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CAPITAL MANAGEMENT

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Panelists:	GLEN M. GAMMILL
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- o How should capital be measured?
- o Cash flow based surplus
- o What performance measures are reliable?
- o Return on equity, book gains, terminal funds
- o How much surplus is needed?
- o Business planning for future capital needs
- o Capital restructuring
- o How should multiple risks be combined?
- o Qualitative issues versus numbers as they relate to future growth

MR. ROBERT C. WINTERS: The first speaker is Rick Kischuk of the Lincoln National, and he will talk about the measurement of, and need for, capital from the viewpoint of a large stock life insurance company.

MR. RICHARD K. KISCHUK: We tend to view capital as a resource -- one of several types of resources that we need to "manufacture" our products. In life insurance, as in all businesses, the primary types of resources are the traditional four Ms: men, money, machines and materials. While automation is increasing, the primary resources used in manufacturing insurance products are still human resources and capital.

In manufacturing products, it's always important to know both the amount and the cost of the resources used. Until recently, the methods used to determine the amount of capital employed in manufacturing life insurance company products were incomplete. In addition, most companies did not have a good understanding of the cost of capital. Most companies believed that they were earning a profit as long as revenues exceeded expenses. For example, if revenues were $3 million and expenses were $2 million, management believed it had earned a profit of $1 million.

However, to get the complete picture, the cost of capital must be included. Suppose that $5 million of surplus is used at a cost of 15%. Then the cost of capital is $750,000. The remaining profit, over and above the cost of capital, is only $250,000. On the other hand, if $10 million of surplus is used, the cost of capital would be $1.5 million. In that case, the company has actually lost $500,000, after taking the cost of capital into consideration.

It is also very important to be aware of the fact that the cost of capital varies widely, depending upon its source. Some possible sources of capital are common stock, preferred stock, debt, retained earnings, sale-leasebacks, and surplus relief reinsurance. In order to determine the cost of capital, a company must determine the cost of each source, and then determine a weighted average based upon its capital mix.

At Lincoln National our working definition of "capital" is based on statutory accounting. This is because statutory accounting determines how quickly funds will become available to service debt and pay dividends to shareholders. However, GAAP accounting provides a better measure of the underlying earnings that are actually being generated by a company or block of business. And GAAP accounting can be used to calculate return on equity.

Ideally, for Capital Management we would use an internal rate of return method of accounting. However, it would be expensive to develop financial statements based on this accounting method. And it would be very confusing to management. We already have one accounting method for state regulators, a second for accountants, and a third accounting method for shareholders.

Our compromise has been to use modified GAAP accounting for internal management reports. The main type of adjustment is that capital gains and losses are amortized into earnings. Other adjustments are made whenever GAAP accounting leads to conclusions opposite of those that would be reached using discounted cash flow analysis.

We use the formula and methods summarized in my recent *TSA* paper, "Strategic Management of Life Insurance Company Surplus," to allocate surplus among profit centers. While that formula is illustrative of the one that we use at the corporate level, more detailed formulas are used within profit centers to allocate surplus by product and among blocks of business. It's important to emphasize that no company should simply use the Lincoln National formula, or the formula of any other company, for that matter. Each company is unique in its portfolio of business, operating environment, strategic plans and management's tolerance for risk. All of these factors should be considered explicitly in developing a surplus formula. The target surplus formula is a very important strategic consideration. Once determined, it will drive capital decision making. If the surplus formula is out of phase with other elements of the company's strategic and operating plans, there can be severe problems. The general process, outlined in more detail in my recent paper, allows us to determine the amount of capital that is used, determine its cost, and monitor results to verify whether we are earning a profit sufficient to cover our cost of capital.

MR. WINTERS: Having heard the stock version, where there is the possibility of common and preferred stock in a capital structure, we turn now to an experienced mutual company actuary, Dave Ingram. He's experienced in three different mutual companies: Penn Mutual, Provident Mutual, and The Prudential, and is currently with the Provident Mutual.

MR. DAVID N. INGRAM: We measure capital for product pricing, performance monitoring and planning. The ways that we look at capital in each step are different, but hopefully, they are consistent.

For product pricing, capital is measured by a modified Anderson book profit. Product assets are set equal to the reserves, plus dividend liability, plus required surplus in each year. The modified book profit is equal to the statutory income after tax and dividends, less the increase in the required surplus.

For internal performance monitoring, capital and return on capital are measured with a modified GAAP statement. The statement is prepared in accordance with principles set forth by the committee on management financial statements for mutual companies. Capital for each product family is kept equal to the required surplus, plus deferred acquisition cost, less deferred tax liability. This is done by the transfer of invested assets to product families with insufficient assets. A corporate line is used to hold the balance of surplus (vitality surplus). Corporate usually directly holds some assets, such as subsidiary companies or home office buildings. These are assets which were acquired by the company with no intention of relating them to any of the products, and the purpose of holding these assets has nothing to do with backing product liabilities.

The required surplus is defined by a fairly simple formula similar to Lincoln National's. We have taken the general format that Lincoln National and others have developed and varied it according to our particular company experience. For C-1 required surplus (for asset value fluctuation), we've defined about six or seven different classes of asset riskiness. For example, at one company we thought that our mortgage portfolio was extremely conservative and, therefore, held a very low required surplus on mortgage investments for C-1 required surplus. On the other hand, we had some real estate joint ventures which we thought were highly risky. We classified them at the same level as we held surplus for common stocks. A mutual company expects to use surplus to cushion extreme losses rather then immediately charging them to dividends. This is why the resulting required surplus and required surplus formulas seem to be very similar to stock companies'.

I do want to mention something about C-3 required surplus (that is, the surplus for interest rate fluctuations). A series of projections were made, evaluating the amount of surplus needed under various interest rate scenarios. The variations of lapse rates, expenses, mortality, morbidity and dividends due to the interest rate changes were projected. The study resulted in the derivation of a simple linear formula that we used for C-3 required surplus. That formula is 1.2% of all assets in a product fund for each year of asset/liability mismatch, plus 30 basis points of all assets. This provides a simple way of "risk adjusting" which could be used to influence daily investment decisions and definitely could influence the strategies for asset/liability mismatching.

MR. WINTERS: At this point we will have the balanced presentation of the person who is an employee of neither a stock life insurance company nor a mutual life insurance company, at least directly. He is rather a consultant. Glen Gammill is a partner in the New York management consulting department of Peat, Marwick, Mitchell and Company, and he is the national practice coordinator of its insurance actuarial practice.

