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Sun Life Financial Inc at National Bank Financial Services
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PRESENTATION

Gabriel Dechaine *National Bank Financial, Inc., Research Division - Analyst*

Good morning, and -- well, welcome to the second day of the Financial Services conference. I'd like to welcome to the stage, Dan Fishbein, who runs Sun Life's U.S. insurance operations, which are heavily skewed towards group benefits and dental insurance, which will also be reflected in the questions that I'm asking today.

Dan, thanks for coming to Montreal. I think it was a couple of years ago that you were also on the stage, right?

Dan Fishbein *Sun Life - President of Sun Life U.S.*

I'm not sure I've been on this stage, but I've been to Montreal a couple of times recently. Thanks for having me.

QUESTIONS AND ANSWERS

Gabriel Dechaine *National Bank Financial, Inc., Research Division - Analyst*

Of course. So speaking of -- well, the type of questions, let's kick off with DentaQuest. So one of the big stories over the past 3, 4 quarters was something that, frankly, I didn't know anything about was these redeterminations and some business was lost, but it looks like we're -- we have a lot more visibility on that business being backfilled, given the sales that have been reported since your trough period.

And what I'd like to get into not too technical, but what's involved in the sales process so we can get more familiar with how this business works. And also, what did Sun Life bring to the mix in terms of possibly improving DentaQuest sales performance?

Dan Fishbein *Sun Life - President of Sun Life U.S.*

Okay. Yes. So as with anything in the U.S., it probably could take the entire remaining 23 minutes to explain all the different parts of this. So -- but I'll try to do it really quickly. So DentaQuest is the business that we acquired in the U.S. almost 2 years ago. They were very heavily focused on government programs, which is mostly Medicaid, the program for low-income people and to some degree, Medicare, which is the government program at a federal level for people over 65.

But they also had a commercial dental business. And Sun Life had a commercial dental business. And by commercial, what I mean is an employee benefits business where people get that benefit through their workplace. So putting those 2 businesses together has had a lot of interesting advantages.

First of all, by the way, just putting the provider networks because that's a critical component of these businesses, putting that together has had some big advantages. But the sales process, there's actually multiple different sales processes. So selling government programs is completely different than selling in the employer market.

Government programs are few but very large. So there's a whole very well-developed process at DentaQuest for going after these very large government contracts, a whole proposal team that studies these months, even years in advance and strategizes out how to win. Where Sun Life has added something to that is through the provider network. That's been very, very helpful.

On the commercial side, Sun Life actually had more commercial business than DentaQuest had, but there's also been some very valuable advantages there. We took the proposal team that's good at going after these large government contracts and put them to work on going after large commercial contracts. So we had a really big early win last year, we won the mandate to cover all the employees of the state of West Virginia.

One of the biggest employee benefits dental business contracts we've ever won, and that was a true collaborative effort of their large case proposal team and our sales team that works very well with brokers, which is the distribution mechanism for employee benefits.

So both organizations have added something to that sales process that wasn't there before.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

And the provider network, you're saying that was enhanced by DentaQuest or by Sun Life?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, both, but it's very much by Sun Life because with DentaQuest in focusing on government programs, which are very -- generally very state-specific is they would build a network in that state. But then they would sometimes have to do that on a pro forma basis when they were going for a contract.

--Sun Life has a nationwide dental provider network that's quite robust in size. And so we've been able to recontract that network as needed for government programs, which really accelerates the process of getting into a new state.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

And just to kind of simple illustration of that. So if you're pitching to a state, previously, DentaQuest might have had a smaller list of providers. And then when Sun Life is in the mix, you -- people can have coverage everywhere in the U.S., and it's a lot -- it's a better offering essentially.

Dan Fishbein Sun Life - President of Sun Life U.S.

So certainly everywhere in the U.S. and also DentaQuest might not have even had a network in that state. So for example, they won the state contract in Iowa last year. And what they typically would have done pre-Sun Life is go out and precontract with some dentists and then present to the state of Iowa: Here's our plan for building the network once you award us the contract.

But this -- that's a much more compelling case now to go to Iowa and say, well, through the Sun Life network, we already have x thousands of providers under contract. We can recontract them specifically for Medicaid terms but we're not starting that work from scratch.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

And then the private market or whatever you call it, the commercial or that was a much smaller component of DentaQuest, is it reasonable to assume that there was a bigger growth outlook for that part of the business because you might have some overlapping clients that don't -- they have Sun Life on the group benefit side, not the dental side and maybe just simply more of an emphasis on that channel?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, I think there's growth in multiple segments. More than 80% of the DentaQuest business was in Medicaid. So -- and there's still more growth like they won 4 states last year. But Medicare, by the way, is also a big growth opportunity. I think DentaQuest is really just in the early stages there.

