

**Tom MacKinnon**  
**BMO Capital Markets**

**The Impact of the Financial  
Crisis on the Life Insurance  
Industry**

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# Overview of Presentation

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- What happened?
  - Markets
  - Earnings
  - Capital
  - Valuations
- What's the market thinking now?
- What are the issues going forward?

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# What happened?

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- Credit and liquidity crisis
- Unprecedented drop in markets
- Credit spreads widen to unheard levels
- Treasury yields drastically fall

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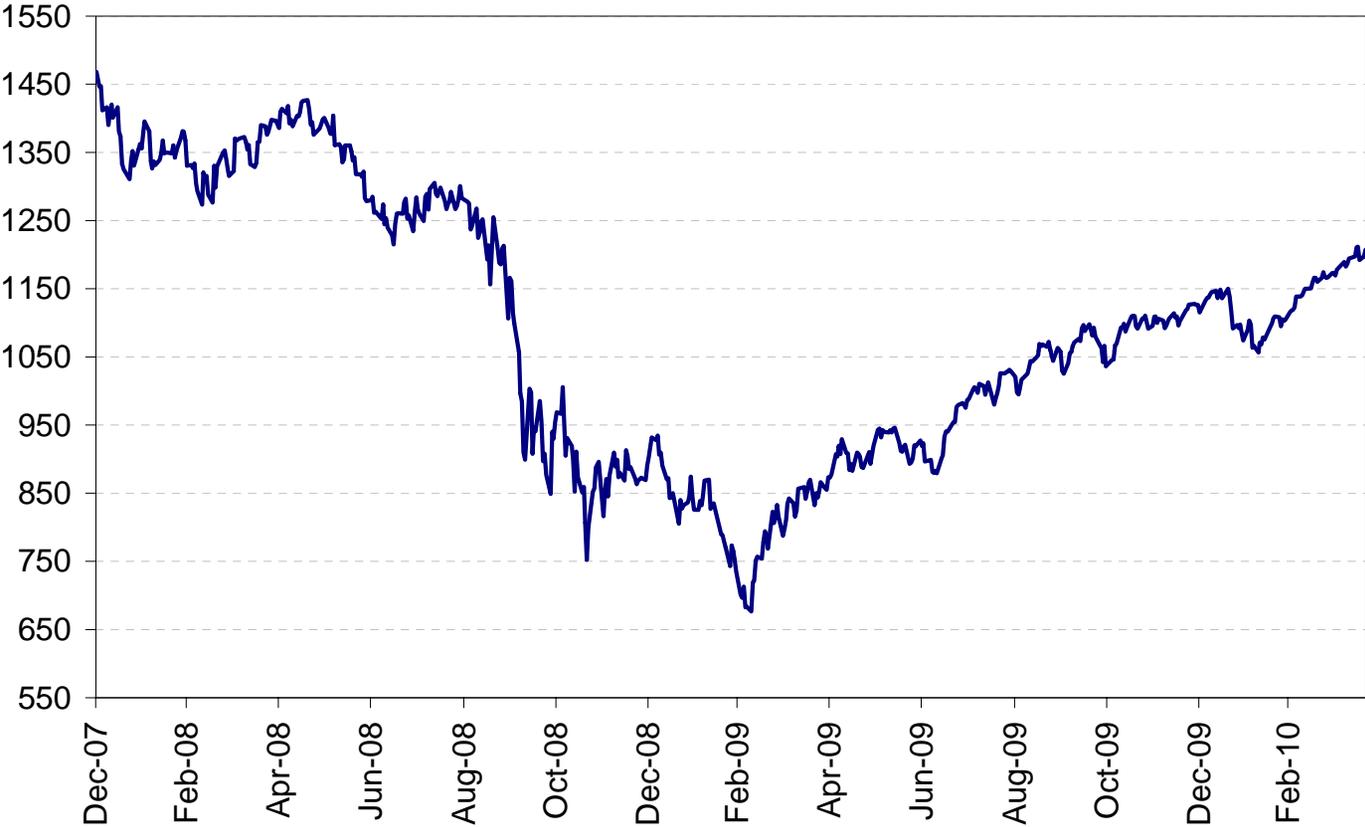


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# S&P 500 Falls 54% Peak to Trough

S&P 500



Source: Bloomberg

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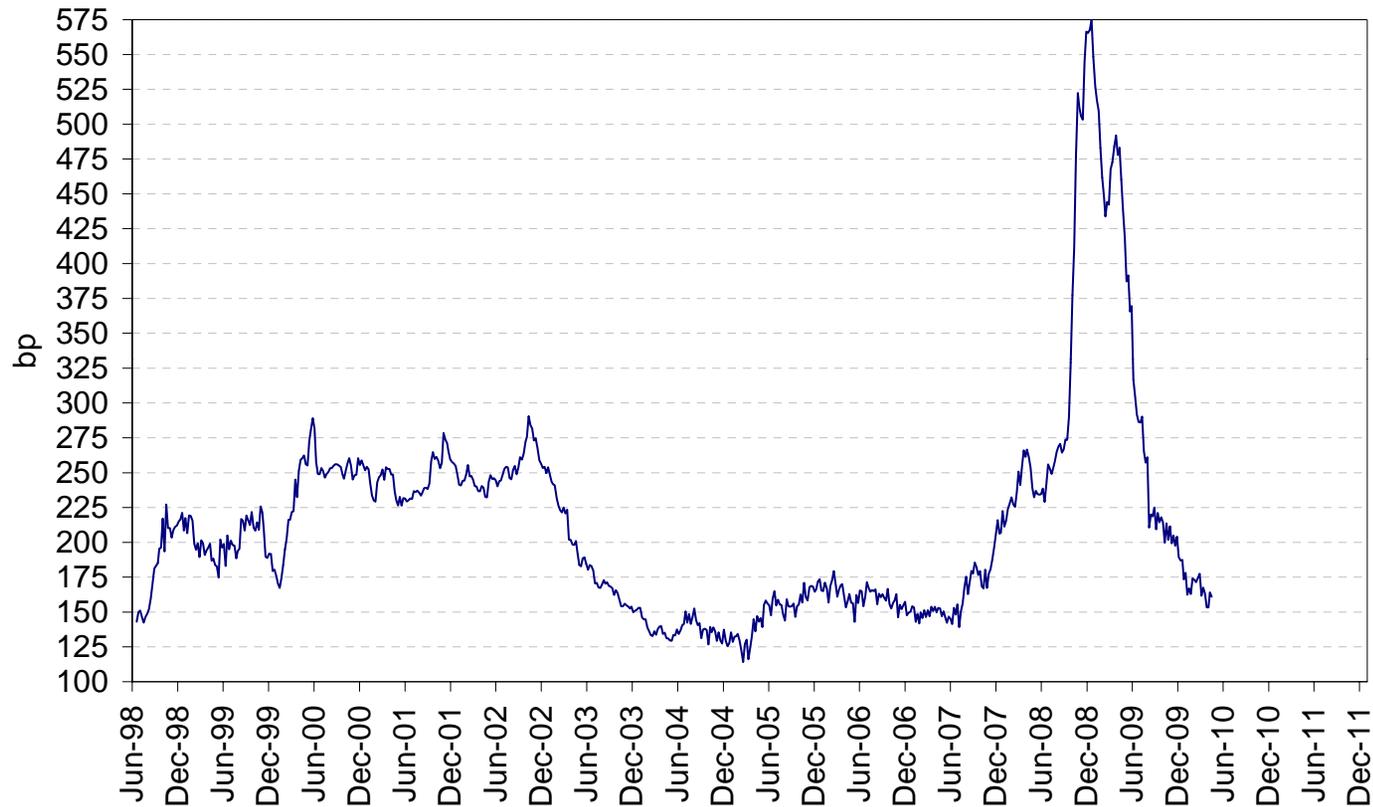


