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U.S. and Canadian Demutualizations—Postmortem

Track: Financial Reporting

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Summary: *In the last two years a number of large U.S. and Canadian life insurers have demutualized. Panelists discuss the changes these companies are making, the experience (so far) of operating as a public company, and how investors are viewing them.*

Mr. Barry L. Shemin: The more I thought about this title, the less I liked it because the phrase "postmortem" emphasizes the death of a mutual company. It's more appropriate to think of the demutualization process as leading to the birth of a public company.

Caitlin Long is a director in the Equity Research Department of Credit Suisse First Boston where she follows the life insurance and financial guarantee insurance industries. Before joining Credit Suisse First Boston in 1997, she spent a number of years with Salomon Brothers, also involved in the financial services industries. Caitlin was ranked as a runner-up member of the Institutional Investor All-America Research Team for Life Insurance in 1999 and 2000, and in the 1999 Reuters mid-to-smaller company survey Caitlin was ranked third by institutional investors and second by the management of life insurance companies. Starmine currently ranks her as the life insurance sector's third most profitable stock picker out of 14 analysts, and, in addition, she's appeared as a guest expert on the life insurance sector on CNBC and CNN-FM.

Caitlin not only has a J.D. from Harvard Law School and an M.P.P. in international trade and finance from Harvard University but also has a B.A. in political economy from the University of Wyoming. Caitlin is going to begin with her global view of the industry and the demutualized companies.

Then we'll hear from each of the companies in order of their dates of birth, which means I will go first. I'm senior vice president and corporate actuary of John Hancock. I've spent probably the last five years working on some aspect of demutualization, initially an educational

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‡Mr. Wheeler, not a member of the sponsoring organization, is senior vice president and treasurer at MetLife in New York, NY.

Note: The charts referred to in the text can be found at the end of the manuscript.

responsibility to teach people about how it would work and then in the actual process heading up the actuarial efforts as well as being involved in virtually all the others. I have been with John Hancock for a number of decades and prior to becoming corporate actuary, I was the head of a variety of John Hancock's businesses such as individual life, GCS, and some others that we are not in anymore.

Bob Wilson will tell you about Sun Life Financial. Bob has been with Sun Life probably as long as I've been with John Hancock. He's the appointed actuary there and is a graduate of McGill University. Sun Life, he tells me, has about 100 branches around the globe. So, if you think dealing with one U.S. regulator is difficult Bob's task is even more difficult.

William J. Wheeler is senior vice president and chief financial officer, institutional business, for MetLife. Previously, he had been treasurer of MetLife since joining the company in 1997 and during his three years at MetLife, he has participated heavily in its demutualization and Initial Public Offering (IPO), as well as the acquisition of GenAmerica. Prior to joining MetLife, Bill worked as an investment banker at Donaldson, Lufkin & Jenrette, where he participated in the demutualizations of Equitable and Guarantee Life and the mutual holding company conversions of Ameritas, Acacia and Security Benefit. He received an A.B. in English, Phi Beta Kappa, Magna Cum Laude from Wabash College and also an M.B.A. from the Harvard Business School.

Ms. Caitlin F. Long: Bill and I worked very closely together on the MetLife transaction. I also participated in the Manulife transaction and prior to that worked on the Ameritas Mutual Insurance Holding Company conversion. Those were all roles where our firm had an advisory role. The research analysts were particularly involved in the advisory process but, of course, have also worked on John Hancock's IPO as a co-manager as well.

From our firm's perspective we've been very involved in the restructuring of the mutual sector. And you are here today to see the unveiling of the new version of "The Mutuals Are Coming" which was a series of reports that we wrote beginning in 1997, and the fifth edition is called "The Mutuals Are Still Coming". This latest report basically concludes that we're probably in the fifth inning of the mutual restructuring in the life insurance sector in the U.S.

A few years ago, before MetLife and John Hancock went public, about 40% of the assets of the industry were housed in mutual companies. Now it's 26% at year-end 1999, pro forma for John Hancock and MetLife's demutualizations and pro forma for the three transactions that are announced for next year, which are Prudential, Principal, and Phoenix. The projections for next year, then, are that 16% of the assets left in the industry will be housed in mutual companies. So, it really has been a dramatic change, and it's been a long time in coming. These transactions take a long time to complete. However, the good news is they've made a lot of money for investors.

Everybody's happy about these demutualizations, believe it or not. I suppose the only ones who are not happy are those that elected to take cash on the IPOs. The top line on Chart 1 is what we call a basket of demutualizations. In other words, if you had bought every IPO on a market cap weighted basis in Canada and the United States, beginning with Clarica's IPO in July 1999, you would be up roughly 115% through last Friday.

The middle line that's basically flat is the S&P 500 over the same period of time. So, essentially the market was flat during that time period. And the bottom line is the S&P life/health index, which includes the large publicly-traded life companies, such as American General, Jefferson-Pilot, Lincoln Financial, Conseco, UnumProvident, AFLAC, etc. So, not only was it the right decision to buy the demutualizations in terms of investing in life insurance companies, but it was also the right decision to buy life insurance demutualizations instead of the market in the past year because you certainly would have outperformed. I'll talk about what's driving that outperformance in greater detail in a moment. However, at the end of the day all these companies had one thing in common, namely, you could have made money by buying any of the transactions. But the outperformance was not was not just driven by the IPO pops. If you look on the second line in Table 1 you see that you still made 72% on a market cap weighted basis if we priced these transactions based on the first day's close.

Table 1
Basket of Six Recent Demutualizations

Date Bought	Recent Demutualization Basket[1]	S&P Life/Health Index[2]	S&P 500
On IPO Pricing Date	114.&%	(20.5)%	(1.7)%
On 1st Day Close	71.7	(20.5)	(2.5)

[1] Basket begins with Claric's IPO, then adds Manulife, Canada Life, John Hancock, Sun Life and MetLife at the time of their IPOs
[2] S&P Life/Health Insurance index includes AFLAC, American General, Conseco, Jefferson-Pilot, Lincoln, Torchmark and UNUM Provident.
Based on closing prices as of October 13,2000.

Sources: Credit Suisse First Boston and FactSet

What all these companies had in common was that they all had excess capital to varying degrees. They all had plans in place to improve their profitability. And investors were buying the improvement story. Also, you will see as we go through this that nearly every demutualization has made money for investors. Investors, then, have caught onto this concept as an investing theme, but the good news is that it's really the improvement stories that investors are looking for in the market these days, and virtually every demutualization is an improvement story either from a profitability standpoint or from a return on capital standpoint.

From The Floor: Could you go back and explain the 114.7% and 71.7% from Table 1?

