MANULIFE FINANCIAL CORPORATION

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Robert Sedran, *Executive Direct, Equity Research* **-**

Okay, Good morning. Our next speaker is Paul Rooney. He is the President and CEO of Manulife Canada. Paul has been with Manulife since his time as an actuarial student in the Toronto offices in 1986. He's had a variety of roles since that time in an organization that must be quite different from the one he joined back in the '80s. He's currently responsible for the Canadian operations, so I think a lot of our discussion is going to focus on Canada. But, he certainly is, you know, a senior guy at Manulife and obviously prepared to talk about some of the more topical issues, as well. So, Paul, welcome to Montreal.

Paul Rooney, *President & Chief Executive Officer, Manulife Canada* **-**

Thank you.

Robert Sedran -

I'm going to start--and please, just throw your hand up. I'm not going to do a formal Q&A, so if you've got a question, your question will preempt mine every time. I want to start with earnings power in what is a challenging operating environment for any life insurance company. What is the interest rate environment doing to your earnings power today?

Paul Rooney -

Well, that's a very topical question, so thank you for the softball. We're in the business around the world, but most exclusively in the US selling long term guarantee liabilities. So, in order to back those liabilities, you need long term assets, mostly fixed income long term assets to match up those liabilities as best you can. But, there's significant interest rate exposure because you're collecting premiums for a very long period of time and making assumptions about how you will reinvest those premiums over that period of time and then ultimately pay out the claims. So, we do have significant interest rate exposure, as does every insurance company around the world. The unique aspect of the interest rate risk that we face is that we operate under a Canadian GAAP accounting basis, which marks to market. So, we took a significant interest rate earnings hit or increase in reserves in the past quarter that most of our competitors wouldn't have seen because they simply don't have the large US long tail business that we have. Our business in Canada will largely behave exactly as our peers here in Canada.

In the US, you didn't see the same phenomenon with long tail interest rate movements because they don't have a mark to market accounting basis yet until IFRS comes in the US. So, you would have seen many US companies not reporting any significant interest rate moves. Had they been on our accounting basis, you would have seen massive earnings losses.

To put it in perspective for you just to understand the difference between the accounting basis, if you look at our worldwide entity in the second quarter--I'm sorry--in the last quarter where we had a $2.4 billion loss, under a US GAAP perspective, which would be our counterparts in the US and how they report, we actually reported just over a $100 million gain or a $2.5 billion difference in reported earnings. Now, the one thing about accounting bases is they all converge to the same endpoint. It's just a question of the volatility in between. Clearly, a mark to market accounting basis that we have here in Canada creates a lot more volatility.

The good news is that relative to our US peers, if interest rates stay at these low levels under US GAAP accounting, they will have to face up to these lower interest environments and make reserving adjustments over time. We've reserved for it all. So, if interest rates stay at these low levels, we are fully reserved for our interest rate risk or largely reserved for our interest rate risk, and if rates come back, then of course we would see significant profit.

So, the earnings power remains very, very strong. The accounting basis will make it much more volatile. And I think that's a challenge for our investors and a challenge for management. We don't want to run an organization that might have a $2 billion loss one quarter followed by a $2 or $3 billion gain the next quarter just because, you know, treasuries moved 50 to 100 basis points during the quarter. But, that is the reality we face today.

Robert Sedran -

Well, you brought up the GAAP thing, so let's stay with that for a second because there was a fair bit of chatter on the conference call last quarter about the difference between US GAAP and Canadian GAAP. A lot of your shareholders that I speak with and me, I mean, I don't know what to do with that because, you know, it seems like there's one--I completely agree that there's--it's almost non-sensical that, you know, it's a developed economy in both countries here and that the accounting regime is so different. But, I mean, what's the regulators saying about this stuff and what--you know, from a practical basis, you know, how should your investors really look at that difference? Ultimately, the rules of the game are Canadian GAAP. Is there any sense that the regulator is similarly concerned about this difference?