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# Credit Spreads Blow Out

U.S. BAA Corporate Spread



Source: Bloomberg

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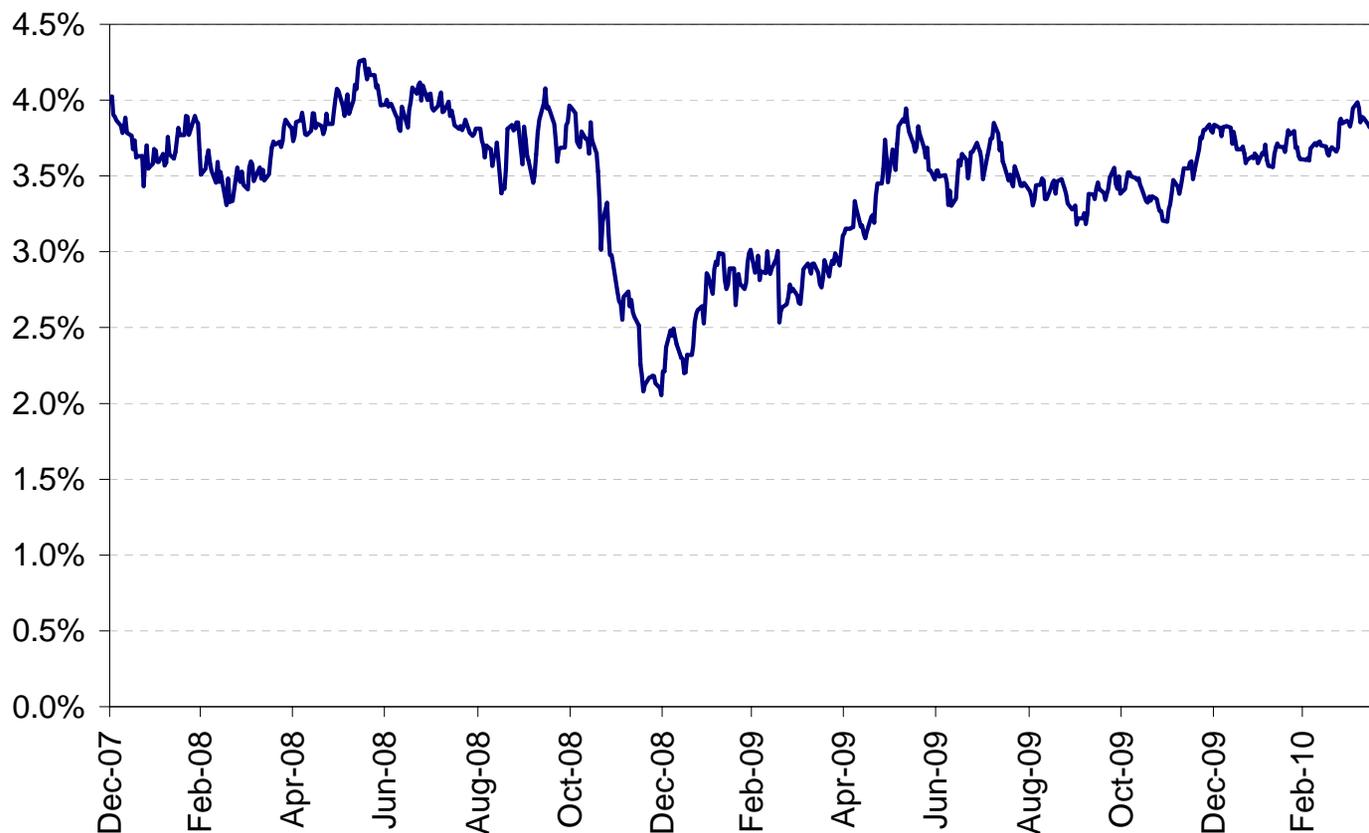


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# U.S. 10-Year Treasury Yields Drop

U.S. 10-Year Treasury



Source: Bloomberg

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# What happened to life insurance stocks?

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- Significantly underperformed the market
- Short seller campaigns fuel fears

