FINAL TRANSCRIPT

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MFC.TO - Q1 2011 Manulife Financial Corporation Earnings Conference Call

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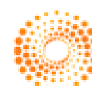

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Operator

Good afternoon, and welcome to the Manulife Financial Q1 2011 financial results conference call for May 5, 2011. Your host for today will be Mr. Anthony Ostler. Mr. Ostler, please go ahead.

Anthony Ostler - *Manulife Financial Corporation - SVP, Investor Relations*

Thank you, and good afternoon. Welcome to Manulife's conference call to discuss our first-quarter 2011 financial and operating results. Today's call will reference our earnings announcement, statistical package and webcast slides, which are available in the Investor Relations section of our website at Manulife.com.

As in prior quarters, our executives will be making some introductory comments. We will then follow with a question-and-answer session. The Heads of our Asia, US, Canada and Investments businesses are all attending this call and are open to taking questions from you.

Today's speakers may make forward-looking statements within the meanings of securities legislation. Certain material factors or assumptions are applied in making forward-looking statements, and actual results may differ materially from those expressed or implied. For additional information about the material factors or assumptions applied and about the important factors that may cause actual results to differ, please consult the slide presentation for this conference call and webcast, available on our website, as well as the securities filings referred to in the slide entitled Caution Regarding Forward-Looking Statements.

When we reach the question-and-answer portion of our conference call, I'd ask each participant to adhere to a limit of one or two questions. If you have additional questions, please requeue, as we will do our best to respond to all questions.

With that, I would like to turn the call over to Donald Guloien, our President and Chief Executive Officer. Donald.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Thank you, Anthony. Good afternoon, everyone, and thank you for joining us today. Our first-quarter 2011 financial results were announced this morning. Those of you who looked at them know that we are making excellent progress on our strategic plan, delivering sales in products targeted for growth, implementing hedging, improving product mix and profitability, maintaining very strong capital levels and delivering excellent customer value and advice.

We had quarterly earnings of CAD985 million.

I am joined on the call today by our CFO, Michael Bell, as well as several members of our senior management team, including our US General Manager, Jim Boyle; our Canadian GM, Paul Rooney; our Asian GM, Bob Cook; Warren Thomson for Investments; Bev Margolian, our Chief Risk Officer; and Cindy Forbes, our Chief Actuary. And I hope that you will have some questions directed to these people on the operating parts of our business in addition to the usual technical questions.

I am pleased to report that we are seeing very solid progress on all fronts of our Company. Our first-quarter sales of wealth and insurance products targeted for growth were up 22% and 15%, respectively.

I am particularly happy with sales growth in Asia, with wealth sales more than doubling and insurance sales increasing 27% compared with the first quarter of 2010.

We continued to diversify our business in Canada, which posted first-quarter record sales across a broad spectrum of offerings, including record mutual fund sales of CAD595 million.

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In the United States, we see tangible signs of success from our repositioning efforts, with record mutual fund sales of CAD3.5 billion, as well as success in other product lines. Funds under management reached a record CAD478 billion in the first quarter.

We also continued to make progress on obtaining state approvals of John Hancock Long-Term Care in-force price increases, now with 15 states approving increases in our retail business.

The first quarter of 2011, we made further progress on reducing equity market and interest rate sensitivity. An additional CAD8.5 billion of segregated fund guarantee value was added to the dynamic hedging program. And CAD200 million of TOPIX macro hedges were added on March 10, 2011, which just happens to be before the onset of the earthquake in Japan.

At the end of the quarter, for a 10% decline in equity markets, approximately 59% to 65% of the underlying earnings sensitivity was estimated to be offset by hedges. The range at the end of 2010 was 50% to 55%. With this, we have achieved our year-end 2012 target.

We have also reduced our net income sensitivity to 100 basis point drop in interest rates before the offset for gains and losses on AFS bonds from CAD1.8 billion at year-end 2010 to CAD1.5 billion. This surpasses the reduction required to meet our year-end 2012 goal.

Fair value gains on oil and gas and real estate investments and continuing favorable credit experience contributed to earnings. As I said, our first-quarter 2011 net income attributed to shareholders was CAD985 million, despite much higher hedging costs relative to a year ago and the estimated reinsurance claims related to the earthquake in Japan.

Finally, our capital levels continue to be strong, with Manufacturers Life Insurance Company MCCSR ratio of 243%.

In summary, we have achieved our year-end 2012 target for equity market sensitivity reduction and have exceeded our year-end 2012 interest-rate sensitivity target. Our capital is strong, our asset quality is superior, and we are seeing strong sales growth.

Our strategy is delivering results that will position Manulife for future earnings growth and ROE expansion.

As you can see, 2011 is off to a very solid start. My management team and I are working hard at growing our business and doing our best at achieving all of our strategic objectives. We hope this call can be focused on your questions about strategic progress and the myriad of initiatives that were working on across the firm. Bob, Paul, Jim, Warren and I are passionate about these divisions and their businesses and would welcome the opportunity to discuss them with you today.

With that, I will turn it over to Michael Bell, who will highlight the financial results and then open the call to your questions. Thank you.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Thank you, Donald. Hello, everyone. Overall, we continued to make good progress on our strategic priorities in the first quarter. Consistent with our strategy to enhance our business mix, we have generated a significant increase in sales in our products targeted for growth. We are also ahead of our original timeline on reducing interest rate and equity market sensitivities, as we have achieved our year-end 2012 equity risk reduction target and we have surpassed our year-end 2012 target for interest rate sensitivity.

These actions, combined with MLI's MCCSR of 243%, provide a substantial cushion against the risk of adverse financial market conditions.

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As Donald said, we delivered net income of CAD985 million in the first quarter despite much higher equity hedging costs and the P&C loss in Japan. And the actions to lengthen the duration of our assets backing actuarial liabilities resulted in a substantial gain. Importantly, I would like you to note that this is a one-time gain and we don't expect material gains to be recurring items in the future.

