ 1,656 |
| **Tier 1 Ratio** | **215%** | 209% |
| **Total Ratio** | **225%** | 217% |

The Company has been preparing for the implementation of the new regulatory capital framework for the Canadian insurance industry. OSFI will replace the current MCCSR guideline with the Life Insurance Capital Adequacy Test (LICAT) guideline, effective January 1, 2018. The first reporting period will be the first quarter of 2018.

## 16. Share-Based Payments

**(a)** In order to promote a greater alignment of interest between Directors and the policyholders and shareholders of the Company, the Company and certain of its affiliates have established mandatory Deferred Share Unit Plans and/or voluntary Deferred Share Unit Plans (the "Mandatory DSU Plans" and the "Voluntary DSU Plans" respectively) in which the Directors of the Company participate. Under the Mandatory DSU Plan, each Director who is a resident of Canada or the United States is required to receive 50% of his or her annual Board retainer in the form of Deferred Share Units (DSUs). Under the Voluntary DSU Plan, each Director may elect to receive the balance of his or her annual Board retainer (including Board Committee fees) and attendance fees entirely in the form of DSUs, entirely in cash, or equally in cash and DSUs. In both cases the number of DSUs granted is determined by dividing the amount of remuneration payable to the Director by the weighted average trading price per Lifeco common share on the Toronto Stock Exchange for the last five trading days of the preceding fiscal quarter (such weighted average trading price being the "value of a Deferred Share Unit"). Directors receive additional DSUs in respect of dividends payable on the common shares of Lifeco based on the value of a Deferred Share Unit at that time. DSUs are generally redeemable at the time that an individual ceases to be a Director by a lump sum cash payment, based on the value of the DSUs on the date of redemption. In 2017, $3 in directors fees were used to acquire DSUs ($3 in 2016).

**(b)** Certain employees of the Company are entitled to receive Performance Share Units (PSUs). Under these PSU plans, these employees are granted PSUs equivalent to Lifeco's common shares vesting over a three-year period. Employees receive additional PSUs in respect of dividends payable on the common shares of Lifeco based on the value of a PSU at that time. At the maturity date, employees receive cash representing the value of the PSU at this date. The Company uses the fair-value based method to account for the PSUs granted to employees under the plan. For the year ended December 31, 2017, the Company recognized compensation expense of $4 ($3 in 2016) for the PSU plans recorded in operating and administrative expenses in the Consolidated Statements of Earnings. At December 31, 2017, the carrying value of the PSU liability is $7 ($5 in 2016) recorded within other liabilities.

**(c)** The Company's Employee Share Ownership Plan (ESOP) is a voluntary plan where eligible employees can contribute up to 5% of their previous year's eligible earnings to purchase common shares of Great-West Lifeco Inc. The Company matches 50% of the total employee contributions. The contributions from the Company vest immediately and are expensed. For the year-ended December 31, 2017, the Company recognized compensation expense of $4 ($4 in 2016) for the ESOP recorded in operating and administrative expenses in the Consolidated Statements of Earnings.

## 17. Pension Plans and Other Post-Employment Benefits

Characteristics, Funding and Risk

The Company maintains contributory and non-contributory defined benefit pension plans for certain employees and advisors. The Company also maintains defined contribution pension plans for certain employees and advisors.

The defined benefit pension plans provide pensions based on length of service and final average pay. For most plans, active plan participants share in the cost by making contributions in respect of current service. Certain pension payments are indexed on an ad hoc basis. The determination of the defined benefit obligation reflects pension benefits in accordance with the terms of the plans. The assets supporting the funded pension plans are held in separate trusteed pension funds. The obligations for the wholly unfunded plans are included in other liabilities and are supported by general assets.

The significant defined benefit plans of the Company are closed to new entrants with plans in several geographies also closed to future defined benefit accruals. New hires and employees who previously accrued defined benefits in the closed plans are eligible only for defined contribution benefits. The Company's defined benefit plan exposure will continue to be reduced in future years.

The defined contribution pension plans provide pension benefits based on accumulated employee and company contributions. Company contributions to these plans are a set percentage of employees' annual income and may be subject to certain vesting requirements.

The Company also provides post-employment health, dental and life insurance benefits to eligible employees, advisors and their dependents. Retirees share in the cost of benefits through deductibles, co-insurance and caps on benefits. These plans are closed to new hires and were previously amended to limit which employees could become eligible to receive benefits. The amount of some of the post-employment benefits other than pensions depends on future cost escalation. These post-employment benefits are not pre-funded and the amount of the obligation for these benefits is included in other liabilities and is supported by general assets.

The Company has pension and benefit committees or a trusteed arrangement that provides oversight for the benefit plans of the Company. The benefit plans are monitored on an ongoing basis to assess the benefit, funding and investment policies, financial status, and funding requirements of the Company. Significant changes to the company's benefit plans require approval from that Company's Board of Directors.

The Company's funding policy for the funded pension plans is to make contributions equal to or greater than those required by the applicable regulations and plan provisions that govern the funding of the plans. Where funded plans have a net defined benefit asset, the Company determines if an economic benefit exists in the form of

potential reductions in future contributions by the Company, from the payment of expenses from the plan and in the form of surplus refunds, where permitted by applicable regulation and plan provisions.

By their design, the defined benefit plans expose the Company to the typical risks faced by defined benefit plans such as investment performance, changes to the discount rates used to value the obligations, longevity of plan members, and future inflation. Pension and benefit risk is managed by regular monitoring of the plans, applicable regulations and other factors that could impact the expenses and cash flows of the Company.