Ms. Long: Yes. What we've done is created an index where, to begin with, we assumed you invested $1 and bought Clarica Life at its IPO price. Then it is assumed you have taken another $1.50 or so, whatever the market cap differentials were, and put that money into the next transaction. In every transaction, on a market cap weighted basis, invested at the IPO price, you would be up 114.7%. We then recalculated this index based upon the first day's close because not everyone was able to purchase at the IPO price, and particularly a number of institutional investors came into the marketplace after the IPO. So, we took the first day's closeout. The average price performance for the first day's close was an 11% pop in the stock, but we recalculated the index assuming that everybody bought on the first day's close as opposed to the IPO price, and the result is 71.7%. So, it's just a market basket of every demutualization.

In Table 2, we displayed the individual performance of each of the stocks. You can see in the right-hand column the results six month after the IPO. Sun Life up 151.6% post-demutualization, was the best performing stock of this entire group. So, there is some variance in the performance but, in general terms, every transaction made money for investors, with the exception of StanCorp, a small, earlier U.S. demutualization. StanCorp was down slightly after an earnings disappointment two quarters after its IPO date. If you go back even deeper in history to UNUM's demutualization in 1986, and look at every demutualization in the United States, only two of them were down in terms of absolute performance six months out of the box.

Table 2
IPO Performance of 17 Demutualizations

% Change Since IPO	IPO Date	Opening Trade	1st Day Close	2nd Day Close	1 Week Close	1 Month Close	3 Month Close	6 Month Close
MetLife	4/5/00	1.8%	3.5%	9.2%	6.1%	23.2%	48.2%	83.8%
Sun Life	3/23/00	1.6	12.0	9.8	9.6	33.6	91.2	151.6
John Hancock	1/27/00	4.4	3.7	0.0	0.0	(2.9)	1.5	36.0
Canada Life	10/28/99	10.0	6.6	10.6	8.6	25.1	24.6	52.0
Manulife	9/24/99	0.0	(0.6)	(1.9)	(3.6)	(1.9)	1.7	13.6
Clarica	7/15/99	4.6	3.5	3.7	2.8	(0.4)	(7.4)	18.5
StanCorp	4/16/99	2.1	1.8	(0.8)	(2.1)	4.0	11.6	(9.2)
MONY Group	11/11/98	23.4	19.7	21.8	26.6	20.7	5.6	17.3
Average for 17		**9.6%**	**11.2%**	**11.6%**	**11.9%**	**16.2%**	**21.0%**	**44.6%**
Based on closing prices as of October 13,2000.								

Sources: Credit Suisse First Boston and FactSet.

So, 15 out of 17 made investors money. That's a pretty good batting average for investors, and this is why investors are so excited about these investments. But investors are compensated not so much on absolute performance at the end of the day. They're compensated on relative performance. We've calculated an average price appreciation of 44.6% for the 17 demutualizations done to date in the United States. A relative outperformance number could be calculated by subtracting out the performance of the S&P 500 which is the benchmark for most of the money managers who are looking to buy these stocks. The relative outperformance is still quite impressive at 33.8%. In other words, this has been a great investing theme and at least in the last round of demutualizations you could make money with virtually any of the transactions. The results were positive in varying degrees, but certainly they all worked.

Why did they all work? Now we're delving into how these transactions get priced and what the key drivers of their performance have been. Table 3 has many numbers on it as it displays the valuations of the large demutualizations that have been done in the past, going all the way back to UNUM in 1986. You can see in the right-hand column that the average return on equity of the demutualized companies in the U.S. is 9.7%. We have excluded the Canadian companies here because the Canadian GAAP accounting is different, but we'll talk about the Canadians in a moment.

To give you a feel for what the rest of the sector looks like, the average return on equity for the life insurance sector that's publicly traded is 15.2%. So, there's a big difference in return on equity of the mutual companies versus the existing publicly traded companies, and that's reflected in the second column from the right, which is the valuation of the stocks. As a multiple of GAAP book value on average these companies came public at 81%. There is a real distinct relationship between price-to-book value of stocks in this sector and the return on equity that they generate. In other words, the higher the return on equity, the higher the multiple of book value that the stocks trade on.

Table 3
Demutualization IPO Valuations, 1986 to Present

($ in millions, except per share data)

Company	Ticker	IPO Date	Size	Price/ Forward EPS	Price/GAAP Book Value	Pro Forma Oper. ROE [(a)]
MetLife	MET	4/5/00	$5.171.5 [(b)]	7.0 x	0.78 x	10.0%
John Hancock	JHF	1/26/00	1,734.0	8.2	1.12	12.8
StanCorp Financial Group	SFG	4/16/99	330.6	9.9	0.88	8.9
The MONY Group	MNY	11/11/98	304.1	12.1	0.66	5.8
Trigon Healthcare	TGH	1/30/97	201.5	9.6	0.67	4.2
SCPIE Holdings	SKP	1/29/97	36.5	8.9	0.72	10.4
AmerUs Life	AMH	1/28/97	76.9 [(c)]	8.1	0.78	9.1
Farm Family	FFH	7/23/96	39.5	7.4	0.68	10.6
Guarantee Life	GUAR	12/19/95	32.5	13.2	0.65	6.5
Allmerica	AFC	10/10/95	231.0	9.3	0.72	7.3
Equitable	EQ	7/16/92	391.5	33.3	0.69	NM
Mutual Assurance	MAI	9/4/91	11.7	6.0	1.25	19.6
UNUM	UNM	11/6/86	561.5	8.1	0.96	11. 4
Mean				8.9 x	0.81 x	9.7%

NM Not Meaningful.
(a) Pro forma operating ROE for the most recent full year prior to IPO, estimated using annualized data.
(b) Includes simultaneous convertible offering of $1 billion and private placements of $855 million.
(c) Excludes subscription offering ($17.9 million).
Sources: Company reports and Credit Suisse First Boston.

The stories are improving stories, both from the perspective of efficiencies in the expense base, but more importantly, from the perspective of capital re-deployment. MetLife, for example, has announced a $1 billion stock buy-back authorization. We calculate MetLife's excess capital and leverage capacity to be about $6 billion. So, if MetLife buys back $1 billion worth of stock a year, the return on equity of MetLife, which is right now about 10%, could easily be about 15% within five years. This is predicated on MetLife's ability to execute on expense reductions and on capital re-deployment. I'm setting quite a standard for MetLife here, but certainly that's the improvement story that investors are looking for. This is why the stocks have been priced as cheaply as they have been.