MR. GLEN M. GAMMILL: One thing that Rick mentioned earlier that I'd like to revisit is the various sources of capital that are being used by the life insurance companies, in particular, the idea of human capital. I think the human element in the capital management process is extremely important, and I'd like to focus on some basic objectives and concepts of the capital management process.

The capital management process is at the heart of the corporate enterprise. The process itself is not materially different for a corporation whose primary business is life insurance and for a non-life corporation of similar size and sophistication. Since the process can typically involve material amounts of corporate resources and can impact the corporation for years to come, the process needs to be closely monitored and controlled.

The ultimate measure of success relative to the capital management process tends to vary depending upon one's perspective. From the business head's point of view, obtaining the business's capital requirements in the appropriate amounts, at the right time, from the right sources, and at the right cost may be the ultimate measure of success. On the other hand, success for the CEO may be a clear understanding of why such funds were approved for that particular business over the other competing businesses within the corporate complex.

While the quantitative aspects of measuring and evaluating each alternative investment's attractiveness to the corporation provide a solid foundation for the capital management process, the overall complexities of the process and its potentially significant impact on the corporation's ability to progress require that several basic concepts be adhered to.

Basic concepts are important to most management activities. As indicated, the capital management process is no different. As an advisor, my experience has confirmed that the lack of attending to basic concepts is often at the root of many corporate issues requiring resolution. What are the basic concepts of the capital management process?

Capital management should seek to accomplish the following basic objectives:

- To ensure that the corporation lives within its means.

- To facilitate the estimation of cash needs to raise the necessary funds economically, and to allocate such funds to the most worthy investment alternatives.

- To ensure that major capital commitments receive a proper evaluation at the appropriate level of senior management.

- To ensure that each investment undertaken fits within the goals and objectives of the corporation (financial or otherwise).

- To foster the development of new and productive uses for capital and to ensure that a variety of investment alternatives are articulated and considered.

- To ensure that each investment alternative competes for capital where consistency and uniformity in the process ensure careful and thorough evaluation.

- To provide a financial reporting mechanism that allows actual commitments to be tracked to provide constant feedback for those responsible for making those commitments, and finally

- To avoid cumbersome procedures which cause unnecessary delays in achieving corporate objectives.

I'm sure many of you can relate to the objective of living within the corporation's means. Recall your last senior management meeting in that plush resort in Colorado. As each business head indicated his business's growth objectives over the next several years, you began to mentally accumulate the capital required to fund that growth. That you're here today suggests that you had the good sense not to raise the issue of scarce capital resources at the culmination of those presentations.

Capital resources are scarce and costly. Therefore, the capital management process must identify which specific sources of capital are available and which of those sources can be accessed at an acceptable cost. By allowing each business unit to facilitate the estimation of the amount and incidence of its available cash flows, the process can assist the corporation to assess its needs in a more anticipatory manner and to allow more time to identify the appropriate sources of such capital at the best possible price.

Next, from the CEO's vantage point, major capital commitments should further the objectives of the corporation, and the evaluation of those commitments should reflect their role in accomplishing the overall corporate mission. For example, is the commitment strategic or tactical? A tactical commitment may require a lower hurdle rate due to its importance to short-term operations, while a strategic commitment, such as an acquisition, may have to compete with the highest hurdle rate available among not only the corporation's existing businesses, but also among all other potential alternative investments.

Further, the capital management process should be applied systematically to permit each investment alternative to be evaluated in a consistent manner. It's not uncommon in actual practice to observe that the fundamental concept that each alternative's financial results be internally consistent with a common baseline economic scenario has been completely ignored. You can't consolidate each business's financial results unless each business is operating on the same planet, in the same time frame, with the rest of the corporation.

Finally, the mandated use of multiple, or singular, hurdle rates should not be blindly adhered to. The CEO's judgment and business experience will usually play a significant, if not determining, role in many capital management decisions, irrespective of the quantitative documentation supporting such decisions. Information gridlock and parameter paralysis often lead the CEO back to the basic tools of the senior manager, experienced judgment and rationality.

Next, let's focus on the capital management process from the standpoint of its time-phased stages and discuss some of the parameters which overlay the issues addressed earlier. First, we might consider a stage called the "idea" stage. Under the assumption that capital resources may not be in short supply but good ideas always are, the process must encourage a variety of new investment ideas. This stage is a good justification for the management retreat in Colorado! This stage may formally occur yearly, quarterly, or more often.

The second stage might be in the form of the "capital request" stage. This is where the business heads, after coordinating business unit requests, would be expected to present the corporation's senior capital management committee with an estimate of the business's capital requirements over an agreed upon budget horizon. Typically, this stage would lead to the formulation of the overall corporate capital needs and would be accomplished prior to any specific authorizations to proceed. On a yearly cycle, such requests would be assimilated by the end of the third quarter of the corporation's fiscal year.

Third would be the authorization stage. Before the corporation's capital management committee authorizes any commitment, the appropriate level of quantitative and qualitative analysis and documentation should be reviewed by the corporate financial office, or staff, or their advisors, to ensure congruity with overall corporate performance objectives and criteria, such as required returns on equity, debt to equity ratios and related corporate credit ratings. On a yearly cycle, such authorizations might be skewed toward the corporation's fourth quarter.

Finally, there's the monitoring stage. Following the authorization, the commitment's results usually are consolidated into the corporation's financial statements. Accordingly, to the extent that the accounting convention used by the company for management purposes departs from the economic evaluation of each such commitment, the ability of senior management to monitor each investment's progress will be made more difficult.

Several significant variables need to be considered during the capital management cycle, including industry conditions, corporate objectives, related strategies and the corporation's own business style. In addition, the profitability and financial strength are also very important inputs to the process. For example, a consistently profitable and financially strong corporation can allow more capital management decisions to be delegated directly to the business head. A company without such attributes, however, should consider exercising a higher level of control and influence over that same process.

In creating a level playing field for the various competitors vying for the corporation's capital resources, certain pervasive issues should be considered:

1. The project life -- In committing a corporation's capital resources, the CEO must be aware of the entire investment horizon. For example, if a new product technology is being promoted, the business must clearly define the total time frame required to make the commitment successful. Long-term businesses may require long-term horizons, not just three years! This concept could also be referred to as the "Paul Harvey concept"; i.e., the CEO needs to know "the rest of the story."