*17. Pension Plans and Other Post-Employment Benefits (cont'd)*

The following reflects the financial position of the Company's contributory and non-contributory defined benefit plans:

**(a) Plan Assets, Benefit Obligation and Funded Status**

| | Defined benefit pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| **Change in fair value of plan assets** | | | | |
| **Fair value of plan assets, beginning of year** | **$ 1,107** | $ 1,102 | **$ —** | $ — |
| Interest income | **43** | 44 | **—** | — |
| Actual return over interest income | **55** | 20 | **—** | — |
| Employer contributions | **21** | 2 | **9** | 8 |
| Employee contributions | **3** | 3 | **—** | — |
| Benefits paid | **(93)** | (63) | **(9)** | (8) |
| Administrative expenses | **(1)** | (1) | **—** | — |
| **Fair value of plan assets, end of year** | **$ 1,135** | $ 1,107 | **$ —** | $ — |
| **Change in defined benefit obligation** | | | | |
| **Defined benefit obligation, beginning of year** | **$ 1,190** | $ 1,142 | **$ 210** | $ 211 |
| Current service cost | **27** | 26 | **—** | — |
| Interest cost | **46** | 46 | **8** | 9 |
| Employee contributions | **3** | 3 | **—** | — |
| Benefits paid | **(93)** | (63) | **(9)** | (8) |
| Curtailments and termination benefits[1] | **1** | — | **1** | — |
| Actuarial loss (gain) on financial assumption changes | **77** | 29 | **9** | 5 |
| Actuarial loss (gain) on demographic assumption changes | **3** | — | **(4)** | (6) |
| Actuarial loss (gain) arising from member experience | **7** | 7 | **(2)** | (1) |
| **Defined benefit obligation, end of year** | **$ 1,261** | $ 1,190 | **$ 213** | $ 210 |
| **Asset (liability) recognized on the Consolidated Balance Sheets** | | | | |
| Funded status of plans - surplus (deficit) | **$ (126)** | $ (83) | **$ (213)** | $ (210) |
| **Asset (liability) recognized on the Consolidated Balance Sheets** | **$ (126)** | $ (83) | **$ (213)** | $ (210) |
| Recorded in: | | | | |
| Other assets | **$ —** | $ — | **$ —** | $ — |
| Other liabilities (note 12) | **(126)** | (83) | **(213)** | (210) |
| **Asset (liability) recognized on the Consolidated Balance Sheets** | **$ (126)** | $ (83) | **$ (213)** | $ (210) |
| **Analysis of defined benefit obligation** | | | | |
| Wholly or partly funded plans | **$ 1,239** | $ 1,167 | **$ —** | $ — |
| Wholly unfunded plans | **$ 22** | $ 23 | **$ 213** | $ 210 |

[1] The impact of curtailments and termination benefits resulting from the Canadian transformation were recognized as part of restructuring expenses (note 21) and are not included in Pension and Other Post-Employment Benefits Expense.

**(b) Pension and Other Post-Employment Benefits Expense**

The total pension and other post-employment benefit expense included in operating expenses and other comprehensive income are as follows:

| | All pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Defined benefit current service cost | **$ 30** | $ 29 | **$ —** | $ — |
| Defined contribution current service cost | **4** | 3 | **—** | — |
| Employee contributions | **(3)** | (3) | **—** | — |
| Employer current service cost | **31** | 29 | | |
| Administrative expense | **1** | 1 | **—** | — |
| Net interest cost | **3** | 2 | **8** | 9 |
| **Expense - profit or loss** | **35** | 32 | **8** | 9 |
| Actuarial (gain) loss recognized | **87** | 36 | **3** | (2) |
| Return on assets greater than assumed | **(55)** | (20) | **—** | — |
| **Re-measurements - other comprehensive (income) loss** | **32** | 16 | **3** | (2) |
| **Total expense including re-measurements** | **$ 67** | $ 48 | **$ 11** | $ 7 |

**(c) Asset Allocation by Major Category Weighted by Plan Assets**

| | Defined benefit pension plans | |
|---|---|---|
| | **2017** | 2016 |
| Equity securities | **50%** | 50% |
| Debt securities | **40%** | 40% |
| Real estate | **10%** | 10% |
| **Total** | **100%** | 100% |

No plan assets are directly invested in the Company's or related parties' securities. Plan assets include investments in segregated funds managed by subsidiaries of the Company on the Consolidated Balance Sheets of $1,135 at December 31, 2017 and $1,107 at December 31, 2016. Plan assets do not include any property occupied or other assets used by the Company.