Turning to slide 7, you will note that there were a number of notable items impacting after-tax earnings in the first quarter. There was a CAD117 million net direct benefit from changes in interest rates, partially offset by a CAD6 million net loss on equity markets relative to our long-term assumptions.

The expected cost of macro hedging, based on our valuation assumptions, was approximately CAD100 million in the quarter.

The first-quarter charge for estimated P&C claims in Japan reduced earnings by CAD151 million. Our actions to lengthen the duration of the assets backing actuarial liabilities in order to reduce our interest rate sensitivity resulted in a CAD254 million one-time gain. These gains reflect the reduction in actuarial risk margins as a result of lower reinvestment risk.

Other investment related results, including market value gains on non-fixed income assets backing our actuarial liabilities and strong credit results and trading gains contributed a total of CAD170 million to first-quarter earnings. And various actuarial refinements netted to a positive CAD8 million.

Now, slide 8 is our source of earnings. Expected profit on in-force was down from fourth quarter of 2010 due to a number of factors, including most notably the impact of the stronger Canadian dollar and lower variable annuity expected profit on in-force.

The impact of new business improved in the quarter. The improvement was driven by lower acquisition expenses and higher new business gains in Asia, and increased prices in the US, which were partially offset by the strain caused by increased selling expenses associated with higher mutual fund sales in North America.

The experience gains largely reflect our actions taken to reduce interest rate sensitivity, as well as investment gains on our non-fixed income assets. Partially offsetting these gains was the first-quarter charge for estimated P&C claims in Japan.

The increased loss in management actions reflects the higher cost on the macro hedging program, as well as realized AFS bond losses and refinements to actuarial models used to value policy liabilities.

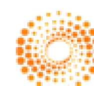
The AFS bond losses were triggered to offset a portion of the gains from higher interest rates in the liability segment.

Slide 9 summarizes our capital position for MLI. As of March 31, MLI reported an MCCSR of 243%. Combined with the actions we have taken to reduce our market exposures, our strong capital position represents a substantial buffer relative to financial market volatility.

I would note that our capital ratio is down 6 points compared to fourth quarter of 2010, primarily due to a combination of our net debt maturities, the phase-in impacts of IFRS Phase I and a change to the MCCSR treatment of an affiliate reinsurance agreement.

Slide 10 summarizes the strong insurance sales results delivered in the first quarter. Sales of insurance-targeted growth products grew by 15% over first quarter 2010 on a constant currency basis. Our Asia division delivered strong sales growth, with first-quarter sales up 27%.

In Canada, we achieved first-quarter record sales in both Individual Life and Affinity. And the overall Canadian insurance sales declined due to a drop in large-case Group Benefit sales. Importantly, though, the higher-margin small case sales increased.



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In the US, we are pleased with our 44% sales growth for the targeted life insurance products, as we replaced more of the No-Lapse Guarantee Universal Life sales with products with less interest rate risk.

Turning to slide 11, our targeted wealth sales for the quarter grew by 22% over 2010. We generated strong growth across all three of our geographic divisions.

In Asia, sales were more than doubled compared to the same period in the prior year. Canada continued to rapidly grow mutual fund sales, up 68% year-over-year. In the US, John Hancock mutual funds had another record quarter for sales with a 42% increase over the first quarter of 2010.

While our group retirement deals in the US were disappointing in the first quarter, we remain confident that the performance of this business will return to stronger levels in the future.

As you can see on slide 12, we continue to change our business mix in order to improve our long-term ROE outlook and risk profile. Products that we have targeted for growth have increased at double-digit rates, while the premiums and deposits for the products not targeted for growth are below the prior-year first quarter.

Moving to slide 13, we see the new business embedded value for the first quarter. I would note that 87% of our new business embedded value was generated from products targeted for growth. And this highlights the traction we are getting with our strategy to change the mix of our business.

We are using a refined methodology for calculating new business embedded value. Going forward, the calculation will be based upon updated parameters each quarter-end, including updated interest rates for all interest sensitive products.

Slide 14 demonstrates that our investment portfolio continues to be of high quality and well-diversified. Our invested assets are highly diversified by geography and sector, with limited exposure to the high-risk areas noted on the slide. We continue to view our investment management as a significant competitive advantage.

The next slide demonstrates the favorable earnings impact of our investment discipline. First-quarter credit charges were a fraction of the long-term expected amount of CAD28 million after-tax per quarter assumed in the valuation of our actuarial liabilities. As a result, we recorded a net gain for credit experience of CAD25 million after-tax in the first quarter.

As you can see on slide 16, we continue to reduce our equity sensitivity. As of March 31, our earnings sensitivity to a 10% equity market decline was reduced to a range of CAD490 million to CAD580 million, which was improved relative to year-end 2010.

The upper end of the range assumes that the dynamic hedge assets cover 80% of the loss from the corresponding increase in the VA liabilities. And the lower end of the range assumes the dynamic hedge assets completely offset the increased liability from a drop in the market.

As a result of the additional hedging implemented in the first quarter, we have achieved our year-end 2012 target, with approximately 59% to 65% of the underlying earnings sensitivity to equity markets estimated to be offset by our hedge programs.

With MLI's MCCSR of 243% and our reduced sensitivity, we have significant cushion to mitigate the risk of adverse financial market conditions.

On slide 17, you will see that we've also made significant progress in reducing interest rate sensitivity. Since the third quarter of 2010, we've decreased our sensitivity to CAD1.5 billion, surpassing our 2012 year-end target and bringing us closer to our year-end 2014 target of CAD1.1 billion.

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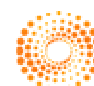

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Turning now to slide 18, we will answer two questions that may be on investors' minds. The first is the status of the Long-Term Care in-force price increases. While it is still early in the cycle, we feel positive about our progress so far with the states and their review and approval processes of our in-force rate increases. Rate increases have been approved in 15 states for our retail business, and this retail business represents the vast majority of the financial impact of the total long-term care business.

We continue to feel comfortable with our estimates and timetable that we developed when we calculated the reserve strengthening at the third quarter of 2010, and are pleased with the progress that we are making.