In Chart 2, you can see just how dramatic the improvement is. On the x-axis is a pro-forma return on equity expectation, and on the y-axis is the price-to-book multiple of the IPOs. These are all done at very different times, but you can see that the R-squared is 84%. So, there's a very strong relationship between return on equity and price-to-book multiples in this sector. For the existing publicly- traded life insurance sector, looking at these two variables together, the R-squared right now is 92%. So, there's a very strong relationship between these two factors, and because there's a strong upward slope to that line it's actually a pretty simple game. You're looking for companies that are moving out to the right on the bottom of the chart. In other words, what investors are really looking for are improvements in return on equity to improve the valuations of the stocks. The good news about these demutualizations is that in almost every case you've seen a real marked improvement in the return on equity. That's what improves the valuations of the stocks, and that's what makes it a good investing theme.

But execution is certainly a key, as you can see in Table 4. We promised a little bit of postmortem analysis, so we picked four transactions that have had enough history of being a public company to really understand how they have improved their situations. Let's begin with UNUM. UNUM is priced at 96% of book value with an 11.4% return on equity in 1986. The company now has a slightly lower return on equity, although prior to the merger with Provident Companies, UNUM's return on equity peaked at about 16%. So, over a 10-year period UNUM improved its return on equity from 11% to 16%. There are merger-specific reasons why UNUM's return on equity is back down at about 11%. However, there was a really dramatic improvement in the valuation of that company over the years, and you can see that that was reflected in the price-to-book multiple at which UNUM's stock traded. It actually traded at almost three times book value when it had a 16% return on equity a few years back.

Table 4
Demutualizations: Then and NowSources: Company reports and Credit Suisse First

		THEN		NOW	
Company	IPO Date	IPO Price/ Book Value	Pro Forma Oper. ROE	10/13/00 Price/Book	2000 ROE
UNUM	11/6/86	0.96	11.4%	1.28	10.9%
Equitable	7/16/92	0.69	9.7*	3.49	21.7**
Allmerica	10/10/95	0.72	7.3	1.42	12.4
Manulife***	9/24/99	1.45	12.9	2.45	14.7

* Represents actual 1993 operating ROE
** Year-to-date actual ROE as of 6/30/00 due to Credit Suisse First Boston's restriction in AXA Financial stock
*** Based on Canadian GAAP

Sources: Company reports and Credit Suisse First Boston.

Equitable is the real winner for investors investing in demutualizations. That company, as many of you know, went public in 1992 with many questions about viability. The IPO pricing was at 69% of book value, with a 9.7% return on equity, but I think we're being generous there in what investors were expecting Equitable to do back in 1992. We at Credit Suisse First Boston are restricted on the stock because we just recently purchased DLJ from Equitable. Equitable's stock, which is now called AXA Financial, is currently trading at 3.5 times book value with a historic return on equity of about 22%. That's not our forecasted number because we are restricted on the stock, but, needless to say, the return on equity of that company more than doubled from the IPO, and the valuation really reflected that. One dollar invested in the IPO of Equitable in 1992 was worth about $95 when AXA Financial was acquired by AXA Group, the parent company. That was the home run of demutualizations in the decade of the 1990s, and we're looking for the next home run for the decade beginning in 2000.

Allmerica is another example of real improvement. Allmerica was taken public at 72% of book, improved its return on equity by almost five percentage points and is now trading at 1.4 times book. And Manulife, which went public a little more than one year ago, has actually improved its return on equity quite nicely as well from 12.9% to 14.7% under Canadian GAAP, and the valuation reflects that as well. So, there's a common theme. Improvements in the return on capital are what move the stock price up. How did these companies do it? They all did it, quite frankly, differently. They all took expenses out to varying degrees.

In Equitable's case a lot of it had to do in the early years with questions as to whether the company was really viable. Then, beyond the first few years, when the company had to restore its risk-based capital ratio, Equitable finally got to the point where it could start to buy back stock. Also, a lot of real estate came up from the subsidiaries, and a lot of stock buy-back was executed from 1997 to the present. Actually, Equitable Life didn't have a risk-based capital ratio of 200% until year-end 1997. Thus, it took a long time to complete the restructuring of that company. However, once they hit a 200% risk-based capital ratio, Equitable was able to do a lot of stock buy-back and a lot of balance sheet restructuring. A good deal of the money in Equitable stock was actually made in the last couple of years. It wasn't made in the early years and I think much of it had to do with company-specific factors relating to the balance sheet.

Allmerica has been a very steady repurchaser of shares and also has done a lot in terms of expense efficiencies as well. In Manulife's case, though, it hasn't actually been due to stock buy-back. It's been eking out higher profitability and closing expense gaps. This has been particularly true in its U.S. business, where it was able to close the expense gap about six months ahead of schedule since the annuity sales have come in considerably better than expected. So, it's varied from company to company, but the improvements have actually been quite dramatic.

To summarize the thought process in terms of what we're really looking for, the challenges for newly public mutuals will always be re-deploying excess capital. In fact, for every company, except Equitable, which was more of a capital-challenged situation, the demutualizations this time around are pretty much all being done from positions of capital strength. Also, in some cases, these companies had a capital basis that ballooned over the years because the company's policyholder basis had shifted away from participating policies, and it made it that much more difficult to pay out the excess profits. With all these years of good securities gains you've got a large number of mutual companies with great balance sheets and significant excess capital. Their biggest challenge coming public will be to re-deploy that excess capital.

The second point is establishing management credibility. Nobody coming public will ever have the credibility that Hank Greenberg has at AIG, for example. It's very difficult, and it takes years to build up that credibility with investors. So, it's got to be proven out of the box. Managing GAAP earnings volatility is a big challenge for those looking to come public. Start, if you can, closing your books on a quarterly basis, well in advance of the IPO, so you don't have a lot of catch-up items in the numbers. Public companies don't have a lot of catch-up items in the numbers, but the recently demutualized companies have had those issues. The final challenge is improving operating efficiencies. The last thought I'll leave you with is to remember that investors are really not compensated on absolute performance. They're looking for the great relative outperformance. So, if you are thinking about coming public, your primary perspective is to figure out how to win over investors and convince them that your investment is better on a relative basis, not just on an absolute basis.

Mr. Shemin: I want to start by giving you just a quick snapshot of John Hancock and its demutualization. After that, I'm going to spend most of my time talking about the changes the company has made both in anticipation of going public and since then, and then I'll talk about some of the challenges we've got going forward.