**(d) Details of Defined Benefit Obligation**

(i) Portion of Defined Benefit Obligation Subject to Future Salary Increases

| | Defined benefit pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Benefit obligation without future salary increases | **$ 1,171** | $ 1,104 | **$ 213** | $ 210 |
| Effect of assumed future salary increases | **90** | 86 | **—** | — |
| **Defined benefit obligation** | **$ 1,261** | $ 1,190 | **$ 213** | $ 210 |

(ii) Maturity Profile of Plan Membership

| | Defined benefit pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| Actives | **34%** | 46% | **16%** | 16% |
| Deferred vesteds | **18%** | 3% | **n/a** | n/a |
| Retirees | **48%** | 51% | **84%** | 84% |
| **Total** | **100%** | 100% | **100%** | 100% |
| Weighted average duration of defined benefit obligation | **14.2 years** | 14.4 years | **12.8 years** | 13.6 years |

**(e) Cash Flow Information**

| | Pension plans | Other post-employment benefits | Total |
|---|---|---|---|
| **Expected employer contributions for 2018:** | | | |
| Funded (wholly or partly) defined benefit plans | $ 32 | $ — | $ 32 |
| Unfunded plans | 2 | 10 | 12 |
| Defined contribution plans | 4 | — | 4 |
| **Total** | **$ 38** | **$ 10** | **$ 48** |

**(f) Actuarial Assumptions and Sensitivities**

(i) Actuarial Assumptions

| | Defined benefit pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| **To determine benefit cost:** | | | | |
| Discount rate - past service liabilities | **3.9%** | 4.1% | **3.9%** | 4.1% |
| Discount rate - future service liabilities | **4.1%** | 4.3% | **4.2%** | 4.3% |
| Rate of compensation increase | **3.1%** | 3.1% | **—** | — |
| **To determine defined benefit obligation:** | | | | |
| Discount rate - past service liabilities | **3.5%** | 3.9% | **3.5%** | 3.9% |
| Rate of compensation increase | **3.4%** | 3.1% | **—** | — |
| **Medical cost trend rates:** | | | | |
| Initial medical cost trend rate | | | **4.9%** | 5.0% |
| Ultimate medical cost trend rate | | | **4.5%** | 4.5% |
| Year ultimate trend rate is reached | | | **2029** | 2029 |

(ii) Sample Life Expectancies Based on Mortality Assumptions

| | Defined benefit pension plans | | Other post-employment benefits | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| **Sample life expectancies based on mortality assumption:** | | | | |
| Male | | | | |
| Age 65 in fiscal year | **22.5** | 22.4 | **22.5** | 22.4 |
| Age 65 for those age 35 in the fiscal year | **24.0** | 24.0 | **24.0** | 24.0 |
| Female | | | | |
| Age 65 in fiscal year | **24.9** | 24.8 | **24.9** | 24.8 |
| Age 65 for those age 35 in the fiscal year | **26.3** | 26.2 | **26.3** | 26.2 |

The period of time over which benefits are assumed to be paid is based on best estimates of future mortality, including allowances for mortality improvements. This estimate is subject to considerable uncertainty, and judgment is required in establishing this assumption. As mortality assumptions are significant in measuring the defined benefit obligation, the mortality assumptions applied by the Company take into consideration such factors as age, gender and geographic location, in addition to an estimation of future improvements in longevity.

The mortality tables are reviewed at least annually, and assumptions are in accordance with accepted actuarial practice. Emerging plan experience is reviewed and considered in establishing the best estimate for future mortality.

The calculation of the defined benefit obligation is sensitive to the mortality assumptions. The effect of a one-year increase in life expectancy would be an increase in the defined benefit obligation of $38 for the defined benefit pension plans and $9 for other post-employment benefits.

(iii) Impact of Changes to Assumptions on Defined Benefit Obligation

| | 1% increase | | 1% decrease | |
|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 |
| **Defined benefit pension plans:** | | | | |
| Impact of a change to the discount rate | **$ (158)** | $ (146) | **$ 197** | $ 185 |
| Impact of a change to the rate of compensation increase | **37** | 38 | **(32)** | (33) |
| Impact of a change to the rate of inflation | **34** | 34 | **(29)** | (30) |
| **Other post-employment benefits:** | | | | |
| Impact of a change to assumed medical cost trend rates | **17** | 18 | **(15)** | (15) |
| Impact of a change to the discount rate | **(24)** | (25) | **29** | 31 |

To measure the impact of a change in an assumption, all other assumptions were held constant. It would be expected that there would be interaction between at least some of the assumptions.

## 18. Accumulated Other Comprehensive Income (Loss)

| | **2017** | | | | | |
|---|---|---|---|---|---|---|
| | **Unrealized foreign exchange gains on translation of foreign operations** | **Unrealized gains (losses) on available-for-sale assets** | **Re-measurements on defined benefit pension and other post-employment benefit plans** | **Total** | **Participating account** | **Shareholder** |
| **Balance, beginning of year** | **$ 111** | **$ 40** | **$ (104)** | **$ 47** | **$ 13** | **$ 34** |
| Other comprehensive income (loss) | **(44)** | **(40)** | **(35)** | **(119)** | **(49)** | **(70)** |
| Income tax | **—** | **10** | **10** | **20** | **14** | **6** |
| | **(44)** | **(30)** | **(25)** | **(99)** | **(35)** | **(64)** |
| **Balance, end of year** | **$ 67** | **$ 10** | **$ (129)** | **$ (52)** | **$ (22)** | **$ (30)** |

*18. Accumulated Other Comprehensive Income (loss) (cont'd)*

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Unrealized foreign exchange gains (losses) on translation of foreign operations | Unrealized gains (losses) on available-for-sale assets | Re-measurements on defined benefit pension and other post-employment benefit plans | Total | Participating account | Shareholder |
| Balance, beginning of year | $ 151 | $ 62 | $ (94) | $ 119 | $ 35 | $ 84 |
| Other comprehensive income (loss) | (40) | (29) | (14) | (83) | (30) | (53) |
| Income tax | — | 7 | 4 | 11 | 8 | 3 |
| | (40) | (22) | (10) | (72) | (22) | (50) |
| Balance, end of year | $ 111 | $ 40 | $ (104) | $ 47 | $ 13 | $ 34 |