The other question is the significance of our downside risk in Japan. First, as we discussed in our press release on March 14, 2011, our financial exposure to the turbulence thus far in Japan is relatively limited and manageable. The first-quarter charge for estimated P&C claims is CAD151 million after-tax. We also took a provision for mortality claims of less than CAD5 million in the first quarter of 2011.

I would note that our current earnings sensitivity to a 10% decline in the TOPIX is moderately greater than CAD200 million after-tax, and this represents approximately 40% of our estimated total equity sensitivity, as noted on slide 16.

Our sales outlook for the entire market in Japan has not materially changed. So overall, we continue to believe our financial exposure to this recent human tragedy is limited.

In summary, we continued to successfully execute on our strategic priorities in the first quarter. We drove strong growth in our targeted high-return businesses as our business mix continues to change.

This quarter, we achieved our year-end 2012 equity market sensitivity target and exceeded our year-end 2012 target for interest rate sensitivity. As such, we remain ahead of our original timeline for reducing earnings sensitivities.

We delivered strong net income, despite the impact of the events in Japan, and much higher equity hedging costs. The lengthening of the duration of the assets backing actuarial liabilities resulted in a substantial gain. But please note this is a one-time gain, and not expected to be the new run rate.

Finally, we maintained a strong MCCSR ratio of 243%, which provides a substantial cushion to mitigate the risk of adverse market conditions.

This now concludes our prepared remarks and, operator, we will now open the call to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Steve Theriault, Bank of America Merrill Lynch.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks very much. First question for Warren Thomson. Warren, CAD170 million, a pretty big number for oil and gas and real estate gains. Can you talk to what drove the gains this quarter and address the sustainability of this item over the rest of 2011?

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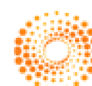

Warren Thomson - *Manulife Financial Corporation - SEVP and Chief Investment Officer*

The notable difference in our gains in the oil and gas front is once a year we do revalue our reserves for the actual drilling that was done in the previous fiscal year. That update did occur in our Q1 results, so we had -- really the gain this quarter was driven by two items.

Part was the increase in oil prices, and in part, it was the increase in our year-end reserves as a result of the movement to actual, based on our 2010 drilling results. So I would expect that number to actually be somewhat moderated relative to the levels [of that].

Our real estate gains are appraised every quarter, so our portfolio is subject to quarterly appraisals. And what our real estate evaluations are reflecting right now is the stability the real estate market is seeing, we are getting increasing rents, improving vacancy, in terms of decreasing vacancy, and cap rates are starting to decline.

So generally speaking, we've been in a favorable environment for real estate in Canada and the US for a few quarters now, actually.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Steve, it's Mike. I would add just one other thing. Please remember that in that CAD170 million, just a little less than half of that CAD170 million included credit gains and trading gains. So the whole piece wasn't just oil and gas and real estate.

And the only other piece I would add is obviously anytime you talk about what is going to be in a run rate going forward, it is a matter of judgment, and subject to a whole variety of factors. But in our view, the strong credit results are really a good indication of the underlying strength in the markets and the economic recovery.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay. Secondly, Don, you stated -- and I think, Mike, you reiterated -- 15 states have approved price increases. Not to get too far into the detail, but so far, have the increases that have been approved, are they pretty much in line with what you've provided for, plus or minus? Can you give us some sense of that?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

You can tell, Steve, it's good news, because we both want to answer the question. Yes, it has generally been very good, Steve. We've been pleased with the reception thus far.

But again, let's also remember it is early. There are obviously still another 35 states to go. But we are real pleased with the 15 states, and it has been -- in nearly every state, it has been virtually everything we've asked for.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Okay. Great. And lastly, with respect to your rate sensitivity, so now you have roughly -- well, I think exactly seven quarters ahead of schedule. You are where you said you would like to be by the end of 2012. Should we expect you to take a breather with respect to synthetically extending duration or selling shorter-dated assets for the next few quarters? Or is that still up for debate?

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Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Well, Steve, the strategy is still the same, which is basically you've got fortress capital, which enables us to do it at a time when it most suits our shareholders. And if rates went up, I guess you might -- or equity markets for the remaining amounts that are unhedged on the equity side, I think you would expect us to go faster. And if they went down or sideways, not the same pace.

It's essentially a market-based approach, bolstered by a very strong equity position. And also, sort of underlying that is a commitment to achieve those targets, regardless of what market levels. But we are so far ahead, we don't think we will be forced by our minimum run rate.

Steve Theriault - *BofA Merrill Lynch - Analyst*

I presume you haven't done anything quarter to date or you would have already disclosed it already today?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Nothing -- nods around the table. I want to just be careful and say, nothing significant, just in case there is CAD5.00 worth of hedging.

Steve Theriault - *BofA Merrill Lynch - Analyst*

Thanks very much.

Operator

Peter Routledge, National Bank Financial.

Peter Routledge - *National Bank Financial - Analyst*

Just a couple quick follow-ups on the Long-Term Care question. You are getting your increases. Does that suggest -- I mean, if that trend continues, do you have conservatism in your reserve, and does that suggest a reserve release down the line?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

First, way too early to be drawing any bottom-line conclusions. But I think it is fair to say that if we had the same success in the other 35 states that we've had in the 15 to date, and nothing else changed, there would be a positive impact. But again, way too early to be jumping to that as the conclusion.

Peter Routledge - *National Bank Financial - Analyst*

I won't. And then any of the larger states, like a Florida or California? Are those done or are you waiting on those?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

We are in the process of trying to get rate approvals done, Peter. And let's -- we want to assure you that there are some very significant states in there. But we really don't want to go into a lot more detail on this.

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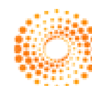

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Remember, we're in the process of trying to get more approvals done. And we are having success. There is no reason to be worried here. But we are not going to project the future. And -- yes, we don't want to go in this -- we're not going to go in on a case-by-case basis.