We have five business segments for GAAP financial reporting purposes:
- A protection segment including life insurance and long-term-care products
- A retail asset gathering segment which includes annuities and mutual funds
- A guaranteed and structured financial products segment covering GICs, funding agreements, and group annuities
- An institutional investment management segment which provides investment management services involving stocks, bonds, mortgages, and natural resource investments to pension funds and other institutions
- A corporate and other segment which includes our Canadian subsidiary Maritime Life, several Asian life insurance companies and various other discontinued or smaller businesses

Let me quickly share our 1999 results. After tax operating income was $613 million or $1.95 per share, and that was up a healthy 22% over the prior year. After tax operating ROE was 13.2%, which is pretty good for an emerging mutual, but not so hot in relation to public companies. And assets under management are $127 billion, which is a good size in total but it grew only $3 billion during 1999 which is not up to the kind of growth rate one would like to see.

In our demutualization and IPO, we allocated 300 million shares to 2.7 million policyholders, sold about 100 million shares in the IPO and used virtually all the proceeds to cash out 1.8 million of those 2.7 million policyholders, so we were left with only about 900 thousand shareholders. An objective of our demutualization was to get the shareholder base to about that level (still a very large level for a public company), while providing cash for policyholders with small amounts so they could avoid the inconvenience of small shareholdings and we could avoid the expense of servicing small accounts.

We started looking at what it would take to be a public company a number of years before we demutualized. One of the things we did early on was to take a look at our corporate strategy compared to large public companies. We weren't interested so much in the specific businesses they were in, but more so in the strategic rationale for each business and the degree of focus and linkage in the overall company strategy.

What we found when we did that is was we weren't comparable strategically to most large public companies. We were in too many businesses, i.e., we weren't focused enough. But perhaps more important, we found it difficult to articulate why we could be a superior performer in each of the businesses that we were in. Obviously, in some we could, but not in all of them. We knew in advance that investors would not look well upon us if we couldn't do a good job of articulating why we were in each business that we were in, as well as having the appropriate degree of focus as a company.

Before we had made a decision to demutualize, we concluded we wanted to act like a stock company even if we weren't sure we were going to become one. So we did a number of things to rationalize our strategy. We exited the HMO business; we sold our group health business to Wellpoint; we sold our securities brokerage business, which included Tucker Anthony and Sutro & Company, to its management in a leveraged buyout. We sold our property casualty insurance business, partly to a subsidiary of Winterthur and in part to Firemen's Fund. And in late 1998 and 1999, we sold the preponderance of our investment real estate because from a capital deployment point of view it didn't really fit with being a public company, or even with efficient capital management as a mutual.

Those actions removed us from a number of things and freed up some capital, but you'd expect more from a successful stock company than freeing up some capital. Thus, we also started to work on some things that would enable us to expand in the businesses in which we were going to stay. We developed a multi-product, multi-distribution consumer strategy whereby we would provide a broad range of products and also sell through a range of distribution channels. We would continue to distribute through our career agency channels, but we would also go through an increasing variety of independent channels. This didn't mean that we were going to try to sell every product through every channel, but we were going to try to take advantage of opportunities to sell more than the basic core product that many of these channels have seen as their initial product focus.

We also took another look at our strategy versus public companies, and this time we could conclude that the strategy we had—both in terms of the focus inherent in our portfolio of businesses and the strategic rationale behind the multi-product, multi-distribution strategy—was going to be comparable to other large public companies. So we felt that at least from a strategy point of view we were in the ballpark and now the main thing we needed to do going forward was put in place the implementation building blocks for that strategy. We did some of that prior to demutualizing.

We acquired a bank third-party marketing firm, Essex Corporation; we established a distribution company for our career agency system and began to make a transition for that system to be somewhat more independent and also to be able to focus on more of a bottom line perspective as a distribution company. We acquired a large Canadian life insurance business from Aetna Canada, and we acquired a large block of long-term-care business from Fortis.

Finally, we did several things on the internal side. We implemented a series of targeted expense reductions. These were not across-the-board reductions, but they did get us started in trying to look for areas to reduce our expense base. We also increased the importance of variable compensation in our compensation structure. We introduced variable compensation at a fairly modest level for every employee, for officer level employees we've actually had a salary freeze in effect for a number of years while we increased the rate of the variable compensation programs. We hired a number of management people with public company experience, to fill some of our openings. And we introduced a number of educational initiatives to accelerate culture change to make employees feel like owners and have them understand what the business dynamics are which drive our success.

After our demutualization we drafted a new set of financial objectives, expressed as the two fifteens. These are a 15% after-tax GAAP operating return on equity and a 15% growth in GAAP operating earnings per share. Remember these are objectives, not immediate projections of performance, but we did derive them from looking at what public companies are doing and what we could reasonably expect of ourselves over a reasonable period of time.

What are we doing to achieve these objectives? Let's start with distribution initiatives. We're trying to increase our penetration within the broker/dealer channel, not only to sell more annuities and mutual funds where we already had some presence, but also to try to sell more life insurance and even long-term-care-products through that channel. In the bank channel, we are trying to broaden our product range beyond fixed annuities to include variable annuity products as well as life and long-term-care insurance. And we've launched a number of Internet distribution initiatives through various aggregators involving an increased range of products.

In our career agency system, we eliminated a branch system and merged it into our general agency system where the general agent owns the agency. Now that we have a separate distribution company we are increasing our use of bottom line distribution financial measures. This is happening gradually, but, over time, the separate company will become more separate and will be expected to stand on its own feet. And we reduced the hiring of inexperienced agents for economic reasons and are focusing more on programs to attract experienced agents.

We started developing products with combinations of coverages in which we have expertise. We introduced a variable annuity with a series of long-term-care insurance riders and are following that up with a variable life product that also has some innovative long-term-care features.

We've also introduced a number of enhancements within our variable life and variable annuity products. And we are in the process of enhancing our universal life family in anticipation of a market correction—we expect our sales to start to swing over from variable to universal life.

We've seen a decline in our participating whole life sales. Our best guess is that a market correction will probably not reverse that decline because there are some issues that both agents and customers have about buying participating whole life from stock companies. Frankly, we are not sure we could get the kind of returns on the participating products that would help us achieve our 15% ROE objective.

Finally, there are a number of internal steps that we are in the process of implementing. First, we are continuing and increasing our focus on expense reductions. We have made a public commitment to cut around $100 million of expenses over a three-year period.

We introduced stock compensation to replace some of our variable cash compensation to the entire range of employees in the organization. And we've continued to expand educational efforts to accelerate the cultural change that's necessary to make the move from a mutual situation to a public company situation.

How are we doing so far? We've reported six months results for this year and our operating earnings per share are up nearly 20% and our after tax ROE was 15.45%. So, can we say that we have now achieved our 15% goals a mere five months after the demutualization? Not exactly. Actually, we don't think these results are representative of our ongoing earnings in the near term and we've essentially told Wall Street that as best we could.