What's very attractive about the commercial market and growing more rapidly there is that each commercial member represents, depending on the benefits, 3x to 5x the premium that a Medicaid member represents.

So Medicaid, they have vast, vast numbers; 30 million or more Medicaid members. But we anticipate commercial will be a big part of the growth story going forward. It doesn't take as big numbers, but if you get 3x to 5x the premium, you can get some really good revenue leverage there.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

So the revenue per covered is higher. What about the margins? Are they -- how do they compare between the Medicaid and the private market?

Dan Fishbein Sun Life - President of Sun Life U.S.

They're probably a little bit higher in commercial. One thing about dental is margins are pretty small, but the ROE is very big. So the numerator is smaller, but the denominator is much smaller.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

Because there's no claims reserves?

Dan Fishbein Sun Life - President of Sun Life U.S.

There's not -- there's some claim reserves. But generally, in a dental benefit, you're talking about a few thousand dollars a year in benefits. So the actuarial formulas don't require us to keep a ton of capital around that business. So the denominator is very low and the ROE is really good in that business.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

So how -- what could go wrong in dental? I know -- I mean, I know employee benefits, if unemployment goes up, long-term disability claims can go up or if you were simply too competitive in your pricing and claim volumes exceed your assumptions. That's when you can have a period of negative growth. What's the analogous risk, I guess, in dental?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, the first thing that can go wrong, which has never happened before is the government can decide to disenroll a significant number of the members which is what is happening right now. What happened in the U.S. is there was what was called the public health emergency around COVID.

That was ended in May of last year and the States, for the first time in more than 3 years, were free to disenroll people who might no longer have been eligible. So this is a pretty significant reset going on. That's a onetime thing. The business will rebase at a different size and then grow from there.

There's always new innovation in medicine, including in dentistry but it's not the same as in medicine. We don't have a \$3 million dental drug coming to market. So we obviously watch very carefully all the trends in dental care. We know what the underlying medical cost inflation is for dental. We have good both internal data and external sources for that, and we can price for that.

In the government programs business, a lot of those arrangements have corridors. We're at risk within a corridor, but there's a minimum and a maximum. So in a sense, we're sharing risk with the States. So there's a lot of protection there actually. Things happen within that very narrow corridor, but that means you can't have a huge amount of volatility.

So dental is actually a much more stable business from a margin perspective than medical is. And it's actually all about scale. It becomes -- it's a growth story and how much scale can you apply to that business and drive expense efficiencies more so than it is a big risk management function.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

So you mentioned one of the risks of group benefits, or medical coverage and there's no \$3 million drugs in dental, while there are \$3 million drugs in medical coverage. Is there anything going on, on that front at the moment? I mean I don't think Ozempic is of that nature, but it's certainly topical as far as everybody is using it these days, it seems. And I don't know if you provide that coverage?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, a couple of things there. So first of all, on the so-called GLP-1 drugs of which Ozempic is the most common. Stop-loss, which is one of our 3 big businesses, one of the businesses where we're a leader, is a little bit at a different part of the medical continuum.

What stop-loss insurance is, is about 2/3 of the people in the U.S. who get their health insurance through work are actually in a plan that has no insurance coverage. The employer is self-funding it, and they just hire an administrator to run that for them. But many of those employers buy what's called stop-loss insurance, which protects them if any 1 person in a year has a very significant amount of claims.

So they set the deductible for that, it's typically something like \$200,000 or \$250,000 a year, and then we reimburse them for the amounts over that. So Ozempic doesn't rise to that level. I looked it up last night, Ozempic is \$936 a month. So about \$11,000 a year. So it's not going to get to those kinds of stop-loss thresholds.

But in the longer term, while, we don't really yet know what Ozempic is going to do for people in the long term, including what the side effects are. But more and more, you're seeing articles saying that it's possible that obesity as a condition has been cured. And that could have profound impacts on other parts of medical care.

Would that mean less diabetes, less heart disease? All sorts of incredible things like that. Now so that could help stop-loss in the long run or really what it would mean is obviously the pricing would match a lower risk, but that would be certainly great news.

I did see a study recently that said if everybody in the U.S. who could technically qualify for Ozempic was taking it, it would cost \$1 trillion a year and that the medical benefit would be far -- would be \$200 billion to \$300 billion. So obviously, there's -- even at the \$936 a month, there's something wrong with the pricing of Ozempic because right now, the way drug pricing works is they take what they invested to develop the drug, and then they try to recover it, and some profit margin on the number of people who are likely to take it.

But if that ballooned to that many people, then that would obviously not be the right price, and I'm sure the government would step in, in some way. Now you mentioned and I mentioned as well, the \$2 million and \$3 million drugs, that's a much bigger, more relevant issue for the stop-loss business because that would certainly come under stop-loss coverage.