Peter Routledge - *National Bank Financial - Analyst*

All right. I'll leave it -- well, just one other question. You are shifting your product mix to less risky products, policies. And I see a drop, not unexpected, in expected profits as it relates to assets under management or other drivers. So you see a bit of margin pressure in Canada and the US, particularly in insurance. And then of course, you also have a little bit of benefit on the sales strain side. Are we at the end of that, or do we see those trends going for another couple quarters?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

We really feel good about the shift in our sales mix that we've been able to accomplish over the last several quarters. And we are doing a really good job in the US, for example, of growing the life insurance products that have much less interest rate risk than the No-Lapse Guarantee Universal Life product. So we really feel good about that shift.

We also feel good about the sales mix -- the insurance sales mix in Canada. We would note that when we raised prices back in late 2010, the good news was by year-end, our two major competitors also increased prices, following our lead. And so we are really pleased with the overall market conditions.

On some of the numbers, again, there are so many different numbers that bounce around in there in terms of expected profit on in-force and new business strain. I think, again, in any given quarter, there are going to be adjustments that are really non-fundamental either increasing those or decreasing those.

I think it is fair to say that we are pleased with the new business strain reduction that we've had globally, and would expect to see continued good new business strain numbers for the remainder of the year, if no other conditions changed.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Peter, at the opening to your question, I think you said tighter margins. We've got wider margins. We've increased prices on a wide variety of things and shifted the product mix, as Mike suggested. We're enjoying better margins now than before.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

And just one data point, just to acknowledge it. We obviously acknowledge that the variable annuity earnings on the in-force, the expected profit on in-force, they are lower. And that shouldn't be surprising to you, given the amount of hedging that we've been doing.

Peter Routledge - *National Bank Financial - Analyst*

Is the pattern -- how your expected profit and sales strain, it has changed. Are we closer to the end of the change in that pattern of results? I.e., have you moved your mix of business more to a run rate mix level or we still have some time to go?

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Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Peter, the biggest determinant of the change in the strain is under the Canadian accounting basis. When you issue a long-term guaranteed product like this, if interest rates fall, you generate more strain up front. That has been the biggest explanatory factor.

We've repriced products reflecting the lower interest rate curve. That is, again, as we said, improving margin. It also improves strain in the early days.

But when you talk about the trend, I can't predict the future in terms of interest rates. If interest rates were too drop to lower numbers, there would be more strain. And if interest rates were to go up, there would be less strain.

We have shifted the product mix in a direction that will reduce strain. We've raised prices; that reduces strain. But the thing we cannot control is what interest rates are, and that has been, frankly, the biggest contributor to strain across the Company.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

And Peter, just one other data point again. On the expected profit on in-force, if you look on slide 8 on the currency-adjusted expected profit on in-force, the only clearly obvious headwind for that number going forward, if you currency adjust it, would be the impact of additional dynamic hedging of VA, which we will do over time. That is the only known major headwind at this point.

Peter Routledge - *National Bank Financial - Analyst*

Okay. Thanks a lot.

Operator

Andre Hardy, RBC Capital Markets.

Andre Hardy - *RBC Capital Markets - Analyst*

Thank you, just a quick clarification, Michael. You mentioned 40% of the equity exposure is from Japan. Can you please provide us a breakdown between the US and Canada for the remainder?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Andre, I don't have those numbers specifically committed to memory, and I'd rather not get into that level of precision. The US is the next largest sensitivity after the hedging. And behind that would be the EAFE and Canada.

But again, importantly in US and Canada in particular, we're virtually at our long-term hedging targets if you include the credit for the macro hedging program. Japan is the piece where we still have the most percentage basis unhedged of the book of business, and that is why I felt like it was important to spike out that number for you.

Andre Hardy - *RBC Capital Markets - Analyst*

All right. Then my question that I had was on capital. Obviously, the MCCSR is high, the sensitivities are way down. The only thing that remains probably not as good as you would want is your leverage ratio. And is that what we need to see come down

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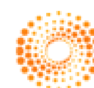

before the Company starts thinking about returning capital to shareholders? Or is it more regulatory uncertainty that is keeping you from considering capital actions?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

So, Andre, first of all, I applaud your astute observation. Obviously, the leverage ratio at 32% is still above our long-term target of 25%, and we are serious about our long-term targets. So we do anticipate reducing that leverage ratio over the next couple of years, and we will have some opportunity with that, given some debt that will be maturing over the next five quarters. So it is fair to conclude that that is a priority for us.

In terms of deploying capital, very much the answer to your question really depends upon the opportunities that are out there to use it. For example, if we saw an attractive acquisition tomorrow that strategically made sense, economically made sense and further diversified our business, we would be all over it. And with our strong capital ratio, and, as you point out, our dramatically reduced equity market and interest rate sensitivities, we would have the capacity to follow through on an attractive acquisition.

So I don't -- I think that would be something that we could do now, again, even with the leverage ratio.

The trickier question would be around things like increasing the dividend. That is trickier because of the uncertainty around the regulatory standards. Now again, at the end of the day, we expect OSFI to be reasonable. But we still -- there are still a number of moving parts out there, and that would really need to take place before we would recommend to the Board that kind of action. Donald, anything you would want to add?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

No, I would just like Andre to restate the question. I think he said we've got a super abundance of capital, and we've got a much reduced risk profile, if I understood it correctly.

Andre Hardy - *RBC Capital Markets - Analyst*

Thank you for that.

Operator

Robert Sedran, CIBC.

Robert Sedran - *CIBC World Markets - Analyst*

Good afternoon. Mike, first, just a quick clarification. On the notable items you list on slide 7, most of them would appear to be -- maybe nonrecurring isn't the right word, but at the very least, subject to some fluctuation quarter in, quarter out. That CAD100 million expected macro hedging loss, though, that is part of the run rate earnings, correct?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Absolutely, Robert. And just to be clear, our plan here is that in any given quarter, we do plan to highlight the notable items. So as an example, every quarter, I would expect to highlight the direct impact of equity markets and interest rates as a notable item.