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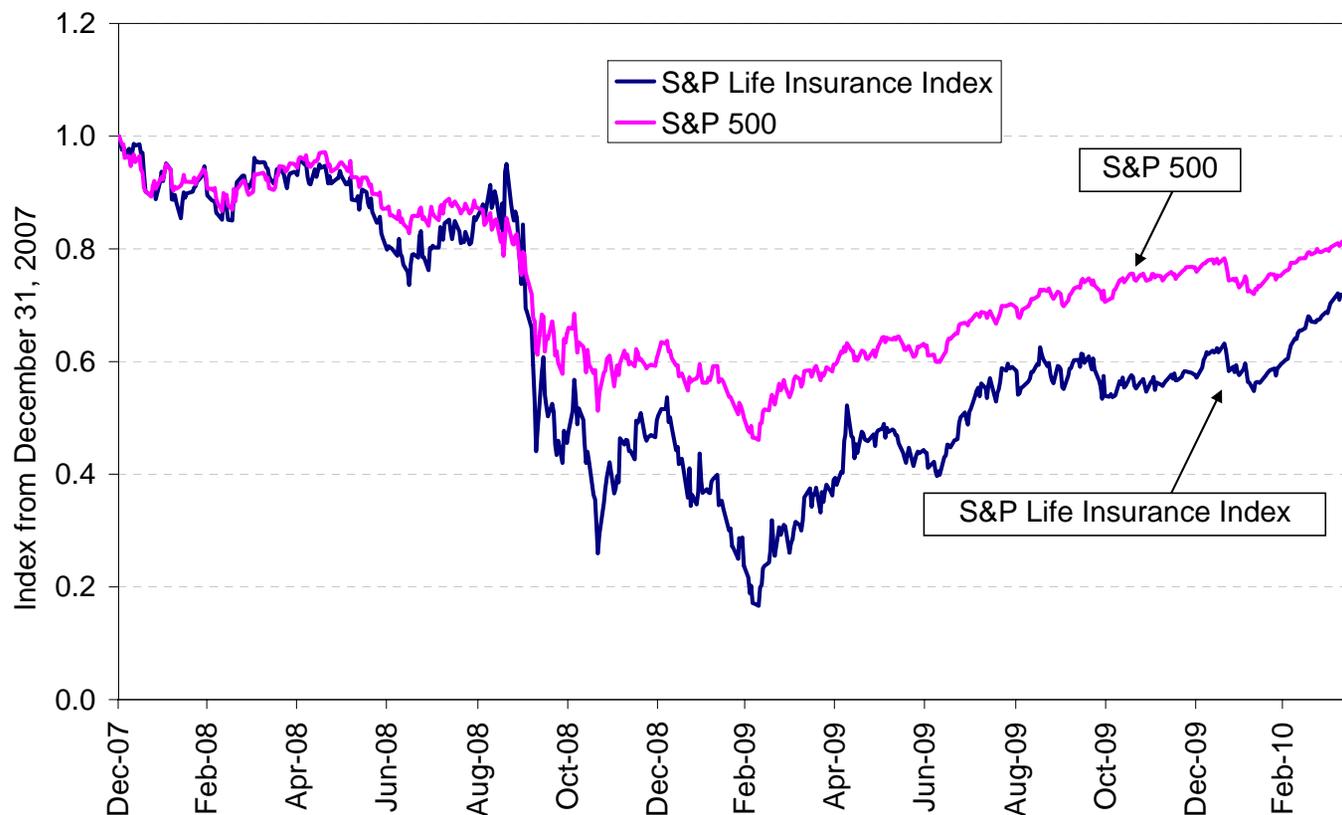


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# S&P Life Insurance vs. S&P 500

S&P Life Insurance Index vs. S&P 500



Source: Bloomberg

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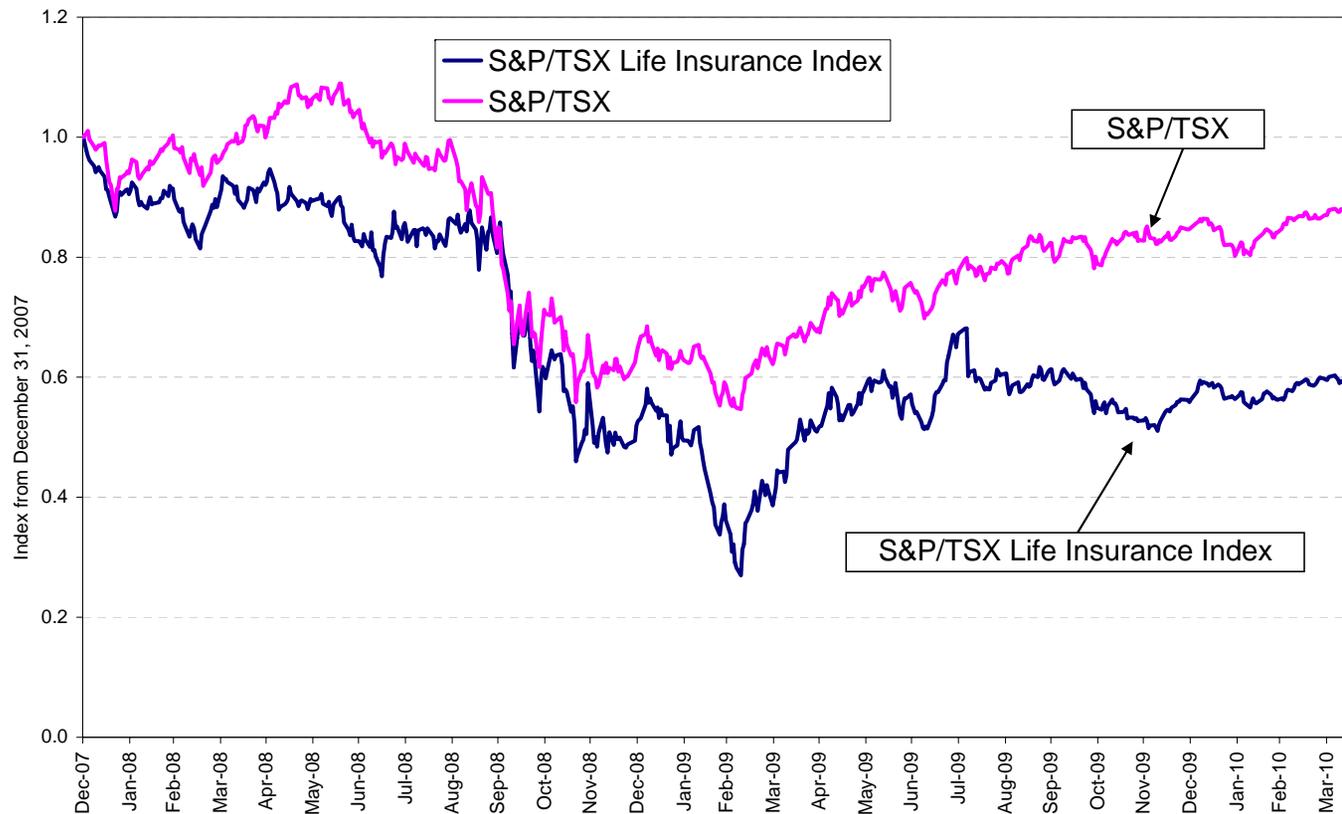


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# TSX Life Insurance vs. S&P/TSX