Paul Rooney -

They're somewhat concerned, but you have got to remember that we're in a bit of a unique position in the fact that, you know, 75 percent of our worldwide earnings come--or worldwide wealth comes from outside of Canada where all of our main competitors in Canada largely draw their wealth from Canada. No one has a US operations of the size and scale of John Hancock. So, we are in a slightly unique position. They do recognize it and, you know, European accounting is in a mark to market world, as well. So, it's something they recognize. We're having constant dialog with them. I'm going to be careful because we're always talking to OSFI about various issues and I don't want to break any confidences there. But, they are aware of it, they are quite concerned about it. We take great solace in the fact that, you know, Minister Flaherty has been fairly vocal on this front. He's said repeatedly that he does not want any accounting regime to disadvantage Canadian companies on the international stage. It's very helpful for us.
But, at the end of the day, as a shareholder, you know, you've got to remember that the businesses that we're in are providing insurance products and wealth products for Canadians and Americans, people in Hong Kong and China and Japan, etc., and these are long tail in nature. And accounting bases will move those results quite dramatically depending on whether it's a mark to market or more of a smooth approach.

So, from a shareholder perspective, for a long term shareholder, you know, you need to focus on our growth, our international growth, the diversity of our businesses around geographies, the strength of our franchises and our brand and our ability to grow the business and grow it profitably. In this move to a capital markets world where you want to have a market value on everything today, it's going to be challenging for not just us, but for every insurance company around the world. So, I think you need to focus, and I think we'll see more non-GAAP measures around new business embedded value, embedded value of the franchise, etc., as you've seen in Europe. If you look at Europe, as they move to a mark to market accounting world, non-GAAP measures actually started to pervade analyst expectations and investor expectations about how to look at companies like ours and other insurance companies. It's a challenge for us. It's certainly a challenge for our investors to understand the strength and stability and long term nature of our business. And it is for the long term investor. I mean, we are a long tail business and I believe that long term investors will be well rewarded should they decide to invest in Manulife.

Robert Sedran -

I don't want to make this all a discussion about the US, but just to follow up on that, you're competing with companies that are on, at least today, a more favorable accounting regime. Does it change operationally what you do in terms of--you know, we have to pull back sales, we've got to pull back our exposure to that market, because in this environment, even if we think we're creating long term value, we're getting killed for it in the short term. And so, we need to refocus away from it. I mean, is it actually having an operational impact, or is this just a measurement impact?

Paul Rooney -

No, it has an operational impact, as well, because the reality is our worldwide accounting basis is CGAAP and Canadian capital rules. And so, we do need to face up to that reality. There's not an unlimited capital base, and we have to put it to work where it's best serviced for our shareholders. And under the current--you know, the US market has taken quite a beating. You know, virtually all of our competitors have cut their dividends to nothing. I know when we cut our dividend; it was quite a shock here in Canada. But, around the world, it was met with a yawn because virtually every financial institution around the world did the same thing with similar exposures to ours and many of our US competitors took TARP money, as well, which of course we didn't need to do. But, it does change the landscape. You know, we look at it now, we look at our US business not only from a local basis and how much capital and what kind of volatility we'll get from that US business, but we also have to look at it from a Canadian GAAP basis and not ignore the Canadian GAAP business when we price and value our business. So, it is having a fundamental shift in our appetite for certain risk, but it's also allowing us to explore other opportunities. We've got some great franchises in the US, our 401K business - the largest 401K provider for small business in the US. Our mutual fund franchise is growing fantastically in the US. So, there will naturally be some shifts as accounting rules and capital rules change.

The good news for our shareholders, I think, is that we have the most diverse geographic footprint around the world of any financial--virtually any financial institution and we're in a myriad of products from banking, wealth management, pension management, group benefits, which really allows a diversification. As we--as products come into favor or out of favor or the accounting rules shift, we can pivot to products and services that have a more favorable treatment under accounting and capital rules. So, our diversity from a product and geography perspective will help us in the long run.