So we've had a very extensive effort going on for several years right now to make sure we're aware of new drugs as they come to market that are in that range and figure out how to cover them, how to price for them. The good news is we have a very large book of business. We have over \$2.5 billion of stop-loss. So we can pay some large claims.

It's kind of why we're here, why we provide that coverage. However -- and this is kind of a little understood fact. When the U.S. passed the so-called Obamacare or the Affordable Care Act, one of the things that -- and this was about a dozen years ago.

One of the things that happened was lifetime and annual maximums in health plans were made illegal. That was probably the right thing to do because health insurance is there to cover you in the more significant situations, that coverage shouldn't just stop. But what happened was that created a market for these kinds of drugs that never existed before.

In the past, the scientist would go to a drug company and say, "I've got this great idea. We can come up with this drug. It will be useful for 1,000 people a year, and we only have to charge \$3 million a year for the drug." Now a lot of health plans had a \$1 million annual benefits cap. So the pharmaceutical company seeing that business case would say, we can't do that. It's not going to be reimbursed. Now it is reimbursed.

As a result, there is a huge pipeline of these \$2 million and \$3 million drugs that are about to come to market because it takes 10 years to develop, test, get approval. So this is going to become a very big issue going forward.

Gabriel Dechaine *National Bank Financial, Inc., Research Division - Analyst*

What disease are they trying to address with these drugs? Or is there...

Dan Fishbein Sun Life - President of Sun Life U.S.

A huge variety of illnesses. Many of them are now in the category of what's called gene therapy. So these are inherited, very serious, but relatively rare conditions. But with gene therapy, you can actually cure a lot of these conditions. You can actually change the person's DNA so that they no longer have that condition.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

Okay. Well, sticking with this stop-loss theme, the results have been pretty good. And in the past, we've talked about this latent impact of COVID where people didn't do -- I mean medical coverage and you've got a period where claims just spike because they didn't catch something in time. Is that still something that we need to be concerned about?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, so what's happened with stop-loss through the pandemic is in the first year or 2, we and everyone else in the industry had unusually good experience because people just weren't going to get care. That ended obviously, quite a while ago.

But what happened was during COVID, a lot of medical practitioners in the U.S., doctors and nurses, in particular, retired early. A lot of people in that 50 to 65 cohort left the field. And of course, that's an outsized cohort because of the baby boom generation.

So we ended up with a shortage of supply, not a shortage of demand. The demand recovered pretty quickly within a year or so. But the ability to fulfill that demand was very much constrained. So everyone can -- health insurers, stop-loss insurers continue to have better-than-expected experience because there simply wasn't the ability to provide the care.

Over the last 6 months or so, we've seen the capacity in the system get back to where it was. And that was obviously a multiyear effort of hospitals to hire more people, schools to train more people, bring more people into the professions. So now with the supply recovering, the utilization has recovered as well.

So in our stop-loss business, for example, we were seeing, experience or loss ratios significantly below what we price for. Inevitably, that has to go back to where it was, and we saw that trend start second half of last year. And clearly, capacity is now back to where it was.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

And another, I mean, disability claims, incidence and severity was also a period of very -- much lower than you would have assumed, and that's pretty much over now, I guess, the...

Dan Fishbein Sun Life - President of Sun Life U.S.

No. Actually, we're seeing...

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

It's -- because we see one number in your results and it's hard to decipher how much is Canada versus the U.S.? So just a little refresher, I guess, on...

Dan Fishbein Sun Life - President of Sun Life U.S.

Yes. Just an editorial comment. In the DOE, when you see positive experience or negative experience that's not really positive or negative, that simply refers to better or worse than expected. So you could expect terrible experience and have it be slightly less terrible, and it would be reported as positive.

So it gets -- those words have value judgments associated with them, but they don't mean exactly what they appear to mean. But in any case, what we saw throughout COVID was pretty average to a little better-than-average disability experience.

Last year, everyone in the industry started to see significantly better disability experience. I wouldn't say dramatically, but it's actually more recent that the experience has been favourable. And it's not -- to be honest, it's not entirely clear why. But one theory would be there's fear of layoffs.

So when -- and there haven't really been a lot of layoffs, but there have been some that hit the news, tech companies and so forth. When people fear layoffs, they tend to -- they're less likely to file for disability insurance. So we are definitely seeing favourable experience. The whole industry has for the past 4 or 5 quarters.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

Tech people won't get the disability claims too often anyway, right? Carpal tunnel...

Dan Fishbein Sun Life - President of Sun Life U.S.

It's a really -- well, but you bring up another very important point. One reason why disability experience may be more favourable is for the roughly half of the economy that can work from home. There's new options now other than just going out on disability. Somebody has an illness or a physical condition that previously might have kept them from getting in the car and going to work.

