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Session 6PD
Equity Analysts Look at Insurers (Still)

Track: Investment

Moderator: HUBERT B. MUELLER
Panelists: COLIN DEVINE†
THOMAS G. MACKINNON
STEVEN SCHWARTZ‡

Summary: Equity analysts describe their views of the quantitative and qualitative factors that drive insurance company stock market valuation levels. The analysts identify current issues and concerns for the companies they cover.

MR. HUBERT MUELLER: I am a principal in the Tillinghast business of Towers Perrin and will be the moderator for this session.

The first speaker is Steven Schwartz. He is a senior vice president with Raymond James in Chicago, which he joined in May of 2000. Prior to joining Raymond James he worked as an insurance and financial services analyst where he covered such things as life and health insurers, mortgage insurers and financial estimator for property and casualty (P&C) insurers and lessors. His claim to fame is that in 1999 he was a *Wall Street Journal* all-star for financial estimates in the P&C sector. In 2000 he placed first in both stock picking and estimate accuracy for the life insurance industry, as well as first and second for stock picking and estimate accuracy for the P&C industry. He had similar rankings in the 2003 survey. He's a

†Mr. Colin Devine, not a member of the sponsoring organizations, is managing director, U.S. Equity Research, Citigroup Smith Barney, New York, N.Y.
‡Mr. Steven Schwartz, not a member of the sponsoring organizations, is senior vice president, Equity Research, Raymond James, Chicago, Ill.

Note: The chart(s) referred to in the text can be found at the end of the manuscript.

chartered financial analyst (CFA) and has both a BA and an MBA from the University of California at Berkeley.

Then Colin Devine will speak. He's the managing director within Smith Barney's equity research division, responsible for providing coverage on basically the large North American life insurance companies, and for the fourth consecutive year he has been ranked number one in the life insurance equity research category of the institutional investors all-America research team. He also received the number-one ranking in the most recent 2003 *Wall Street Journal* Best-on-the-Street poll, and was one of *Fortune* magazine's 2003 all-star analysts. Before joining Smith Barney about six years ago he was a director in Standard & Poor's (S&P) insurance ratings groups where he covered a wide variety of life and P&C insurers. Before working at Smith Barney, he was the vice president of a major Canadian life insurance company where he worked in the investment and risk management department. He's also a CFA, as well as a certified management accountant, and he has an MBA in finance from York University in Toronto and a Bachelor of Science degree in biology, interestingly enough.

Last, but not least, we have Tom MacKinnon. He's the director of insurance and equity research and is basically the lead insurance analyst at Scotia Capital in Toronto. He is also an actuary, and he's an FSA. He is ranked as the number-one insurance analyst in Canada according to the most recent Greenwich survey. He joined Scotia Capital in August of 1998, and before that he was actually with the firm I'm affiliated with, Tillinghast, where he spent three years in our Toronto office and three years in our New York office working on a wide variety of mergers and acquisitions (M&A), product pricing projects, reserving and valuation, using both Canadian and U.S. GAAP. Before his six years of Tillinghast, he also worked six years at Canada Life as an actuary in product development and in some of the corporate areas. He is a Fellow of the Society of Actuaries and the Canadian Institute of Actuaries, and a member of the Academy.

MR. STEVEN SCHWARTZ: I'm going to speak on critical issues of security from a securities analyst's perspective. We have issues in the industry. We have regulatory issues, and in that I include the NAIC, the federal government and rating agencies right on down the line. We have accounting issues, whether it's Standard of Practice (SOP) 03-01, which has to do with accounting for the guarantees that insurers provide on variable annuities (VAs) and other types of products; whether it's DIGB 36, which has to do with Statement of Financial Accounting Standards (SFAS) 133 accounting for modco and funds withheld reinsurance; or FIN 46, which has to do with the consolidation of variable interest entities. There are plenty of accounting issues out there that we as insurance analysts have to deal with.

Consolidation. We've had a complete wave of consolidation, whether it be MONY and AXA, Hancock and Manulife, Safeco and whoever buys Safeco, ERC and Scottish or Allianz and RGA. There has been a massive consolidation. Is this good for the companies involved? Maybe this is good for the companies' competitors. Is it good for the consumers? And what does it mean for the industry overall? This is a very important issue to deal with.

Tax changes. When I became involved in the securities business 15 or 16 years ago, the tax threat was the federal government thinking about attacking inside buildup on life insurance policies. That's no longer really on the board anymore. The Bush administration has taken a completely different direction in terms of lowering rates on other products that could compete with life insurance products. So, that is a very important difference and really a pickle for the industry to have to deal with.

Benefits and hedging. Whether it's guaranteed minimum death benefit (GMDB), GMIB, GMAB, GMWB or minimum guaranteed account values (MGAV) on equity-indexed annuities, there is a real issue here. Do these make sense? Do these make sense for the companies? Do these make sense for the computers? And can they be hedged? What is the risk, and what is the downside if the hedging doesn't work?

Valuation. No matter how good the fundamentals of a company, a company is worth something. It can't be worth too much just because the fundamentals are good, and it's certainly not valueless if the fundamentals are bad. But what is the valuation, and how do we as analysts attack that valuation in a post-September 11 world, in a world where the NASDAQ can decline 75 percent in three years, a decline only equaled by the DOW during the Great Depression? How do you value something in a world like that? How do you value something in a world where maybe you're going to do the Tokyo flip where you have interest rates and crediting rates coming down to where minimum guaranteed crediting rates are today? How do you deal with something like that? How do you value that?

Finally, I really want to talk about the changing demographics, what that means for the life insurance industry and what that means for how I look at the industry. There are issues, but I want to let you know that from the bottom of my heart I believe that life insurance is a growth industry. This thought concentrates every thought that I have in dealing with the industry, recommending stocks and setting valuations. This thought helps me look past the trees and look at the forest. Driven by the nation's demographics, the opportunities in asset accumulation business, wealth and income protection and wealth transfer for the life insurance industry, in my opinion, remain enormous.

There are three franchised rights guaranteed in the financial services industry. Two we're granted and one has been earned. The first to be granted was the franchised right of banks to take deposits backed by the federal government. It's a franchised right. If you don't blow it, you'll make money. The second is the one that is enjoyed by the government-sponsored enterprises, such as Fannie Mae, Freddie Mac and those companies. That's the ability to create liquidity in the mortgage markets, backed by the implicit guarantee of the federal government. The third, and the one that was earned, is enjoyed by the life and health insurance industry. That is the franchised right to underwrite morbidity and mortality risk. Those, I believe, will come to play as the demographic story in the United States plays out over time.

Chart 1 is the graph of age cohorts. This is from the U.S. Census Bureau. If you take a look, 45- to 64-year-olds today, it is no surprise to anybody that baby boomers are the fastest-growing age group in the United States. Even more amazingly, the 85-and-older group is growing nearly as fast and will be the fastest-growing age group in around 2022. That's an amazing statistic when you come to think about it. And then eight years from now, that baby boom generation will begin to hit the senior citizen age cohort, and that will be the fastest-growing group in the United States. So what does this mean, and what are the opportunities that can be offered here?

Demands of the 45- to 64-year-old age cohort will drive the industry for at least the next eight years. The age wave will create certain demand. These 45 to 64-year-olds face an uncertain retirement. They face an increasing lifespan. They face a decline in defined benefit plans. They also face a potential decline in social security. Although I'm not quite 45 years old yet, I will be shortly. It's interesting to compare myself to my father and what this means. My dad is 67 years old. I'm 42. He has his investments. He was a reasonably successful businessman. I admit that I'm still working on it and nowhere near where I hope to be. He gets social security every month. He knows every month a check is coming from the federal government to him. I don't know if I'm ever going to see anything from social security, and if I do see something from social security, it will be later than my father saw it.