Robert Sedran -

Okay. So, let's assume for a moment then, because a lot of this discussion has been, you know, what happens in a world like last quarter where interest rates come screaming down and there's a big charge, Canadian GAAP, US GAAP, different model, all the rest, let's assume this fantasy world where interest rates just stay flat and equity markets are sort of range bound to the extent we are today. Talk then about--so, forgetting the big charges and the big gains and let's just look through normalized earnings how much this company can earn in that environment, and you can talk about it from the Canadian perspective if you wish, and I actually would like some color on the Canadian market itself, as well.

Paul Rooney -

Absolutely.

Robert Sedran -

So, forgetting the volatility, what's the environment doing to earnings power? And if we don't come through to a better operating environment for 12 to 18 months, you know, how much can you earn in this environment?

Paul Rooney -

Well, I mean, we've disclosed our, what I'll call our core earnings, our normalized earnings. And those are very solid. I mean, that is what we should expect to earn going forward in the near term. But, the growth prospects are quite good, as well. All of our businesses in Canada are growing quite dramatically, the banking business, our mutual fund business, our group pensions business, our affinity business. Other businesses are growing at a more modest pace given our large market share like the group benefits business or the life business. But, all businesses are growing. All of our forecasting plans have us growing our core earnings around the world quite dramatically, especially in Asia where we're seeing 30, 40 percent growth in top and bottom line. So, the area where we're going to be more moderated is going to be in the US, given the accounting rules and the product constructs down there.

But, the core earnings look quite rosy, because you've got to remember, if interest rates just stay where they are, there'll be no big charges to earnings. There will be some minor changes as we change our ultimate reinvestment rate through our basis changes. But, any large swings would be non-existent and if interest rates go up, you would see all those large charges reverse.

Same with equity markets - we get a more normalized equity market, our core earnings that we've disclosed are quite supportable and we will achieve the growth that we're planning on. We have some very aggressive growth plans that we'll be discussing with the Board when we're over at our Board meetings in October, and I think I feel quite bullish about our prospects. The best thing for us is the benign markets that you described because it takes the accounting noise out of the equation, which is so concerning to our investors.

Robert Sedran –

If you'd like a question while you're standing there, feel free.
Talk a little bit about the competitive environment in Canada. In the past at any given time, there's been a lot of foreign competitors that have either been aggressive on pricing or pulling out of the market. Where do we sit today in terms of, who are you fighting with in Canada and do you expect those foreign players to be a material factor again?

Paul Rooney –

Yes, our competitive landscape in Canada is quite diverse now because we've moved from an insurance company to a broad based financial services company. A significant part of our earnings and our value now comes from our banking business, from our wealth management business. Between banking and wealth management close to 40 percent of our earnings now come out of those businesses, still a huge chunk from our insurance businesses, and we plan on continuing that.

In terms of the pure insurance space, you know, you've got the three large carriers - ourselves, Sun and Great West. And it's a fairly reasonable market right now. Everyone, I think, that builds good products and doesn't under-price and has great prospect in the group benefits business, in the life insurance business to do quite well. There was a time before I joined the Canadian division when the Canadian market was very, very competitive. You had a number of foreign players, we can list them all, that entered Canada and entered with a strategy of a low cost provider keeping their costs down a minimal as possible as a subsidiary or a branch of their US or European operations. Virtually all of those kind of companies have left Canada because it wasn't a sustainable strategy. They developed a one product or two product strategy. Like at any market place, consumer preferences changed from term insurance to long tail universal life to whole life to critical illness, etc. Unless you have a broad based portfolio of products, as we do in some of our competitors, it was very difficult to really pivot with and maintain a franchise here in Canada.

So, I would describe the insurance business largely as competitive but intelligent competition. I can't think of any--there's always little bits and pieces here and there where you'll see companies doing something where they'll gain some market share, and you'll say I don't think that's sustainable, and then they pull back. But, there's no competitor out there right now that I would say is acting foolishly as we've seen in the past. And there's a few still here that have a track record of doing that but have pulled back, as well. So, in the insurance space, I think it's a place where everyone can do reasonably well if they're intelligent about it.