So we still need to work on improving our so-called "run rates" so that we will be able to sustainably achieve the 15% goals going forward. And that will be somewhat more difficult because our assets under management are actually down 3% for the first 6 months, primarily because of redemptions in our mutual fund and investment management businesses. Our mutual fund business has focused on a few very large funds in some sectors like financial services that just fell out of favor during this time period and are experiencing significant net redemptions. We are trying to reverse that by broadening the scope of the funds we have, but that process hasn't really reached fruition yet.

As you might imagine, we have our own set of challenges going forward. We need to implement the distribution initiatives that we've undertaken. This means building up the wholesaler base in the bank and broker/dealer channels and successfully broadening the product range in those channels. We also need to continue to improve the economics in our career system. We need to implement the commitment we've made to achieve $100 million in expense reductions over a three-year period.

We also need to reduce the quarterly fluctuations in our earnings. We've seen these fluctuations in the initial earnings we released as we became a public company and to some extent, in the first couple of quarters. To accomplish that, we need to work on reducing the noise that shows up in our quarterly earnings. In addition, we've got to reduce some of the sources of fluctuation.

We need to use our capital more efficiently. We have some excess capital, and we need to either deploy it or move it up to the holding company and consider using it to buy stock or perhaps for acquisitions.

Finally, we need to keep improving how we explain what we're doing. Whether your results are great or not, we believe that Wall Street will place a higher value on your results if they can link the results to activities and strategies which are and will be successful in the business environment. So you need to be able to explain what's happening, and why it's happening, and if there is something that isn't ideal about it, what you're doing to change things going forward.

This is something that, as a mutual company, one had to do at infrequent intervals, and only to one's board and occasionally to rating agencies. But now one has to be able to explain things on pretty much a continuous real time basis. We've made some progress in this area but I'll be the first to admit that we need to get better at it.

Mr. Robert W. Wilson: When I was offered the chance to be on the panel, I had this vision that we were all going to get up here and say the same thing because when you look at what's actually been happening, a lot of the issues are very common to any demutualizing company.

Sun Life Financial is somewhat different than either John Hancock or MetLife, and part of that came to roost in the demutualization. As Barry mentioned, we had branches in more than 100 countries at various times, and when we demutualized we were giving shares to people in more than 130 countries. We have active operations currently in five major countries— six, if you count South America, but it's not very active, and it's not insurance.

From a logistics standpoint we had to deal with far more regulators and security analysts than any company in the history of demutualizations. Our home country, Canada, was the largest country in terms of policyholders that were getting stock from the company. The Philippines was second, followed by the United Kingdom. The United States actually was the fourth largest. . This made for interesting negotiations with the U.S. regulator and the British regulator, who have totally different views of how demutualization should work.
Another difference is that we actually haven't been a mutual very long. We mutualized in 1962, and, as a result, when we demutualized we still had people on staff at vice-president levels who actually remember mutualizing the company back in the early 60s. MetLife

As part of our process, we have subsidiarized all of our non-North American operations where we are still active. Instead of having branches in 100 countries, there is now a subsidiary company in about five countries where we're still active. Restructuring the organization in this way was part and parcel of our demutualization to gives the company flexibility in adjusting to changes in direction. In the future, we can sell these subsidiaries. It's much easier to sell off a subsidiary company, if that becomes an issue, than a portion of a branch's business.

Over the last few years we've also become much more focused on looking to see which core businesses we should be in, and why we're in them, much the same as John Hancock. We have sold off several businesses, which either we determined were no longer core, or where our presence in the market was so small that it just wasn't viable. These have included our reinsurance operations, Mass Casualty Insurance Corporation, which was a small individual life disability carrier, and New London Trust, which was a savings and loan that we had picked up in New Hampshire in the late 80s.

On the other hand we have also entered into new operations. We have entered into joint venture agreements in India for mutual funds and life insurance. The mutual fund company in India is now the second largest mutual fund company on the subcontinent. This sounds extremely impressive except that it only has $1 billion of assets under management, which is a long way from number one. We are working on it. We have entered into a joint venture agreement in China to sell insurance products in the People's Republic. Also, we entered into a joint venture agreement in Chile in 1998 for the sale of retirement products under the Chilean pensions scheme. Under this arrangement, everyone in Chile has to contribute to a pension fund that's all been outsourced to the private industry, and we own 30% of a company doing that business.

We have also entered into re-branding from Sun Life Assurance to Sun Life Financial. This is not quite the same as Mutual Life Assurance of Canada going to Clarica or some of the other companies that have new names, but the new brand and a new logo is actually an expression of changes in the company. Our previous brand was not consistent throughout the world; it wasn't even consistent between different divisions of different operations.

The re-branding exercise has an internal as well as an external focus to it. Most employees of Sun Life thought of it as an insurance company, Sun Life Assurance Company of Canada, a company that had existed forever. The name had the highest name recognition in Canada short of Coca Cola. No one knew exactly what we did, but everyone knew the name. Everyone thought of us as a life insurance company, yet 90% of our assets are actually in the wealth management business, which is the fastest growing section of the company.
One of the things that we have done is to split the company formally into wealth management and life insurance, and now all of our reporting to the external world is on a wealth management versus protection basis. Doing that change internally caused some grief because we had never looked at the business that way until we started to go through the demutualization process. A greater focus, as you might guess, has been placed on expense management with a resulting downsizing of the company. Head count reports now feature very prominently in quarterly reviews. Interestingly enough, the current problem is that the head counts are too low in a many of our territories because, as I'm sure people from John Hancock would know, hiring in the Boston area has been very difficult.

I think the effect of cultural changes going from a mutual company even if we were only mutual for 30 years to a stock company can never be overestimated. As a mutual, the policyholders were the owners. They were also the policyholders. You did not have inherently any disagreement between the two. So, there was no conflict between the rights of the policyholders and the rights of the shareholders. If you benefited one, you benefited the other. Now there are new owners. They may be-indeed, most of them still are-the same people, but their viewpoint is entirely different now that they are shareholders, and they phone up and complain when the share price goes down. They didn't do that when all they had to worry about were dividends.

For many employees, balancing the new reality has been a difficult transition, and many of the people decided not to stay. We have had a huge change in management. The general managers of each of our national offices are new within the last two-and-a-half years. We have a new president and a new CEO. Some of these individuals are from inside the company, but many have experience from the public world. This has been a significant change that has had ripple effects throughout the company.

We've also put in an early retirement package in Canada and Great Britain. In Canada, 250 people out of around 3,000 took the opportunity to retire. In Britain, about 60 people retired, but it's a much smaller operation. This has resulted in a very significant loss in corporate memory which has interesting ramifications since we have new management who don't really know how the company has worked. They know how the public world works, but they don't know the company itself.
Our financial reporting measures and dealing with Wall Street are somewhat inter-linked. The Street is now our primary reporting focus so any measure that we use internally needs to be communicated to the Street.