They can now work from home and the ability to get people back to work or partially back to work has gotten much better in this new world.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

So stop-loss still doing well. Dental, improving, the disability coverage also doing well. Like what sort of pricing actions have you been taking going into this year? Wouldn't suggest that you needed to reprice much higher, maybe other than coverage costs are higher, but maybe you can clarify that?

Dan Fishbein Sun Life - President of Sun Life U.S.

Yes. So I think in terms of -- there are 2 resets going on, right? Dental, the latest external estimates is that -- are that the States have disenrolled or will have disenrolled 18% to 19% of their Medicaid members. So that's a reset. That also changes the mix of the business. A lot of the members that were being -- that are disenrolled were not high utilizers, maybe not utilizing at all.

So we've got to get through that reset. Same thing, stop-loss, obviously, utilization going back up because supply is back up. So to your question though, what kind of pricing increases. All of the businesses always have an inherent trend in them and some pricing increases. And obviously, I'm not going to give you what our pricing is.

But in stop-loss, we generally have seen over the years, medical trend, medical inflation in the U.S. is 6% to 8%. So that drives a growth in the business even without doing anything. And then we are taking share, by the way. What we are seeing right now is with loss ratios recovering, the pricing is getting more rational. It has tended to be a very cyclical business. Some players will price very aggressively when the loss ratios are good, saying, "Hey, that's great business. Let's get more of it", then they overdo it, their loss ratios go up. They say, "Oh, we don't like this business, we better put through big price increases to get it back to where it needs to be." We've never done that. We've been a much more stable pricer than most of our competitors.

But at the moment, we are seeing a somewhat more rational pricing environment in stop-loss. So we've been able to get the increases that we think are appropriate. In dental, there is a low single-digits medical inflation or dental inflation. That's certainly part of it. One of the big issues for us is the state contracts generally reprice every year. But we've got to go back to the states and say, you have now delivered to us a completely different mix of membership.

All the low utilizers were just disenrolled, the higher utilizers stayed, you have to adjust your pricing to reflect that but that takes some time. We have to go through a full pricing cycle to do that. But we are seeing and anticipating getting appropriate increases to reflect that risk. And then in the group business, life, disability, generally, you see low single-digit increases. It tends to track with the size of the economy, if a lot of the benefits are related to income. So if incomes go up, prices go up. And generally, we're seeing a pretty reasonable pricing environment there as well.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

Quickly on investments. I don't know what you can -- any major investment initiatives taking place other than integrating DentaQuest, that's a big one. But are there any big tech overhauls that you're pursuing right now?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, we tend to avoid big tech overhauls because we're in -- those are super risky. And so we -- and we do sit on top of a set of legacy systems. So I think the whole tech world has matured to the level where it understands that we build on top of those legacy systems as opposed to scrapping them and starting all over.

But that's actually been our biggest and most important investment is in our group business, that's the disability, life, absence management, voluntary. We've invested quite a bit in enabling our employer Clients to integrate with the rest of the benefits ecosystem. We've invested heavily in things like APIs that allow data to move back and forth in a smooth way and integrations with benefit enrollment firms and benefit administrators.

We're actually probably one of 2 companies that's done the most in that area, and it's providing real differentiation for us. And the last 2 years, our business -- our group business has grown at double digits. And that's a business that hadn't been growing for a long time. So we're definitely taking share with those capabilities.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

I'd want to wrap up on M&A. If I go back over the history of Sun Life in the U.S., the Genworth Group business 10, 15 years ago, there was Assurant, DentaQuest. I'm sure I'm missing another along the way. The message from the company was a lot of these acquisitions and the smaller tech-oriented ones were to fill in gaps and increase capability. It seems like you've got all your bases covered now. So the case for future M&A isn't as strong as it has been in the past. What's your perspective?

Dan Fishbein Sun Life - President of Sun Life U.S.

Well, we're always active in looking at what's out there, and there's always things. We like the 3 active businesses we're in. So the stop-loss business, which we call Health and Risk Solutions, the group business and the dental business. We want to be a leader in each of those businesses.

So we're not necessarily looking for a fourth business. By the way, we've grown that over the past 10 years. The employee benefits business has grown from \$2 billion of revenue to over \$8 billion. A big part of that has been an M&A program, but -- and there's also been a lot of organic growth.

So where we would look, would be for capabilities or scale if that could help us in any one of those 3 businesses. So we're not necessarily done, but we're also not looking for some massive acquisition or for a new unrelated business area.

Gabriel Dechaine National Bank Financial, Inc., Research Division - Analyst

Got it. Okay. Dan, great talking to you, as always. And thanks for coming to Montreal.

Dan Fishbein Sun Life - President of Sun Life U.S.

Thanks for having me.

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