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Session 4PD
Impact of Demutualization on Actuarial Careers

Track: Actuary of the Future

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Recorder: JOHN W. MORRIS

Summary: Many mutual life insurance companies have considered or are considering converting from a mutual company to a stock company. Panelists at this session provide their viewpoints on some of the changes needed in an actuary's work, objectives, and viewpoints to be successful in this new structure.
Topics include:
- *Changes in financial reporting requirements and needs*
- *Changes in product design and pricing*
- *Changes in focus of profit measurements*
- *Changes in roles and opportunities of actuaries*

Mr. John W. Morris: Let me start by introducing our panel. First, we have Doug Brooks from Clarica. Doug is vice president and actuary of Clarica. He has been with Clarica for close to 25 years and has been their appointed actuary since 1997. Next is Mike Harwood. Mike is vice president and actuary in MetLife's Corporate Actuarial Department. Mike had the responsibility of being the coordinator of the actuarial phases of MetLife's demutualization. Mike now has oversight and coordination responsibility for product pricing, dividend policy and reinsurance. After Mike is Rob Vrolyk. Rob is vice president and chief actuary for the U.S. National Office of Sun Life Assurance Company of Canada. Previously, he was vice president of finance. Like Doug, Rob has been with his current employer for nearly 25 years. I am a consulting actuary with PricewaterhouseCoopers (PwC) in the Valley Forge Office. I have been with PwC for eleven years. During this time, PwC has been engaged to work on many of the demutualizations, starting with The Equitable in the early 1990s. It either worked for the demutualizing entity or for state insurance departments by assisting in their review of demutualizations.

We're going to start with Doug who will talk about enhanced disclosures to analysts that are required after the initialization. That's probably too narrow of a title. Doug actually has some very excellent insights into areas that an actuary's role changes after demutualization. Mike is going to talk about closed-block management and new business issues. Rob will talk about the changing role of the actuary.
Even though I'm not on the agenda, there are a couple items I want to talk about. The first thing I want to talk about is that I don't see the role of an actuary changing

that much after demutualization other than some additional tasks that are required as a result of demutualization. I've actually heard some people say that the only difference between an actuary going from a mutual company to a stock company is that he or she has to learn that the profits are no longer a variable in the equation. They're pretty much fixed. What does change is the responsibility that a company has to other constituencies such as the SEC and investment analysts. This requires more discipline on the role of the actuary. That's pretty much what I've seen and perhaps what other panelists will reinforce.

There are a couple of topics that we won't go into in detail, but if you have any questions, we can address them. There are changes in an actuary's responsibilities that are required after demutualization. First, there must be an independent actuarial review of a closed block. In every demutualization I'm aware of, the state requires there be an independent actuarial review every five years or so. For some demutualizations, it's more frequent than that, and what we're not sure of is exactly what that means. It's a fairly vague terminology. As more companies demutualize and states go through this, they'll likely get more ingrained as to what they're looking for. I know that Equitable finished their first five-year block a year or so ago. It's my understanding that their review wasn't all that rigorous. It was more of a high-level review to make sure that the closed block was being operated properly. But that could change.

The second item on my list of an actuary's role that definitely will be changing is merger and acquisition activity. We've seen a little bit of it from companies that have demutualized or formed mutual holding companies. There has not been a great deal of activity to put a trend to it, but it's definitely something an actuary needs to consider when going forward, with demutualization.

The last item on my list is the AICPA draft Standard of Practice (SOP) on demutualization accounting. This came out early in 2000. The SOP is likely to cause a lot of additional work for an actuary by complying with the SOP's requirements. I've jotted down three items that I felt were most critical, but since then, I've thought of about three more I should probably mention. The combined financial presentation is a lot different than it used to be, or will be, if this SOP is adopted. In prior demutualizations, the GAAP financial statements have always shown closed-block assets and closed-block liabilities as separate line items in the financial statements. In the income statement, there was a separate line item for closed-block income. The SOP draft proposed that this treatment be eliminated, and you should just report assets and liabilities the way you did before demutualization, with some additional footnotes on things such as in-force business, but we clearly do not have separate balance sheet or income statement items.

In the draft SOP, there's something called an actuarial calculation. This is often referred to as a GAAP glide path. The "glide path" pertains to the future projection, at the date that a closed block becomes operational, of future assets and liabilities. The SOP suggests that gets locked in place and any earnings that deviate from that get absorbed in a policyholder dividend obligation, which is the last item on my list.

For instance, in the first year, if you had favorable closed-block results, they need to get returned to the policyholders in increased dividends down the road. On a GAAP basis, the SOP suggests that you establish a policyholder dividend obligation for the amount that actual income deviates from that projected in the actuarial GAAP calculation. This would get you back to showing GAAP profits consistent with the actuarial calculation.

The current draft of the SOP has some unusual results in certain circumstances. First of all, the **PDO** can't go negative. Let's say that, in the first year, you end up with less-than–favorable experience. Even though you're going to eventually reduce dividends to account for that, you would end up with a GAAP gain that is less than what you have in your actuarial calculation because you can't set up a negative dividend obligation. There is another unusual aspect of the way the SOP is currently written. Let's say your entire closed block went away, with all the liabilities having been fulfilled. If this happened sooner than what you had projected when you started your closed block many years ago, you would still be required to hold a PDO until your actuarial calculation projected that it would go away. I hope that will get addressed in the final SOP that comes out, and I think they're expecting that to be done later this year.

The one thing that the SOP didn't address clearly is how does the change in PDO affect deferred acquisition cost (DAC) amortization? It's my opinion that the majority of the change in PDO should affect your **EGM'**s in doing your DAC amortization. However, that's not clear in the SOP. Some of the change in PDO is going to come from taxes or terminal dividends or possibly certain commissions if they're in the closed block. These items are not part of any EGM calculation. So we're waiting for the final draft of that, which we expect in late 2000.

There are three other items in the SOP. It does require adoption of SOP 95-1, which tells you how to do DAC amortization for products with dividends, that is when using the EGM calculation. There were some options not to adopt that. Demutualization costs, according to the SOP, should be considered ordinary expenses, and not extraordinary. That affects income statements.

The final item in the SOP involves the transition rules. The current draft suggests that you go back to the date of demutualization and restate all prior GAAP earnings. That seems a little severe for companies that demutualized many years ago. It requires a lot of work but does not give much benefit.

Mr. Douglas W. Brooks: What I've found to be true throughout the world about demutualization, is that the work of the actuary, in some senses, doesn't change. The environment within which that work is done is significantly different. You'll see the same basic job skills, training, and knowledge input to work. But there are an awful lot of things that aren't fundamentally the same. I'm going to go over some of these areas and point out a few things that are similar and a few things that are different. What does that imply about actuaries and actuarial careers.