S&P/TSX Life Insurance Index vs. S&P/TSX



Source: Bloomberg

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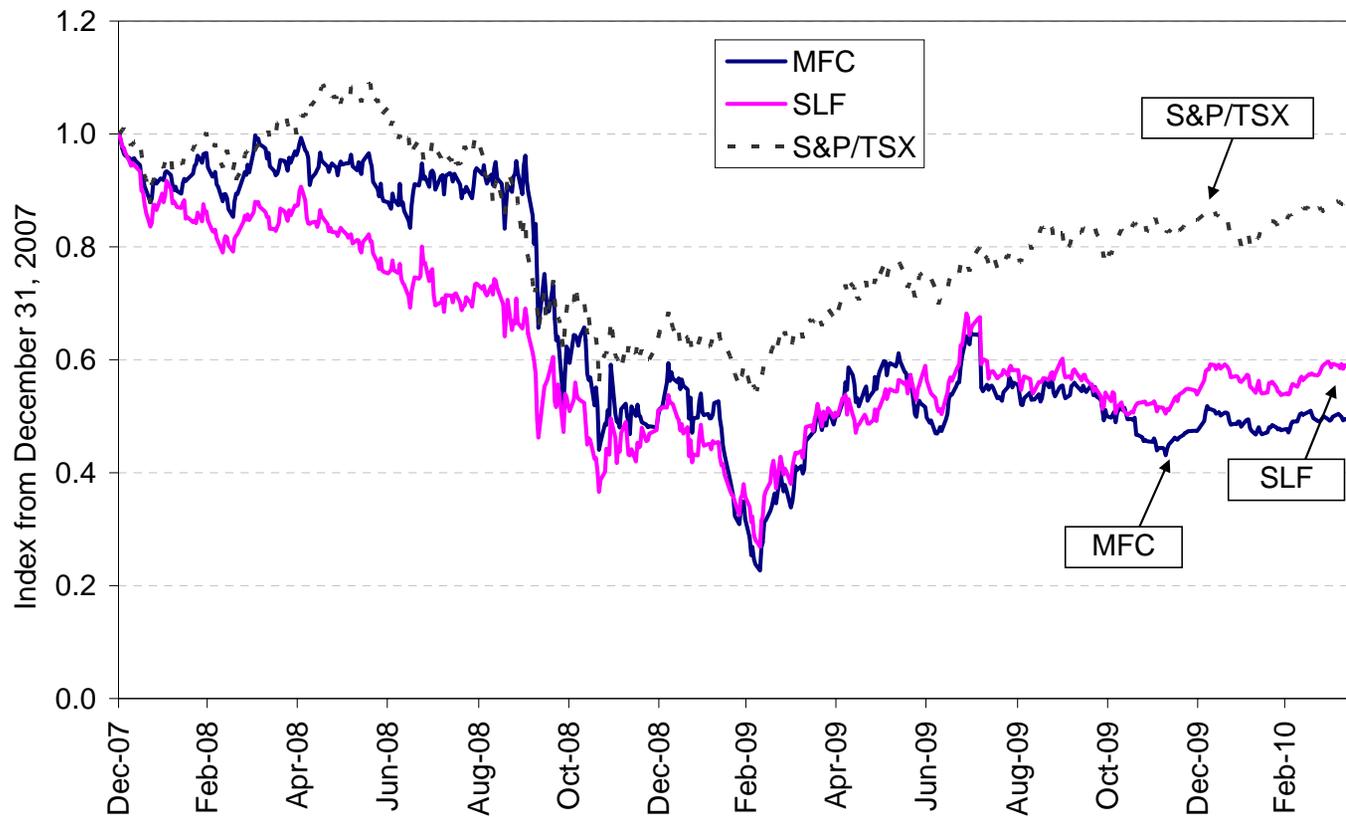


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# MFC and SLF vs. S&P/TSX

MFC and SLF vs. S&P/TSX



Source: Bloomberg

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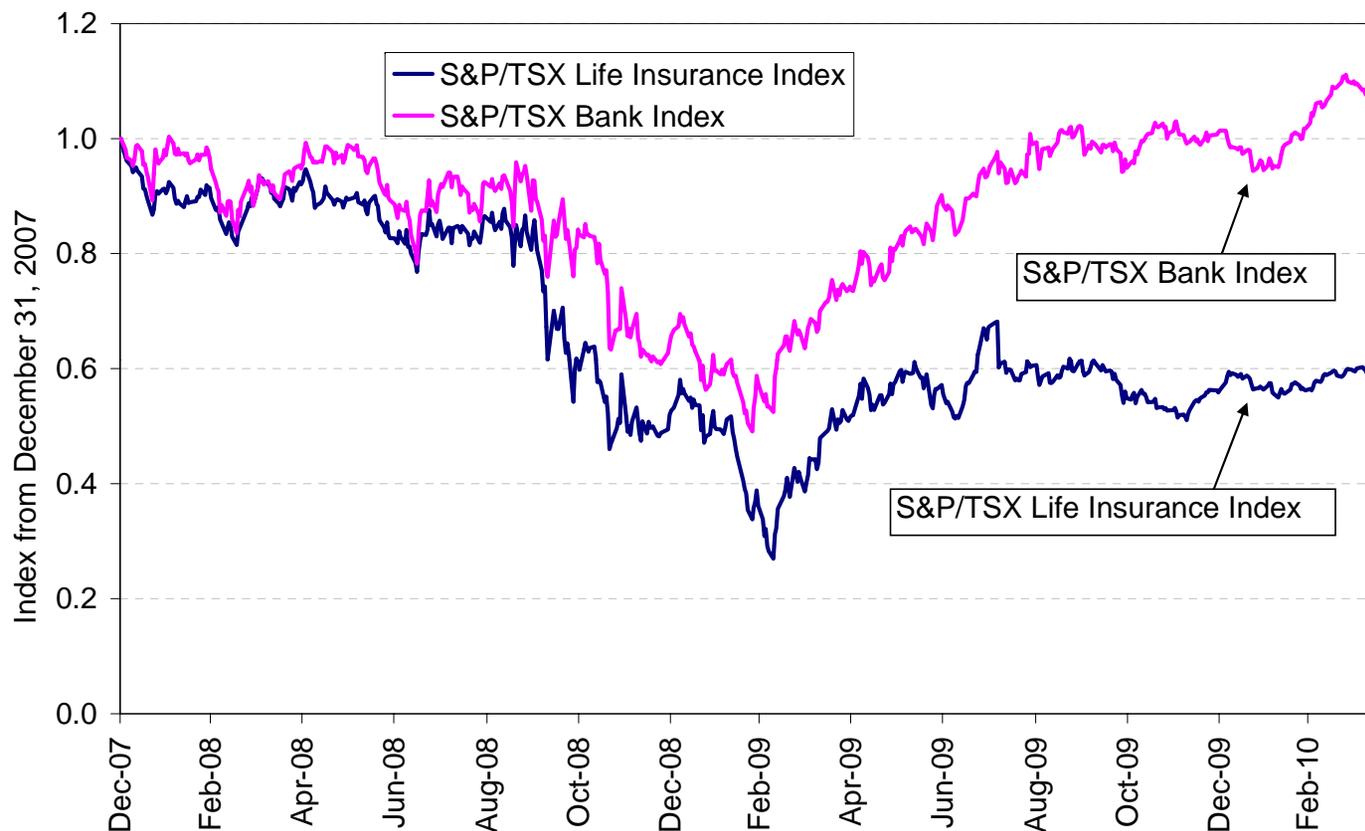