My father began his social security checks at the normal retirement age of 65. As social security stands today, my age cohort will not receive normalized social security payments until I'm age 70. I'm willing to guarantee that I won't see them when I'm age 70. That number is bound to go up. That is a very scary thought for a lot of Americans who don't realize what is going on. My father gets a steady check from his employer and his defined benefit plan. I'm not a member of a defined benefit plan. I have never been a member of a defined benefit plan. I really doubt if I will ever be a member of a defined benefit plan. I do not have the security that my father's generation had.

What this all means is that Americans' needs to save have not diminished by any means. In fact, they've only expanded. Hubert failed to mention that I also cover the asset managers. Chart 2 is really an asset management chart, but we'll deal with just Figure 1 here because it pertains to the discussion and how I think about what's going to be happening over the next five to eight years.

Figure 1 breaks out the age cohorts according to the U.S. Census Bureau. A 30-year-old really refers to somebody who's 25 to 34 years old. A 40-year-old is somebody who's 35 to 44. And so on and so forth. The U.S. Census Bureau in the statistical abstract breaks down the population percentages into various age cohorts within the United States, so people 25 to 34 are 22 percent of the population

From *Federal Reserve Bulletin* data you can determine what the median financial assets of a person are in each cohort. This is per person, not households or families. The fact of the matter is, according to the Census Bureau, there are about 1.7 people per household. So to get a household number you'd multiply that by 1.7. Your typical 40-year-old or somebody in the 35- to 44-year-old age cohort would have median financial assets of about $26,000. That is surprising. When you deal with the people on the buy side, such as huge hedge fund managers, it's astounding.

Everybody knows that Americans need to save more, but nobody knows how to accomplish this goal. I think it's important to put a number on that. So what we tried to do, with a lot of assumptions, is to figure out how much a person needs to start and to survive their retirement. We used the social security Web site calculator to figure out what the average income would be. From that we did a poll of about 300 Raymond James registered representatives and asked them to suggest how much they thought people needed in retirement as a percentage of their last year's working income. That came back around 75 percent. I've seen other estimates that suggest anywhere from 65 to 80 percent, so the Raymond James registered reps were pretty much in the ballpark.

We assumed, using the CSO 1980 table, that everybody saves like they were going to make it to 65 in order to get social security. And the people who make it to 65 will then live another 20 years. Unfortunately the Census Bureau doesn't break out data very well, but we assumed that everybody 65 and older would live 20 years no matter what their age, and then spend down basically until they died dead broke. The third part of this chart shows how much people needed in retirement, plus their social security, to live those 20 years in a comfortable manner. You can see that the numbers we came out with, to some extent, are very shocking, particularly for the 60-year-old group that are way, way undersaved. This probably has a lot to do with the equity markets. These are based on 2002 data, so it doesn't have the current up equity markets that we have. But, clearly they have been damaged, and the need to save is there. If you look at the population percentages, the growth and, of course, the offset of 65-and-older spending down, you would come up with a 10.9 percent savings growth rate in the United States that you all would participate in. Now, admittedly, that's not Internet growth pre-1999, but 10.9 percent is not a bad number by any means, and I think a lot of industries would like to have that built in.

Chart 3 is by Scott Brown who's a Raymond James & Associates economist. When we talked about what people needed to save, we didn't need to assume anything about what the stock market did or what the bond market did. The fact of the matter is that Americans tend to be target savers. They're looking at a target to get to. And if the stock market is up, giving extra savings, then the savings rate tends to go down because Americans are targeting a number at the end. That's what the behavior seems to indicate. And, of course, as the market fell, we saw a bit of an uptick in the savings rate. I would expect that correlation to continue.

Let's talk quickly about the age wave and creating demand. This is where it gets really interesting. In about eight years from now, life income is going to become a very important market. As I pointed out, I'm not my father. My key concern going into my eventual retirement is how I'm going to survive within the assets that I've generated, and to make sure that they are there for my life, whether it be income annuities or other life types of solutions. Legacy creation is, unfortunately, not something I worry about, but maybe it's something that my boss worries about. However, legacy creation is going to be an important issue. Wealth transfer will be another issue. The efficient transfer of wealth doesn't go away if the estate tax goes away, and it's the Raymond James view that the estate tax does not go away, but rather that at some point that will come back, probably at a higher minimum credit level than originally.

I think long-term care is an opportunity, although a difficult one. Long-term care is probably the biggest challenge that the life and health insurance industry faces today in terms of helping Americans to afford long-term care. At Raymond James we've coined a term—bedpan daughters. The soccer moms took care of their kids from the time they were born until the time when they were 17 and then went back to work. Their mothers are now 65 to 70. Their fathers are older or maybe they've passed away already. The average woman in the United States is going to take care of her mother longer than she took care of her kids. Think about that. Long-term care is going to be a huge opportunity if the pricing can be managed and somebody can make this work.

And, finally, Medicare is an issue. Obviously with the age wave Medicare or something like Medicare is going to become more important. With what's going on in Washington right now, the way the Medicare system will ultimately look still remains to be seen, but the demands for Medicare or Medicare-type products are not going to dissipate.

We have serious and important issues in the life and health insurance field that seem really daunting in the near term. The people at this conference, and your colleagues back at home, are some of the brightest, hardest-working people this country has to offer, and I'm sure that with your help, your companies and your clients will do very well in dealing with these issues and getting past them. The most critical issue, in my perspective as a securities analyst, is whether or not the people in this room have the guts and the discipline to help your companies compete profitably in the enormous opportunities that I think are to come.

MR. COLIN DEVINE: I will give you our perspective on what some of the key industry issues are. I'm not going to talk about the demographics. At the end of the day I'm a stock analyst. I'm not a rating analyst anymore. I'm not really looking at what company is the best. I focus on what stock is the best and what this group is going to do in terms of share performance. What you're looking for in your mutual funds when you put your money into it is to pick the funds that go up the most, not necessarily the best companies. It's the stock. It's not on the company, and you would think that's obvious to many of your management teams, but that's not always the case.

I love the demographics. I think for this industry, if we can solve the aging issue, and, frankly, for financial services, the question is how the 401(k) generation is going to manage its money in retirement. I happen to think the life insurance industry is going to be a big part of that, maybe at the expense of the asset management industry, but that's really, in our view, the key to Pandora's Box right now. If you can get into that, it's where the gold is right now.

That said, there are a lot of issues in this industry right now. One of them is investment loss. In 2002, several companies basically blew up their investment portfolios. Low interest rates are another issue of importance. I don't think we have seen the end of that. I think this is going to put pressure on earnings for years to come. We'll talk about that. Another issue I want to discuss is rising capital requirements coming out of the rating agencies. At the end of the day they set the capital requirements. It's their sandbox and their rules. If we want the ratings, even if we think they're insane, we're going to have to march to the beat of their drum.

We perceive product pricing as a big industry issue right now. Frankly, in my view, for many years we have probably deluded ourselves with the returns. I think many senior management teams have kidded themselves that people are ever generating 16 to 18 percent returns on VAs and that they're making that same kind of return today with the way universal life (UL) with the secondary guarantees is priced. What I have to focus on at the end of the day, and what's going to drive long-term shareholder value creation, is what kind of return you're making on the economic risk. There's a lot of accounting arbitrage that goes on. GAAP does not capture the economics of life insurers particularly well. The Street arguably learned that last year when GMDBs on VAs blew up. When markets go up, companies don't have to expense these on their GAAP. They can just expense them when the claim comes in. Too bad you can't do that on life insurance. It would be great to collect the premiums for the first 80 years and then book an expense in Year 81—so much for matching revenues and expenses.