One thing that has surprised me in the postdemutualization world is the impact on the number of actuarial resources that are required. As we were going into demutualization we saw, and this is again coming particularly from a Canadian context, the consulting companies stocking up on actuarial staff. We had a special team, which included quite a number of actuaries to work on our demutualization. People were wondering what was going to happen after demutualization. What are all these actuaries going to do? That hasn't been a problem. We've found plenty to do, and the consulting firms are still well staffed with actuaries. We actually have a shortage. Although part of that, from a Canadian context, is to blame on the attraction of the U.S. dollar. We've had a number of our actuarial staff move to greener pastures over the last couple of years. We've certainly faced and continue to face some resourcing challenges. With all of the additional work that's required and additional contexting and so on, we continue to see a high demand for actuarial staff.

I'm going to be speaking from the context of my company, Clarica, which has fairly recently gone public. We finished our demutualization process in July 1999. So it has been a public company for about a year, following a couple of years of anticipation and preparation and perspiration too. I'm going to talk about a number of the changes we've faced and are working through, including cultural changes, financial changes, and business impacts. What do these mean for actuaries?

I'd like to give you a bit of a background on Clarica, a company you may not be familiar with. We were formally called the Mutual Life Assurance Company of Canada. We were a primarily Canadian, 130-year-old company. About 85% of our income comes from Canadian business and the remainder comes from U.S. business, life business, and a reinsurance business. We have about $40 billion of assets under administration, and that's in Canadian dollars, so it really doesn't go very far down in the U.S., but that gives you a little bit of background about our company. We had a very ingrained mutual culture. One of the differences between ourselves and the other Canadian companies that have demutualized is that we were always a mutual company throughout our 130-year history, whereas Sun Life and the other two majors that demutualized, ManuLife and Canada Life, were originally public companies that mutualized about 40 years ago. This was mainly done to avoid foreign takeover. They have since converted back. So we probably have the most ingrained mutual culture of any of the four Canadian companies.

When I'm asked personally about the impact of demutualization on actuarial careers, what I always say is that the biggest difference is just the amount of additional external interest and scrutiny. There's a huge amount of additional rigor and additional information that's required. There is a whole new dimension to financial reporting. As a mutual company, we certainly took our obligations to our policyholders seriously. They were viewed as our owners. We recognized the need for strong financial performance, and to some extent, the provision of information externally. The new focus on shareholder value and the creation of shareholder value is continually reinforced by a constant barrage of questions from analysts and investors. Again, there is the need to provide full information and explanations externally on a quarterly basis.

These new audiences demand and deserve disclosure that enables an understanding of the company's results and value. This has led to a demand for an understanding of the margins in our actuarial valuations. In Canada we refer to these as provisions for adverse deviation (PFADs). In general, the actuarial profession's reaction when disclosure of valuation margins comes up is to say that these margins can't be interpreted in a meaningful way without a huge amount of additional data and information. That's true, to some extent. However, rather than resisting useful disclosure, we have to find ways to disclose it and make it relevant.

A concept that is used in England and other parts of Europe, South Africa, and

Australia, is embedded value. It's a relatively new concept, particularly as a reporting basis in the North American context. Certainly, in Canada, a number of analysts have seized embedded value as a calculation that is going to provide them with meaningful information about a company's value. In fact, what is a little scary in Canada is how we've had a number of analysts do their own calculations of our embedded value, as well as the other companies' embedded values. They have published these values. They're basing these values on extremely sketchy information. They're sort of extrapolating about three times over to come up with their projections of our embedded value. The companies are, in a sense, scrambling to keep up. Most of us are in the process of calculating embedded value, but a larger question is putting a sufficient process around that which will make the information accurate and reliable when it's published, as well as being able to analyze changes in embedded value from period to period, which is really the key information that helps interpret embedded values. So we're all playing catch-up to some extent, and also trying to put in place common practice and standards in the Canadian environment to ensure consistency across companies. A subcommittee of the Canadian Institute of Actuaries is working on a paper around embedded value calculations to help standardize these calculations. Over the next year or so, I expect most of the Canadian companies will be disclosing embedded value and comparing the numbers that the analysts have already put out there.

We're also looking at a number of other issues, such as things we haven't disclosed before, such as a return on equity or return on capital by line of business. The issue isn't so much whether we have this information available, but before we disclose information, we want to make sure we have good solid processes around them, so that when they're disclosed, they're consistent from period to period and we can explain them accurately. On top of that, we have to have a management that is used to working with these measures and who understand the drivers of whether it's profit or whether it's change in embedded value. Is it return on equity? We need to have a management that's comfortable with what influences these measures before we disclose them. That's one of the concerns I have around something like embedded value, which is building up a momentum of its own. We haven't used it particularly. We've used aspects of it in managing the business internally, but we haven't used it as an internal measure, let alone disclose it externally.

When you become a public company, the world suddenly revolves around quarterly earnings. Actuarial methods have generally been developed with much more of a long-term focus and an appropriate focus on solvency. As a consequence, quarterly earnings might not be particularly meaningful, and might have significant fluctuations. Smooth income emergence is something that everyone looks for and blips in that pattern, particularly negative ones, aren't obviously desirable. Actuarial methods and accounting standards for the life industry typically haven't been developed with the objective of smooth or even particularly meaningful earnings in mind. We have to resist the temptation to use this as an excuse to avoid disclosing; instead, we must look for meaningful ways to provide information externally, which is useful. We also must continue to look at opportunities for improvements in methodology or other measures, and perhaps something like embedded value falls into this category. It will provide meaningful information about company value.

The emphasis on smooth earnings can also lead to the practice of offsetting negative changes (particularly those resulting from assumption changes and so on) with positive ones. This can be done quite legitimately at times, but it might add to the impression that earnings can be managed and, consequently, are discounted in terms of their meaningfulness to the outside world. So we need to reinforce the fact that earnings do have a certain amount of rigor to them. They're not just arbitrary based on the whim of the actuary at the time.

We also have to release earnings and earnings information in a timely way. In the past, companies might have felt that, given the long-term nature of the business, there was no particular urgency to put out earnings information. The market obviously won't appreciate this tardiness or understand that problems in producing timely earnings are more difficult than they are for other industries. I'm sure there will be increased pressure to shorten quarter end cycles. On top of that, we have to also provide, along with just the pure earnings number, useful and reliable supporting information.

In some cases there's increased disclosure required for regulators. I'm not going to go into the structure from a Canadian point of view. I'm happy to answer any questions about how we've structured our participating account and closed block and how we worked with regulators to improve that, but I'm not going to talk about it in any detail.

In Canada, the operation of the closed block must be reported annually to the regulators. At this time, there isn't a lot of form around that because all four of the large mutuals demutualized at the same time. We've led the development of the reporting on the participation information and taken that to the regulators to facilitate that process and ensure consistency among the companies. Obviously, actuaries must be accountable to ensure that the participating policyholders continue to be treated fairly. We have to certify that on an annual basis.