## 19. Related Party Transactions

Lifeco controls London Insurance Group Inc. (which is the parent of the Company) through its ownership of The Great-West Life Assurance Company. As such, the Company is related to Lifeco and its other major operating subsidiaries including The Canada Life Assurance Company, Great-West Life & Annuity Insurance Company and Putnam Investments, LLC. In addition, Lifeco is a member of the Power Financial group of companies. Through this relationship, the Company is also related to the Power Financial group which includes IGM Financial, a company in the financial services sector along with its subsidiaries Investors Group, Mackenzie Financial and Investment Planning Council and Pargesa, a holding company with substantial holdings in a diversified industrial group based in Europe.

### (a) Principal subsidiaries

The consolidated financial statements of the Company include the operations of the following subsidiaries and their subsidiaries:

| Company | Incorporated in | Primary business operation | % Held |
|---|---|---|---|
| London Life Financial Corporation | Canada | Insurance and wealth management | 100.00% |
| London Reinsurance Group Inc. (owned through London Life Financial Corporation) | Canada | Insurance and wealth management | 89.40% |
| (owned directly by London Life) | | Insurance and wealth management | 10.60% |
| Quadrus Investment Services Ltd. | Canada | Wealth management | 100.00% |
| Toronto College Park Ltd. | Canada | Real estate investment | 100.00% |

### (b) Transactions with related parties included in the consolidated financial statements

Reinsurance Transactions

The Company has agreements with Canada Life and its subsidiaries to reinsure certain life and health business. In 2017, for the Consolidated Statements of Earnings, these transactions resulted in an increase in premium income of $10,672 ($9,045 in 2016) and total paid or credited to policyholders of $10,620 ($8,992 in 2016). The transactions were at market terms and conditions.

The Company has agreements with Great-West Financial, an affiliated company, to assume certain life business. In 2017, for the Consolidated Statements of Earnings, these transactions resulted in an increase in premium income of $534 ($421 in 2016) and total paid or credited to policyholders of $545 ($411 in 2016). The transactions were at market terms and conditions.

The Company has an agreement with Great-West Life and Canada Life to assume risks for certain policies. In 2017, for the Consolidated Statements of Earnings these transactions resulted in an increase in fee income of $151 ($125 in 2016).

Recapture of Insurance Policies

Effective January 1, 2017, Great-West Life entered into an agreement with London Life to recapture certain group life and health insurance policies assumed by London Life under an Indemnity Reinsurance Agreement dated November 13, 1997. In 2017, for the Consolidated Statements of Earnings, this transaction resulted in a decrease in premium income of $876 and a decrease in total paid or credited to policyholders of $906. The transaction was at market terms and conditions.

Other Related Party Transactions

Segregated funds of the Company were invested in funds managed by Investors Group and Mackenzie Investments. The Company also has interests in mutual funds and open-ended investment companies. Some of these funds are managed by related parties of the Company and the Company receives management fees related to these services. All transactions were provided at market terms and conditions (note 11).

During 2017, the Company provided to and received from IGM Financial Inc. and its subsidiaries (IGM), a company within the Power Financial group of companies, certain administrative services. The Company and segregated funds maintained by the Company also paid $16 ($14 in 2016) for property management and leasing services from GWL Realty Advisors Inc., a wholly-owned subsidiary of Great-West Life. The Company received $92 ($87 in 2016) in fees for distribution services provided to IGM. All services were provided at market terms and conditions.

During 2017, the Company purchased residential mortgages of $137 ($184 in 2016) from IGM. The Company sold residential mortgages of $172 ($185 in 2016) to Great-West Life and $99 ($135 in 2016) to Canada Life. The Company purchased residential mortgages of $15 ($25 in 2016) from Great-West Life and $5 ($10 in 2016) from Canada Life. The Company sold bonds and stocks of $27 ($5 in 2016) to Canada Life and of $23 (nil in 2016) to Great-West Life. All transactions were at market terms and conditions.

Other Related Party Balances

At December 31, 2017, London Life had a temporary outstanding balance of $50 ($75 in 2016) payable to Great-West Life that is included in other liabilities. London Life also had a temporary outstanding balance of $74 ($66 in 2016) receivable from Canada Life that is included in other assets. The transactions were at market terms and conditions in respect to administrative services provided.

The Company has a promissory note receivable, included within bonds, with Canada Life of £32 ($55). The promissory note bears interest at 4.68% and matures on February 25, 2034. During 2017, interest income of $3 ($3 in 2016) is included in the Consolidated Statements of Earnings.

The Company has a promissory note receivable, included within bonds, with Canada Life of £13 ($23). The promissory note bears interest at 4.35% and matures on May 15, 2029. During 2017, interest income of $1 ($1 in 2016) is included in the Consolidated Statements of Earnings.

London Life has a $400 subordinated note receivable from Canada Life. The note is non-interest bearing and matures on September 29, 2026.

The Company has an interest bearing loan receivable from Canada Life with a balance of U.S. $104 ($131). The loan is payable on demand and bears interest at a rate of the London Interbank Offered Rate plus 1.25%. During 2017, interest income of $3 ($3 in 2016) is included in the Consolidated Statements of Earnings.