I think we're seeing that again on the UL secondary guarantees. We're certainly seeing it on the living benefits. And it's really key that we get management teams at the top to have the discipline to understand what the actuaries are telling them as to what the real economic risk is for this. Companies today are saying, "Well, they're going to catch on, you know, secondary guarantees, so we're going to have to jack the pricing up on the UL we've been selling for the last two years." That just means you've been underpricing it. Who's kidding whom? We learned that on VAs. I don't think any VA sold since 1998 is probably going to make money. Now, stat may better capture that, but I don't think they have. We're never going to recover, not with the way markets have moved around.

Investment quality is another issue we'll look at a little bit. I never thought this would be back after living through the late 1980s and early 1990s, but, surprise, surprise, margins get squeezed. It's very easy to take a little bit of extra investment yield to try to make your returns, and we certainly saw what that's done to Hancock, Met and UnumProvident, just to name a few.

Now I'll get into the rating agencies and where they're going. You may think that their capital requirements are too high, and I may also, but it doesn't matter. If you want that rating, you have to do what they want. And then we'll go into interest rates.

VAs. I think in many ways the way investors perceive this industry is, in a sense, that we're going to live or die with how the VA market does, for better or worse. Last year investors had all kinds of wake-up calls of deferred acquisition cost (DAC). They had never even heard of that before—GMDBs and the different types of those and what that could do to your capital. I think a lot of those products are not really priced for the economic risk. I think if we go the route the Canadians are, using a stochastic modeling process, it's a lot more sensible. We're going to get much better risk-based capital (RBC) requirements for this. And, frankly, the fact that we are at where we're at today is not that surprising.

RBC came out of the late 1980s and early 1990s, when the asset side of the house blew up. Back then it was pretty hard to really mess up your capital base on your liabilities. It's a lot easier to do it on your asset side. RBC today, whether it's with the rating agencies or the NAIC, is still very heavily focused on the investment side of the house. We didn't have VAs back there. We didn't have all these equity-linked futures that all of a sudden could cause some pretty spectacular capital requirements under adverse market conditions. We're playing catch-up on that. The conditional tail expectation (CTE) 90 formula to me really starts to capture that. I think if we go that route we're going to be a lot better.

The big upside, though, of what we're looking at right now are some of these living benefit products. I don't think the accumulation benefit ones are really going to drive this industry. I don't think the income benefit ones are. The product that I think in many ways is going to determine the fate of this industry, if we get it right, is the withdrawal benefit. I think to understand where this industry's going right now you have to understand where the retail consumer is. Look at product sales this year. VAs are going to be up, but it's a binodal distribution. If you have the living benefits, your sales are up 35 or 40 percent (in fact, if you are Hartford, your sales are up over 60 percent). And if you don't, they're down about that much.

Let's look at life insurance. Variable universal life (VUL) is down 35 percent again this year, after that kind of drop last year. UL is up that much. I think that's saying consumers will come back into equities because they know they have to be in equities, but they want a safety net. I think the withdrawal benefits pioneered by Hartford with the principal-first product are sort of what they're looking for. Managing the risk with that is a whole different subject. But, I think the demand from that product, which has well exceeded anything Hartford Life ever thought it as going to do, is an indication of where the consumer is. One market that has yet to be tapped and, again, where we think the demographics are going and where we can solve a lot of people's problems right now, is to take the living benefits into the 401(k) segment.

In the past, if I were to get up here and say, "Let's put a VA inside a 401(k) plan," everybody would say, "How dare you!" But think about it. Your 401(k) is an asset designed to be used for your life. Unfortunately, many people die with money in that product today. What happens? It's all taxable, ordinary income on death. This is an asset you want to use. Why not put it in a VA? Put it in one of the benefit products like Hartford's, in which you can take out up to 7 percent of the principal per year. Now you have the client on a systematic withdrawal program. They can't lose principal, which I would submit to you beats the risk tolerance in their 401(k) asset. But they still have all the upside to equity market. Will they pay an extra 35 to 60 basis points in fees for that kind of guarantee? I think they will. I think that's what we're back to selling them. We're back to selling them a guarantee.

Their risk is outliving their savings, but who intends to buy an immediate annuity? I don't know what the mortality risk is. But who's going to give up control of their assets? And who wants to do it when you're going to use a discount rate of maybe 5 percent? I don't think anybody is. And certainly we haven't seen any product sales to support any belief that they are. I know many people that try to come out with these new immediate annuities. It's great. Unfortunately they don't sell. If we start to see these living benefits going into 401(k) plans, they're going to sell because you don't give up control of the assets. It's not lifetime income guarantee, but for most consumers it's probably the next best thing, and it's a bet they're willing to take. Maybe at 75 or 80 they'll start to think about income guarantees and immediate annuities, but I think where the demographics are going over the next 10 years is more suited to these withdrawal benefit products. That's where you're going to see all the emphasis go, and that'll be over the next 12 months.

Now the issue with this, of course, is: Can you manage the risk? That's the thing for investors. They're very nervous about it because last year many insurance companies didn't have a lot of confidence because they blew themselves up.

David Foy, Hartford's former chief financial officer (CFO) and certainly one of the most highly respected actuaries, always pointed out that it's not the cost of the benefit, because when Hartford looked at death benefits on the VA it would only blow them up once out of 250 times. However, the way David looked at it, about one in five times the volatility of the capital requirements in response to a short-term market movement would have blown them up, and that's why they reinsured it. The reinsurer wasn't thinking about it. It's not the cost of the benefit over the lifetime of the contract; it's what the short-term capital swings are going to do.

Now think about that with respect to these living benefits. We have the interim capital guidelines right now in which it's 1 percent if it's not in the money and 2 percent if it is. Remember, that's a denominator charge in your RBC ratio. All of the companies out there are probably looking to maintain now a 3 to 350 percent RBC ratio. So if you get a market drop like we had in 2002, what's going to happen to your capital requirement then is it's not one to two, because it's the denominator. It's really going from 3 or 3.5 to 6 or 7 percent, and that's what causes the big surprise equity offerings. If companies have to pull a share repurchase, it can make it a pretty rocky environment for stocks.

Let's talk about investment quality. This is one of those interesting conundrums. This thing came back. A lot of companies were in trouble last year. Frankly, today I think they're pretty well managed. But, again, it's not our views that count. It's the rating agencies'. And if anybody had any doubts that this thing is behind us, check out the *Wall Street Journal*. Moody's is back in the paper, on the front page of the *Journal*, talking about life insurer credit quality. It's an issue for them. It's probably the one thing that the rating agencies think they understand more than anything else, and that's what sends them on the warpath. That's despite the fact that corporate bond defaults peaked in the first quarter of 2002. They're still fighting that battle, and that's going to, I think, put a lot of pressure on all of us. Remember what drives stock performance is rising returns on equity (ROEs). It's tough to get your ROE up if you have to hold more and more capital.

The rating agencies. I want to give you a word of advice. Your RBC ratio determines about 80 percent of your company's claims-paying ability rating. I know they will tell you that they look at a host of things, but I did this for a living. That RBC ratio determines whether you're AAA, AA, A, BBB, etc. Everything else determines whether, within the A category, you're A+, A, A- or AA+, AA, AA-, etc. The anchor is your RBC ratio. At the end of the day that's how they look at this. When they say downgrades are going to exceed upgrades, how do you avoid a downgrade? You raise more capital. You can never have that ratio high enough to satisfy them. Unfortunately that's driving the capital allocation on your products. That's driving your pricing decisions. They're really the ones who are setting it. Now, what does this mean?

Let's look at what S&P is going to do. Again, remember this is a rating agency that knows corporate bond defaults peaked about 18 months ago. Still at the end of this year look at how much the charges are going up on your bond portfolio. They say they'll bring this out in two years, but don't believe it. They'll run this at the end of the year. If you don't score on this, your rating's going down. What is this going to do to your product capital requirements? Take them up at least 10 percent, and probably for the investment-challenged companies at least 15. That's why when I look around the industry today people with excess capital positions basically have disappeared. Nobody can afford to buy stock. They're already in debt, selling off other business lines to raise some capital. That's what's keeping this industry under pressure. The rating agencies are not letting up. Maybe they'll start to ease back next spring when they get the year-end numbers, but it's going to be the spring of 2005 before their view turns positive on this industry. Until that happens, they're going to keep raising the bar, and that's going to keep downward pressure on ROEs.