Regulators are certainly well aware of the increased pressure for earnings that exist in a public company environment. They might have concerns about how companies are responding to that pressure, particularly if it involves taking on more risk. One of the specific issues we faced in Canada was whether or not to list both on the Canadian and American exchanges. Listing on the New York exchange necessitates producing U.S. GAAP financial results, as well as the Canadian GAAP results that we would normally produce. These two bases are quite different, and therefore the drivers of profitability on the two aren't necessarily the same. This can create tension in managing these two sets of income statements. In addition to that, conversion to, or at least the calculation of U.S. GAAP results in an extremely costly and time-consuming exercise. Because virtually all of our participating policyholders are Canadian, we had the option to not do a U.S. GAAP conversion. We've chosen not to do it, largely because of the work involved, as well as this potential conflict between managing two different sets of income statements. However, Sun Life and Manual Life have both converted to U.S. GAAP, and Canada Life is in the process.

The additional external scrutiny and the need to provide information to and develop relationships with analysts and key investors has, of course, increased the role of investor relations in the company. It has become a primary function. We really didn't have investor relations per se in the past. The demutualizing companies have some particular challenges in this regard, given the very diverse nature of the shareholder basis. When we demutualized, we had about 900,000 policyholders that were eligible to receive shares in our demutualization. Because of both the way we structured our share allocation and the options we gave to policyholders, we were able to reduce that number by 50%, and since then, we have continued to whittle it away. However, we still have about 400,000 shareholders, which is one of the largest shareholder bases in the Canadian market. The other demutualized life companies would be up there in terms of the number of shareholders as well. The resulting base of shareholders ranges from very sophisticated institutional investors to sophisticated retail shareholders to quite unsophisticated retail shareholders, all of whom acquired their shares as a result of being our policyholders. We have an accountability to provide information on an equal basis, or to make it equally available to all. It's obvious that the same type of information won't be equally useful to all shareholders.

In Canada, in particular, the life industry is relatively new in terms of following from the investment community. Prior to the demutualizations of the four large mutuals, there was only one that had a public following, and it was closely held effectively and received very little attention. As a result we've been trying to educate analysts in the Canadian life industry on what affects profitability and how profitability works. We did a conference about a month-and-a-half ago for analysts to try to explain life insurance accounting. What factors affect pricing and valuation and so on in a Canadian context. That was very well received. There's obviously a big appetite for this type of information out there. Some of the companies have faced issues around the geographic mix of shareholders as well. We haven't had that issue because, as I said, most of our policyholder base was Canadian.

All of this has had, both internally and externally, a significant impact on the actuarial profession. There is a need to open the "actuarial black box" to provide better explanations. I think it starts internally and externally. My experience shows that there's a willingness to listen to the explanations we have to give both within the company and externally. But we have to make them meaningful. This provides a great opportunity for the actuarial profession to find ways to explain things like earnings or how liabilities work, or other factors. We have an opportunity that we have to take hold of to give explanations. If we don't, people will find ways of coming up with their own estimates of value and their own ways of explaining it. We have to find ways of talking about fluctuations and earnings and explaining them in a meaningful way rather than giving a technical explanation. We have to come at it from the point of view of the business drivers. That applies whether it's part of normal experience fluctuations or whether it's assumptions or other changes.

Another thing that I think the actuarial profession needs to do is to have an equal balance between a focus on solvency and a focus on emergence of earnings. I think the tendency has been for the actuarial profession to focus on the long-term and on solvency, and let earnings emerge. John referred to that earlier. The earnings aren't an item in the equation anymore. We need to drive towards earnings rather than let them fall out.

One of the prime motivations for demutualization is to have better access to capital markets and do more active capital management. We've taken a much more proactive approach to managing capital. Instead of effectively letting capital build up as a mutual company within reasonable limits, now try to manage our capital within a target range. We use a basis in Canada called minimum continuing capital and surplus requirements (MCCSR), which is a regulatory basis for capital and, as I said, we used to have a ratio that drifted up over time unless we made an acquisition or something. Now we've targeted a range of 175–200% that we want to stay within. That will give us sufficient comfort from a regulatory and rating agency perspective. We have more tools to be able to do that, but that will also mean operating within a range that has somewhat more risk associated with it. The more efficient capital structures using other forms of capital, whether it's preferred shares or debt, also means more leverage. Again, there is a little bit of an increase in risk. The area of risk is one that I see as being a natural for the actuarial profession to be involved in. These greater pressures on performance and higher targets necessitate higher risk in order to get the benefit in the form of earnings. We need to take on more risk. We also have, as I said, lower capital ratios and more leverage. This all leads to better risk measures and the requirement for more risk analysis. Again, I think it's a natural area for actuaries to get involved in. We need to understand the risk/return relationships and then work toward optimizing the risk/return relationship. We must also develop ways to measure, monitor, and manage risk on an ongoing basis.

I won't say much about management behavior. I'm running a little short on time. The cultural changes are quite significant and do take time to work through. There's a greater degree of accountability, which I think is a very good thing. There is a focus on performance and growth that can also be good, but again needs to have discipline around it, which the actuarial profession can bring. You have to be careful that you don't develop too much of a short-term view and, if you're sitting there watching the stock price every few minutes, it can get a little bit scary. You should not react to every change.

I think Mike is going to cover the policyholder's impact and products and so on, so I won't say anything about that at this point. There is just one last note on strategies of companies. In Canada, we've seen a fair bit of consolidation in the Canadian industry over the last number of years, but I think this is going to increase. John mentioned that merger and acquisition work is increasing. I think that's equally true in Canada. Because companies have greater access to capital markets, and due to the pressure on performance and other competitive pressures, I'm sure there will be more consolidation, both in Canada and the U.S. I also think there will be different types of business ventures that will effectively lead to companies that look somewhat different from the way they do now. There'll be more outsourcing, more joint ventures, and a greater range of options in looking for ways to operate efficiently and effectively.

Mr. Michael P. Harwood: I'm pleased to be able to speak to you on what has become my favorite subject over the last few years, demutualization. As John said, I was the actuary at MetLife, responsible for the actuarial phases of the demutualization, which included setting up the closed block and actually computing the equity share to distribute value to each of our policyholders. MetLife became a public company on April 5, 2000. The initial public offering price (IPO) was $14.25. We are currently trading in the $19–20 range, which puts a market value on the company of about $15 billion. As I said, we distributed 100% of the value of the company to our policyholders. In the process of distributing value, we distributed shares based on the contribution each policyholder made to the surplus of the company. We valued some 14 million policies and distributed value to 11.2 million unique policyholders, because some policyholders had more than one policy. With that as background, I didn't want to talk a lot about the process of going through the demutualization. I wanted to spend some time on the types of jobs that will come out of demutualization.