2. The investment characteristics -- The evaluation, selection and monitoring of investment alternatives may be impacted significantly by their characteristics. For example, tactical investments, to maintain existing market penetration, may require lower hurdle rates and less overall quantitative justification than strategic commitments, such as acquisitions, which could change the entire character and profitability of the corporation in question.

3. The evaluation process -- In addition to qualitative aspects of the capital management process, the quantitative aspects, which emphasize the real economics of the alternatives being evaluated, continue to be used as

appropriate basis for ferreting out and screening the multiplicity of in-investment alternatives generally available to the corporation. Methods which emphasize internal rates of return based on available cash flows have been widely applied in our industry. Today, the inclusion of required surplus in the process may tend to reduce the number of hurdle rates ultimately employed, as risks become more equalized between insurance business units. The continuing battle between the short-term (reflected in historical ROE/ROI analyses based on particular accounting conventions) and the long-term (reflected in prospective evaluation techniques using real, or available, capital) will continue to haunt the CEO.

In preparing for the final ten yards, the business head needs to make sure that the capital authorization request has enough relevant and appropriate information to gain acceptance. Accordingly, in addition to a thorough but brief executive summary, the authorization request must provide clear and concise documentation to support the following:

1. Critical assumptions -- All assumptions are equal, but some are more equal than others. The ultimate congruence of actual emerging experience with the investment's underlying business assumptions is critical to attaining stated objectives. A clear statement of the underlying business assumptions supporting the investment and their internal consistency with the corporation's baseline economic scenario will be critical.

2. Calculation methodology -- Our ability to clearly articulate the calculation methodologies used to prepare the investment's prospective financial results may help to avoid information gridlock. My own experience indicates that the education of the senior manager, in this regard, will take time and must of necessity evolve over a long period characterized by open communications and credibility building. The effective CEO understands the professional's ability to produce desired results using scientific methods and assumptions.

3. Other key elements of documentation supplied with the request should include: alternative approaches to the investment, risk analyses and significant non-economic consequences.

The capital management process must be executed in such a manner that the corporate executive who authorizes such expenditures is confident:

- o That the process encourages a submission of investment alternatives consistent with the corporation's objectives and strategies.
- o That the alternatives presented are adequately and consistently evaluated.
- o That the corporation has done its best to promote real corporate growth.
- o That the financial management information will permit significant investments to be monitored against the plan in some meaningful way.

Top management is always faced with a balancing act maximizing short term earnings and their associated short term rewards while, at the same time, investing long term to enhance the corporation's future financial strength and growth. The capital management process cannot solve this dilemma, but rather, if it is handled properly, it can help the corporation to adjust the weights more often. Successful capital management relies on paying attention to fundamental concepts. As professionals, our role is to be guided by such concepts and assist our business associates to follow our lead.

MR. WINTERS: The notion of capital as a scarce resource, at least for mutual life insurance companies, is a relatively recent one. Glen mentioned that as a given, but it's a given that we've only recently discovered. I know that a lot of mutual companies are going through a process of evolution, no doubt including the education of top management.

I had one question for Dave on the formula basis of establishing surplus requirements for C-1 risk. Do you find that the formulas are driving asset selection decisions? Do the formulas generate portfolio decisions?

MR. INGRAM: To date they haven't. We haven't incorporated them into our investment selection process. There's an education process that's just starting, between the investment officers and the actuaries, to get the investment officers to be aware of both statutory accounting and the required surplus with the effects that it has on the investment selection process. More than a year ago we looked at a massive change in a portfolio for a particular product. One of the elements that led to the rejection of a strategy that included a lot of high risk investments was the impact of required surplus. On a day to day basis we have yet to incorporate required surplus. But in large decision making, where we've already taken senior management through the education process on what required surplus is and how it can be used in decision making, they've applied it. We're still working with the investment people to get them to recognize it in their decision making.

MR. WINTERS: Dave mentioned a structure for discussions between the investment people and the insurance people on investment portfolios. Taking it a step further, I think that what I'm hearing is the people in charge of the liabilities talking to the people in charge of the assets with the idea that they really ought to have something in common. For those of you who are with insurance companies, how many companies have such a structure, whether formalized or not, specifically aimed at getting communication between the investment people and the insurance people focused on portfolio decisions? I would say that most have.

MR. GAMMILL: Rick, I recall in reading some of your remarks earlier that you were focusing on one hurdle rate of 15% after tax. Are you applying that uniformly across all lines and all investment alternatives, or do you make exceptions?

MR. KISCHUK: We pretty much use the 15%. I think there are a number of reasons for that. One is the concept that Glen talked about a little while ago: keeping it simple. You can focus people's attention a lot more if you can talk about 15%, and we do publicize that goal across the whole company down to the lowest levels. So it would be hard to find anyone in the company who doesn't know that our objective is to earn a 15% return on equity. The second reason for that is if you vary the return target by product line, you start to get into some difficult issues with management. First of all you have to explain why you have different targets. That isn't as difficult for someone who has a 12% target versus 15%, but it gets harder if you are requiring someone to earn 20% on equity versus the average of 15%. Somehow no matter how you try to explain that, he never understands it.

Another issue is that we have looked at historical returns from various product lines. Somewhat surprising to us, and this included not only life and health insurance but also property and casualty insurance, was that the returns really don't vary that much. They do vary somewhat, but within one or two percentage points. So again, we didn't see enough variability there to really justify getting into that complex a structure. We don't totally understand yet why the returns are so close, except that one would surmise it has something to do with the various rules of thumb, including premium to surplus ratios, that are used in property and casualty insurance and so forth. Somehow the capital levels that are used in capitalizing those businesses do tend to equate the risks so that similar rates of return are appropriate.

MR. GAMMILL: I think you have to assess what constitutes the entity that the return on equity is required for. For example, I suspect that there are a number of business unit heads who think the entity is their overall business complex. The business complex is composed of business units. The business manager believes he knows how to run his business and doesn't want to be told that every business unit has to be at a 15% return on equity (ROE) after tax. He'll run some units at 10%, some at 20%, and some at a loss, but overall he's going to come up with a 15% after tax ROE. I think that you've got to consider at what level the ROE is to be specified. Are you going to require 15% after tax ROE on everything in the company? Maybe not. There may be some units that return far less than 15%, because if you're not in that business, you're not in the business. The process has to recognize where the various performance measures stop and at what level the corporate office can allow the business unit head to run his business.