Interest rates. People are keeping these annuities in force a lot longer than we all priced for because all of the sudden the minimum crediting rate looks pretty good. It's basically like demand money. But I think the thing that Wall Street doesn't understand yet is what's happening with the renewal premiums. Money's going out today at 5.5 percent, which is a lot lower than the pricing assumptions when many of these contracts were written five or 10 years ago. That's an issue right now. If rates stay fairly flat or don't come up much, it's going to hold back earnings development in this industry for many years to come. It's going to make it very tough to get the returns back, and that's what's going to make it difficult to get investors back behind this group.

Stock picking. Again, for me at the end of the day this is where it's at. Things are starting to look pretty encouraging, but, again, investors still remember what happened last year, and they still view this as a defensive group. We may believe it's a growth industry, but everybody thinks about it as mortality protection industry, which most of us probably agree is fairly mature. And so it's a defensive group. If you want growth stocks, with all due respect, you're probably not out buying Prudential or Met, and certainly our ratings reflect that.

Chart 4 shows a regression of life insurer price to books versus ROE. ROE drives your stock price. But if ROEs for the group aren't going up, ask yourself where valuations are going. ROEs are down about 300 points from a couple of years ago, and I don't think they're ever coming back. With the interest-rate environment we're in, I think this is an industry where approximately a long-term 13 to 14 percent ROE for the best companies is probably as good as it's going to get. If you have a 10-year bond at 4 or 4.25 percent, that's not so bad, but it's managing expectations. There are some out there who'll say stocks are mid-range where they were over the last decade or the last five years, but I think they are probably at about the top of the new valuation range because we just don't have the ROEs to push it up anymore.

In summing it up, I love the demographics. I think if we can capture this retirement market, there's enormous money there. There are assets we're going to manage for the next 20, 30 or 40 years, and these living benefit products may be the way to do it if you can get the risk hedged. If you can't, I'd submit to you the volatility on some of these things will make what we've seen on death benefits look like a warm-up act. The risk with these benefits is if the market drops and stays down for a while. You just can't make it back from appreciation to fund the guarantee. I said on returns that I don't think they're coming back. Even though stocks have done pretty well with the markets coming up, I think the pressure from interest rates is going to hold returns back for a while.

VAs. One thing we didn't talk about was that DAC may be coming back, and I think it's going to be back because of 1035s. Internal exchanges on VAs are about 70 percent of industry reported sales. If you go back seven or eight years ago, they were less than 15 percent. There's a lot of money moving around. For the kind of market run we had it's not that hard for a broker now, and the client's not in the money on the death benefit anymore, so let's flip you into a living benefit product. Let's lock in your principal. You can't lose principal from here. That's what they're going to use while they're alive. That's a very easy sell. Of course it makes another 6 percent for the broker. I think as everybody rolls out these living benefit products over the next 12 months, we're going to see 1035s like we've never seen them before, and that's going to cause more DAC issues.

Finally, with what the rating agencies are doing, I think ROEs are going to drop 50 to 75 business points in each of the next two years. When we put that all together, looking at it from the stock perspective, although I like the long-term growth outlook for the industry, it's very tough for me after the kind of run we've had to say that I think the stocks are going to outperform.

MR. THOMAS G. MACKINNON: About five years ago I returned to Canada to work as an equity analyst, and to cover the insurance sector in Canada. The insurance sector in Canada is pretty small. There are just a handful of P&C insurers and maybe two life insurers, but there were five demutualizations that were up and coming. So I was willing to accept the challenge. I've learned a couple of things in the business in five years. First of all, you have to be able to summarize an insurance company's earnings on the back of a postage stamp, and that is a very difficult thing to do with all the moving parts.

Second, within 10 seconds of the company reporting you're going to get a phone call. All you're going to see is a number run across the tape, and you're going to have to determine if it is good or bad. You have an estimate out there, but there's a lot of working parts, and what does that mean going forward? When you work in a consulting firm or in an insurance company, you spend all of the time trying to determine what the exact number is. In this work, you get the number and you have to decide what it means going forward and give a recommendation.

And then, finally, you have to try to avoid any actuarial mumbo-jumbo when you're working on the sell side. It's very important in what you're doing, but investors don't necessarily have the tolerance to listen to it. Certainly there's a lot of assumption-based stuff that goes on in an insurance company's earnings, but in the end you have to stick to the business basics. You have risk versus profitability, deploying capital effectively and growing sales, and I think those are the things you want to stick to.

The Canadian insurance companies make up 10 percent of their market, and if you look at the U.S. life insurers, not counting AIG, it's only 1 percent of the index. In the United States you have to kind of sell the sector. In Canada you have to be in the sector. That's a difference right there. It's hard for pension funds and mutual funds to beat the sector if they're going to avoid 10 percent of it at times. They have to be in it. So, you end up looking for more switch plays within the sector, rather than trying to push a sell on a certain sector, or initiate a new sector, to some investors who've never been in it.

Just in terms of North American life insurance companies, if we take AIG—which is dwarfing everything—out of the picture, we find that three of the top five are Canadian companies, growing through acquisitions. The top five behind AIG's $154 billion, are Manulife, assuming the merger with John Hancock, with $23 billion; Met Life, with $21 billion; Prudential, with $20 billion; and Sun Life, which actually grew to $14 billion as a result of a couple of recent acquisitions (Clarica, an insurance company in Canada, and Keyport, a New England-based company). Sun Life is followed by Great-West Life, which has a sizable managed care business in the United States and picked up Canada Life, bringing it to $13 billion. Purely in terms of life companies, these companies rank fairly high in the North American spectrum.

The U.S. life company sector has been a bit of a shrinkage play as a result of AIG scooping up Sun America and American General. In addition to a few foreigners kind of stepping in and picking up plays, this has pulled away some stocks from the North American insurance sector. I'd have to say that consolidation will continue. It's beneficial knocking money off your maintenance costs, and so you continue that play going forward and take maybe a little bit of the fixed costs associated with distribution as well. That continues to be the play going out. There are other issues than just the economics and acquisitions.

If we look at the global perspective, Manulife and Sun are in the top 10, globally. Canada, with 30 million people, has two insurance companies in the top 10. ING and Aegon are also in the top 10, so I guess the Dutch have kind of figured that out a little bit as well. Why are some of these Canadian companies global? They've been global for a long time, and I think that's an important thing to note. You just don't go and plant your flag and say, "Okay, I'm global." Manulife has been in Hong Kong for 100 years. I think what you have to do is build a presence and build the distribution there. That's an important part of being global. Also, the regulators in Canada have allowed for some consolidation. That is a result of being more federally regulated than state regulated as it is here. I think that allows for the insurance companies to effectively lobby better. They said they were going to demutualize. The law didn't let them, and they said that they were going to do it anyway, so change the law, and then they changed the law. I think that allows for a regulatory environment that's more responsive to the companies' needs.

Great-West Life, Industrial-Alliance, Manulife and Sun Life are also global players. Canada Life, despite its name, is global and derives only about 20 to 25 percent of its earnings from Canada. I think global diversification is important. I think one of the plays an insurance company has, particularly in the Asian market, is to leverage their infrastructure and the administration system supporting policies that were sold under old whole life policies, and under a tiered agency system. You still have those systems supports for that business you sold in the 1960s, so why not leverage it? That's the kind of business you're going to be selling in Asia. You really have to take advantage of a rapid improvement in mortality over there as well. Privatization of a pension system certainly is going to add fuel to the fire here as well. I think Asia certainly is going to be the place to be. It's very important to have a global perspective, and certainly these companies have diversification. That's important.