Same on the benefits, group benefits space - I think they're really just--you know, we have about 22 percent of the market, as does Sun and Great West. And then, the rest of the market is spread around a number of regional players. Again, you see from case to case basis some aggressiveness, but overall, I would say quite an intelligent marketplace.

The segregated fund marketplace - you know, we never got into the challenges that they saw in the US with, you know, 7, 8 percent bonuses, quarterly resets, daily resets. The product constructs in Canada when the segregated fund business evolved to a payout version like the US evolved in a very sane way. Again, the benefits were manageable, they weren't unreasonable. So, we're quite pleased with our segregated fund business. We plan on staying in that business. After the cost of hedging, the margins are significantly higher than the mutual fund margins. And we intentionally price it that way because there is breakage as we do dynamic hedging and there's risk of ineffectiveness. So, we want to make sure we have a buffer in our profitability on those products to-- my view of the world is if you're going to get into a business that is mutual fund like but with additional risk, you must ask for significantly higher margins. And we're attaining those today, so we'll stay in the business as long as the marketplace continues to stay relatively sane.

The area that we're really excelling right now--and there are a couple of areas. The mutual fund business - we've made a conscious effort to grow in that business. Our sales are up over 300 percent from last year, and we've made the AIC acquisition, which has gone exactly as we expected and we'll continue to grow that mutual funds space. We're shifting some of our distribution focus away from the seg fund space towards the mutual fund space quite consciously and we're getting good results. We need to build a better product portfolio. We need more four and five star managers. So, we'll look at potential acquisitions, lift outs as well as growing our own internal asset management base.

Then, there's the bank, probably our--the diamond in the rough. That bank 10 years ago had $0.5 billion in assets, 50 employees and had no earnings. Today, we have the most innovative banking product in Canada. In fact, the Dean of Rotman's School of Business was lauding this product just a few days ago in the press, the all in one bank account, and it has grown dramatically. So, the bank now has $16 billion in assets, 500 employees and I don't believe we disclose our bank earnings separately, so I can't talk about that. But, it is quite significant and a very significant part of our Canadian-

Robert Sedran –

So, that is a core part of the franchise in Canada--.

Paul Rooney –

It is a core part, the fastest growing part, and I would expect over the medium to longer term that it could become the largest part of our Canadian vision when you look at all the businesses that we're in. It is, from a top and bottom line perspective, our fastest growing and most exciting business today. And iwe have a unique product that has not been copied in the Canadian marketplace today, which gives us a unique competitive advantage.

Unidentified Speaker -

Your concept of being a financial services firm versus an independent firm, typically the most costliest customer is a new customer versus an extension of wallet or gain in wallet share**.** So, can you talk specifically about the strategy that you guys have to expand wallet share of your current customers, and then on the group business whether there's specific strategies you're using to capture more of that business?

Paul Rooney -

Well, that's a great question and I hope I'll pay you later. This has been my number one theme since I took over the Canadian division I guess about two and a half years ago, because you're right, we serve now one in five Canadians. One in five Canadians owns a Manulife policy, either a bank product, a mutual fund, a segregated fund, an insurance product or part of our group benefits or group pensions platforms. And the opportunities are endless. I'll give you a few anecdotes to gives you a sense of some of the things that we're able to do. Let me start with the group benefits space.

So, if you look at our group benefits certificate holders, we have 3 million Canadians who are part of our group benefits business. And they look exactly like the rest of Canada. One in three of these people will be retiring in the next 10 to 12 years. So, if we do nothing else, Rick Burnett who runs the group benefits business is going to lose a third of his customer base just through normal retirement. But, it gives us a tremendous opportunity to then go and look at those customers and see what we can do with them.
The other phenomenon you're seeing is that most employers now are not funding post-retiree benefits. In the past, many companies, paternalistic in nature, would extend the employee benefits into retirement. That is a thing of the past now that employees have to actually capture that liability on their balance sheet at the point of retirement. So, all companies are moving away from post-retiree benefits.