MR. WALTER N. MILLER: If you're going to have a return on equity target that is consistent across all of your business units or all of your product lines, maybe that really doesn't have very much meaning at all, unless and until you are satisfied that you have a consistent definition of equity as between those units or lines.

MR. INGRAM: I think the biggest controversy that I've seen is the extent to which different lines' equity on the GAAP statement comes from required surplus versus the deferred acquisition cost. In lines where there's a very low amount of deferred acquisition cost, there's an awful lot of contention as to the meaningfulness of the return on equity measures, because all you're doing is dividing their income by some number that the corporate people made up.

MR. KIRAN DESAI: I have a question regarding 15% versus the real rate of return. In all those measures, I'm not hearing a single sound about the risk cost which should be subtracted before the cost of capital is also measured. Then you get to a third level. After you subtract the cost of capital and cost of risk, then whatever is left over, positive or negative, is a rate of return of some sort. Any thoughts on that?

MR. WINTERS: What about risk adjusted rates of return?

MR. GAMMILL: You can come at risk in at least two ways. In terms of determining what your hurdle rates are, your cost of capital can assess risk. For example, using a capital asset pricing model you can come up with the cost of equity. If you're a stock company, you'll have some risk element in the cost of equity capital that will increase your hurdle rate to a point that attempts to reflect the risk of your business. Another approach would be to actually allocate the various risks in terms of asset impairment (C-1), pricing risk (C-2) and risk of interest changes (C-3). If you properly evaluate those risks at each level of business unit, you may be able to expect fairly equal returns on equity across such units.

MR. DESAI: That's a somewhat oblique way of doing it. If you take arm's length transactions from people who give you capital and people who provide you some risk returns, then you have some measure of equity among lines. Namely, you have equal amounts of capital being given, and the cost of risk is independently assessed across the annuity line, life insurance or some form of property and casualty, because capital is being infused by a so-called investor.

MR. GAMMILL: I generally agree with you. For example, debt capital has associated risk. Providers of debt capital are going to look at debt to equity ratios and the company's business risks. Such providers require that if the company goes belly up, they can still have their loan satisfied. To that extent, the cost of debt capital reflects risk.

MR. WINTERS: I must say my sympathies are more with the idea of different hurdle rates, partly for risk reasons. Also, the market generally charges more for capital which is put into businesses with volatile earnings than businesses with stable earnings, even though they both average out the same over a period of time. That is, if the underlying rate of return on, let us say, the property and casualty reinsurance business is the same as the life business, suppliers of capital will demand a higher price for capital going into the reinsurance business owing to the volatile nature of the returns.

MR. KISCHUK: I think that's a tough one, because you start talking about the chicken and the egg. For example, if you're comparing property and casualty reinsurance to life insurance, I think a standard rule of thumb there would be that you had a premium-to-surplus ratio of something like 1.5 : 1 or 2 : 1. Those are obviously extremely high capital and surplus requirements compared to what you would see in life insurance. One reason for that, of course, is the volatile nature of the business. You need enough capital and surplus so that a swing in experience won't wipe out the company. So, to an extent, those capital and surplus requirements are adjusting for the more volatile basis of the company, and in fact you do find that price-to-book-value ratios tend to be fairly consistent across these lines of business. On the other hand, a lot of times if you do look at price-to-earnings ratios, as Bob just said, I think you do find that for more cyclical product lines you tend to find lower price-earnings ratios than for more stable lines.

MR. WINTERS: I think it's also worth noting that there are a lot of mutual companies that are nowhere near their full level of possible leverage. Stock companies have, I think, been more thoughtful about leveraging their capital structure than many mutuals.

PANEL DISCUSSION

MR. JOSEPH H. TAN: I would like to make two observations regarding the ROE measures of a GAAP statement. The first has to do with unrealized gains. They are not part of the numerator, but part of the denominator. The second deals with the deferred tax liability. Investment income is on the statutory assets. That presupposes that the investment income is generated also on all the liabilities. But the deferred tax liability is not a discounted item. This has an effect on growing operations. For instance, you overstate the liability, and therefore, you understate the surplus. That has the effect of increasing the ROE measures for growing operations.

MR. WINTERS: I would suggest that your company, like the Prudential, enjoys the freedom of being a mutual company. Why don't you discount the tax liability? We can define our own accounting, and we don't have to, in many respects, be bound by what the Financial Accounting Standards Board would have for published statements.

MR. GAMMILL: We have dealt with mutual companies that have converted to management basis financial statements. Even though most of those mutuals used GAAP for such statements, adjustment for unrealized and realized capital gains and losses was considered for internal reporting purposes, e.g., the Canadian method. I think that for those mutuals that wanted to have something close to GAAP, reconcilability was a most important issue. To use such financial statements as a communications tool, it's helpful to understand the language. The GAAP language is sometimes easier to understand than the statutory language and many other accounting model languages.

MR. TAN: How about for a stock company?

MR. GAMMILL: For a stock company, for internal management reports, you can do anything you want.

MR. KISCHUK: For our internal reporting we do make a modification in at least one of two things that you talked about, and that's in the investment area. The problem is that if you're going to drive your financial planning and even your incentive compensation management by return on equity, you've go to be awful careful that the capital gains and losses don't flow through earnings and yet are included in the denominator for return on equity. What happens there is you start to create a bias away from investments that might generate most of their returns through capital gains, and you could find that you're not making very many of those investments, even though those investments may have a higher total return than things like bonds and mortgages. We went to a Canadian-style amortization method in order to correct that.

I'm not going to try to defend GAAP deferred taxes. We haven't made a modification to that for internal management reporting. The main reason is that although we do still use GAAP deferred taxes in our management reporting, that really has not distorted our decision making and tax planning, because we pretty much ignore GAAP taxes for those purposes anyway.

A third area that you didn't mention that does cause a problem in GAAP is the interest rate that is used in amortizing the deferred acquisition cost. If you're pricing your products to an internal rate of return such as a 15% after tax return, and then turn around and capitalize and amortize deferred acquisition costs at a pre-tax rate of something like 10%, you're introducing a real distortion when you then try to calculate return on equity. I think that's probably the single major reason why, when we start to do financial reporting for a product, we get questions from our profit center head such as, "We priced this product for a 15% after tax return. Why isn't that coming through the financial statement?" I think that a difference in the interest rate assumption is probably one of the primary reasons.