I talked a little bit about valuation measures, but I want to go over them again. One of the things is relative valuation. We're finding that this is an important metric as well. Is your sector now predominantly ahead of or below where it's normally been? Hedge funds pick their spots, and if they find a sector that's generally trading higher than it normally does, they'll go and find some of the highly leveraged companies within that and start attacking. I think that's an important thing to note. Also look at the price/earnings (P/E) ratio or their earnings yield relative to bond yield. Certainly a P/E of 11 or 12 would be more attractive in a 5 percent interest rate environment than it would be in a 10.

In Canada there's a lot of interest as to how these things look relative to banks. Banks make up over 20 percent of the sector, and the insurance companies are 10 percent. So, there's a lot of trading back and forth within that. We want to see how those things trade. Life insurance company P/Es have generally been about 65 percent of the S&P 500 P/Es. That's another gauge to keep in mind, naturally—all the other things about a company as to how fast it grows its new business, generally how fast it grows its top line and all the other metrics you look at an insurance company. Price-to-book versus ROE, as Colin mentioned, has always had a very strong correlation. Embedded values are a metric that we used in Canada with some success.

Chart 5 shows a logarithmic view of the price-to-book versus ROE. It shows a fairly good fit, with a 90 percent correlation. This has been one thing that has been an attractive feature in the sector for valuation. If you're above or below the line, why are you? And what does that mean going forward? Naturally the thing is to climb up the curve. This still breaks down into a P/E, which is the y-axis, price over book, and the x-axis is ROE, which is earnings over book. I think we don't need to go through too many exams to determine that we have a nice book value on either side here, and it breaks into a P/E. So, again, this is somewhat of another way of describing that a P/E can help drive the stock as well.

People want to determine if they want to be in financial services with interest-sensitive stocks. Do you want to be in the banks or the life companies? Chart 6 is sort of forward-looking multiples over the last 15 years for life companies and banks. Generally, we find that banks are a little more interest-sensitive than the insurance companies. Insurance companies try to, or at least claim to, stay cash flow matched. The banks are probably a little more mismatched and play a bit on a steeper curve. They tend to be a little more credit-sensitive also.

Generally the insurance companies have historically provided more stability in their earnings than the banks. This is one thing that we've used in Canada to describe when one of the major Canadian banks didn't make any money one year. That was a pretty important thing. At least you'll get some earnings stability with the insurance companies. I think this is in part because of their diversification. The more globally you diversify, as well as across product lines, you should get a little bit more stability. Effectively if you live by the VA sword, you're going to die by the VA sword. So, as long as you can keep that to somewhat of a manageable part of your earnings and diminish some of the volatility, you should look relatively good amongst other financial services companies.

I now want to talk about the issues and concerns here. I see sensitivity to the equity markets. What I'm amazed at, though, is how quickly these concerns change. I think it's just a function of the volatility in the markets right now. I imagine that volatility wasn't around with the sector, say, 10 or 15 years ago. They certainly didn't have some of these issues or the speed at which they came into the forefront.

Another issue is earnings quality. We saw some issues like Enron, WorldCom, Tyco and whatnot. One of the things that we had with these Canadian insurers is they started trying to look at different disclosure mechanisms. The Canadian reporting is basically a bit of a U.S. stat, but it's also like U.S. GAAP in that there's a constant unlocking on prospective assumptions as well. So you're going to get strained, but you're going to get unlocking as well. So I think there's a bit more of an assumption-driven concern with the earnings, and people wanted to know the earnings quality issues. There is also the issue of capital flexibility. Can you buy back your stock? A lot of financial services companies throw in the 5 percent buy-back every year and then try to bump the dividend if they can. That just makes everybody happy. And to what extent have you been able to do that? How have you been able to use any cash for acquisitions?

So, quarterly reporting still ends up being some of the key disclosure mechanisms now. You can't go and talk to management and say, "Hey, I had a discussion with management and they said sales are going nicely." You can't do that kind of stuff. They have to have an investor conference where they showcase their team. I really like to see the role of the capital here. What's going on? Where is an insurance company's excess capital position going to be? I used to believe effectively that those insurance companies, just by unbundling the product and then passing on the investment risk to the consumer, were really just rolling out of capital play. All this old capital-intensive stuff was just going to roll off the books, and the new products were less capital-intensive. In that game the companies just basically had more and more capital, and then effectively this created more acquisitions to squeeze down on the maintenance cost.

It wasn't as if the properties were more expensive; they just went to the bar with more money. The price of the beer went up in the bar. I always try to pay attention to how the capital's rolling out, but effectively what's happening now is they've been probably writing products where they claim they can just price for something. However, you can't really price for everything. So, thinking that we could price for risk that we really don't understand is where we probably got a little in trouble. I think the capital requirements are catching up with us on that. In Canada, though, they have done a good job moving to sort of stochastic reserving and stochastic capital requirements. I think the movement that they've done here is sort of trend setting for the industry, and I respect companies for that.

Another thing they've tried in Canada is a source-of-earnings analysis. I know internally companies kind of have to put this together—with each one of the divisions announcing its earnings—how they varied from the plan and why. And it all rolls up. So it would be more of an analysis of what you actually expected for the quarter and what actually happened. Actually this is going to be a regulatory requirement for the Canadian companies by the end of next year for sure. Some companies will put it in by the end of this year. Some of them have already started it. It's sort of a rollout as to what the strain is associated with the business that you wrote and the profitability on your inforce business. And then, to what extent was your actual mortality different than expected here?

Tables 1, 2 and 3 show a series of companies and what they did at the end of 2001 and 2002 on this source-of-earnings analysis. You have your inforce business and obviously just the roll-off from that—that kind of rolls off at the valuation interest rate or some mechanism thereof. You also have strain on the new business. I like to look at that one. That effectively means how much of the earnings in that year were held back as a result of selling what you would expect to be profitable business. We'll look at that on an embedded value thing. But at least here that effectively could be earnings in the gas tank here, earnings that come out later on. The experience gains here kind of show that maybe in that year there was some great lapse experience or a great mortality experience, and is that necessarily going to be ongoing?

Table 1

Source of Earnings for Canadian Lifecos

	Canada Life		Industrial-Alliance		Manulife		Sun Life	
$MM	2002	2001	2002[3]	2001	2002	2001	2002	2001
Expected profit from in-force business	$422	$377	$184	$171	$1,068	$918	$1,849	$1,148
Strain on new business	(43)	(87)	(60)	(51)	(119)	(195)	($278)	(292)
Experience gains	138	38[1]	(3)	(12)	215	118[2]	($253)	(233)
Change in assumptions	16	21	2	1	(9)	(131)	$94	140
Earnings on surplus	90	146	40	45	527	645	$410	396
Income before taxes	623	457	164	154	1,682	1,355	$1,822	1,159
Income taxes	(133)	(153)	(44)	(47)	(304)	(196)	($479)	(246)
SH Net income	490	304	120	107	1,378	1,159	1,343	913

[1] Includes impact of 9/11 of $131 million

[2] Includes impact of 9/11 of $150 million

[3] 2002 data for Industrial Alliance excludes impact of Teleglobe ($19.4M) on net earnings

Sources: Company Reports, Scotia Capital Estimates

Table 2

Manulife: Divisional Source of Earnings, Q2/2003

$MM	Canada	U.S.	Asia	Japan	Reinsurance	Total
Expected profit from in-force business	62	94	56	27	48	287
Strain on new business	(9)	(16)	(1)	(9)	(9)	(44)
Experience gains	50	30	7	5	6	60
Change in assumptions	0	0	0	0	0	0
Earnings on surplus	60	45	14	8	24	165
Income before taxes	163	153	76	31	69	468
Income taxes	(38)	(42)	(3)	(6)	(18)	(82)
SH Net income	125	111	73	25	51	386