The Company has notes receivable with Great-West Life which have an outstanding balance of $255 ($255 in 2016). These notes are non-interest bearing and are payable on demand.

The Company has notes payable to Great-West Life which have an outstanding balance of $203 ($142 in 2016).

At December 31, 2017 the Company held $10 (nil in 2016) of debentures issued by IGM.

**(c) Key management compensation**

Key management personnel constitute those individuals that have the authority and responsibility for planning, directing and controlling the activities of London Life, directly or indirectly, including any Director. The individuals that comprise the key management personnel are the Board of Directors as well as certain key management and officers. The key management personnel are defined at Great-West Life.

The following describes all compensation paid to, awarded to, or earned by each of the key management personnel for services rendered in all capacities to the Company and its subsidiaries:

| | **2017** | 2016 |
|---|---|---|
| Salary | **$ 13** | $ 13 |
| Share-based awards | **9** | 6 |
| Option-based awards | **2** | 3 |
| Annual non-equity incentive plan compensation | **9** | 8 |
| Pension value | **5** | 7 |
| **Total** | **$ 38** | $ 37 |

## 20. Income Taxes

**(a) Components of the income tax expense**

(i) Income tax recognized in Consolidated Statements of Earnings

Current income tax

| | **2017** | 2016 |
|---|---|---|
| **Total current year income tax** | **$ 70** | $ 69 |

Deferred income tax

| | | |
|---|---|---|
| Origination and reversal of temporary differences | **$ (8)** | $ (15) |
| Effect of changes in tax rates or imposition of new taxes | **(4)** | 1 |
| **Total deferred income tax** | **$ (12)** | $ (14) |
| **Total income tax expense** | **$ 58** | $ 55 |

(ii) Income tax recognized in other comprehensive income (note 18)

| | 2017 | 2016 |
|---|---|---|
| Current income tax expense (recovery) | $ (10) | $ (7) |
| Deferred income tax expense (recovery) | (10) | (4) |
| **Total** | $ (20) | $ (11) |

**(b) The effective income tax rate reported in the Consolidated Statements of Earnings varies from the combined Canadian federal and provincial income tax rate of 26.75% for the following items:**

| | 2017 | | 2016 | |
|---|---|---|---|---|
| Earnings before income taxes | $ 482 | | $ 596 | |
| Combined basic Canadian federal and provincial tax rate | 129 | 26.75% | 159 | 26.75% |
| Increase (decrease) in the income tax rate resulting from: | | | | |
| Non-taxable investment income | (57) | (11.82) | (36) | (6.04) |
| Lower effective income tax rates on income not subject to tax in Canada | 13 | 2.70 | (38) | (6.38) |
| U.S. tax reform impact of rate change on deferred income taxes | (8) | (1.66) | n/a | n/a |
| Impact of other rate changes on deferred income taxes | 4 | 0.83 | 1 | 0.17 |
| Other | (23) | (4.77) | (31) | (5.20) |
| **Total income tax expense and effective income tax rate** | $ 58 | 12.03% | $ 55 | 9.30% |

**(c) Composition and changes of net deferred income tax liabilities are as follows:**

| | 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Insurance and investment contract liabilities** | **Portfolio investments** | **Losses carried forward** | **Intangible assets** | **Tax credits** | **Other** | **Total** |
| **Balance, beginning of year** | **$ (519)** | **$ (103)** | **$ 143** | **$ (10)** | **$ 63** | **$ 58** | **$ (368)** |
| Recognized in Statements of Earnings | **17** | **(19)** | **(12)** | **1** | **9** | **16** | **12** |
| Recognized in Statements of Comprehensive Income | **—** | **—** | **—** | **—** | **—** | **10** | **10** |
| Foreign exchange rate changes and other | **20** | **—** | **(8)** | **—** | **—** | **—** | **12** |
| **Balance, end of year** | **$ (482)** | **$ (122)** | **$ 123** | **$ (9)** | **$ 72** | **$ 84** | **$ (334)** |

| | 2016 (note 27) | | | | | | |
|---|---|---|---|---|---|---|---|
| | Insurance and investment contract liabilities | Portfolio investments | Losses carried forward | Intangible assets | Tax credits | Other | Total |
| Balance, beginning of year | $ (523) | $ (98) | $ 151 | $ (8) | $ 55 | $ 48 | $ (375) |
| Recognized in Statements of Earnings | 11 | (5) | (4) | (2) | 8 | 6 | 14 |
| Recognized in Statements of Comprehensive Income | — | — | — | — | — | 4 | 4 |
| Foreign exchange rate changes and other | (7) | — | (4) | — | — | — | (11) |
| Balance, end of year | $ (519) | $ (103) | $ 143 | $ (10) | $ 63 | $ 58 | $ (368) |

| Recorded on Consolidated Balance Sheets: | **2017** | 2016 (note 27) |
|---|---|---|
| Deferred tax assets | **$ 6** | $ 2 |
| Deferred tax liabilities | **(340)** | (370) |
| **Total** | **$ (334)** | $ (368) |

A deferred income tax asset is recognized for deductible temporary differences and unused losses and carryforwards only to the extent that realization of the related income tax benefit through future taxable profits is probable.

Recognition is based on the fact that it is probable that the entity will have taxable profits and/or tax planning opportunities available to allow the deferred income tax asset to be utilized. Changes in circumstances in future periods may adversely impact the assessment of the recoverability. The uncertainty of the recoverability is taken into account in establishing the deferred income tax assets. The Company's annual financial planning process provides a significant basis for the measurement of deferred income tax assets.