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# S&P/TSX Life Insurance vs. Banks

S&P/TSX Life Insurance Index vs. S&P/TSX Bank Index



Source: Bloomberg

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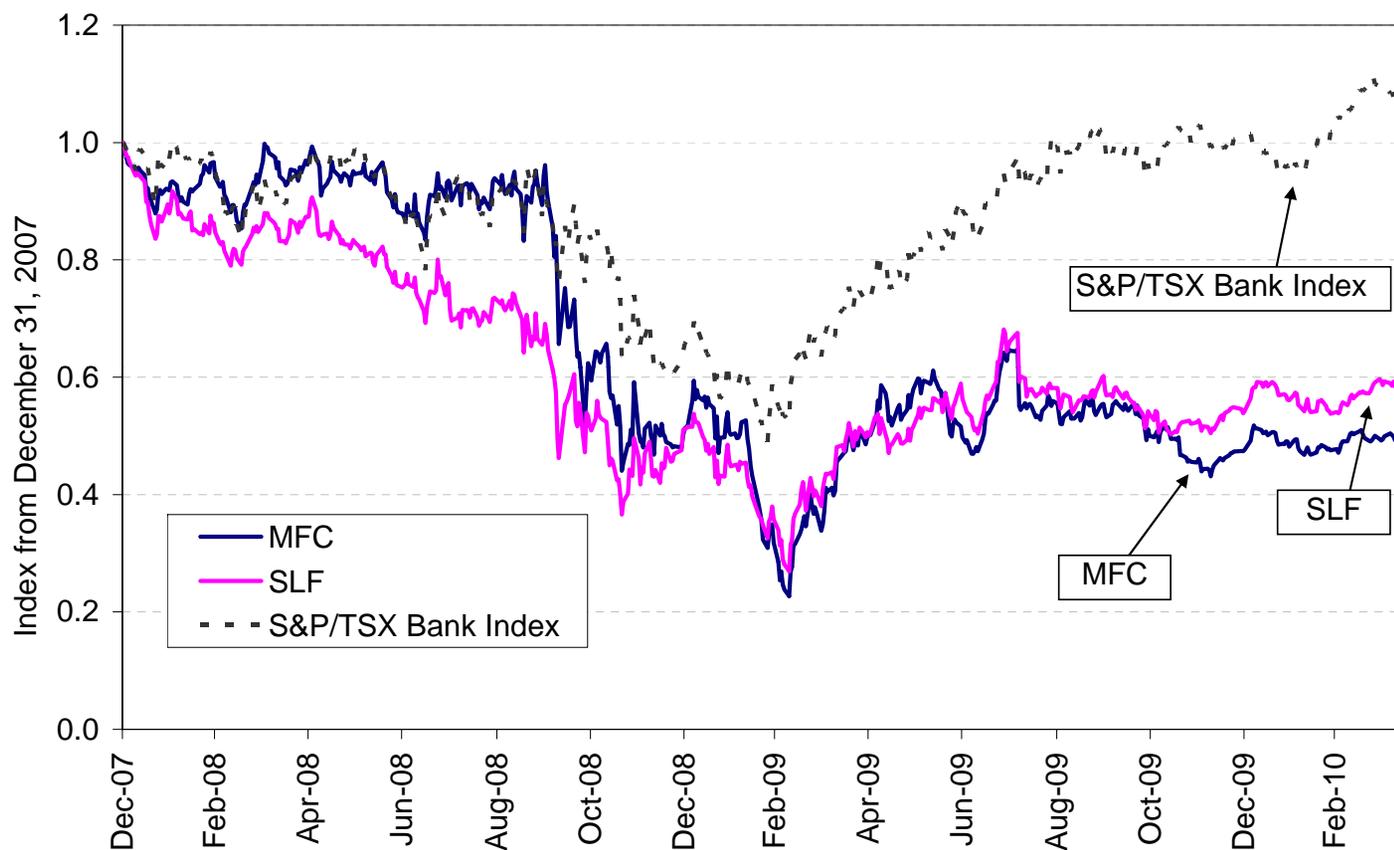


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# MFC and SLF vs. Canadian Banks

MFC and SLF vs. S&P/TSX



Source: Bloomberg

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# Earnings for Most Lifecos Were Brutal

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- Suffer from impairments, rating agency downgrades on asset portfolios
- Decimated due to marking on market seg fund liabilities and AFS assets
- Significantly realized losses on investments

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# EPS for MFC and SLF decimated

## EPS for GWO, IAG, MFC and SLF

	<u>2007</u>	<u>2008</u>	<u>2009</u>
GWO	\$2.41	\$2.26	\$1.72
IAG	\$2.99	\$0.82	\$2.55
MFC	\$2.82	\$0.32	\$0.82
SLF	\$3.98	-\$0.10	\$0.94

Source: Company reports

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# SLF Suffers the Most From Credit

Credit hits for GWO, IAG, MFC and SLF

	<u>2008</u>	<u>2009</u>
GWO	\$0.04	\$0.62
IAG	\$0.25	\$0.04
MFC	\$0.16	\$0.51
SLF	\$1.33	\$1.90

Source: Company reports, BMO Capital Markets estimates

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# Preservation of Capital #1 Priority

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- The obvious end of share buybacks
- Most U.S. lifecos and Manulife cut dividends
- Common/preferred equity, and debt capital raises
- Sell non-core assets to bolster capital
- No capital ratio can be deemed to be too high

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# Canadian Lifecos Capital Raises

Canadian Lifecos (C\$)	Net Raised Less Debt Repayments, or Funds Marked for Repayments	Net Raised Less Repayments As a % of Q1/09 BVPS	EPS hits as a % of BVPS
GWO	\$1.2B	10%	15%
IAG	\$0.4B	12%	11%
MFC	\$7.1B	29%	23%
SLF	\$3.6B	<u>21%</u>	<u>17%</u>
Average		18%	17%