Sources: Company Reports, Scotia Capital Estimates

Table 3

Industrial Alliance: Divisional Source of Earnings, Q2/2003

$M	Individual Insurance	Grou Insurance	Individual Annuities	Grou Pension	Total
Expected profit in-force business	32	5	11	2	50
Strain on new business	(16)	0	(2	0	(18)
Experience	2	1	1	2	6
Change in assumptions		0	0	0	(8
Earnings on surplus and other	13	3	5	2	22
Income before	23	9	15	6	52
Income	(7	(4	(4	(2	(17)
SH	16	5	11	4	35

Sources: Company Reports, Scotia Capital Estimates

Change in assumptions is a big thing here. You unlock some stuff, change some assumptions around, and, as a result, you may have goosed the earnings in the year. To what extent is that going to be ongoing? They do that for their lines of business, and they throw off some target surplus and then the earnings on the target surplus. There's another important thing that kind of reflects the amount of excess capital. I think this is a good tool, and I think all companies should be using that tool each quarter to determine the earnings that they actually put up. Some of them do it by division. That's even better. And some of them do it by product line, which is probably even better because you're not going to get any strain on your individual insurance business, but you probably will on the group. So, you can slice it and dice it as many ways as you can, but I think it is still a good management tool internally. The management uses it internally, so why not disclose it externally?

People were estimating embedded values, and stocks looked cheap relative to Europeans. What actually ended up happening is the Europeans came down rather than everybody else going up, and it was a good tool for determining a proxy appraisal. The embedded value was a bit of a proxy appraisal value as well. It was the movement in it that I was more interested in, rather than the one-time value of the thing. Why did the numbers move and change? I think that was important. There are arguments for and against it. It is quite assumption driven, and it's quite volatile, and they only do it annually now.

The two guys who were effectively using it as takeover targets have been taken over. So, now the only thing you really look at it is the profitability to the value of the new business. I think it is an important metric, and I think that relates back to that quarterly thing on the strain. You see this strain come out of the company each time. That's nice, but is that new business profitable? The value of new business they report each year is important. Sometimes you can look at the value of the new business relative to the value of business in force or embedded value. There are all kinds of ratios you can play in this game. Is it a basis for management compensation? Sometimes it is.

Did this metric actually ever work? Charts 7 and 8 show information from a year and a half ago. This is when a company, Sun Life, had launched a bid for Clarica. So you can see Clarica here was in the midst of a takeover. It hadn't closed yet. And was somebody else going to come in? If you looked at its P/E, it's 14 to 1. Everybody else is 14. It doesn't look like it's that much of a premium, despite there being a friendly bid out there on it. Also its price-to-book versus its ROE is pretty well standard with the rest of the sector at 12¼ and 15 ROE. The other sector is at 12¼ and 15, too. Its embedded value was at 164 versus 143, so it was above. The consensus was kind of that no one else would step in because on that metric it probably looked like it was fairly priced. That's what we argued, and nobody else did.

But this thing all fell apart. When you get a hostile bid, and then you're able to produce your embedded value, things are different. It's sort of like having your house for sale, and somebody comes in and lowballs on a bid, and then you get to reappraise your own house. That's effectively what happened. Manulife had launched a hostile bid for Canada Life. Their bid looked relatively attractive on a P/E and a price-to-book basis, right? You can see that: Canada Life at 11 to 5 versus 10 to 5; then 170 on 158 for a 14 ROE. But, it wasn't attractive on a price-to-embedded-value basis. That was in part because of the fact that Canada Life was able to produce an embedded value that was 22 percent higher than last year's because they did it on their own, and they made an acquisition. So, it was harder to gauge. But then I guess we're in the day and age now where people will pay $47 billion for a 41 percent premium. So, there are other reasons than just making the economics work for acquisitions.

MR. JAY NEWMAN: I'm not an actuary. I'm a CFA. Because a lot of my work is in the private equity field, working with larger private equity investors, to see an expectation of ROEs at 13 to 14 percent isn't very exciting. When you talk to the better managers in and around the industry, what do you see them doing and thinking about in order to differentiate themselves competitively? How do they improve margins? Where might they be thinking of outsourcing? Are they contemplating acquisitions? Where might they may be able to sell off some units? Are they interested in selling other units in the course of things in order to raise some capital and reduce outside needs?

MR. SCHWARTZ: It's not the 15 to 17 percent that Nationwide Financial Services may have reported at the height of the equity bull market, but a 13 to 14 percent ROE is not the end of the world. Just to put this all in perspective, if you went back and looked at the S&P 500 over time, that average equity's probably around 14 percent. So the life insurance industry at what may be a cyclical low—I don't believe it's a secular low—is only slightly behind what the S&P 500 as a whole has been producing. What are companies doing in terms of trying to raise the ROE? I think that is really what we've touched on. We've seen outsourcing. India is becoming a huge market for outsourcing for all the financial services industries. As for acquisitions, despite what the top managers might say about synergies with regard to distribution or moving product sales from one market to another, if you're strong and fixed you may want to add variable or vice versa, which seems to be the Manulife/Hancock plan. I think in a lot of the acquisitions we're going to see an awful lot of bloodletting. Although acquisitions may hit a low, in the long run they're going to be done. Obviously pricing, as Colin pointed out, is going to be a key. You must know what your risks are and price properly for that risk.

MR. MACKINNON: If you look before any of these demutualized companies came in, ROEs were higher because none of them had closed-block ROE drag. Maybe we should start trying to disclose some ROEs and drag from the closed block. I'm sure people are still trying to price just as effectively and try to hit target ROEs, and I think as the industry consolidates to some extent it's going to be similar to what's happened in banking by squeezing more profitability out of the current consumer.

MR. TOM CAMPBELL: Colin, you had spoken very briefly about secondary guarantee UL business and how you look at companies in picking stocks. Could you expand a little bit more your thoughts on secondary guarantee UL business?

MR. DEVINE: Sure. I have nothing against the product itself and adding that feature. Clearly what it's done for sales speaks for itself. The issue is the price floor. It's the same as term. When term blocks came in on the 20-year level term policies, everybody knew that you should hold more capital on a 20-year level term product versus a one-year renewable, the same as everybody in this room probably knows they should hold more capital if they're going to put a secondary guarantee on a UL product. The fact of the matter is, today you can get away with not doing it. And so you have companies out there that, until the regulars catch up, think they're pricing for 15 percent return. Then you start to hear they are going to take their rates way up because they are going to have to hold more capital. My point is that economically you always knew you should have held the capital, but there's too much of this accounting arbitrage going on right now. There are too many management teams that just kid themselves because the economics don't change. I think one of the biggest problems, as chief actuary, is that not one company I cover reports to the board independently each year. I think that's one of the biggest problems this industry has because the message from the actuaries gets stopped by senior management. It doesn't get up to the board. The actuaries know what the risks are. But all too often it gets stopped by marketing, and it's not getting up to the top.

MR. CHUCK FISHER: With this GAAP accounting, I've noticed over the years that many companies are showing huge surpluses, such as $2 billion or $3 billion on GAAP accounting, and then it all disappears. Somebody mentioned earlier that GAAP accounting isn't exactly applicable to life insurance, and I've noticed that there are many ways under GAAP accounting you can increase your surplus in your earnings. Would anybody like to comment on that statement?

MR. MACKINNON: It might show up in the MONY bid. There is something like $17 of DAC. If you look at that price on a statutory basis—I don't know what it was on a statutory basis—you still have to come back to C-3 and some of the intangibles existing on the balance sheet in a U.S. GAAP basis. I think you have to pay careful attention to both those metrics, and I think that showed up in that bid.