I'm going to be talking about new jobs related to closed-block management and changes in existing jobs related to product pricing. I also want to touch upon some cultural changes, as specifically noticed at MetLife.

How many in the audience work on closed block issues in their companies? We have a few people who are already familiar with closed block. How many people are here just to learn more about the demutualization process and closed blocks in general? So we have some of both.

Let me say that a closed block is basically a segmentation of assets that the regulators require as part of the demutualization process. Those assets back certain liabilities. The liabilities are individual participating life insurance policies with currently payable dividend scales. At MetLife, it was our whole life and endowment block of business, which we put aside into a closed block. That amounted to some 10 million policies with liabilities totaling about $37 billion. The idea is that you fund the closed block with assets so that those assets, investment income on those assets, plus premiums on those policies, are enough to run off that block of business over time, given the current dividend scale and assuming current assumptions going forward. That's basically the concept of the closed block.

The path by which that closed block runs off is commonly referred to as the glide path. At the end of the day, let's say 100 years from now, the last asset is discharged at the same time as the last liability. For example, you don't want to run out of money 20 years before the liabilities run off, and you don't want to have a huge amount of money left over at the end of the day when the last liability runs off either. So the whole concept of a glide path is to run off those assets smoothly over time.

As John mentioned in his opening remarks, that glide path is commonly required to be reviewed by regulators. I'm going to refer to a few regulations and sections of the insurance code. Since MetLife is a New York State company, it will be a reference to New York State regulations and insurance codes. New York State requires a review of the glide path every five years. So five years from now, we will have to submit a formal statement to New York State as to how we're tracking on that glide path.

When managing that glide path over time, there are lots of other things to consider, such as our plan of reorganization, which was established in accordance with New York State's rules and regulations. There are specific descriptions in the plan regarding how we can pay out dividends over time. Of course, there are Actuarial Standards of Practice (ASOP) for paying out dividends, like ASOP 15. Furthermore, ASOP 24 covers illustration actuary requirements and ASOP 33 covers closed-block requirements. In setting dividends on your closed blocks, there are a lot of different standards that you have to consider.

Outside the closed block, MetLife needed to provide some protections to policyholders as well. New York State specifically requires that protections be provided to all individual participating policies. I mentioned before that we used the closed-block mechanism as a way to protect those policies by currently paying dividend scales, mostly whole life plans and endowments. We have a whole bunch of policies that are individual and participating, without currently payable dividend scales. For instance, there are individual annuities with interest credits, and term plans with indeterminate premiums, rather than dividends. At MetLife, there are approximately one million of these policies in force.

What we needed to do for the State of New York was to describe, for each one of these policy classes, protections that we were going to provide outside the closed block. We described our profit profiles of these projects and promised not to exceed those profit profiles going forward. According to our plan of demutualization, we need to file a report to the state every year as to how we're complying with these profit profiles that we've established for each policy outside the closed block.

In New York State, there is Circular Letter 4 from 1983, that affects the pricing of nonguaranteed or flexible factors, especially in term plans and universal life (UL) plans. So, in managing these promises for business protected outside the closed block, you also have to weigh Circular Letter 4. There are also similar requirements in New Jersey. Other states might have their own requirements, but I think New Jersey and New York are the most extensive.

Some other things to consider in managing closed blocks. MetLife had funded expenses in its closed block at a guaranteed rate. For individual whole life plans, we funded expenses for maintenance costs at a guaranteed rate of $40 per policy. Those of you familiar with closed blocks know that this is not often done. Most other closed blocks did not include expenses at all and just excluded expenses completely from the closed block. That's with the exception of taxes—premium taxes, state and local income taxes, federal income tax (FIT) and things of that nature that are generally included in the closed block.

To the extent that your expenses are in the closed block or outside the closed block, there are some expense management issues. For instance, if your expenses are greater than what you've projected or funded for in the closed block, then you have a management risk for the open block. At MetLife we funded whole life plans at $40 per policy. If our expense rate is higher than that, that's a risk for the open block. Similarly, if we can manage our expenses down below $40 per policy, since that's a guaranteed charge, that would be a source of income for the open block. The same is true of persistency. If we could improve persistency beyond that which we assumed in funding the closed block, that will give us a stream of $40 payments further into the future than we anticipated, and again this can be an open block profit source. The flip side is that if persistency is much worse than what we included, than there might be a net cost to the open block. So, expense management is an important consideration, from both a persistency and expense point of view, in managing closed blocks.

As far as the closed-block investment policy, first let me say that MetLife funded its closed block with about $33 billion of assets. Our approach in setting a closed-block investment policy going forward was a bit unique. In the past, the state of New York would agree to establishing specific investment limits in company's closed blocks. For example, more than a certain percentage of the closed block cannot be invested in common stock equities. Or, no more than a certain other percentage could be invested in real estate. The state of New York did not spend a lot of time discussing with MetLife strict proportions of investments for the closed block. There are no extensive limits in our investment plan. New York State spent a lot of time making sure that the management of the closed-block assets perspective was appropriate. New York State wanted to avoid two opposite risks in the closed block. The company puts too much equity or real estate or similar assets in the closed block, but it also puts too little. On the conservative end, if you just fund your closed block with Treasuries, you don't necessarily produce a great benefit to the participating policyholders in the closed block. New York stressed with us, as is described in our Plan of Reorganization, "appropriate management" of the assets going forward.

One point that was very important to New York State, that we will need to certify for them on an annual basis, is that the closed block has fair access to investments available to the company. We cannot just place the prime assets, in our case, into other businesses, like pensions or other lines of business that are not in the closed block. We need to certify that the closed block does indeed have fair access to the investments. Furthermore, there could be no affiliated assets in our closed block. That includes everything from the bonds we own of affiliated companies to real estate. If we have one office in a huge office building that we own, that building is disqualified from being included in the closed block.

As I said, with the agreement of New York State, we established guidelines for the appropriate management of the investments in the closed block and those guidelines require us to report to New York State each year. We are also required to report internally to our own board of directors each year on the investment management activities of the closed block. So there are two reporting requirements: one is to our board and the other is to New York State. As part of the process, we developed a new position—a closed-block actuary who is the person designated, along with an investment professional, to report on these activities to the board of directors.

There were some other portfolio considerations. To form our closed block, we took assets amounting to about 85% of the policy reserves and we sectioned them off. So what happens with the other 15% of assets? We need to put those in a different portfolio. These are the "residual assets" so to speak. What happens for new business going forward if we want to continue selling participating whole life plans? Going forward, they won't be included in the closed block, so there again we may wish to set up an additional portfolio. What about closed-block business with certain ancillary benefits that were left out of the closed block? In MetLife's closed block, for example, extended term insurance and dividends with interest on policies in the closed block were thought to be more nonparticipatory in nature and were left out of the closed block. How do we segment the assets backing those liabilities in our portfolio? There are a number of big considerations in redesigning your general account portfolios around the closed block, and that necessitates, of course, for those of you familiar with it, a filing in New York State under Regulation 33.