One of the most obvious changes for us in demutualizing was that, since we listed in New York, we had to move to U.S. GAAP. As a Canadian company we had no experience with U.S. GAAP and, to be quite honest, consider it somewhat strange. We made a worldwide conversion to U.S. GAAP in 10 months which our advisors, PricewaterhouseCoopers, told us couldn't be done. We did it anyway, and, as a result, we're still in the process of institutionalizing U.S. GAAP. However, we still report internally on Canadian GAAP.

Another issue that came up was earnings per share. Obviously, the concept is fairly easy. You divide your earnings by the number of shares and produce a number. We thought that this wouldn't be a problem. But the importance of hitting the correct number, whatever that might be and doing it within a very narrow window, or having yourself punished, was a new concept. The employees who came in from the public world were used to this, and we kept asking them if they were joking. They replied that, "if earnings per share is supposed to be 45, it has to be between 44 and 46. If it's 43, there are serious repercussions." As a mutual company we didn't worry as much about quarterly fluctuation in income and there was more financial reporting flexibility.

The serious emphasis that the Street puts on the stability of earning came as surprise to us. I look at our banks in Canada, and their income bounces around like a yo-yo. They always have restatement, but it still seems to bounce around by as much as $1 billion per quarter on occasion. One of the effects that the Street's emphasis on stability of earnings has had is that we are reinsuring massive amounts of in-force business that we never did in the past purely to obtain stability of income. For example, we have put through reinsurance programs on group disability insurance.

We're now in the process of setting up a system to report embedded value on an ongoing basis as part of our financial reporting. This is something that is very common in the U.K. And it's something the analysts in Canada want to see from Canadian insurance companies because when you get right down to it there aren't that many publicly-traded insurance companies reporting on a Canadian GAAP basis. Indeed, up until the demutualizations there were exactly two, London Life and Great West, and then one decided to buy the other. So, we're down to one. Even with the demutualizations of five Canadian companies there are just six companies in the world that report on a Canadian GAAP basis.

Closely aligned with reporting to the world on embedded value is using value added both as a compensation basis and to run the company. We are moving in that direction, but we are not going to move too far until we have a little bit of experience at seeing what the numbers look like. There's a company in the U.K., which did not publish its embedded value numbers until it had been doing it for a decade because you can get some pretty strange looking results.

The focus on expenses leads to looking at expense gaps and body counts. As I mentioned before, body counts are now a big item in financial reporting, and expense gaps have taken on a much higher profile, as if they could have taken on a higher one. It's interesting hearing Barry speak about the $100 million in expenses that they promised to eliminate. We promised to eliminate $160 million. Of course, that's Canadian dollars, and that may be $100 million the way the currency's going. About $152 million Canadian would be $100 U.S. as of this morning.

Now I will talk about dealing with Wall Street. The biggest problem we had in dealing with Wall Street was being noticed. For us it's not just Wall Street. It's Wall Street and Bay Street, primarily Bay Street, which is the equivalent of Wall Street in Toronto. Our basic initial problem at the time of our IPO road show was that institutional investors felt that we had a good story, but nobody's buying value stocks today. If you recall Chart 1 that Caitlin put up, we like to think that it's not a coincidence that those stocks immediately started going way up at the time of the Sun Life IPO. Actually it had nothing to do with Sun Life. If you looked at technology stocks, you'd find they immediately turned south. And when our people were out on the road there had already been four Canadian demutualizations. In addition, we were coming between the John Hancock and MetLife IPOs. We found that the investors were burned out and didn't want to see another person promoting an insurance IPO. So, our biggest problem with Wall Street was getting them to even notice that we existed.

The other problems: We didn't have an investor relations function or any investors. So, we have set up an entire investor relations area from scratch. We were a company that was always quite circumspect about publishing its strategies and information for review by the outside world. Thus it's a little unusual today that we actually publish our capital ratio on our Web site. Five years ago my boss, who had the job I now have, refused to give the CFO this piece of information because he was afraid he'd share it with analysts. Now we display it on the Web site. This opening up and explaining strategies to people has been different, although actually it's good. It forces you to figure out that at times they don't make sense and they need to be changed. The Street is wonderful with its advice on which we should buy, what our acquisition strategy should be, and what we should do with Mass Financial Services.

We now produce U.S. GAAP financials, but we actually run the company on Canadian GAAP, and for insurance these two methods really aren't the same. So, this is an issue because U.S. analysts don't understand Canadian GAAP. Perhaps they don't think that they need to because there aren't many companies reporting on this basis. But they can't use our U.S. GAAP numbers either because our U.S. GAAP numbers don't mean anything from the perspective of what drives our management decisions.

There are vagaries of U.S. GAAP reporting that cause the numbers to look rather bizarre. To give you an example, we have an issue in the United Kingdom with regard to some settlement option guarantees that were put into contracts that we picked up from a company known as

Confederation Life which went bankrupt in 1994. We discovered these hidden treasures about two years later because they weren't written into the contracts, but were written into some trustee agreements. And, because interest rates in Europe are lower than they are in North America, these are now in the money. We have set up liabilities of roughly $500 million Canadian for these particular supplemental benefits, and they're hedged with derivatives. Under U.S. GAAP, because they are settlement options and for a number of other reasons, our accountants have told us that we're expressly forbidden to set up liabilities for these particular items. When you mark to market, which is what happens on the derivatives, you can't use hedge accounting because there's no liability that you're hedging. Therefore, the entire movement in the derivative instruments goes through the bottom line on a U.S. GAAP basis. So, I question if any analyst on Wall Street would ever be able to make sense of our U.S. GAAP numbers.

Anyway, that briefly describes some of the things that we found in dealing with the demutualization. It's very difficult to deal with what is caused by the demutualization. One might raise the question as to what we would have done if we had not demutualized. Actually, a great many things we did that we say are the result of demutualization we'd have done anyway. We'd already moved out of the career agency system in the United States and put everything into general agents and brokerage distribution before we even thought of demutualizing. So, I can't claim that we took that action solely due to demutualization.

Mr. William J. Wheeler: I'm going to talk briefly about MetLife and about our demutualization and IPO process. I don't want to take you through it because there are many people in this audience who are experts at that and would know about as much of it as I do. So, what I am going to do is share a couple of war stories. It is a life-altering event for the people who go through it. But, more important, I'm going to talk about what going public has meant to MetLife in terms of some of the cultural change and the strategic things we're doing. Things are different now and there's no doubt about it. And then we'll talk a little bit about the future.