Source: Company reports, BMO Capital Markets estimates

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# U.S. Lifeco Capital Raises

U.S. Lifecos (US\$)	Net Raised Less Debt Repayments, or Funds Marked for Repayments	Net Raised Less Repayments As a % of Q1/09 BVPS	EPS hits as a % of BVPS
HIG	\$6.0B	40%	24%
LNC	\$2.7B	26%	13%
MET	\$5.0B	14%	11%
PFG	\$1.4B	21%	7%
PL	\$0.1B	6%	20%
PRU	\$2.5B	<u>12%</u>	<u>16%</u>
Average		20%	15%

Source: Company reports, BMO Capital Markets estimates

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# Canadian Bank Capital Raises

Canadian Banks (C\$)	Net Raised Less Debt Repayments, or Funds Marked for Repayments	Net Raised Less Repayments As a % of Q1/09 BVPS	EPS hits as a % of BVPS
BMO	\$3.3B	19%	12%
BNS	\$4.1B	22%	6%
CM	\$5.1B	46%	57%
NA	\$1.2B	23%	19%
RY	\$4.9B	16%	14%
TD	\$6.7B	<u>19%</u>	<u>4%</u>
Average		24%	19%
Average ex CM		20%	11%

Source: Company reports, BMO Capital Markets estimates

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# What happened to valuations?

- Forward P/E had always been the traditional valuation metric
- P/BV vs. Forward ROE (which translates to forward P/E) was another
- With earnings completely decimated and in no way predictable these traditional valuation metrics gave way to P/BV
- When market were in complete panic P/Tangible BV was looked at

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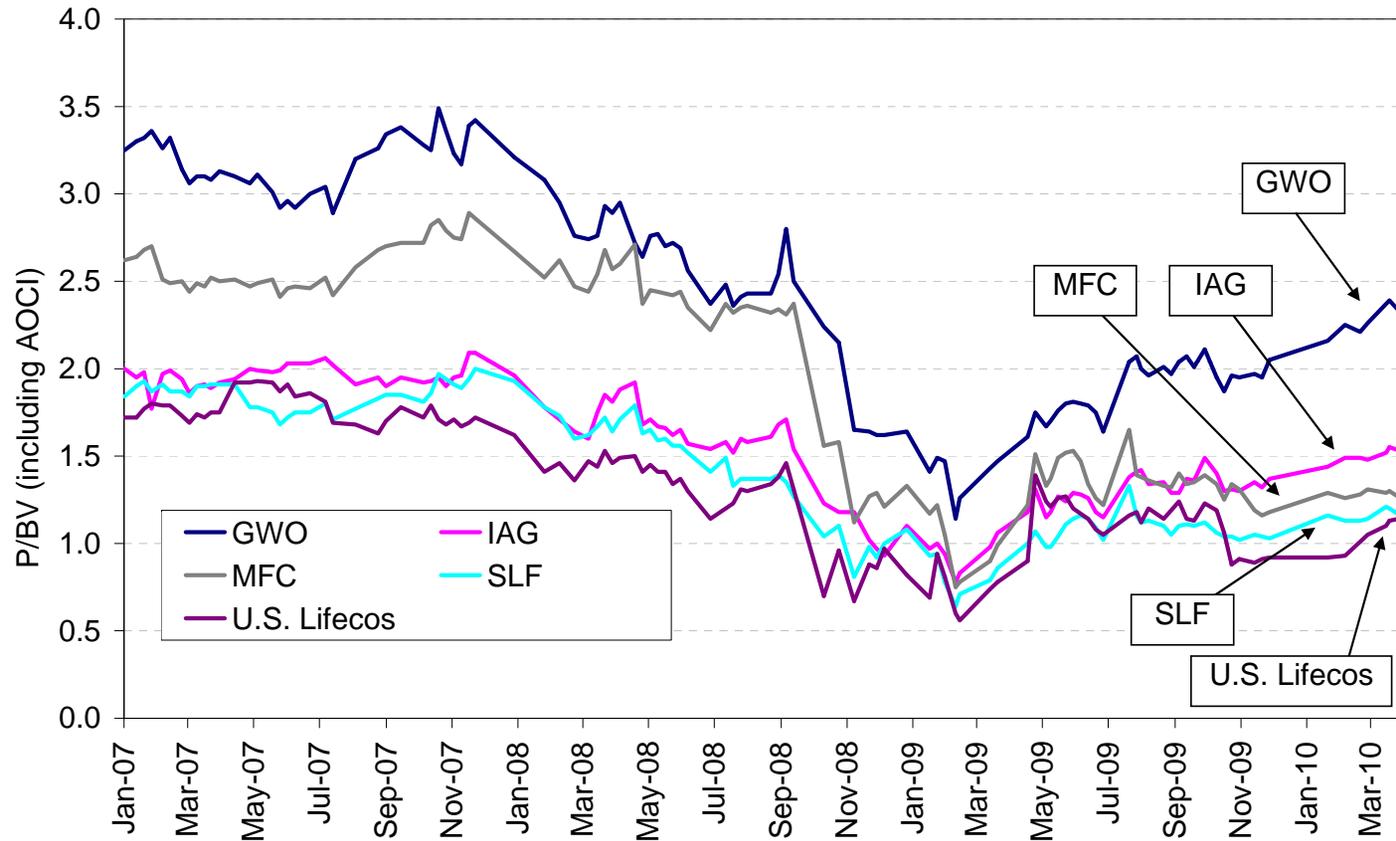


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# P/BV for U.S. and Canadian Lifecos