MR. GAMMILL: Life insurance is a long term business. Most corporations have a capital management process, and many of those corporations are going to analyze alternative investments using discounted cash flow techniques. Once you superimpose an accounting model on top of cash flow, you've got a problem in measuring ROE.

MR. WINTERS: We heard an interesting thought from Dave: the notion of charging business units for mismatching assets and liabilities -- that is to say, it's permissible to have a mismatch if you pay a price. Did I understand that correctly?

MR. INGRAM: That's in effect what happens. The required surplus which has to be held by a line or a product that has a significant mismatch is larger than that which would be held by a line that is matched. The net cost of that shows up in the return on equity.

We've studied the charge that comes out of the formula that we derived against the marketplace. The net charge brings you in and out of the market for any significant amount of mismatch over time. We felt that the risk adjusting done by the formulas was very similar to what the marketplace is doing with risk adjusting for duration.

MR. KISCHUK: We had a similar approach. It's a non-linear formula. Our formula doesn't exact a very heavy penalty to be out of whack a little bit on asset/liability mismatch, but as you go out on the mismatch spectrum it starts to exact a pretty heavy toll. We admittedly developed that formula without a lot of sophisticated modeling. I don't know that you really can model a lot of types of liabilities with any degree of certainty. We've gotten some feedback that our formula tends to be overly conservative in some areas as you get out on the asset/liability mismatch curve. We're in the process of reviewing that to see whether we think that's true or not. It may modify our formula to some degree.

MR. DONALD D. CODY: I've been the chairman of the Committee on Valuation and Related Areas for some years. I am fascinated by the way these discussions are developing over the years -- not this particular one necessarily, but in general. It was our committee that invented C-1, C-2, C-3, and C-4, risk and we invented it for the valuation actuary. I guess, to be blunt about it, some valuation actuaries felt that we scared hell out of them, and we haven't made as much progress as we hoped in talking about proper determination of surplus needed. In the meantime, the pricing people and the management basis financial planning people have adopted this phraseology. All the things that the valuation actuaries said they couldn't do, you guys are going ahead and doing, which is very interesting. I applaud you for it. I don't know to what extent you're using the theories of the Committee on Valuation and Related Areas to determine your needed surplus. I got the impression that 5% or 6% was probably used by a majority of you determining it in accordance with the extent of your asset/liability matching, but at least you're using it.

I'm a bit confused, because being the chairman of the committee that invented this language, I now begin to write about the connection between what we've done for the valuation actuary and what you fellows in the pricing and management basis financial planning areas are doing, and I'm told that I don't know what I'm talking about. If I don't, I sure would like to know.

The question I'd like to put to you is this. Let's assume for the moment that we're using statutory financials to determine the surplus needed. Actually, the reserves and surplus needed add up to the assets needed, and those assets needed go across all financial systems that you may develop, so we're talking about the same thing. I'd like to think that the required surplus used for the allocation of company surplus for inforce requirements across lines and what we're talking about for the valuation actuary are the same thing. If they aren't, why not? I think in the pricing field they probably aren't the same, because it's quite evident that pricing today doesn't do a lot of things, including providing for required surplus for a good many products. I hope that will pass. When we get into the management basis financials area, this is the ultimate of honesty. You're dealing with yourselves and your own management, and you really ought to level up as to what the required surplus is. I've been told, for instance, that it's more important to set up required surplus that would meet the Best's standards than it would be to determine it scientifically according to the valuation actuary theory. We're about to extend the area of our formalized research in the Committee on Valuation and Related Areas into this unified theory, because I think that to understand the valuation actuary, you have to understand the whole thing. All three pieces are going to have to fit together.

MR. KISCHUK: There can be some confusion. To address your first topic, in our pricing we do use required surplus. Theoretically we agree that we should be using something that is consistent with the other two -- namely, an internal rate of return type of an accounting approach. From a practical standpoint, however, we find that we have to go with something that is a little simpler, hopefully not too far out of line with what we theoretically should be using, and then be watchful at all times. If the financial reporting seems to be driving us towards a dumb decision, hopefully we'll catch that at an early stage and correct it.

MR. WINTERS: Dave, it seems the question also evokes the matter of vitality surplus. Is the whole larger than the sum of the parts?

MR. INGRAM: The example that I gave on the C-3 required surplus creates that situation. There are similarities between the valuation actuary's requirements, our management statements and our pricing. We did multiple-scenario testing under various environments to determine the surplus that we should hold. The formula that evolved has an absolute value in it around the durational mismatch. When we looked at our specific mismatches in products, we found that some were mismatched long and some were mismatched short. The company didn't need all of the C-3 required surplus that the formula would give for the products. We did introduce a new quantity into our formula, which was a subtraction from the required surplus amount for the combination of risks. We kept the formula for C-3 required surplus the way it was originally derived because we felt that the marginal additions to mismatches, either long or short, should be recognized in the pricing and in the financial reporting internally.

MR. WINTERS: On the subject generally, I would observe also, Don, that the valuation people have now repudiated your C-4 risk as something that they could do anything with. This is an interesting development.

MR. ROBERT M. ASTLEY: I wanted to offer some observations based on the experience of my company, Mutual Life of Canada. These observations relate primarily to the role of the investment function within a company and how you deal with that in terms of capital allocation. About three years ago we developed an internal financial reporting system based on a discounted cash flow approach. Then, having done that, we transferred all of the surplus into a corporate surplus line. We then measured all of the lines naked, as it were, and found out that we had to scratch like blazes to generate any kind of return at all on the group life and health operation or the individual insurance operation or the individual annuity operation. But, we found that an extra 1%

return on the common stock portfolio dwarfed all of those expected profits. We also learned that the actual investment income that was being earned and allocated to those lines was so critically important to their success that those business unit managers really didn't have control over their entire operation.

We have done a couple of things, toyed with a couple of ideas. The first goes back to the kind of system that Mr. Ingram mentioned whereby we had required surplus allocated to the business units. In retrospect, I think we were in error in letting them go without any. The second involves identifying the corporate investment operation as a separate line of business and having it provide a guarantee, if you will, at a negotiated rate, of investment income to the other lines, and then measuring the investment operation as business unit as a well. I'd be interested in any comments on the role of the corporate investment operation in all of this capital management.

MR. WINTERS: It's sort of in the nature of a business unit?

MR. ASTLEY: Yes, it is in the nature of a business unit. The investment operation, in effect, guarantees a rate of return, and its performance is measured, better or worse, against the standard.