I imagine a lot of you know something about MetLife. We obviously have a world-class brand with Snoopy and the gang, and we like to leverage that as much as possible. We claim that we're the largest U.S. life insurer. We have $1.8 trillion in-force, mainly because of our group insurance business. We have a very strong individual life and annuity franchise, and that includes over 11,000 tied agents wanting to sell MetLife or New England or GenAmerica products. We have a life insurance or annuity product in one out of every 11 U.S. households.

What you may not know about MetLife is that we're also the largest group life insurer and non-medical health insurer in the U.S. by a large margin, and that's a very interesting franchise for us. We're the number one marketer of auto and homeowners business at the worksite, and strategically it makes a lot of sense for us to be in that business. Although many think about MetLife as a monolith, we're really not just MetLife anymore. We have a number of different brand names including New England, GenAmerica, RGA, and State Street. All of those brands are used in the marketplace in different areas, and that is very successful for us.

Now, let's put in perspective what MetLife is today. We have two big growth engines, which in the first six months of 2000 comprised about 90% of our earnings. This percentage was a little higher than normal. Normally it would be 80% except for some moderately large

catastrophes in the auto and homeowners business, which depressed auto and homeowners earnings. The individual career agent business is roughly 50% of our earnings. Institutional business, which is group insurance and pensions, is about 39%, and reinsurance is 4%, asset management 3%, and international 2%.
Now, I'll talk a little bit about our financial results. We went from an ROE of 7% in 1997 and we'll be a little over 10% this year. We're proud of the progress we've made at MetLife over the past three years. We know we have a long way to go since many of our peers have ROEs above 15. Given our business mix, however, there isn't really any reason why we can't be at 15, too, but we've got some things to do before we get there.

Bob, I totally agree about not wanting to get into what Canadian GAAP is all about. I still don't understand it well. U.S. GAAP, because it is so strange and in some ways not entirely rational, sometimes puts us at a competitive disadvantage. This is especially true compared to European insurers who have much more flexibility in how they can present their results. But if you just look at our financial results over the past three-and-a-half years, we've obviously done a nice job of improving earnings, albeit from somewhat of a low base, and that continues in 2000. Our earnings are up 19%. So we've made some progress, but we have a lot to do.

Let me talk about the demutualization itself. From the announcement date to the date of the IPO the demutualization took 16 months. This was the shortest amount of time for a U.S. life insurer demutualization and so we're proud of that, even though it's still a long time. The main reason it takes so long, at least in our case, was that the actuarial equity-share calculations are enormous for a company like MetLife where we have a very old block of business. We have many different product lines. We had literally 100 actuaries, both our own inside and outside advisors, who worked for one year straight on these calculations. It's a very complex process.

Also, we claim that we have done the largest private mailing in U.S. history in terms of poundage. Some of the wild statistics were 800 trailer loads of paper that were required for our mailings to policyholders. It was an ecological disaster. We also now have nine million shareholders, which is close to three times more than any other U.S. public company, and those shareholders would normally be very expensive for us to service. However, we did something very unique in the U.S. We have a shareholder trust where our policyholder shares are inside the trust, ergo, we don't have to send them annual reports and annual proxies every year. There are actually certain benefits to being in the trust. Shares from the trust can be sold commission free. They can end up commission free forever. It's a very shareholder-friendly kind of a trust, and it is the reason that we can now afford to have nine million shareholders, which cost us something like $4 a year each.

In the IPO process, we did something that was a little different than some of our peers. Between demutualization expenses, and the amount of money we had to raise to cash out policyholders, we needed to raise $4.4 billion, which at the time would have been the largest U.S. IPO ever. And we were doing that, as both Bob and Barry alluded to, in a stock market environment that was not very excited about owning any more insurance stocks. Frankly, the chance of raising $4.4 billion through a true common stock deal was questionable. So, we re-cut the deal. We still did an IPO but shrank it to $2.7 billion. We sold $900 million of stock through a common stock private placement.

We also did an $800 million mandatory convertible preferred in conjunction with the IPO, and that converts into common stock within three years. So, we went to another group of investors to get some of their money because many people were tapped out in terms of wanting to buy any more insurance stock.

The S&P Life Index started to dip down at year-end 1999, and John Hancock did their deal in the teeth of that, and that was made a very challenging transaction as well. When we started our road show in March 2000 , the S&P Life Index started to go up and, I think that was the defining moment. That's a great example of "it's better to be lucky than smart." The Sun Life deal was in March 2000, and in April 2000 we priced our deal, and since then all life insurance stocks have outperformed the S&P 500. MetLife has done very well, as have both John Hancock and Sun Life. Our reports indicate we're up 72%, which was 90% a couple weeks ago. So, we've actually backed off a little bit.

Let's talk now about what actually happened in terms of going public. It's fun to listen to other companies' stories because they sound so much like our own. We, too, went through a re-evaluation of our portfolio of businesses and decided what we had to exit and what we were going to focus on. Over the past few years we've made a lot of changes, and some of those were kind of wrenching for us. For instance, MetLife had an operation in Canada for more than 100 years, and most of our senior management had at one time worked in that operation, so it was a very emotional thing to sell that business to Clarica. At the same time we've tried to buy businesses which we think would help expand our core operations. These types of acquisitions include the career agent shops of New England and GenAmerica and also alternative distribution through the acquisition of Security First and Nathan & Lewis. We recently announced that we bought a small bank in order to get a license to do consumer banking in the U.S. We think of that as a natural product line extension to a lot of the things we're doing currently.

We've also had to instill a lot of financial discipline in MetLife which, frankly, wasn't there before. We, also have told the world we're going to grow earnings at 15% a year over the next three years, or this year and the two following years, and that we're going to continue to improve our ROE at 75 basis points a year. Part of the way we're going to do that is by closing our large expense gap. We've already made some progress in reducing head count and employing more technology to continue to reduce head count and improve automation.

For instance, now we automatically adjudicate almost all of our dental claims. We are differentiating between business opportunities. As managers we learn that there are some businesses inside MetLife which are growing very fast, and we have to feed those and expend the resources to keep them growing. However, some other businesses, no matter what we do, are not going to grow anymore. We have to learn to squeeze those and treat them differently, and that is harder to do than it sounds. We've talked a lot about capital efficiency today. Yes, MetLife has a great deal of excess capital. Most of the mutual life insurance industry has a lot of excess capital and we have to do something about it. At MetLife we've been very aggressive in terms of releasing capital and we've announced an aggressive buy-back program which we're already implementing strongly.