So, we have an affinity markets business, which is a direct to consumer business that does a lot of individual health business, and we have designed something called the FollowMe Program. So, when someone is now retiring from a group benefits space, we have designed products that will come in and replace that with an individual product that looks, smells and behaves exactly like the benefits they had under the group plan. And we get them at the magic moment when they're retiring, when they're talking about what they need to do with their pension assets. When they're told their, you know, their retiree benefits, their vision, their health, their dental care will be gone, they need to replace it, we're right there as the alternative. We have the opportunity at the magic moment to capture that client. So, we're very excited about this. It's off to a very good start, and I believe it has a lot of legs for the future.

Unidentified Speaker -

What is the capture rate?

Paul Rooney -

Well, very low. We just started this, so I'll give you a couple of examples because a lot of--first of all, the employer has to decide they want this. So, we recently had an employer who looked at this, and the way we brought it into their firm was we said, okay, so we're going to get 100 percent capture on this employer because what we said to them was, you know, it's a difficult choice for the employee as they retire and you want to get off the cost of post-retiree benefits. So, why don't you pay the first two years of the premium on their behalf? So now, you're getting rid of all the long tail risk of this, but you're paying the first two years of the individual health premiums, and then once the retired individual is two years into the program, they will just naturally pick it up because they value and like the benefits. So, on that particular client, you know, we'll get 100 percent penetration. But, it's too early to tell how this program will go.

Another example is our group benefits and our group pensions business. You know, when I moved from the--moved from our US operations to Canada, you know, I thought there would be tremendous crossover between our group benefits and our group pension space. So, like any new leader, looking for some metrics, and I got some metrics in terms of the number of customers that we have on the group benefits space and the group pension space. So, we had, ballpark, about 15,000 employers or 15,000 customers on the group benefits space and about 5,000 on the group pension space, you know, large employers around the country.

Can anyone in the room guess how many common customers across group benefits and group pensions that we had at the time? Well, it was 458. I mean, that's pretty low. So, I sat down the leaders of both of these two businesses and I quite facetiously told them, you know, even if you tried, you probably couldn't do this badly. And they agreed. So, we've put a number of programs together to start cross-selling. I mean, if you look at the property and casualty business, they sell home insurance, they sell auto insurance. And then, when they bundle them, you get discounts for buying both. We're linking together the distribution forces. And one of the strengths of Manulife--I don't know if you're aware of this, but we operate in business silos. We have a general manager for each of our businesses. We wall off the assets and the liabilities of those businesses. Every general manager has their own financial organization, their own operations, their own call center, customer service, CFO, you name it. Every one of our businesses could simply be sold to someone else because we hive off the balance sheet. They have their own assets, their own liabilities. Every general manager in the Canadian division is responsible for every line of their income statement, their balance sheet and their return on equity. It creates clear line of accountability, clear focus. What it doesn't allow us to do is collaborate across boundaries, which is my big theme. So, we've been working quite hard to get cross-selling across our group benefits client. Last year, we had our second best year in our group pensions business ever with over $1 billion of sales. Twenty-three percent of those sales came from--sorry--this first half of the year, 23 percent of our group pension sales came from existing group benefits clients. So, we're really starting to get a lot of traction on this front.

Some other examples of things that we've been doing on a collaborative front is we pay out a significant number of claims from our group benefits business. We also have a bank. And in the past, what we would do is we would simply write a check to the heirs of the deceased from our group benefits space, and then we would--that money would disappear from the franchise. Today, what we do is we open a Manulife bank account for them. So, they don't get paid with a check. They get paid with a Manulife bank account, which they can write a check on or do whatever they want. But now, from a consumer's perspective, at a time when they're not focused on financial issues but they're focused on grieving, their money is put to work instantly in a bank account earning high interest, and hopefully, we can keep those clients as bank clients. So, there's a number of opportunities, given our broad based financial services space where we can find innovative ways to cross-sell and to be very consumer friendly.