Let's now move from closed-block issues into new business pricing issues. Prior to my assignment on MetLife's demutualization, I was the individual life pricing actuary. I can say from my experience that when we priced a product in the past, we looked at statutory internal rates of return (IRRs) or the present value of future profit. Now, as a stock company, we will probably still look at those measures, but must take other things into consideration as well. As Doug mentioned, the concept of embedded value is being used more today. Some companies are considering GAAP returns on investment (ROIs) based on a value at risk capital basis (VaRC), which is a concept borrowed from the banking industry.

In pricing a product, you have to be very worried about capital. How much capital does that product consume, and over what period of time will you get your return on the capital? It's no longer acceptable for mutual companies to take most of their profits on whole life plans after year 15. That's why we've got to move some earnings up into the early years. As Doug said before, companies need to reinforce those smooth and steadily growing earnings early on, rather than into the future. Investors, we've noticed, will pay for current earnings much more than they will pay for earnings 15–20 years into the future.

As far as the need to sell participating plans in a stock company, there are a couple of things to consider. Stock companies are allowed to sell participating plans. There were a couple of groups to consider. One was the policyholders. What are their expectations? A lot of policyholders, for example, bought term plans with the intent of converting those term plans into whole life plans going forward. Perhaps you want to have a participating whole life plan just to satisfy that contingent. At MetLife, there's no formal contractual requirement that we actually provide participating whole life plans to policyholders that convert from term plans. Perhaps your companies write into the term contracts, "You have the right to convert into a participating whole life policy." The contract language is an important driver for this point as well.

Agent expectation is also an important point, to the extent that you have long-term agents at your companies. I know that at MetLife we have agents that have been selling participating business for 20-30 years, which is the bulk of their careers. They're familiar with the product, they're familiar with the selling technique, and they've built a client base who are familiar with whole life. There's some "inertia" here, so to speak, where the agents still prefer a whole life type dividend-paying participating policy, even going forward as a stock company.

In New York State, you are allowed to issue participating policies out of a stock company. A section of the insurance law, Section 4231, dictates how those policies will be treated as far as profits. In a nutshell, Section 4231 is a pretty convoluted piece of insurance code, designed and implemented in the first half of the 1900s. In issuing participating policies out of a stock company you must give back 90% of the profit to the participating policyholders. There are other details in Section 4231. You do the accounting through schedule NP reporting. In summary, if you decide to issue participating plans going forward as a stock company you must consider how exactly you're going to be accounting for the participating policies' profits. How exactly will they be paid back to the participating policyholders?

As far as selling new business, let's say you came out with a new product, outside of the closed block, and needed to establish a new portfolio for that product. There are illustration actuary considerations. How do you illustrate that product? What interest rate do you use? Our thinking is that you should seed the new portfolio with assets yielding a certain level, to give it a start, and maybe tie in the interest crediting assumption on the new plan with old products in the closed block. The seeding process, as well as the tying-in process, should enable us to be comfortable with our illustration actuary requirements in projecting dividends on that new business going forward. Those of you in the audience that price new products from scratch are probably familiar with the techniques used to illustrate new products.

Now, I would like to wrap up with some actuarial work environment issues, specifically from a MetLife point of view. I will say the demutualization effort at MetLife has really focused the company, and it was a good segue from a mutual to a stock company as far as promoting cultural change. As Jim Benson the keynote speaker at this meeting said, and it's very true at MetLife, things have changed; things are much more result-oriented and much less theoretical or research-oriented. You don't get an "A" for effort, you get an "A" for results. In fact, in our own incentive compensation programs at MetLife, lines of business have profit goals built right into the variable compensation plans. The variable plans, by the way, are a much bigger percentage of pay now than they were five or ten years ago. A larger percentage of my total compensation now, for example, is variable compensation as opposed to salary. Our chairman, in fact, says that we might consider all of our compensation to be variable—that the base salary should just be considered a draw against total compensation for the year. It's very much a different mindset. The "go-to" people are much more recognized now than they have been in the past. I remember five or ten years ago having a staff of actuarial students and going through the rating process by distinguishing those that were superstars from those that were average or below average. The "average" guys would get your average budgeted merit increases of 3%. Then you considered the superstars—you really wanted to reward them with a big increase. These were the go-to people. You gave them 5%, which was a lot higher than 3%. Can anybody relate to that at all?

At MetLife, this is changing. There is meaningful differentiation between the top performers and the medium performers. At MetLife, we strive to exceed market averages for our best people. It has been a transitional program that has been implemented over a number of years and we're actually doing it. Maybe you folks have similar experiences.

As far as working in a stock company, as Doug alluded to before, the treatment of "information" is a little different. Things are being circulated now on a need-to-know basis. We have to distinguish between material information and nonmaterial information, between timely information and not so timely information. We have to be very careful about who we discuss things with—family members, peers, friends, etc.—because these things could have implications on our stock price as far as insider trading or tipping. That has been a new consideration that we haven't been used to.

The team focus has been very much stressed at MetLife. Again, it was a great experience going through the demutualization process in which we developed this focus. The layers of management are being broken down slowly. There are more horizontal teams being formed throughout the company. These teams change constantly, depending on the projects those teams are working on. Again, there's much more of a team focus. I would like to reiterate what Jim Benson was saying during his keynote address. We did not rehearse in advance, but it was good that he agreed with the things I am saying. Project management and communication skills going forward are the things that are going to differentiate the top performing actuaries from the other actuaries. I would stress communication skills and management skills going forward as something that everybody needs to develop.

Mr. Robert P. Vrolyk: While planning for this session, we recognized that we had somebody from Canada, Doug Brooks, who would speak to the technical items on the

Canadian company perspective, and then we had Mike Harwood who would talk to us about the U.S. perspective. So I was stuck as far as what I would talk about? I decided I would take a slightly different tack on this thing. First, I made the assumption that most of you would probably not be too familiar with Sun Life of Canada, or Sun Life Financial, as it's called now. So what I propose to do is take a few minutes and talk to you about who we are and what we're trying to do. I'll also talk a little bit about our demutualization. What I want to do is turn to what I would call the softer things happening to actuaries and what I see as our required response. I'm not an expert in this subject. Some of the messages that I'm about to deliver have already been delivered by the previous presenters, and by the keynote speaker, Jim Benson. In his last few minutes up on the podium, he talked about the future role of actuaries over the next ten years. If my notes were right, he divvied it up into three categories. One role would be the traditional role, which is continuing to do product developing and financial reporting. Second is the role of actuaries as analyzers, and the ability to think about reserves and capital adequacy, which is a rather unique skill for actuaries. In the third role, actuaries are leaders in which they share knowledge, assimilate groups, execute, and communicate. That will be the main emphasis of my talk. I want to emphasize that I don't know whether it's because of demutualization or whether it's just a general trend in the industry. I do know that some of this softer stuff needs to be dealt with now at Sun Life.