MR. DEVINE: I think GAAP, as a rule, does a pretty lousy job of capturing the economics of a life insurance business. It's still playing catch-up. I think stat accounting is better. It's not perfect, but I think the regulators have a better handle on what the real returns on this industry are than GAAP does. That's one of the problems, and I think people learned that the hard way last year on the VA side, whether it was GMDBs or DAC. That is one reason why it's tough to get investors interested in this group, because the accounting to them is too much of a black box. It's just too fuzzy.

MR. SCHWARTZ: I think to some extent what Colin just said is correct. When I was first starting out somebody on the buy side pointed out that only financial services companies go belly up overnight. It took forever for Chrysler. That said, I'll defend GAAP a little bit. In our business part of our job is to kind of understand where the earnings are going to come out every quarter. There is a value associated with being a little bit low rather than a little bit high in terms of making our estimates. Clearly the emphasis that statutory accounting practices (SAPs) are better kind of falls in with that. I'm not so sure that is correct. I think both accounting measures have their problems. The GAAP accountants are probably slower than the regulators in understanding what is going on. Also, to be honest, they're being paid by their clients, which is a major problem. But ultimately, I think GAAP is a good measure because of the appropriateness. At least they try to match. So, I'm not so sure that GAAP is necessarily better than statutory. That said, you can wake up in the morning and a company is gone.

MR. MACKINNON: Companies can't dividend their money or send an increase of dividend based on GAAP earnings. At the end of the day it's just about their distributable earnings. That's a regulatory constriction that's based on the statutory earnings. So, if you're just as good as your dividendable cash flow, then that's the only metric for that at the end of the day.

MR. JON LUNDY: My question relates to transparency of earnings and sources of earnings. Over the last couple of years a lot has changed in how we report earnings, and yet with the MONY/AXA transaction, we all learned that a lot of investors really didn't understand the accounting behind insurance companies. Could you give a view of where you feel transparency of earnings is today and where you think that it will go over the next few years? And then when you think of the benefits and embedded guarantees in the insurance products today, do you have a list of a few of those benefits that you'd like to see a lot more disclosure on and understand better?

MR. MACKINNON: I like the source-of-earnings analysis that the companies do now, and I don't think that is necessarily what their earnings number is. It's why it is that. What does that mean going forward? I think that speaks to the quality, especially given the fact they show the strain associated with the new business and the impact of any assumption changes. I think that's important. So if I look over the five years I've been in this, I think the disclosures have picked up a lot. In fact I've heard some people say we are giving them too much stuff. In terms of the guarantees, sometimes they want to know to what extent you're out of the money. If everybody died right now, how much are you going to be paying up? That is, to some extent, a metric, but I think the Street kind of misuses that.

MR. DEVINE: I think the Canadians are further ahead on this. I think the source of earnings, for most investors, kind of starts to demystify how an insurance company makes money. They actually start to understand what's going on, and that makes a lot more sense. Most investors want to know there's enough capital there, and if the RBC is based on the stochastic type of modeling, it's a lot more sensible system and it's a lot less of an issue. It would certainly put more pricing discipline on some companies in the United States than we've seen in the past, and some of them got in trouble last year with the capital problems. They wouldn't have gotten the problems they had if they had to put up capital in advance under a CTE (90) type formula.

MR. SCHWARTZ: I think what Tom said is definitely true. I've been in this business since 1987, and the disclosure has increased by leaps and bounds. I think technology and regulation have greatly increased the disclosure and the transparency of earnings. It's interesting, for those of you who don't work for Lincoln, that that question came from somebody from Lincoln. Lincoln's pretty good at this in my opinion. As well, Lincoln is the only company to put together a market volatility spreadsheet. The effect of the market on VAs and VUL and DAC and GMDB expense and things like that were big problems for us in trying to estimate earnings, and Lincoln put together a market volatility spreadsheet which explains that pretty well. That said, transparency could always be better. We're securities analysts. We're absolute information junkies. If you saw our models, you'd be aghast, I'm sure, about what goes in there trying to get an edge over each other and to help our clients. I think it's a major move, like Colin was saying, to something closer to CTE (90). I think what they believe are their true economic risks as opposed to what the rating agencies think their economic risks are is very interesting. You know, to a large extent they very much overlap. I don't follow the Canadians, but I thought what Tom showed, that some of the Canadians were doing and the sources of earnings, was very interesting. It would be very nice if the United States would move that way.

Chart 1

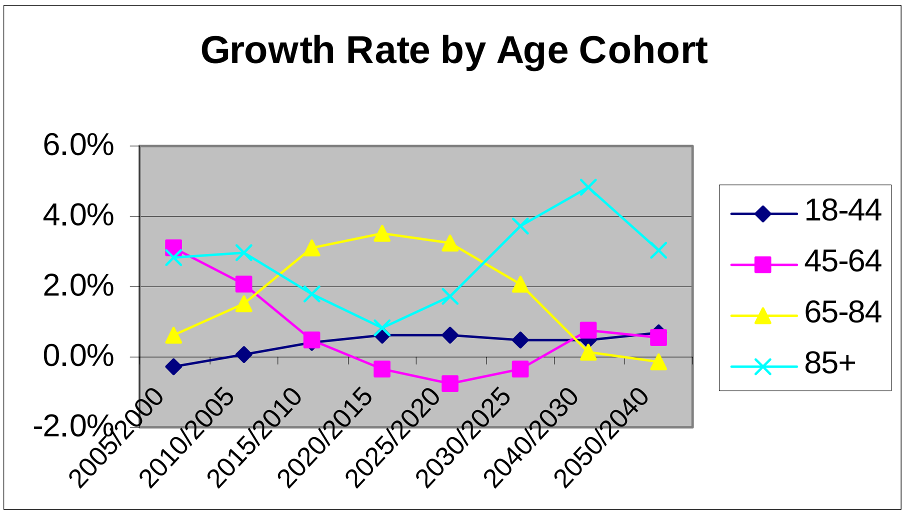

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Chart 2

Figure 1.

Projections of Assets Needed to Retire by Age Cohort				
Age	*% of Pop.*	*Median Financial Asset*	*Estimated Asset in Retirement*	*CAGR*
30	22.0	$ 949	427,000	17.8%
40	25.5	26,372	401,600	10.6%
50	20.4	41,114	261,200	12.3%
60	13.4	57,078	185,360	26.6%
65+	18.7	46,430	0	-10.0%

Source: U.S. Census Bureau, Federal Reserve and RJA Estimates

Figure 2.

Expected Growth of the Retirement Market			
	Total AUM		Expected
Plan Type	12/31/2002		Growth
$ in billions			
Defined Benefit	$	5,724	7.7%
Defined Contribution	$	2,070	10.6%
IRAs	$	2,406	12.1%
Retirement Savings Market	$	10,200	9.2%
Retirement Savings Market ex. DB Plans	$	4,476	11.4%

Figure 3.