Our Manulife bank product, Manulife One, is our largest cross-sell product. If you now own--and many advisors now are actually leading with Manulife Bank. When they're developing new relationships with clients, they lead with the bank because once you have the banking assets, once you have the mortgage, once you know where all the financial assets are in a banking relationship, you can then follow up with insurance products, with wealth management products, with mutual funds. So, our cross-sell ratio on our--excuse me--on Manulife One is 3.1. If you own a Manulife One product, on average, you own 3.1 Manulife products - so again, our best cross-sell product in Canada and one we'll strongly encourage. So, there's a number of opportunities. I could go through more, but I won't belabor it. But, we have tremendous opportunities on this front. You know, when you have 7 million customers, it's actually the easiest way and the best way to grow, and we're intensely focused on that.

Robert Sedran -

You mentioned in some of--in one of your answers the opportunity for some acquisitions domestically. I mean, you've done--Pottruff and Smith I guess is one. AIC you've already touched on. Is that the kind of deployment we should be expecting? I'm not looking for you to comment necessarily on market rumors. But, there were some more transformational type acquisitions kicking around a little while back. Is Manulife even considering anything big or is it small tuck-ins that'll fit in with your Canadian operations?

Paul Rooney -

Well, I think the big ones will always be available and we'll be looking. But, you know, in this uncertain accounting and capital environment, I think, you know, the prospects for big ones anywhere in the world by anyone is greatly diminished because there are certain uncertainties in the world right now. And until those get clarified, especially IFRS, people will be more cautious. And all the investment bankers in the room might not like to hear that, but I think that's the reality that we face. I'm a big believer, and we've had a strong track record--I mean, if you look at the Canadian division, it's really an amalgam of what we've grown organically. But, I believe if I last count, there are 23 different companies where people have bought policies from someone else that are now part of the Manulife fold from Commercial Union to Zurich to Confederation Life to Maritime Life and all of the Cigna and all of the companies that have been purchased underneath that. We have a unique core competency, I believe, at Manulife in terms of not overpaying, finding good gems and then expertly integrating them and driving significant synergies. I intend to continue to leverage that expertise where it makes sense for our shareholders, where we could put the capital to use for good work. Virtually any acquisition that we do in Canada would be a tuck-in where we could bring it in, we'd be smaller than what we have in that space, we could drive significant synergies and drive significant value. But, that would be in Canada where all of the focus would be. Elsewhere in the world, especially in Asia, there would be possibility of things more transformational. And in the US, I think given the state of the US, it would be a bigger challenge.

Robert Sedran -

Okay. We've got time for one more question. So, OSFI came down--just getting back to the regulator a little bit, they came down with--and suggested that they're not going to change the rules, because you mentioned segregated funds is still a product you like in Canada. They didn't say they were going to change anything for in-force block, but they did indicate that they're going to tighten on new products, on new sales. Can you still earn an acceptable rate of return in Canada under whatever new rules are coming?

Paul Rooney -

Well, I can't say with certainty at our current price point because the rules haven't been finalized. But, we've been discussing with OSFI. They've given us a number of trial balloons. The final new capital rules for seg funds should be out very, very soon. But, we're pretty sure we know the range that they're going to come in on. Within that range, which I'm pretty confident we'll end up, our current products are very acceptable from a profitability perspective. Again, my goal is to have significantly higher segregated fund new business profitability, then mutual fund profitability because of the other risks and other potential ineffectiveness of our hedging. So, we must demand a higher return. And under any range of capital rules that we've looked that we believe OSFI will ultimately come out with, it's pretty clear that these products meet that goal. So, we will stay in the business under this new capital regime in Canada.
And again, I think all of our competitors are largely priced for this same phenomenon. So, I don't think you're going to see the wholesale product changes that you saw in the US as happening here in Canada.

Robert Sedran –

Okay. We're out of time, so thank you very much for your time today, Paul and thanks for coming to the conference.

Paul Rooney -

Thank you. Have a great day, everyone.