Management assesses the recoverability of the deferred income tax asset carrying values based on future years' taxable income projections and believes the carrying values of the deferred income tax assets as of December 31, 2017 are recoverable.

At December 31, 2017, the Company has recognized a deferred tax asset of $123 ($143 in 2016) on tax loss carryforwards totaling $716 ($409 in 2016) that expire between 2018 and 2037. The Company will realize this benefit in future years through a reduction in current income taxes payable.

A deferred income tax liability has not been recognized in respect of the temporary differences associated with investments in subsidiaries, branches and associates as the Company is able to control the timing of the reversal of the temporary differences, and it is probable that the temporary differences will not reverse in the foreseeable future.

## 21. Restructuring

Canadian Business Transformation

In 2017, the Company recorded a restructuring provision for the Canadian operations transformation plan of $79 pre-tax ($50 pre-tax in the shareholder account and $29 pre-tax in the participating accounts) with the charge recorded in restructuring expenses in the Consolidated Statements of Earnings. This restructuring is in respect of activities aimed at achieving planned expense reductions and an organizational realignment to respond to changing customer needs and expectations in Canada. The expense reductions address costs across the Canadian operations and corporate functions primarily through a reduction in staff, exiting of certain lease agreements and information system impairments.

At December 31, 2017, the Company has a restructuring provision of $39 remaining in other liabilities. The change in the restructuring provision for the Canadian Business Transformation is set out below:

| | |
|---|---|
| **Balance, beginning of year** | **$ —** |
| Restructuring expense recorded | **79** |
| Amounts used | **(40)** |
| **Balance, end of year** | **$ 39** |

## 22. Operating and Administrative Expenses

| | 2017 | 2016 |
|---|---|---|
| Salaries and other employee benefits | **$ 364** | $ 378 |
| General and administrative | **186** | 214 |
| Amortization of fixed assets | **12** | 12 |
| **Total** | **$ 562** | $ 604 |

## 23. Derivative Financial Instruments

In the normal course of managing exposure to fluctuations in interest and foreign exchange rates, and to market risks, the Company is an end-user of various derivative financial instruments. It is the Company's policy to transact in derivatives only with the most creditworthy financial intermediaries. Note 5 illustrates the credit quality of the Company's exposure to counterparties. Credit risk equivalent amounts are presented net of collateral received, including initial margin on exchange-traded derivatives of $25 as at December 31, 2017 ($10 at December 31, 2016).

**(a) The following summarizes the Company's derivative portfolio and related credit exposure using the following definitions of risk as prescribed by OSFI:**

| | |
|---|---|
| Maximum Credit Risk | The total replacement cost of all derivative contracts with positive values. |
| Future Credit Exposure | The potential future credit exposure is calculated based on a formula prescribed by OSFI. The factors prescribed by OSFI for this calculation are based on derivative type and duration. |
| Credit Risk Equivalent | The sum of maximum credit risk and the potential future credit exposure less any collateral held. |
| Risk Weighted Equivalent | Represents the credit risk equivalent, weighted according to the creditworthiness of the counterparty, as prescribed by OSFI. |

| | 2017 | | | | |
|---|---|---|---|---|---|
| | **Notional amount** | **Maximum credit risk** | **Future credit exposure** | **Credit risk equivalent** | **Risk weighted equivalent** |
| **Interest rate contracts** | | | | | |
| Swaps | **$ 1,011** | **$ 50** | **$ 13** | **$ 61** | **$ 4** |
| **Foreign exchange contracts** | | | | | |
| Forward contracts | **140** | **2** | **1** | **2** | **—** |
| Cross-currency swaps | **2,424** | **34** | **170** | **183** | **9** |
| | **2,564** | **36** | **171** | **185** | **9** |
| **Other derivative contracts** | | | | | |
| Futures - short | **224** | **—** | **—** | **—** | **—** |
| Equity contracts | **195** | **2** | **19** | **21** | **1** |
| | **419** | **2** | **19** | **21** | **1** |
| **Total** | **$ 3,994** | **$ 88** | **$ 203** | **$ 267** | **$ 14** |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Notional amount | Maximum credit risk | Future credit exposure | Credit risk equivalent | Risk weighted equivalent |
| Interest rate contracts | | | | | |
| Swaps | $ 948 | $ 72 | $ 11 | $ 83 | $ 5 |
| Foreign exchange contracts | | | | | |
| Forward contracts | 156 | — | 2 | 2 | — |
| Cross-currency swaps | 2,108 | 21 | 144 | 156 | 6 |
| | 2,264 | 21 | 146 | 158 | 6 |
| Other derivative contracts | | | | | |
| Futures - short | 254 | 2 | — | — | — |
| Equity contracts | 189 | — | 19 | 19 | 1 |
| | 443 | 2 | 19 | 19 | 1 |
| Total | $ 3,655 | $ 95 | $ 176 | $ 260 | $ 12 |

**(b) The following provides the notional amount, term to maturity and estimated fair value of the Company's derivative portfolio by category:**