Expected Non-Defined Benefit Savings Growth			
$ in trillions	2002 Assets		Expected Growth
Tax Qualified Plans	$	2,214	11.4%
Other Savings Assets	$	4,268	11.4%
Total Non-DB Savings	$	6,482	11.4%

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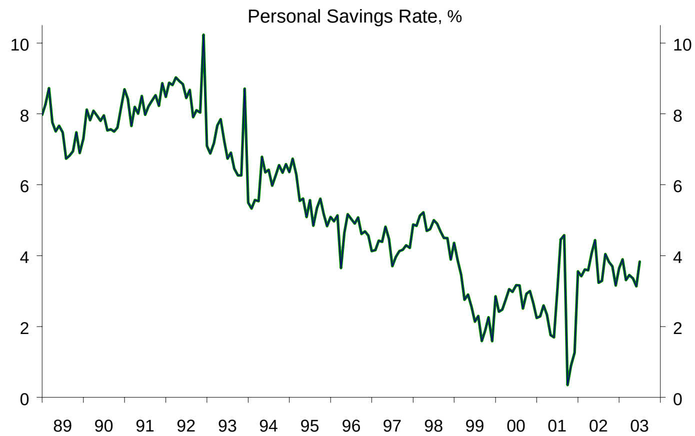
Chart 3



Source: Scott Brown, PHD Raymond James & Associates

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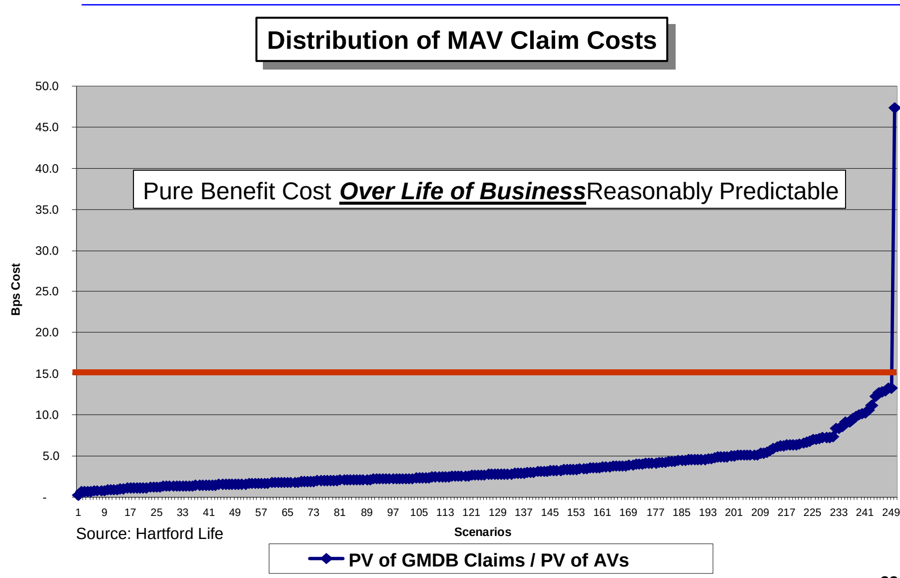
Chart 4

Evaluation of GMDB Risk



Source: Hartford Life

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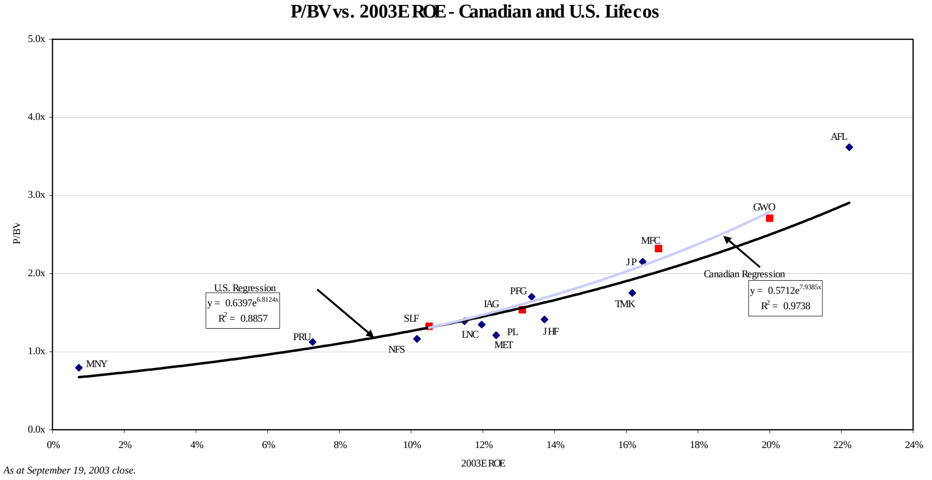
Chart 5

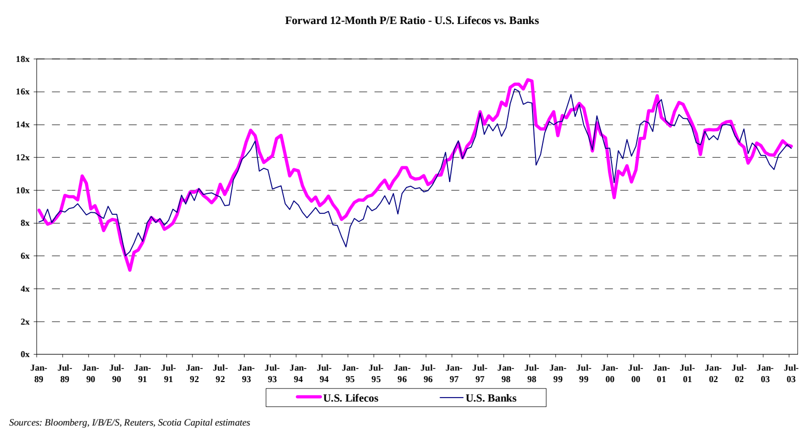


As at September 19, 2003 close.
Source: Reuters; Bloomberg; I/B/E/S; Scotia Capital estimates.

Scotia Capital

Chart 6

Traditionally Lifecos and Banks trade in line



Sources: Bloomberg, I/B/E/S, Reuters, Scotia Capital estimates

Chart 7

Embedded Value at Work – February 2002

Company	12/31/01 Reported[1] EmV	VNB	VNB/ EmV	12/31/01E[1] EmV	Return on EmV	P/EmV 2001E	P/E 2002E	P/BV 2001	ROE 2002E
Canada Life	$33.98	$0.99	2.9%	$31.63	9.1%	1.27x	12.8x	1.99x	14.6%
Clarica	$32.02	$0.65	2.0%	$31.08	12.2%	1.64x	14.1x	2.26x	15.1%
Great-West Lifeco	N/A	N/A	N/A	N/A	N/A	N/A	13.5x	3.19x	22.0%
Industrial-Alliance	$41.11	$1.76	4.3%	$39.55	14.3%	1.15x	14.5x	2.18x	14.2%
Manulife	$29.05	$1.20	4.1%	$30.00	22.7%	1.42x	14.7x	2.53x	16.1%
Sun Life[2]	$22.72	$1.19	5.2%	$22.64	13.6%	1.46x	13.6x	1.87x	13.1%
Canada Lifecos					**16.0%**	**1.43x**	**14.0x**	**2.26x**	**15.2%**

[1] Normalized 2000 and 2001E assumes 9.5% discount rate and mortality improvements

[2] Excludes embedded value of MFS, which Sun Life reported as $4.87/share @12/31/01

Prices at February 15, 2002

Sources: Company reports, Reuters, Scotia Capital estimates

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Chart 8

Embedded Value at Work – February 2003

Company	12/31/02 Reported[1] EmV	VNB	VNB/EmV	12/31/02E[1] EmV	Return on EmV	P/EmV 2002E	P/E 2003E	P/BV 2002	ROE 2003
Canada Life	$39.28	$1.37	3.5%	$37.92	21.8%	1.06x	11.5x	1.70x	14.1%
Great-West Lifeco	N/A	N/A	N/A	N/A	N/A	N/A	12.9x	2.26x	19.3%
Industrial-Alliance	$43.77	$1.68	3.8%	$40.71	4.5%	0.85x	10.9x	1.61x	13.9%
Manulife	$32.46	$1.39	4.3%	$32.48	10.3%	1.10x	10.8x	1.91x	16.6%
Sun Life[2]	$22.93	$1.03	4.5%	$20.10	(10.3%)	1.10x	9.5x	1.10x	11.1%
Canada Lifecos					**3.8%**	**1.08x**	**10.5x**	**1.58x**	**14.2%**

[1] Normalized 2001 and 2002E assumes 9.5% discount rate and mortality improvements

[2] Excludes embedded value of MFS, which Sun Life reported as $2.75/share @12/31/02

Prices at February 15, 2003

Sources: Company reports, Reuters, Scotia Capital estimates

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