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But you're absolutely right. Just because it is a notable item doesn't mean that it is a one-time item. And I think your point is exactly right. We would expect at this point the expected cost of the macro hedge in fact to be a recurring item for the remainder of the year. Now ultimately, we would expect that cost to come down if markets increase. We would also look for opportunities down the line to move it from macro over to dynamic.

But if you're just looking at 2011, I wouldn't try to conclude notable items are nonrecurring. It is -- that one in particular is likely to recur for certainly the next three quarters.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Robert, it is Donald here. It is there to remind people if they are doing a year-over-year analysis. If you are doing that and trying to reconcile operating earnings, you would say, gee, there is 100 missing here. And that is what it is, because we weren't doing the same amount of hedging last year as we've successfully done this year.

Robert Sedran - *CIBC World Markets - Analyst*

I didn't want to give the impression that it wasn't. I wanted to make sure I wasn't missing something.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

No, no, you are absolutely right.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

And Robert, the other piece to add there, just going back to Warren's answer earlier, we would expect a portion of those investment gains as well, if the markets continued to be strong. We would expect credit results to be a positive for -- certainly for the remainder of this year, and we would expect some other investment gains to be there.

Again, I wouldn't quantify it at this point. And it is a judgment and subject to things changing in the world. But that is our view at this point. That is our judgment.

Robert Sedran - *CIBC World Markets - Analyst*

Understood. I just wanted to ask about the reinsurance business. When I look at most of your other businesses, they are customer-focused, you are basically trying to build a franchise. This one, to me at least, is more akin to a trading business, I guess. Maybe it is just because of the loss this quarter, but I would like to hear your views as to whether the reinsurance business is a strategic asset for you and whether you might consider divesting if it is not.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Robert, I'll start, and I'll ask Donald to add. First, just to be very clear, the loss that we had this quarter in reinsurance relates to our property and casualty retro business. We feel very good about that business. It is a good diversifier. It has been a very high return business. It is a niche business. The losses are contractually capped, so it is not a black hole that can swallow up everything else. And so we like that business, and in a very -- we find it very attractive. And it would be the kind of business that would be unlikely to ever be divested. It is the kind of business that you either want to be in or you are not, and it is not -- it wouldn't be in that category of being divested.

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We obviously make it a practice not to talk about potential divestitures publicly. But I want you to understand how good we feel about the P&C business.

Robert Sedran - *CIBC World Markets - Analyst*

It sounds like that business is ROE accretive to a 13% long-term target for the overall business.

Is that fair?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Sure. I expect it too, although it is limited. I mean, we are not going to grow at by a factor of 100 or anything, so it is not the Nirvana. But it is a nice diversifier and it is a high-return business.

Robert Sedran - *CIBC World Markets - Analyst*

Okay. Thank you.

Operator

Tom MacKinnon, BMO Capital Markets.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Thanks very much. Mike, I just want to get a little bit more detail in terms of what you did with this CAD254 million in gains, the reduced interest rate exposure.

Was there -- maybe just walk me through some of the pieces. I remember you did something like -- something similar in terms of -- in the third quarter of last year. Is this whereby you took some of the assets out of the surplus account, [turned] them out in terms of assets that would support the liability; then, as a result, that would have reduced the mismatch risk, and consequently, you got some gains in the surplus account as well? I mean, there is a lot of moving parts that go into that, and I'm wondering if you can just kind of lump all those things together and explain the process there.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Okay. Sure, Tom. I will start, and I will see if Scott and Bev would like to add here. But maybe just taking a step back for a second.

As you know, since last year, we have been taking actions to reduce our interest rate sensitivity, and have been very public about our goals in terms of doing more of that between now and year-end 2014.

In terms of the impact on the reserves and the earnings impact, Canadian actuarial standards require us to have a provision for adverse deviation in our actuarial reserves for reinvestment risk. Actually, I know you know this, so I am not really teaching you anything on this --- it's to answer it for everybody else. But as you know, the Canadian standards require that PfAD. And that occurs because the CALM process notes that there is a cash flow mismatch between the projected asset cash flows and the liability cash flows, and we have to put up a PfAD for that reinvestment risk.

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So this quarter in particular, mechanically, we had accelerated release of that PfAD, since we've now got lower reinvestment risk from the forward-starting swaps that we put on for the liability segment. So this quarter, that was the gain. And obviously it was material. And as I've said probably now seven times, while we might have more of this in the future, I would not think about this as the new run rate.

Now, the way this differs from what we did late last year is that -- it differs actually in two pieces. One is that late last year, in addition to doing some forward-starting swaps, we also bought a significant amount of 30-year treasuries, particularly 30-year treasuries in the US. 30-year treasuries in the US hurt income because in effect we lose the spread that we would expect to get into the future by buying that 30-year treasury. So that was a negative to income. It happened to be roughly offset by the gain we had on the forward-starting swaps in 2010.

We took both of those actions to -- again, to reduce our interest rate sensitivity, not to produce quarterly income. This quarter, we didn't have that same 30-year treasury piece.

The other piece that we did last year that is a little bit different this year is that out of expedience, last year we significantly expanded the duration of the assets in our surplus segment. We knew that wouldn't have an earnings impact, but it would give us a natural partial hedge for further drops in interest rates. Because if there is a further drop in interest rates, we could reap those gains.

So we did that quickly to reduce the economic sensitivity. This year, we actually divested -- we sold -- realized some capital losses in the AFS bonds that offset part of the interest rate gain. So it served as a partial hedge; it just happened to be a realized capital loss because interest rates had gone up. And we have also now consciously shortened the duration of the fixed income investments in surplus to get it back closer to our longer-term target.

Let me see if Scott or Bev want to add anything there.

Scott Hartz - *Manulife Financial Corporation - EVP, General Account Investments*

The only thing I would say, Michael, is you gave a very fulsome answer looking back a few quarters. But for this quarter, it was pretty simple. There weren't a lot of moving parts. It was lengthening out on the liability segment, as Michael said, you release the PfAD, and that is what it is related to.