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Notional Amount | | | | Total estimated fair value |
| | 1 year or less | Over 1 - 5 years | Over 5 years | Total | |
| **Derivatives not designated as accounting hedges** | | | | | |
| **Interest rate contracts** | | | | | |
| Swaps | $ 78 | $ 202 | $ 731 | $ 1,011 | $ 38 |
| **Foreign exchange contracts** | | | | | |
| Forward contracts | 140 | — | — | 140 | 1 |
| Cross-currency swaps | 9 | 449 | 1,966 | 2,424 | (201) |
| | 149 | 449 | 1,966 | 2,564 | (200) |
| **Other derivative contracts** | | | | | |
| Futures - short | 224 | — | — | 224 | — |
| Equity contracts | 3 | — | 192 | 195 | 2 |
| | 227 | — | 192 | 419 | 2 |
| **Total** | $ 454 | $ 651 | $ 2,889 | $ 3,994 | $ (160) |

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Notional Amount | | | | Total estimated fair value |
| | 1 year or less | Over 1 - 5 years | Over 5 years | Total | |
| Derivatives not designated as accounting hedges | | | | | |
| Interest rate contracts | | | | | |
| Swaps | $ 116 | $ 138 | $ 694 | $ 948 | $ 68 |
| Foreign exchange contracts | | | | | |
| Forward contracts | 156 | — | — | 156 | — |
| Cross-currency swaps | 79 | 347 | 1,682 | 2,108 | (305) |
| | 235 | 347 | 1,682 | 2,264 | (305) |
| Other derivative contracts | | | | | |
| Futures - short | 254 | — | — | 254 | 1 |
| Equity contracts | 3 | — | 186 | 189 | (4) |
| | 257 | — | 186 | 443 | (3) |
| Total | $ 608 | $ 485 | $ 2,562 | $ 3,655 | $ (240) |

Futures contracts included in the above are exchange traded contracts; all other contracts are over-the-counter. At December 31, 2017 and 2016, none of the Company's derivative portfolio is designated as accounting hedges.

**(c)** Interest Rate Contracts

Interest rate swaps, futures and options are used as part of a portfolio of assets to manage interest rate risk associated with investment activities and insurance and investment contract liabilities. Interest-rate swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which payments are based. Call options grant the Company the right to enter into a swap with predetermined fixed-rate payments over a predetermined time period on the exercise date. Call options are also used to hedge minimum rate guarantees.

Foreign Exchange Contracts

Cross-currency swaps are used in combination with other investments to manage foreign currency risk associated with investment activities and insurance and investment contract liabilities. Under these swaps principal amounts and fixed or floating interest payments may be exchanged in different currencies. The Company also enters into certain foreign exchange forward contracts to hedge certain product liabilities.

Other Derivative Contracts

Equity index swaps and futures are used to hedge certain product liabilities. Equity index swaps are also used as substitutes for cash instruments and are used to periodically hedge the market risk associated with certain fee income. Equity put options are used to manage potential credit risk impact of significant declines in certain equity markets.

## 24. Legal Provisions and Contingent Liabilities

The Company and its subsidiaries are from time-to-time subject to legal actions, including arbitrations and class actions, arising in the normal course of business. It is inherently difficult to predict the outcome of any of these proceedings with certainty, and it is possible that an adverse resolution could have a material adverse effect on the consolidated financial position of the Company. However, based on information presently known, it is not expected that any of the existing legal actions, either individually or in the aggregate, will have a material adverse effect on the consolidated financial position of the Company. Actual results could differ from management's best estimates.

## 25. Commitments

### (a) Letters of Credit

Letters of credit (LOCs) are written commitments provided by a bank. Great-West Life has entered into certain LOC facilities which are available to certain of the Company's subsidiaries under various reimbursement agreements. Total LOC's issued under these arrangements total U.S. $770 as of December 31, 2017.

Additionally, the company and its subsidiaries have LOC facilities directly available totaling U.S. $24. Amounts issued under these facilities total U.S. $5 as of December 31, 2017.

The Reinsurance operation periodically uses letters of credit as collateral under certain reinsurance contracts for on balance sheet policy liabilities.

### (b) Lease Obligations

The Company enters into operating leases for office space and certain equipment used in the normal course of operations. Lease payments are charged to operations over the period of use. The future minimum lease payments in aggregate and by year are as follows:

| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 and thereafter | Total |
|---|---|---|---|---|---|---|---|
| Future lease payments | $ 24 | 17 | 12 | 9 | 6 | 17 | $ 85 |

*25. Commitments (cont'd)*

### (c) Pledged Assets

In addition to the assets pledged by the Company disclosed elsewhere in the consolidated financial statements, the Company has pledged, in the normal course of business, $6 ($11 at December 31, 2016) of assets of the Company for the purpose of providing collateral for the counterparty.

In addition, under certain reinsurance contracts, bonds presented in portfolio investments are held in trust and escrow accounts. Assets are placed in these accounts pursuant to the requirements of certain legal and contractual obligations to support contract liabilities assumed.

## 26. Segmented Information

The major operating segments of the Company are the participating and shareholder operations. Within these segments the major business units are: Individual Customer & Group Customer, Reinsurance/International and Corporate. These business units reflect the Company's management structure and internal financial reporting. Each of these business units operates in the financial services industry and the revenues from these business units are derived principally from interests in life insurance, health insurance, retirement and investment services, asset management and reinsurance businesses. Business activities and operations that are not associated with the specific business units are attributed to Corporate.