First, I'll give a very short introduction to Sun Life. Sun Life introduced its intention to demutualize on January 27, 1998. I guess we can say it culminated its demutualization with an IPO on March 23, 2000. As was mentioned earlier by Doug, we're actually returning to our roots. We were a stock company from the early 1870s right through to the early 1960s when the company mutualized in order to avoid what could have been a potentially hostile takeover by a U.S. investor group. Why demutualize now? Again, it has already been well documented. First there is acquisition currency—we have some very key ideas about how to grow through acquisitions. Of course, there should be direct access to the capital markets.

Who is Sun Life? We want to be a world class provider of financial services through individuals. A great argument can exist over who the customer is. Is it the agent, the intermediary, or the end consumer? Our focus is turning increasingly to the end consumer. Our core value is: to operate with integrity, always working with the customer's perspective in mind, relentlessly pursuing excellence. I offer you all these because when I get to the softer side of things, what's happening is a direct influence on what we perceive is our ability to execute with these values.

We're an international financial services company. We have operated historically wherever the British Empire was, and as the British Empire collapsed, so did our presence, although, over the last five years, we have seen our presence return to where we were before. We're very pleased to see that our name has not been forgotten. As we demutualized, we had very material presence in five territories: Canada, the U.S., the U.K., Hong Kong, and the Philippines. As a consequence, we had to develop a plan that found that singular path through five different regulatory environments. Finding that path caused us quite a bit of grief and pain.

We have been in the United States since 1895. We established our U.S. presence in Boston on Route 128 in the early 1970s, and we have about 55–60 actuarial professionals in the Wellesley Hills complex. We have about another 100 or so actuarial professionals scattered throughout the rest of the major offices internationally. As we demutualized, we exited the individual disability income business. We also exited the community banking business. We sold subsidiaries that we had bought earlier. One of the things you go through in a demutualization exercise is focus, focus, focus. The hard question from equity analysts is, "Why are you in this business?"

As we worked our way through demutualization, we ended up subsidiarizing the U.K. business, the Hong Kong business, and the Philippine business. So corporate restructuring was very much a key development.

We believe we have a very well-diversified stream of earnings. We reported $717 million of *pro forma* income in 1999, having taken a few licks over the past few years with vanishing premium or premium offsets as well as from pension misselling issues in the U.K. We have reorganized our businesses into two primary segments: (1) the wealth management business, which constitutes about 53% of our business, and (2) the protection business. Those are the two major segments that we now report on.

In terms of our offering summaries, as I mentioned, we went public or had our IPO on March 23, 2000. Building up to that, our road show involved visiting 268 institutional accounts in 37 cities in 9 different countries over a span of 3.5 weeks. Clearly, that's quite a task. Much of the material was actually compiled. We raised money on two currencies—the Canadian dollar and the U.S. dollar. We listed on four exchanges; Toronto, New York, London, and the Philippines. Our offering size was just under 144 million shares out of a total of 400 million shares. We came out at $8.5 U.S. per share. We raised $1.2 billion. Our offering was actually more than two times oversubscribed, and we were very fortunate in that the stock went up on the first day by over 12%. It's now trading in the range of $15.75, and our market cap is in the $6.5 billion range.

As we prepared to demutualize, as has already been said by the previous presenters, there were very specific tasks that were given to the actuarial community. The most important task was the determination of "policyholder reasonable expectations", a fancy way of asking, "so what are those assets that you truly need to have in the closed block?" We also did a U.S. GAAP conversion in 15 months—a record-setting accomplishment. We were a bit lucky in that a lot of the work that goes into doing Canadian GAAP reporting provides a good basis for doing U.S. GAAP conversion. Nonetheless, I think it was still an heroic effort.

We don't issue full U.S. GAAP statements. Being a Canadian company, all we need to report or disclose is a worldwide reconciliation of Canadian GAAP to U.S. GAAP. However, we do operate in the United States with some wholly-owned subsidiaries that do sell registered products. For those subsidiaries, we will be issuing full U.S. GAAP financials. Although we don't issue worldwide U.S. GAAP financials, we have to do all the work to generate those statements anyway.

Along the way, we also revised our internal financial management methodology. The revision reflects the restructuring of the capital into debt and equity proportions. It's actually a relaxation of our previous pricing methodology. We previously had no other basis but to assume everything was equity. In turn, we introduced, for about the fifth time during the 1990s, revised pricing standards. There's certainly a lot more discipline and required sign-offs. There is also a lot more focus on embedded options (which I will speak to in a few moments).

As a mutual company, actuaries had a very prominent position in the company. In fact, there was a long era during which the chairman and the president were actuaries. That certainly has changed over the last couple of years. The office of the president is now filled from the investment division. The chairman is still an actuary, although he confesses quite openly that he hasn't been an actuary for many years. The rise of prominence of the corporate finance function is clearly evident within our company. As has already been mentioned, the need to do public reporting, the need for a faster close, the need for stable, predictable, and explainable earnings, and the whole need for capital management are subjects that simply demand focus. I was the CFO and chief actuary for the U.S. operations from 1990 through 1999. The last couple years have been absolutely crazy. As we demutualized, I was involved in the decision to split this function up. As hard as it was to give up the finance role, as I look back, it is now clear to me that the joint responsibilities were just too much. I'm very grateful that the current CFO and I talk regularly; ultimately, you have to have good connections between the capital structure, reported earnings, plans for reserving, and plans for pricing. But I can tell you firsthand, I can't do the two jobs anymore. It's too much to do.

So with the rise of both the prominence of investor relations and the corporate finance functions, there has been a refocus role of the actuarial function. I have been pursuing the idea that the actuaries within our U.S. operations should be "fast financial engineers." In order to support the objective of having stable, predictable, and explainable income, we need to provide stable, predictable, and explainable changes in reserves. Much of the focus is being put on adding controls to the whole valuation process, as well as connectivity between pricing and what's actually coming out in earnings. We need to focus on producing innovative products and getting them out into the marketplace very quickly. Historically, we had long incubation periods prior to our demutualization.

Finally, we are experiencing the emergence of risk management. Again, it's not unique to us. I see it everywhere. What has been happening is that more and more products are being developed that have embedded options. For example, we happen to have a very large variable annuity franchise, and we have been selling guaranteed death benefits since the early 1990s. I had a gut feeling that the pricing seemed a little light. As we go through the whole exercise of looking at it on a stochastic basis, we are surprised by what the potential costs of these benefits could be. Another example would be secondary guarantees on UL products—do we truly understand what those options are? I don't even understand how to price secondary guarantees on variable life products, yet I already see these in the marketplace. Of course, if you're going to play, you not only have to be able to compete, but you must be able to react quickly. We are going to have to focus on these designs.