Tom MacKinnon - *BMO Capital Markets - Analyst*

So just putting on the forward-starting swaps is the key thing here, right?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Yes, that is what gave us the earnings benefit. And again, we may have some more of that in the future if we use that as the tool, Tom. On the other hand, if we use it as the tool more of the 30-year treasuries, that would be a negative. Again, at the end of the day, I would think of this as a one-off and not try to do something with run rate, if I were in your shoes.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Yes, our decision is driven by the ALM perspective, right, in reducing the risk and volatility perspective, rather than the earnings perspective. So you should not build that into your model with any expectation that we will do it on any regular basis.

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Tom MacKinnon - *BMO Capital Markets - Analyst*

And the loss on the AFS bonds, was that just something you decided to sell these bonds? That has nothing -- was that used to do anything else or just the loss as a result --?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Well, a couple things. Again, it is a natural partial hedge to interest rate sensitivity. So we consciously went out and sold it. A portion of it, we consciously sold just to offset the interest rate gain. We basically said, look, this only works as a partial hedge if in fact we go ahead and harvest gains and losses in any given quarter.

A portion of it, though, as well was getting back to a shorter position in surplus. Again, we were longer than our duration targets for the surplus bonds.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Just for everybody else on the phone, an explanation that Tom is obviously aware of, is our liabilities are marked to market based on interest rates. And as interest rates go up, the reserves will go down. That would lead to income.

We have an offset for that in our surplus, which is on a not mark to market -- on an AFS basis. When rates were going down, we would sell some of our bonds in surplus to realize the gain. We don't want to do that on a one direction. So when rates go up, we benefit in the liability segment but we are also selling some portion of it. So we don't build up an unrealized loss in surplus.

Tom MacKinnon - *BMO Capital Markets - Analyst*

How much, Don -- do you still have a sizable amount left in the AFS potential -- I guess there is -- in gains there in order to offset any kind of losses as interest rates have kind of fallen since the quarter?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

We do, but you put your finger on it. It doesn't matter what the balance is now; it depends on what interest rates do at the end of the quarter. If interest rates were to drop by the end of the quarter, you would expect that we would realize some significant portion of that. On the other hand, if rates went up, we would also realize a portion of that. And that attenuates the income sensitivity.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Take it on both sides?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Yes.

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Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

We do take it on both sides, Tom. That is the way that works. And again, that is important to do that because again, if we don't realize the losses when rates go up, we won't have the potential gains when rates come down. I would also note we did -- we laid this out on page 27 of the release. So, obviously, if you want to talk off-line on that in some more detail, we could do that.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Okay, and just one quick follow-up here. In terms of the US, you seem to -- US individual insurance sales, I don't know if Jim is on the line there, but seem to be doing reasonably well, I mean 44% growth on what you are targeting. And even if I look at overall sales, they are not that bad. What is it that you are selling here? How much of that is kind of no lapse guarantee, if at all, and what do you attribute your success to?

Jim Boyle - *Manulife Financial Corporation - SEVP and President of John Hancock Financial Services*

Thanks for the question, Tom. It's Jim. You know, we do have a dominant life insurance distribution franchise in the United States. And we've clearly made a conscious decision to back away from some of the long-term guaranteed business to reduce our interest rate sensitivity.

So we expected sales in those segments to be reduced by 50%, and we are seeing that.

At the same time, we understood that when you buy those guaranteed products at interest rates -- at these historically low levels, there is very little room for a client to participate in markets as they move up. And so we have repositioned our sales force with a suite of products that have more participating characteristics. And there is a segment of our distribution that, frankly, understands that and is excited by that upside.

So there is still a very large market for the guaranteed business. We've raised prices. Our competitors have as well, but not to the same degree. So for us, the product makes sense in this market environment. Our people are doing a good job telling the story. Their deep distribution relationships allow them to execute.

The numbers, although on a percentage basis are up quite a bit, are still relatively modest, if you were to look back two or three years relative to the level of guarantee sales. But we are executing to the plan almost as we designed it here. So we are very happy with our ability to make this transition, and the early signs here are quite good.

Tom MacKinnon - *BMO Capital Markets - Analyst*

Thanks.

Operator

Gabriel Dechaine, Credit Suisse.

Gabriel Dechaine - *Credit Suisse - Analyst*

Good afternoon. Just a strategic question. I noticed that Asia is popping up first in the supplement and in the presentation. Is that just an alphabetical order or are you trying to do something more messaging-related here?

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But aside from that, you talked a bit about acquisitions. There is a big asset in Asia that could be up for sale right now. My question is, how aggressive could Manulife be in the M&A space right now? Are you restrained at all by regulatory capital concerns, the unknowns, or are you willing to do something big?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Well, Gabriel, I love those questions. Let's deal with the first one. The ordering -- I would like to take credit for that. The fact is it came from one of our investors that has a very substantial stake, and said, you guys aren't getting it. -One of the most exciting stories in the Company is the Asian growth story, and, you've got it tucked back in behind everything else. Bring it out first. And we just took that investor's advice. And I hope you're listening on the phone here to hear the compliment going your direction. I'm not going to name the investor, but -- that might be a little embarrassing for a few people. But you've got it absolutely right.

The second thing is, yes, we are very active on the M&A file, as we always have been. Remember, when we raised equity, we said we have two purposes for this -- offensive and defensive. We can't be specific about the proportions. If markets turn ugly, they will be used for defensive reasons, but we would hope that wouldn't be the case; it would be offensive reasons.

What has actually happened is when markets went down, it was awfully nice having that capital. Markets have gone back up, and going back to Andre's question, we've still got the capital and now we've got a much derisked profile, both in the business that we are selling and because of the hedging activities. So we have some serious amounts of excess capital that could be deployed.

The other thing is we have cultivated through the whole piece relationships with investors that would be prepared to co-invest with us on large transactions. I think most people know that we came very close to doing one of the landmark deals, and for various reasons, did not conclude that. But we know the people who have the money who could enable a deal like that to happen.

We've been operating in Asia for 115 years. We've got as good a franchise there as anybody. We are very excited about growing that, and that would include acquisitions, as well as very, very strong organic growth. But we will never get into a position where we have to rely on the acquisitions. As you know, we've said it before, strong organic growth is the best way to do acquisitions, because you don't need to do them. You can be very choosy, pick your time when it is most suitable, and that is in fact what we will do.