Canadian and U.S. Lifecos P/BV



Source: Bloomberg

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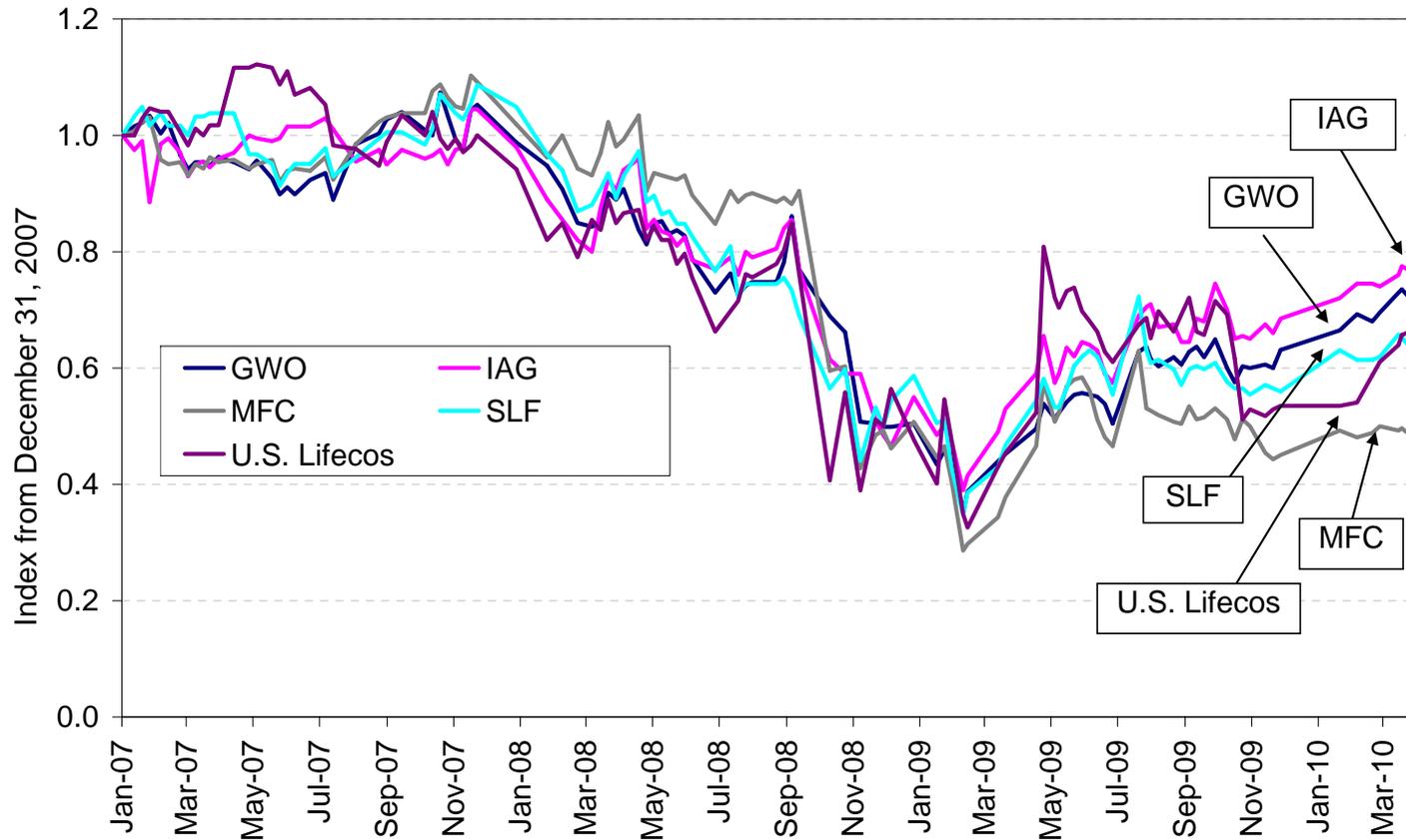


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# P/BV for U.S. and Canadian Lifecos

Canadian and U.S. Lifecos P/BV



Source: Bloomberg

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# Markets Have Recovered

- S&P 500 has climbed from 700 (March 2009) to 1200
- Credit spreads have come in from 550 bps to 150 bps – back to 2005-2007 levels
- U.S. long term treasury yields have climbed from under 2.5% (March 2009) to 3.8% and are expected to continue to rise

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# But in the last 12 months Canadian lifeco Manulife and Sun Life continue to underperform

## 12-Month Stock Price Change April 15, 2009 to April 15,2010

GWO	37%
IAG	38%
MFC	-7%
SLF	8%
S&P/TSX	28%
S&P 500	32%
Canadian Bank Index	48%
U.S. Lifecos	139%

Source: Bloomberg

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# Lifecos Valuations Below Banks

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	<u>Forward P/E</u>
Canadian Lifecos	11.9x
Canadian Banks	13.7x
U.S. Lifecos	11.6x
U.S. Banks	13.0x

Source: Bloomberg, BMO Capital Markets estimates

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# Earnings Volatility Hurts Valuations

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- Equity markets sensitivity has declined as markets improve but still remains well above historical levels for MFC
- Interest rate sensitivity has increased significantly for both MFC and IAG
- Appreciating Canadian dollar hasn't help

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# Equity market sensitivity

	<u>2009 YE</u>	<u>2008 YE</u>	<u>2007 YE</u>	<u>2006 YE</u>
<b><u>10% Increase in Equity Markets</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>
Great-West Lifeco	\$0.03	\$0.18	\$0.12	n.a.
Industrial-Alliance	\$0.22	\$0.21	\$0.23	\$0.21
Manulife Financial	\$0.57	\$0.99	\$0.20	\$0.14
Sun Life Financial	\$0.18	\$0.56	\$0.22	\$0.23
<b><u>10% Decrease in Equity Markets</u></b>				
Great-West Lifeco	(\$0.08)	(\$0.18)	(\$0.12)	n.a.
Industrial-Alliance	(\$0.22)	(\$0.21)	(\$0.23)	(\$0.21)
Manulife Financial	(\$0.68)	(\$0.99)	(\$0.24)	(\$0.14)
Sun Life Financial	(\$0.32)	(\$0.56)	(\$0.23)	(\$0.24)

Source: Company reports, BMO Capital Markets estimates

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# Interest rate sensitivity

	<u>2009 YE</u>	<u>2008 YE</u>	<u>2007 YE</u>	<u>2006 YE</u>
<b><u>100 bp Increase in Yield Curve</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>	<b><u>EPS</u></b>
Great-West Lifeco	(\$0.01)	\$0.02	\$0.02	\$0.06
Industrial-Alliance	\$2.98	\$2.10	\$1.36	\$1.00
Manulife Financial	\$0.91	\$0.11	\$0.18	\$0.17
Sun Life Financial	\$0.00 <sup>1</sup>	\$0.22	\$0.35	\$0.11
<b><u>100 bp Decrease in Yield Curve</u></b>				
Great-West Lifeco	(\$0.21)	(\$0.11)	(\$0.11)	(\$0.18)
Industrial-Alliance	(\$2.98)	(\$2.10)	(\$1.36)	(\$1.00)
Manulife Financial	(\$1.25)	(\$0.16)	(\$0.22)	(\$0.22)
Sun Life Financial	(\$0.36) <sup>1</sup>	(\$0.32)	(\$0.40)	(\$0.29)

Source: Company reports, BMO Capital Markets estimates

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# What to expect going forward

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- Weak earnings
- Slow growth
- It's going to take a long time to return to peak 2007 EPS for MFC and SLF
- Greater regulatory oversight

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# Source of Earnings tells the story