Let me give you some specific examples about cultural change. We have been integrating our staff with outside talent. Roughly 25% of the new officer appointments at MetLife over the past few years have been from the outside, including people like me who have very specific skills that we bring to the table that perhaps weren't resident inside MetLife as a mutual insurance company. When other companies have done this you've seen an environment "us versus them" creep in, that is, the newcomers versus the old guard, a type of class warfare. At MetLife I think we've done a very good job of integrating everybody, and everybody thinks they're on the same team. I credit our CEO for creating an atmosphere where we, as we say, "honor the past". Thus we respect the people who are there who built MetLife to be what it is today, and now we're going to take it to another level.

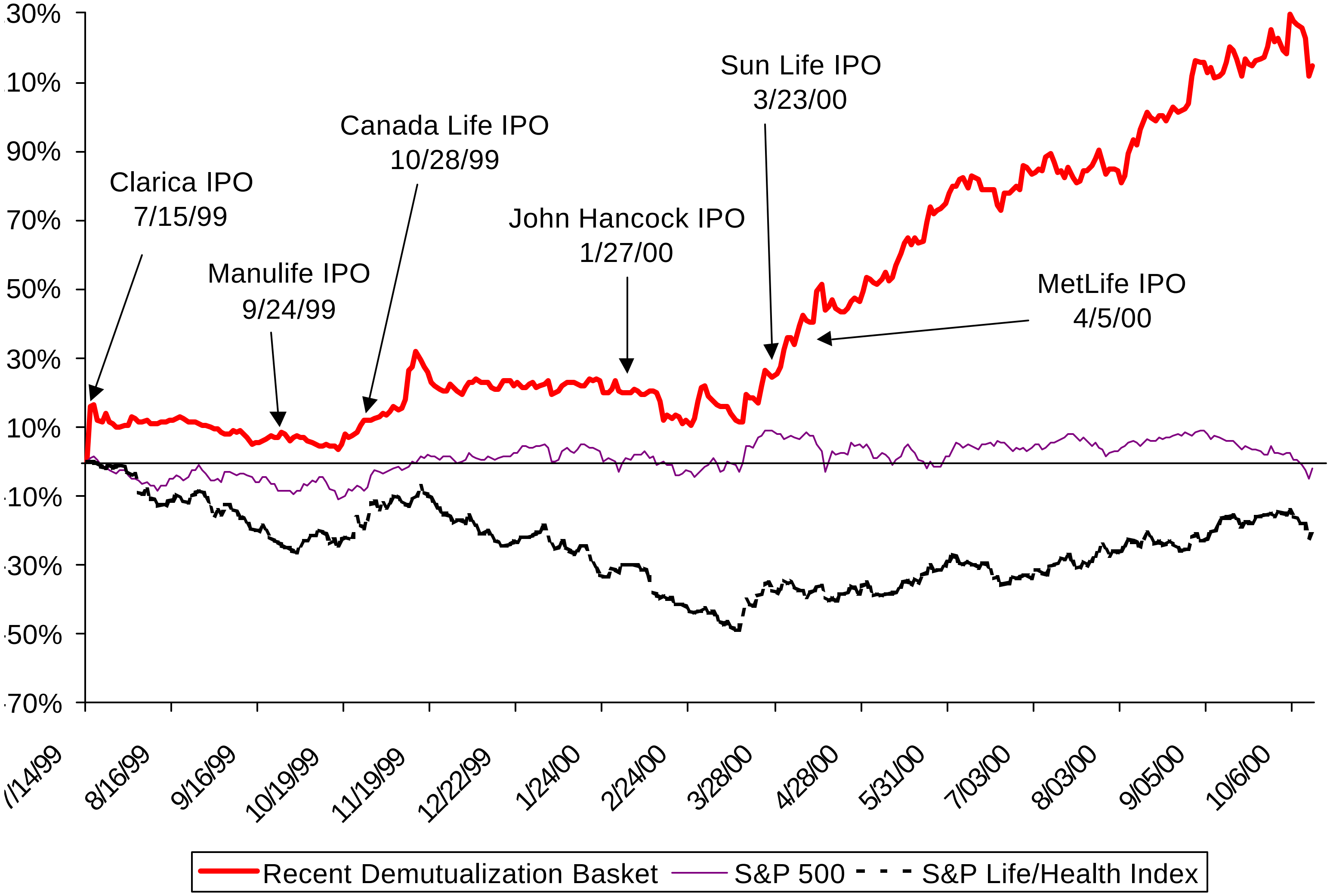
We have strengthened the employee performance review process. MetLife has always had employee performance reviews and a rating system. Under the old one, you could be rated as excellent, very good, good, or poor. In 1997, 86% of MetLife's employees were either excellent or very good, yet we had a 7% ROE. There was somewhat of a disconnect between reality and what we all thought about ourselves. Over the past two years MetLife has implemented a new rating system where we employ a forced curve, and it is forced. Under this system 30% of employees will be rated above average, 50% will be rated average, and 20% will be rated below average.

Now, why is that important? In the last two years, since that program has been introduced, half the people who were rated below average are gone. Most of them left voluntarily. They realized that they were not cutting it here and decided to go somewhere else or took early retirement. Of the people who were rated above average, 90% of them are still there. So, we're retaining good people, and raising the bar for the poor performers, and I think that's worked very well. I'll be very honest in telling you that the people who were obviously non-performers are pretty much gone. You all know who these people are in your own organization. These people have been weeded out and this year I think it is going to start to be much tougher. Now we will need to rate people below average who sincerely are trying to make a good effort but who perhaps aren't quite performing up to requirements. I think that's going to be much more emotionally wrenching for us, but we're going to do it.

Let's talk briefly about the future. Frankly, we've given a very consistent message here in terms of our experiences and what's important to us. Caitlin put it very politely when she said that we have to prove ourselves as a management team in the public arena. The truth is Wall Street is very cynical about mutual insurance company management teams. Its expectations are incredibly low in terms of our capabilities. We have to prove that we're competent, that we're in control of the numbers, and that we understand what's going on in our businesses and can truly manage them. Wall Street is not so sure and this is the environment we're working in today.

Finally, why did MetLife really decide to go public? Our competitors include John Hancock, Sun Life, Prudential, and Northwestern. But, with all due respect, in many ways our real competitors are Merrill Lynch, American Express, CitiGroup, and Fidelity, and they're eating our lunch and will continue to eat our lunch unless we become a more effective competitor. We feel we have to level the playing field and have the same kind of financial and legal flexibility that those organizations enjoy because our goal is not to be a really good life insurance company. Our goal is to be one of the premier retail financial services in this country. We want to be on the short list.

Chart 1
Stellar Outperformance of "Basket"



Based on closing prices as of October 13, 2000

Source: Credit Suisse, First Boston

CHART 2
HISTORICAL DEMUTUALIZATION VALUATIONS: U.S.