I would argue that the key factor for success for actuaries is their ability to move away from their traditional actuarial skills. I'll speak to that more in a minute. I think Jim Benson talked about that. There is an increased demand for stochastic analysis as things are becoming more volatile and sophisticated and as we see more embedded options.

All of this demands more effective management of relationships and communications. There was a recent issue of the *Actuarial Update* on the Internet that included the results of a survey of 14 CEOs. Admittedly, most of them were property and casualty company CEOs. The issues raised within that article were: actuaries have egos; actuaries need to get past their egos; actuaries are analysts and they should spend a little more time putting themselves in the other person's shoes; and actuaries need to listen more.

A fundamental issue is simplicity. Actuaries in my company (I certainly don't want to be disrespectful to any other company), have had a tendency of making things awfully complex in their desire to make sure that management understands all the nuances that are involved in whatever the issue is. The explanation ends up being far too complex. Things should be made as simple as possible, but not any simpler. A metaphor I've told the actuaries in our operations is that actuaries should think of themselves as doctors. If we were to go to a doctor seeking a diagnosis, and the doctor said, "Well, I'm not quite sure what you have. It could be any one of five different diseases.," I don't think you'd leave the office feeling very good. When you go to the doctor, you want a specific answer. You want to know what's wrong and what you can do about it. That's exactly what actuaries need to do.

We need to learn to communicate in soundbites. We need to have easy ways of leaving messages that can be remembered by the other party. We need to recognize that some form of repetition is necessary. We also need to take much more time to prepare our presentations. I am sure you can relate to "Boy, just another half hour and I can get this run in," or "I would have a little better analysis if I just take some more time." The consequence is, of course, that you don't spend enough time working on the delivery of your message. Spend more time. I've seen my investment or marketing colleagues take a lot of time to prepare, and their presentations go smoothly, and their presentations get remembered. We should be doing likewise. Moreover, we need to take multiple approaches to explaining the same thing. We need to ask more often, "Do you understand what I'm saying? Do you get it?" We also need to be comfortable with admitting that perhaps we haven't taken something into account or that we simply don't have the answer. That has always been a difficult one for me.

In order to segue to the response to these observations that I'm initiating and trying to implement in our operations, I need you to have somewhat of an appreciation of what our core corporate values are. The order isn't important, but the first value is "deliver excellence." By this we mean that we want to exceed customer expectations; we want to demand the very best from ourselves; and we want to celebrate our successes and learn from our mistakes. The second value is, "make a difference." This is my favorite. We want to encourage creativity, risk-taking, and innovation; we want to deliver value to our customers each and every day; and we want to lead by example.

"Anticipate the future" is our third value. We welcome and adapt to change. We want to create opportunities; and we want to shape our destinies. Fourth is "Be Open." We want to communicate fully and honestly, and we want to encourage and value differences, differences of opinion, differences of perspective; and we want to share what we know. Our last core value is "Acting with Integrity" and we mean that we want to uphold the very highest standards of business conduct (the very highest standard of professionalism for the actuaries); we want to own our actions; and we believe that the right way is the only way. I'm not suggesting that these values apply universally to all companies; I simply want you to understand that these values are for Sun Life, particularly, Sun Life in the United States.

So with this background, how do you think actuaries were perceived? I'm part of the senior management team of the U.S. operations, and I went around and talked to my colleagues. Here's some of the feedback I received (I wonder if you can relate): actuaries are too bureaucratic; actuaries are too far removed from the business and/or business issues; actuaries are too oriented toward pointing out problems, rather than helping to solve them; actuaries are perceived to be too prone to making things too complex; actuaries are not the greatest communicators; and actuaries are perceived as walking into a business meeting, saying, "I've done my analysis. Here are my results. Don't do this at home. I am a professional" and walking away. Our challenge is to overcome these perceptions.

To complicate things, we operate in an environment where there's a war for talent; finding good actuaries is increasingly difficult. Part of that is due to the introduction of the new examination structure over the last 6–12 months. In a few instances, a student becomes an ASA, and it seems like very soon after he or she is an FSA. There is not enough time to gain valuable experience. If your compensation schedule is not competitive, consulting firms will be quick to grab your students up, because there's a great deal of work out there. We're seeing some actuaries move away from the actuarial profession. It is a lot of hard work and a lot of studying. Even though you get good pay, programmers are getting paid awfully well these days too. Investment-oriented careers are also looking real good. Of course, there is industry consolidation. My view on this is a little bit different than Jim Benson's view, but I'll be quick to adopt Mr. Benson's view that industry consolidation will not see a reduction in the need for actuaries, if indeed I can see some evidence that he is right.

In response to this (again, I'm not saying it's because of demutualization, although demutualization just happened at a time when there was a convergence of a whole bunch of events), I introduced what's known as a competency model. I want to break down performance into two dimensions: (1) what you do (you don't get an A for effort, you get an A for results), and (2) how you do it. I believe that competencies can give you some shared understanding of what it takes to achieve satisfied customers and satisfied management; what defines success; and what will be monitored and measured. Although pay for performance will still be based very much on results (if you want to get a good salary increase, deliver results), how you do something will win the engagement. If you are perceived to be difficult to work with, chances are you won't be called upon again. However, if you not only deliver but also go out of your way and make the customer (and management) feel good, they'll call upon you more and more, and actuaries need to be called upon more and more.

I'll talk a little bit about behaviors. Behaviors are values that almost reflect the way we were raised; they're attributes that you can't be trained to have. They're in you. They're observable. On the other hand, results are what you leave behind; behaviors are what happened during the exercise. If you're not there to see the behaviors in action, there's nothing to measure.

We're big on this. We're pushing it hard. I believe that competencies will differentiate the best from the rest. Once again, a competency is any characteristic of an individual that predicts outstanding performance.

It goes without saying that traditional actuaries, new actuaries, and even best practice actuaries, all need to have strategic actuarial skills and knowledge—you simply can't get in the door without it.

However, let's compare the different breeds of actuaries. How about values and image? On the one hand, traditional actuaries say, "I can get things done myself." On the other hand, the new actuary, as Jim Benson alluded to, would be a change agent. Someone who can make things happen through others. What about traits? Traditional actuaries have a tendency of using very typical actuarial vocabulary. The newer actuaries would use clearer communications, simplified language, and simplified ideas. With respect to motives, the traditional actuary is more task-oriented; the newer, best practice actuaries listen to others' input to facilitate a joint solution. Traditional actuaries focus on personal accomplishments; newer actuaries have power and influence.