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- EPS growth in good years, especially for Manulife and Sun Life, was augmented by exceptional experience gains, favourable reserve releases and well-above average earnings on surplus
- These are unlikely to be repeated in the near term unless we get extremely buoyant markets (S&P 500 over 1500), a very benign credit environment, and significantly economic rebound
- Expected profit growth will be the key driver, and this could be challenged in the current environment

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# Assumption & Experience Gains

## Pre-tax EPS Impact of Assumption Changes/Experience Gains from Source of Earnings

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	Contribution to pre-tax <u>2005-2007 EPS</u>
GWO		\$0.69	\$0.65	\$0.45	\$0.41	24%
IAG	\$0.21	\$0.24	\$0.09	(\$3.58)	\$0.03	5%
MFC	\$0.55	\$0.93	\$0.96	(\$1.85)	(\$2.19)	25%
SLF	\$0.96	\$0.87	\$0.88	(\$4.57)	(\$3.19)	20%

Source: Company reports, BMO Capital Markets estimates

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# Earnings on Surplus

## Pre-tax EPS Impact of Earnings on Surplus for Source from Earnings

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Contribution to pre-tax 2005-2007 EPS</u>
GWO		\$0.26	\$0.30	\$0.22	\$0.21	10%
IAG	\$0.93	\$0.96	\$1.09	\$0.77	\$0.99	26%
MFC	\$0.70	\$0.64	\$0.81	\$0.33	\$0.06	23%
SLF	\$0.94	\$1.05	\$1.07	\$0.69	\$0.46	23%

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# Expected Profit

## Pre-tax EPS Impact of Expected Profit for Source from Earnings

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	Contribution to pre-tax <u>2005-2007 EPS</u>
GWO		\$1.81	\$2.17	\$2.34	\$1.74	69%
IAG	\$3.35	\$3.95	\$4.35	\$4.83	\$3.97	101%
MFC	\$1.74	\$1.92	\$2.11	\$2.13	\$2.29	60%
SLF	\$2.61	\$3.16	\$3.66	\$3.61	\$3.58	69%

Source: Company reports, BMO Capital Markets estimates

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# Greater regulatory oversight

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- Tougher regulatory capital requirements globally
- Counter-cyclicality
- OSFI conducting a comprehensive review of segregated fund guarantee requirements
- Capital metrics for holding companies
- OSFI will implement changes consistent with the implementation of IFRS Phase II

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# Risks going forward

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- Economic slowdown
- Interest rate risk – primarily URR-related
- Credit – primarily commercial mortgages

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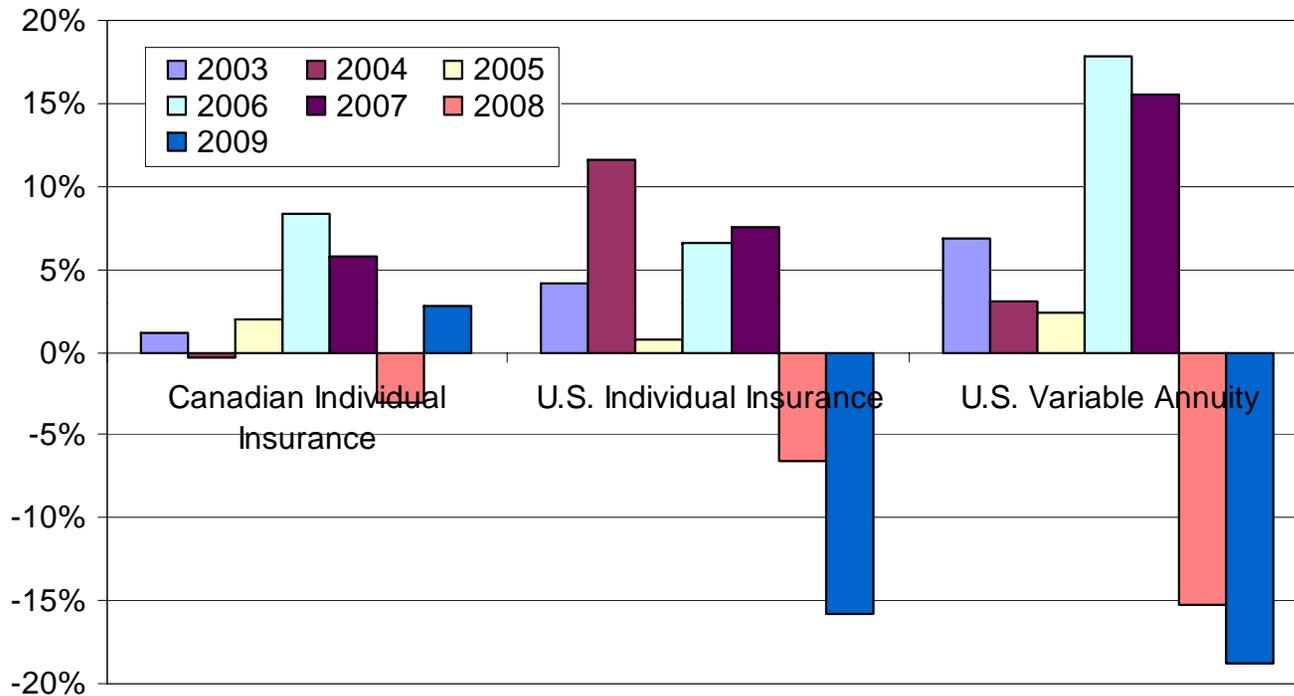


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# Canadian Individual Insurance Recovers, While U.S. VA and Individual Continue to Shrink

Annual Industry Sales Growth



Source: LIMRA, VARDS, Company reports

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# Ultimate Reinvestment Rates for Reserves – Continue to decline but lifecos generally ahead of trend

	<u>CANADA</u>	<u>U.S.</u>
2005 YE	4.97%	4.84%
2006 YE	4.68%	4.65%
2007 YE	4.45%	4.53%
2008 YE	4.26%	4.41%
2009 YE	4.07%	4.24%
2010 YE(est.)	3.98%	4.22%
2011 YE(est.)	3.95%	4.26%

Source: Company reports and BMO Capital Markets estimates.

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# The winners will be the ones who can...

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- Build robust capital management
- Focus on core businesses
- Readdress product and distribution strategies given the environment
- Capitalize on dislocation in the marketplace
- Improve effectiveness of company infrastructure

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# Life insurance is still a good business

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- Favourable demographics
- Excellent growth opportunities in unpenetrated markets, primarily Asia
- Scalable
- Still highly fragmented in most countries

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