MR. INGRAM: There's another solution to the situation that you described there. It's been addressed by one of the companies I've been working with; it was to continually refine the degree to which the investment portfolios are delineated and attributed to particular product lines either through subsidiaries, separate accounts, or segments of the general account. Personally, that is the approach I favored, and it does get the communication between the investment and the product areas going when there are clearer responsibilities in the investment areas towards the products.

MR. WINTERS: But how do you measure their performance? I think Bob is asking how you evaluate the results the investment organization produces.

MR. INGRAM: I have not heard of a proposal that does not appear to be subject to a significant amount of manipulation.

PANEL DISCUSSION

MR. GAMMILL: Maybe we ought to talk about transfer pricing. Is there really an option? Can you go out and get another investment management company? I doubt it. It's a difficult issue. The segmentation of assets can help in assessing investment management performance.

MR. WINTERS: I think one line of attack that is being considered in some quarters is to differentiate between business units which should be evaluated on return on equity and business units which should be evaluated on return on assets, the more bank-like functions. A typical banking efficiency measure is return on assets, and I think there is some of that kind of thing being formulated.

MR. STEPHEN R. RADCLIFFE: This is a tough question. Let's just suppose you have a major product or a major division that is not meeting the hurdle rate of 15%, for example -- a universal life product that you're selling. Suppose that you have now made all your calculations, and there is no way that you can meet that hurdle rate of 15%. Don't you now have to make another calculation, the cost of going out of the business, especially if it's supported by a major distribution system? You have to make a calculation of the cost of going out of business versus the cost of accepting a lower return. In other words, you've got this oil tanker out in the middle of the ocean, and you can't turn it 90 degrees on short notice. Can you comment on that?

MR. KISCHUK: There are a lot of things you can talk about in that. I think one is the situation where you have a product line that is not meeting the return on equity requirements. Let's say you're looking at 12%. I think a lot depends on what the rate of growth is. You can more easily tolerate that in a product line growing at 5%, because if you take 12% minimum, you still have a 7% cash return that is being thrown off. On the other hand, if you have a product line that is earning 12%, but it's growing at 20%, not only is it earning a below par return, but it's also consuming capital rather than throwing capital off. That makes a big difference. I think the issue that Steve may be alluding to here is that you can't just look at the rate of return versus some hurdle rate and automatically make a decision. This is where you get into more similarities with manufacturing then a lot of us would like to admit. We do have some elements of fixed cost, and the distribution system is one of those that won't go away because you discontinue a product. You can discontinue a product. You can discontinue a major product that is funneling revenue into that distribution system, and you may cure the problem of earning a below par rate of return. But now you're going to be saddled with a lot of fixed costs, and management might be surprised that it didn't solve the problem it thought it was solving when it discontinued that product. So, I think Steve does have a good point. You do have to factor all those things into your decision.

MR. WINTERS: I had the impression that that kind of thinking underlay what you were talking about, Glen, in the distinction between tactical and strategic decisions.

MR. GAMMILL: Yes, there are concepts like the "glide path." What is the business unit's glide path? There's a difference between the eventual return on equity and the glide path of the business unit towards that return on equity. You can't just suddenly turn that tanker around in the middle of the ocean. You've got to look at the business you're in, what you've got on the books and how it's going to run off, and what you might do relative to new investments that are coming on stream. You can't take something that's earning 10% after tax ROE and turn it into 15% overnight. As an aside, if you set a hurdle rate and then ask the business unit heads to identify investment alternatives, there aren't many alternatives presented which achieve less than that hurdle rate. You have to be very careful in coming to grips with some very fundamental concepts about the process itself.

MR. WINTERS: There was mention earlier of managing for the rating agencies, and while we may deplore it or may not, isn't it a fact of life? Isn't the company's rating something that management should be concerned with?

MR. INGRAM: The formulas that are implicit in the rating agencies' evaluation of company surplus, as well as what everybody else is doing, are important considerations in setting the required surplus level. You can be right and be the first company to go insolvent in your class of companies because everybody else provided for 99.9% of the risk and you provided for 99.3%. The one you didn't provide for came through. You do have to look at both of those eventualities. We found that, generally, the required surplus formula that we're setting exceeds the rating agencies' requirements, and that hasn't become a major issue.

MR. KISCHUK: While it's easy to criticize the rating agencies, I think we have to recognize that they were here first. They had to attempt to do this before any of us became interested. I think part of the task that we have as a profession, as companies and as individuals is to help educate the rating agencies on what we're doing and some of the things that we're finding out as we get into this subject.

MR. LEWIS P. ROTH: I think the subject of return on equity is vastly more complex for a mutual company than for a stock company. We have been struggling, for example, on the return on equity in the various business units in our company. Just let me ask some rhetorical questions. Is it right to ask from our basic participating policyholders in the individual life and annuity area the same return as we should expect from buying some regional stockbroker out in the Midwest? I don't think so, and yet we don't quite know how to deal with that. The Lincoln has a hurdle rate which is the same across the board, the 15%. For a mutual company to have the same 15% return on equity (or on net worth or on investment, or whatever you want to call it -- it's all the same thing, you get the same retained earnings), what do you do with it? In a stock company, there is an obligation to stockholders. In a mutual company, we have been told, at least by the federal government, that a part of our return is already a return on equity. I don't know if we really believe that, but we have been told that. I'm just wondering if there are mutual company representatives either on the panel or in the audience who have struggled with not only if should there be a difference, but how much of a difference there should be between the return on equity from a stock subsidiary or a non-life business versus your core participating individual life policyholders.

MR. WINTERS: I think that Lou raises an interesting question. Is there a difference in philosophy between mutual company managements and stock company managements? The Lincoln certainly typifies a view that money is fungible and is what the shareholders want, and it should be devoting its attention to the businesses that will get it the 15%. I got the impression that Dave's experience was somewhat different, and I can tell you that the Prudential's view is somewhat different. We do not believe that all business units should have the same hurdle rates.

MR. INGRAM: In general we've used a two-pronged approach there. For the company in general, we try to set the overall hurdle rate -- something to keep the company in balance, to fund the growth of the company. Setting the hurdle rate for the mutual company in general has not been "let's see how high a hurdle rate we can get," but what is the right rate of profits that we need to fund the growth that we are going to have over time. The goal is not to see how big we can get, either, but to try and keep things in balance and to keep our costs under control with the pressures that are there from inflation, while controlling, also, the cost of growth. We don't want to put exorbitant charges to our policyholders for either the kind of fixed cost spreading that you get with a bigger company or with the excess cost of growth you have with a rapidly growing company.