We've developed an actuarial competency model, broken down into three clusters. Each of the competencies has four or five levels of intensity or completeness or complexity of expression. Someone who is performing at a higher level is assumed to have mastered the lower levels as well.

The first cluster is being "Personally Effective." There are five competencies. The first one is "thinks conceptually." I think that's pretty self-explanatory and includes being able to teach others. I'm very keen on having actuaries pursue a teaching organization. The second cluster is, "analyzes business results," which is the ability to decompose complex problems into smaller problems, including risk-based decision/making. Third is, "thinks ahead, acts now." What we're trying to capture here is the need to act proactively to avoid future downfalls or, better yet, to anticipate future opportunities. Fourth is, "demonstrates confidence." An actuary can act independently and take more risks. What we are saying is that actuaries need to overcome the aloneness of being the smartest person in the room. Actuaries should be comfortable taking responsibility for both success and failure. They should not be intellectually arrogant and should demonstrate an eye towards self-control and self-awareness. Finally, there is "flexibility" which is the ability to understand and appreciate different perspectives and opposing opinions. Then one can adapt one's own approach to the requirements of getting a consensus solution.

The second cluster is "influencing for results." There are three competencies here. First is, "leveraging a positive image for results."—There is the ability to manage what others perceive. Remember, you might have the best of intentions, but if your impact on others is not so great, you're not doing yourself any favors. Recognize the difference between intention and impact and be self-aware. The key question here is, did you win the battle but lose the war? The second competency is "impacts others. " This is the ability to persuade, convince and build support for ideas and options. The third competency is "group cooperation," which is the ability to work cooperatively with others.

The last two competencies are in the last cluster, which is "setting standards." We believe very strongly in the need for "acting in the best interest of the company;"

hence, there is the willingness and ability to not only align yourself but also to get others to align themselves with organizational objectives and work with a sense of urgency. The last competency is, "takes ownership,"—which means someone demonstrates personal accountability and inspires others to take personal accountability for the success of the overall business result, not just pushing his or her own agenda.

What has changed as a result of demutualization? It's just different! It's not better or worse; it's just different. Actuaries are not being singled out by any means. Change in our company is incumbent upon all professions. In the past, actuaries were led by their knowledge and their strength in financial analysis. Today, the company is looking for different leadership skills and/or behaviors that we, as a profession, might or might not have. But if we're going to succeed, we're going to have to acquire them.

Mr. Morris: We now have some time for questions and answers. I'd like to start out by asking Mike a question. Is a closed block actuary an official position at MetLife, and is it something that's comparable to an illustration actuary and an appointed actuary?

Mr. Harwood: The term *closed block actuary* does not appear in any law or regulation, but in determining our guidelines, which we need to submit and have approved by New York State, that term came up. It's specifically with reference to the investments in the closed block. It does not have to do with the glide path or other management phases of the closed block. It's specifically with reference to the investment activities of the closed block. So we will need to appoint a closed block actuary, which is a board-appointed position, as required by the rules established with New York. That person, with an investment professional, will describe the investment activities of the closed block each year. It wasn't just an investment professional. The state felt strongly that it's the actuary that really needs to give an opinion as to whether the assets that were required for the closed block were indeed appropriate for the closed block. That goes beyond just investment knowledge. It has to do with the actuarial knowledge of the management of the business.

Mr. Morris: Doug, do actuaries get directly involved in dealing with analysts in question and answer sessions? Can you give us an idea on how that's working?

Mr. Brooks: When analysts come in to visit the company, we usually have actuaries from the corporate area involved in that. I've been involved in a number of meetings with analysts at our quarterly earnings conference call. I'm always there for questions and so on. We did our own conference for analysts about a month-and-a half ago, which we had a couple actuaries, including myself, participating in. We've been trying to ensure that the actuarial perspective is always there and available to the external community.

From the Floor: I heard there about 400,000 shareholders in Clarica, and 11 million in MetLife. I also heard that you were drawing down the shareholders in Clarica. Is there some kind of balance you are trying to work on between the expenses of sending out reporting to the shareholders, and the affiliation aspect of having shareholders who might want to buy your product. How are you handling that balancing act?

Mr. Brooks: I'll give a quick answer from the Clarica perspective and then let Mike explain the MetLife perspective. First, keep the two groups separate after demutualization. We view the shareholder relationship as separate from the policyholder relationship, although you always have to be aware that you are dealing with the former participating policyholders who might also be shareholders. In terms of managing the number down, we're not doing that through incentives, but by providing facilities for selling shares. From an expense point of view, we try to have a reasonable number of shareholders and more active trading of the shares too. We try to have few shares concentrated in small retail shareholders.

Mr. Harwood: In MetLife's case, we were in a very unique situation. MetLife's default was to get stock to its shareholders, versus other companies, such as John Hancock, where the default was cash. At MetLife, you actually had to elect cash versus stock. As a result, most people took the default as being stock. We now have approximately 8 million shareholders, the bulk of the policyholders, which gives us a shareholder base of 3–4 times Lucent Technologies. Lucent used to be the most widely held security in the U.S., with only a couple million shareholders. The investment relations aspects of that are enormous. So it's part of our demutualization to the bulk of our shareholders. We put them into a shareholder trust. The trust manages the day-to-day decisions of the shareholder. Therefore, we avoid the need to send out all the annual statements, annual reports to policyholders, who, for the most part, wouldn't really appreciate them. If they want them, they can get them. They're on an Internet site, and they can write in and get them. The majority of our shareholders are being managed as one group through the trust mechanism, which keeps the investment management expenses to a minimum. That's, again, fully described in our plan of reorganization.

Mr. Paul G. Schott: An area where a desire for higher earnings and a desire for regular, predictable earnings are at odds with each other, is in setting a reinsurance retention limit. A mutual company that doesn't care about having very regular earnings has set the retention limit low. Once they demutualize, then they have something to care about. In real life, among demutualized companies, are we seeing cases of companies either lowering their reinsurance retention limit or not raising it when they might have?

Mr. Harwood: That has not been an issue for MetLife. With reinsurance rates so competitive in the last five years, as you all probably are aware, a lot of our new business is reinsured on first-dollar quota share, thereby making the decision less important. The bulk majority of new business is reinsured to begin with.

If things change because reinsurance rates aren't as good as they have been, that could be an issue. Right now, it has been a moot point, only because of the reinsurance market as it is today.

Mr. Brooks: We have certainly made more use of reinsurance, and we are taking a broader view of the use of reinsurance. As a public company, we want to make the most effective use of capital. There are sometimes capital arbitrages available through the use of reinsurance, and to the extent that reinsurance rates are particularly attractive, which they are, at least in our case on some products. We have made use of those to try and improve our overall return.

It wouldn't be so much from a risk point of view or due to a retention limit per se. We are just using reinsurance as effectively as we can to generate the return on equity that they want.