Gabriel Dechaine - *Credit Suisse - Analyst*

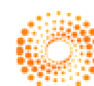
Yes, but it would sure avoid all these hedging questions on the conference call.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

I must commend you. I tell you -- we are getting a lot of feedback from investors, the buy side, that said, it is nice you get some of the technical stuff clarified. But they yell at us, actually, because we spend too much time on the technical questions. It's nice to get some strategic questions now and again.

Gabriel Dechaine - *Credit Suisse - Analyst*

No problem. Presumably, it would be like -- let's say you are doing it on your own. It would most likely be funded 100% or close to it equity, and you would be maybe okay with accepting some dilution near-term in the hopes of making it accretive over a longer period?



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Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

We are always driven by the economics of the deal. I do want to caution you -- things in Asia aren't trading cheap. And you can get all excited about embedded value and that's a good concept. But I tell you, there is about 14 different ways of measuring it, and I'm not sure everybody understands it as well as they ought to. And we won't buy anything that doesn't represent good economic value. And I just want to caution people on that.

Gabriel Dechaine - *Credit Suisse - Analyst*

All right. And last one -- just a very conceptual question. If the US were to be downgraded, and given your bigger position in US treasuries, how would that affect your -- have you been bolstering your credit default risk reserves for any of those eventualities or potential eventualities?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

I'm going to let Scott answer this, but I can't imagine any risk of the US government defaulting on obligations. The rating agencies, now observing with 20/20 hindsight that the United States government is actually spending a lot of money relative to its revenue, might downgrade the government. There is a risk of that. But that would not have a material impact on our Company. Scott --?

Scott Hartz - *Manulife Financial Corporation - EVP, General Account Investments*

Yes, I think it is fairly unlikely. Maybe S&P had some other motives. But we've looked at it. To go from a AAA to a AA in our system, there is not much additional credit loss. So even though we have large amounts of treasuries, the impact to capital and income would be pretty immaterial.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

I think the most likely impact -- wouldn't it be, Scott -- is that could lead to higher interest rates in the US government bonds, which would be very favorable to all those interest-rate issues that we have observed and take away a lot of the sensitivity. So a lot of us have been waiting for rates to go up, felt it was inevitable. So far, they haven't, for a whole bunch of reasons. But inevitably, water has to find its level, and I think the clearing price on interest rate for the US government debt is higher than it is at present.

Gabriel Dechaine - *Credit Suisse - Analyst*

All right. Thank you.

Operator

Mario Mendonca, Canaccord Genuity.

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Mario Mendonca - *Canaccord Genuity - Analyst*

Good afternoon. If you could help sort of square something for me. There are several references on the call to excess capital. And Mike, you've referred to the Company's priority get the leverage ratio down over time. And those two are definitely connected.

What I'm trying to understand is -- is the priority for this Company over the next little while, as the MCCSR improves -- and let's assume it does simply because markets are good and interest rates move higher -- would the priority be to reduce the leverage ratio and pay down the debt that was downstream to MLI?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Well, certainly, Mario, that would be a priority. Again, we meant what we said earlier. If there were attractive acquisitions out there, we would obviously look very hard at those.

But absent that, putting that aside, my expectation is that we will reduce that leverage. When we raised it to the 32% -- it is 32% now -- when we raised it through the additional debt last year, it was with an idea that was temporary, not permanent. And we're real serious about the 25% long-term target. So near-term, that is a financial management priority that is real.

Mario Mendonca - *Canaccord Genuity - Analyst*

So the references to excess capital then, I would imagine then you are including the double leverage that bolstered the MCCSR. Perhaps this is best for Donald. You are including that in your concept of excess capital then?

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

I wouldn't call it double leverage. We have a holding company that has raised some senior debt, and we've downstreamed that as equity in our operating company. That is a well-known phenomenon. In fact, as banks are getting recapitalized around the world, that, as well as contingent capital, will be a means of doing that. That is wholly acceptable. We will use that.

Mario, our goal was to create financial flexibility that would enable us to hedge at the most appropriate times. We've done that. We still have the capital. We can choose to retire some of the debt at some stage. That would be good to do. But as Mike said, we are not going to commit to that. If we see an acquisition, we'd be happy to keep the leverage ratio where it is.

If we saw an acquisition, that would obviously add to earnings going forward, and it would possibly diversify our streams of earnings going forward, which is also a positive thing, because it has a more diversified earnings stream to service the debt.

So we are very comfortable with the amount of leverage we have now. It is at a very attractive coupon. It is easily serviced. You can see why we are feeling pretty comfortable here that we have a lot of flexibility. We would expect through some of our actions over the next little while to actually be improving the MCCSR more. Again, it gives us the flexibility to either pay down debt, invest in accretive acquisitions or return it to shareholders at some appropriate time.

Mario Mendonca - *Canaccord Genuity - Analyst*

The reference to double leverage isn't the name -- isn't something I've created. That is what the rating agencies have been referring to it for probably the last decade. So it's certainly not something I created on this call.

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Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

I understand, but I don't like the term. Because you can choose to raise -- you call it double leverage -- it was raised in the opco. You can raise it upstream of the opco and essentially the same thing; obviously, more efficient (multiple speakers).

Mario Mendonca - *Canaccord Genuity - Analyst*

But the cost is different, depending on where you raise it, though. That is the whole point.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

And, as you can see, the cost, the way our debt is trading, is not very expensive, raising in the senior.

Why is that, Mario? Because people don't see a lot of risk associated with that. Every buyer of our senior debt knows that if we had a significant problem in the opco, their debt would be worthless. They are not terribly worried about it. Why? Because they understand we operate under some of the most conservative guidelines in the world, and are a very prudently managed company. And our senior debt, while it is subordinated, trades a nick above government debt because we are such a solid company.

The rating agencies will eventually come to realize that, when they look at the spreads in our debt, and work backwards from that the rating that is implied, the rating agencies will actually figure out what the bond investors figured out last year.