MR. GAMMILL: I wanted to comment on one specific thing that Lou said, and that is the terminology (for example, return on invested equity, return on investment, return on capital, return on equity, internal rates return, net present value, etc.). Unless you define such terms at point blank range, eyeball to eyeball, communications could break down. For example, you cannot talk about ROE without defining "E."

Too many discussions on capital management begin with everyone assuming that such terms have specific, definite meanings and that everyone understands those meanings. You must define what the numerator and denominator are and what the rules of the game are going to be. There is no uniform definition for each of these terms. If you talk about return on capital, you're talking about, potentially, equity and debt capital and other forms of capital.

The process is important. You have to set the game rules: you've got to establish the definitions; you've got to elevate the players to a common level of understanding. The process may be imperfect, but at least it should function in a consistent, systematic and rational way.

MR. INGRAM: In practice we have set higher goals for non-participating lines, but it's been completely arbitrary so far. We have had to rationalize to our board why it is we're entering these non-participating lines. How does that work out with the mission of the company? The thinking there has been in terms of capital management for the participating lines. These investments in non-participating lines are ways that we are sheltering capital that we hopefully want to use in the participating lines in the long run.

MR. WINTERS: One of the lessons you learn in this game is that ultimately you are out to influence management behavior. In the way you set these things up, certainly including how you define things (especially in a mutual company, where you have a lot of freedom), you have to keep that target in mind. It's management behavior that you are after.

MR. HARRY D. GARBER: I'll comment on whether you use return on equity for all of your business entities. Clearly, we at the Equitable found in the work that we're doing that the investment management companies, in particular, have very small equity. If you ask them to only return 15% on equity, you're setting a very low target for them. You really want to find, in the many businesses you may be running, different kinds of measures which will produce an amount equivalent to or greater than 15% return on equity. The investment management business just doesn't have much equity, because it has no need.

On the broader issue that Lou raised, it's interesting to me that we're having a discussion here which presumes that the mutual companies need to accumulate equity and have to earn a return on it. Ten years ago we would have had a lot of controversy about that subject, and I think it's fairly well accepted now.

The cost of capital is only part of the cost to your policyholders. In fact you have investment earnings, which are a credit, and you have expenses, which are a cost. Those costs depend very much on the scale of the company, on the place you are in the market, how efficiently you can operate, and how large you are in terms of whether you can participate in certain very favorable investment deals or you can't participate in them. So to assume that you have the single cost, and it isn't related to anything else, is a false assumption.

Basically you have to look at the total amount that you're doing for your policyholders in terms of the way you choose to operate. That may require you to grow very fast, or it may require you to enter into certain markets. Things which require a lot of capital require you to build up capital, but out of that you may make your operations more efficient; you may be able to get into investment markets that provide a very favorable return that you wouldn't be able to get otherwise. If you look only at the return on capital, then you'll be taking a very narrow view of this. I think the critical thing is to seek to get the kind of return that is comparable to the marketplace return on your business. To the extent you don't require it to grow the company and to build the company for the growth of your policyholders, you can deliberately return some of that in the dividend scale.

We are trying to look at what that would mean for some of our businesses, deliberately saying we should be earning X% on our business. To the extent that we don't require it we will be returning some. But let's see where our present dividend scale is, as compared with earning that kind of rate of return on current business and on past businesses, as a way of finding out where we are and what we are implicitly returning in that process. That will help us better understand the world in which we're in.

MR. WINTERS: So the Equitable is in the camp of different rates of return for different businesses.

MR. GARBER: No, I don't think so. I think we're really trying to find our way through this, Bob. You know the add-on tax makes this very confusing at this point. One has to look at that without that particular tax element. We are struggling with this as an issue as we seek to establish rates of return. Obviously, the individual participating business is turning up a lower rate than it would otherwise. I think the reasons for that are historical and probably appropriate, but I think that's something one has to look at these days as one is trying to work ahead.

MR. GAMMILL: Bob, there may be only one return on equity if the Chairman of the Board is looking at the return on equity for the company as a whole. Each business unit has a different ROE and a different glide path.

As chairman, you're trying to manage the overall corporate resource to *the* ROE.

MR. WINTERS: That is part of what led Lou to observe that mutual companies are harder to manage than stock companies.

MR. KISCHUK: Harry did mention one area that I want to comment on, and that's return on equity for businesses that have low amounts of equity, such as service businesses. That is a problem for us in trying to assess performance, because a lot of these businesses have almost no equity showing on the balance sheet, and when you calculate return on equity you get something pretty astronomical.

Unfortunately, that doesn't say that you should automatically get out of the insurance business and into the service business. What it says is that most of the costs that you tend to incur in developing a business like that don't get capitalized on the balance sheet. So when you actually analyze that from a present value of cash flow standpoint, you probably aren't getting all that much higher return on equity than you would in the insurance business. It just looks that way because of the accounting approach. We find that for situations like that a lot of times it's more meaningful to look at profit margin than it is to look at return on equity. That is, we look at the after tax profit divided by the revenue for that product line.

MR. WINTERS: Essentially return on sales.

MR. KISCHUK: Right. Another area where that comes in handy a lot of times is where you have a lot of goodwill on the balance sheet. We do calculate return on equity for our various product lines, including goodwill as part of the denominator. A lot of times that gives you a fairly low return on equity. It's amazing after you buy a company. The management sat on the other side of the negotiating table from you, and then when you turn around and try to set targets in terms of return on equity, they say, "Well, our return on equity is low because you guys made a bad deal."

MR. WINTERS: We have distinguished between the return on equity as viewed by the acquiree and as viewed by the acquirer, and we don't use goodwill for the acquiree.

MR. KISCHUK: Again, a lot of times you don't expect to make a 15% return on equity immediately after an acquisition, and return on sales can be helpful in assessing the progress you're making with that acquisition toward the 15%.

MR. JAMES E. FELDMAN: I just want to echo Lou's comments. Northwestern National Life Insurance is both a stock and a mutual company. It's not a mutual with a subsidiary. We're dealing with the same management, dealing with the same types of questions, and we have a lot more difficulty in the mutual branch setting the ROE targets and measuring them. We also have different objectives for the stock side and mutual side.