### (a) Consolidated Net Earnings

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Shareholder | | | | Participating account | |
| | Individual Customer & Group Customer | Reinsurance/ international | Corporate | Total | Total | Total Company |
| **Income** | | | | | | |
| Total net premiums | $ (142) | $ 12,226 | $ — | $ 12,084 | $ 2,443 | $ 14,527 |
| Net investment income | | | | | | |
| Regular net investment income | 153 | 94 | 5 | 252 | 876 | 1,128 |
| Changes in fair value through profit or loss | (10) | — | 1 | (9) | 154 | 145 |
| Total net investment income | 143 | 94 | 6 | 243 | 1,030 | 1,273 |
| Fee and other income | 1,131 | 13 | — | 1,144 | (2) | 1,142 |
| | 1,132 | 12,333 | 6 | 13,471 | 3,471 | 16,942 |
| **Benefits and expenses** | | | | | | |
| Paid or credited to policyholders | (318) | 12,382 | 6 | 12,070 | 2,954 | 15,024 |
| Other[1] | 851 | 7 | (2) | 856 | 479 | 1,335 |
| Amortization of finite life intangible assets | 17 | — | 2 | 19 | 3 | 22 |
| Restructuring expenses | — | — | 50 | 50 | 29 | 79 |
| **Earnings before income taxes** | 582 | (56) | (50) | 476 | 6 | 482 |
| Income taxes (recovery) | 138 | (10) | (43) | 85 | (27) | 58 |
| **Net earnings (loss)** | 444 | (46) | (7) | 391 | 33 | 424 |
| Net earnings - participating account | — | — | — | — | 33 | 33 |
| **Net earnings (loss) - common shareholder** | $ 444 | $ (46) | $ (7) | $ 391 | $ — | $ 391 |

[1] Includes commissions, operating and administrative expenses, premium taxes and financing charges.

*26. Segmented Information (cont'd)*

| | 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Shareholder | | | | Participating account | |
| | Individual Customer & Group Customer [1] | Reinsurance/ international | Corporate | Total | Total | Total Company |
| Income | | | | | | |
| Total net premiums | $ 1,085 | $ 10,280 | $ — | $ 11,365 | $ 2,270 | $ 13,635 |
| Net investment income | | | | | | |
| Regular net investment income | 198 | 63 | (2) | 259 | 885 | 1,144 |
| Changes in fair value through profit or loss | (22) | 3 | 5 | (14) | 426 | 412 |
| Total net investment income | 176 | 66 | 3 | 245 | 1,311 | 1,556 |
| Fee and other income | 1,036 | 15 | — | 1,051 | (2) | 1,049 |
| | 2,297 | 10,361 | 3 | 12,661 | 3,579 | 16,240 |
| Benefits and expenses | | | | | | |
| Paid or credited to policyholders | 1,018 | 10,239 | 7 | 11,264 | 2,952 | 14,216 |
| Other[2] | 843 | (32) | (6) | 805 | 603 | 1,408 |
| Amortization of finite life intangible assets | 16 | — | 1 | 17 | 3 | 20 |
| Earnings before income taxes | 420 | 154 | 1 | 575 | 21 | 596 |
| Income taxes (recovery) | 90 | 5 | (21) | 74 | (19) | 55 |
| Net earnings | 330 | 149 | 22 | 501 | 40 | 541 |
| Net earnings - participating account | — | — | — | — | 40 | 40 |
| Net earnings - common shareholder | $ 330 | $ 149 | $ 22 | $ 501 | $ — | $ 501 |

(1) Effective January 1, 2017, the Company realigned its Insurance & Investment business units into two business units: Individual Customer & Group Customer. The realignment resulted in a change to comparative figures within these business units. The adjustment had no impact on the net earnings or cash flows of the Company.

(2) Includes commissions, operating and administrative expenses, premium taxes and financing charges.

*26. Segmented Information (cont'd)*

**(b) Consolidated Total Assets**

| | 2017 | | |
|---|---|---|---|
| | **Shareholder** | **Participating account** | **Total** |
| **Assets** | | | |
| Invested assets | **$ 6,660** | **$ 26,964** | **$ 33,624** |
| Goodwill and intangible assets | **89** | **—** | **89** |
| Other assets | **3,905** | **414** | **4,319** |
| Investments on account of segregated fund policyholders | **60,446** | **—** | **60,446** |
| **Total** | **$ 71,100** | **$ 27,378** | **$ 98,478** |

| | 2016 (note 27) | | |
|---|---|---|---|
| | Shareholder | Participating account | Total |
| Assets | | | |
| Invested assets | $ 7,400 | $ 25,787 | $ 33,187 |
| Goodwill and intangible assets | 104 | — | 104 |
| Other assets | 4,333 | 260 | 4,593 |
| Investments on account of segregated fund policyholders | 55,575 | — | 55,575 |
| Total | $ 67,412 | $ 26,047 | $ 93,459 |

**(c) Geographic Distribution of Total Assets and Income**

| | **2017** | | 2016 (note 27) | |
|---|---|---|---|---|
| | **Income** | **Assets** | Income | Assets |
| Canada | **$ 4,609** | **$ 94,793** | $ 5,879 | $ 89,496 |
| International | **12,333** | **3,685** | 10,361 | 3,963 |
| **Total** | **$ 16,942** | **$ 98,478** | $ 16,240 | $ 93,459 |

**27. Comparative Figures**

During the year, the Company reclassified certain comparative figures for the change in accounting policy (note 2) for presentation of certain income tax balances (note 5, 10, 20 and 26).

These reclassifications had no impact on the total equity or net earnings of the Company.