MR. WINTERS: There's been a lot of criticism of American management generally for being too short term in its orientation -- for focusing too much, or permitting stock analysts to force it into focusing too much, on this quarter's earnings or the next quarter's, at the price of a longer term orientation. Clearly that's a pressure from which mutual companies have been exempt. At least the stock analysts have not been a source of pressure. Do you see any tendency towards a shorter term time horizon as mutual companies move into more explicit management accounting and targeted returns?

MR. GAMMILL: Yes, I do.

MR. WINTERS: Do you have any advice for mutual company managements that would like to avoid that?

MR. GAMMILL: I think you need to look at both the short term and the long term. It's a balancing act. I think that, in today's mutual companies, the business unit head looks every bit like the CEO of a stock company. As the performance measures become more and more clearly defined in the organization, he is starting to worry about the kinds of issues that any normal stock company CEO would worry about: returns on equity and amounts of cost that are being allocated to him by providers of service (e.g., investment complexes, legal departments, etc.). I think that there's been a change. In today's mutual company, you hear a lot of discussion about profits and profitability. I don't think you would have heard such discussions ten years ago.

MR. WINTERS: I agree.

MR. KISCHUK: I think there are a couple of things you can do. As a stock company that has had some experience with those trade-offs, I think you can see what some of the pitfalls are. If you start trying to manage based on return on equity and use that as your sole criterion, you're going to make a lot of bad decisions. A very key thing you have to have is a strong strategic planning process. You have to know where you're going, and have that pretty much mapped out so that you're not simply making a lot of random decisions based on what happens to provide the best return on equity in the short run. You might decide to do something that provides a lower return on equity because it fits the strategic plan versus something that provides a very high return on equity and doesn't fit the strategic plan. You also have to be willing to accept doing things that may create a lower return on equity in the short run in order to drive the strategic plan forward.

Finally, another pitfall to avoid is making decisions based on historical returns on equity to the exclusion of what you expect things to be like in the future. I think a prime example for us was actually going out and acquiring a couple of property and casualty companies, at a time when their return on equity was negative, because of a view that we had of the property and casualty industry and where it would be going down the road. You have to factor those things in. I think that's where the chief executive officer comes in, and it alludes to some of the things that Glen talked about involving the overriding judgment of the CEO. The CEO may look at everything that's presented in a capital budgeting process and decide to do something completely different for some of the reasons I just outlined.

MR. DAVID A. HALL: All of the comments thus far have talked about capital requirements in the generic form. I'd like to focus for a minute on two different types of capital requirements. One of those is capital requirement in the form of cash, and the other is that which is not in cash. By example, a cash capital requirement might be for a product such as a traditional individual product where first year expenses exceed the first year premium, and you've got to reach into your pocket and pull out some dollars to spend this year. Or perhaps it is for a variable annuity product where you put 100% of the policyholder's deposit in the separate account and yet you still have to come up with some source to pay some producer's compensation.

As an alternative you might have a flex annuity product in the general account, which generates net positive cash flow from day one. The compensation or expenses paid out are much less than a first year premium. The surplus requirement is in the form of reserves that you have to set up which might exceed the premium that's received, but you don't actually have to convert that surplus into cash. To back that reserve strain, you can allocate any asset on your balance sheet which may or may not be liquid and which may or may not have a market value that differs from its book value. Do any of the panelists have any experience in systems which would differentiate between these two types of capital requirements, either in decision making (e.g., how you allocate capital, how you report earnings to line of business when non-cash capital is required) or perhaps in how you differentiate between a profit objective or return objective for cash versus non-cash capital needs.

MR. GAMMILL: There are different kinds of capital, such as real capital and accounting capital. I would start out by looking at the company from an evaluation or investment perspective using discounted cash flow. In the insurance business, unfortunately, we have to deal with something called available cash flow, because there are statutory reserves that get in our way of accessing cash flow. Once we've got available cash flow, we might set up some C-risk reserves, which commit further capital resources to the business unit. For a pricing accounting model, our balance sheet might reflect the present value of these available cash flows as an asset, and we might subsequently amortize that asset at its internal rate of return (IRR), obtaining a level return on equity. At that point you're really working with a line of business equity under a pricing accounting model. Any other accounting model other than the pricing accounting model will develop ROE's different than the IRR used in pricing. We need to understand and appreciate such differences.

MR. WINTERS: I think David raises a good point: most insurance company managements, in particular mutual company managements, have grown up in the world where cash was something that cascaded in on you. The idea of cash being a potentially scarce resource is a useful insight.

MR. KISCHUK: One way to cut through that is to picture yourself as a guy writing the checks. From that perspective it really doesn't matter whether you're paying something out as a first year premium, whether it's reserve strain or required surplus. If you're writing out checks to various people to grow their product lines, you're going to have to write out a check to that product line whether the cash is going out as first year premium or whether it needs the cash in order to set up reserve strain or required surplus. If you discount cash from that perspective, it all translates into cash. You're discounting it, and you get to the idea Glen was talking about: by the time you factor in the reserve strain and the change in the required surplus, and factor all that into a cash flow that you discount, you've really got it all there.

MR. JAMES F. REISKYTL: A question for Glen on behalf of the policyowners of the mutual companies. You pointed to an increased focus among some of your clientele apparently in how they do their measuring. Does this process improve the dividend that you're paying to me as a policyholder?

MR. GAMMILL: Hopefully it will. Our industry is in the infancy of capital management. I think there are two ways to manage capital: with a process and without a process. Without a process is called crisis management. As the mutuals begin to look at statutory accounting and to develop management basis financial statements, they're starting to enhance their knowledge of the business they're in, which is good. The more they understand about how they make money and the more they understand about how much capital they need, when they need capital, what their sources of capital are and what it's going to cost, the better they're going to run their businesses. So, I've got to believe, in the long term, that the process will help, but I cannot say when.

MR. REISKYTL: Surely, because otherwise you don't have any more money by moving your accounting numbers around. But if you do in fact become more efficient, surely you can pay higher dividends. A number of speakers said that it is very difficult to do this for a mutual company. I would like to suggest that it is really very simple to decide what your measure ought to be, particularly for the participating line. It's simply that the return on equity is going to be the rate of growth you seek. That is, how fast should a mutual company grow? I would say in part that is determined by how efficient and how effective it can be in lowering the cost for its policyholders. As to other lines of business, I believe they should be run like any other investment. You ought to look at the risk, and you ought to get a rate of return commensurate with it, and it ought to be for the benefit of those policyowners.