Mario Mendonca - *Canaccord Genuity - Analyst*

Well, we will have to give them more time, I presume.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

It will take a little more time, but they will get there. They will get there one of these days.

Mario Mendonca - *Canaccord Genuity - Analyst*

I get it. A different type of question then. Mike, what do you feel -- what sort of operating ROE do you feel the Company earned this quarter? And I mean let's -- you've been very clear there is a lot of numbers in there, a lot of earnings numbers in there that you would not want us to build into our models. What do you feel the sort of run-rate ROE was for the Company this quarter?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Mario, you're absolutely right, a lot of moving parts. And candidly, it is not something that I would calculate off of a single quarter. I think it is fair to conclude that our run rate ROE right now is in the low double digits, and still short of the 13% target that we put out there at the Investor Day. But we expect to get it up to the target that we described at the Investor Day, particularly through the business mix exchanges that we've talked about.

Mario Mendonca - *Canaccord Genuity - Analyst*

Do you feel you can get there sooner now?

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Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Obviously, we are pleased with the number of tailwinds that we have out there. And if we got some cooperation from financial markets, that would accelerate the path, so we're pleased.

But we are not using today, Mario, as the opportunity to give you new 2015 targets. At some point, when -- maybe at an Investor Day or if the recovery kept going for the remainder of this year, there might be an opportunity, but that would not be today.

Mario Mendonca - *Canaccord Genuity - Analyst*

Thank you for your help.

Operator

Joanne Smith, Scotia Capital.

Joanne Smith - *Scotia Capital - Analyst*

Wow, I squeaked right in there. It's two minutes left here. I have a couple of questions. The first one is regarding the extra equity market sensitivity hedging that you did during the quarter. So we build into our models CAD100 million, and then you do CAD100 million plus another CAD138 million.

So I'm wondering if that means that we need to build in more costs going forward because we are in a favorable market environment and you want to try to get as much of this done as you possibly can. Or was this just something that just happened to come together and you took advantage of it, and this is kind of a nonrecurring, incremental increase to the cost?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

I'll start and ask Bev to add. At this point, we have CAD5.5 billion of notional shorted as part of the macro hedging program. And that includes a little bit that we added here mid-quarter, specifically the CAD200 million that we added at the TOPIX in early March, just before the earthquake. And so I think it is fair to say that the CAD100 million expected hedge cost will creep up a little bit. But absent a big change in our notionals, I think that CAD100 million plus a little bit is a fair run rate for the next several quarters.

In terms of dynamic hedging costs, we reported on the last call that we had added another CAD8.5 billion of guarantee value has been added to the dynamic hedge program. And as we've talked about before, a reasonable approximation of the cost of the dynamic hedging program when we hedge the in-force is 50 basis points a year. So you could conclude that 50 basis points on that, so that is like CAD40 million to CAD45 million after-tax per year is a reasonable expected cost for that.

Now, your point on if markets start now looking better. Obviously, you can do your own modeling in terms of what you think the equity market returns are going to be over the course of the year. But the expected costs that I just described to you are based on our long-term assumptions, which are a total market return of approximately 10% a year, for example, in the US. That is price change plus dividends.

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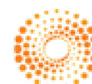

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Joanne Smith - *Scotia Capital - Analyst*

Got it. Okay. And then just -- when I'm looking at the US insurance business, and I am looking at the experience gains in the quarter of CAD411 million, can you kind of give me an idea of what that is comprised of? Is that part of that CAD254 million and part of other CAD170 million? I mean, I am just trying to get my arms around where these numbers are originating from.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Absolutely, Joanne. The experience gains in the US were the investment gains that we had highlighted in the notable items slide on slide 7. I believe -- I don't have the number right in front of me -- but I believe we had a small policyholder experience loss in the US. Again, relatively immaterial, but just for completeness, the early duration lapses were a little bit worse than expected. Again, that may be economic weakness. We had a little bit of weakness in terms of the late-age mortality. Again, way too early and way too small to draw any material conclusions, but I believe the policyholder was a small loss. But the investment gains in the US in particular were large.

Joanne Smith - *Scotia Capital - Analyst*

Okay. And then I just had one more technical question, and then I have a strategic question. So just bear with me for one minute. So when I look at the US wealth management business and I see the experience gains there, when we were going over this big technical discussion in the fourth quarter about the geography of where all of this stuff is showing up, I would have expected to see some offset from the decline in the value of the derivatives in the US wealth management sources of earnings table. Where am I supposed to look for that? Because I see the CAD253 million in experience gains, but I don't see the offsetting loss associated with the hedging instrument.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Joanne, that's a very insightful question. My compliments. We are reporting the cost of the macro hedge in corporate. Because it is not assigned to a specific block of business, and therefore it is a corporate management action. So you see the cost of the macro hedge in corporate, both the expected cost as well as the actual cost.

You see in the SOE, for example, the expected cost is in the management actions and the actual hedge loss is in experience losses. In the US, what you are seeing in the experience gains in the VA block is the strong market performance.

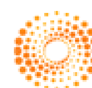
So if you step back and look at Manulife as an enterprise, as opposed to looking at it by geography, the strong equity performance we had in the US was mostly offset by the combination of the macro hedge and the dynamic hedge. But geography-wise, the macro hedge result shows up in corporate.

Joanne Smith - *Scotia Capital - Analyst*

Okay, all right. So then, I just want to make sure that I understand. You are putting -- the change in the value of the derivative is in corporate, but the change in the value -- the change in the fees associated with the positive equity market environment are showing up in experience gains up and above what you would expect from a 10% market return in the US?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

That is mostly right, Joanne. Again, it's complicated. Let me give you a short answer, and then maybe we could take this off-line and go into it deeper.



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The increase in the fees, importantly, ultimately makes their way into the expected profit on the in-force. The drop in the actuarial liabilities from the strong markets do show up in the experience gains in the US. The cost of the dynamic hedging program also shows up in the US. It is the cost of the macro hedge program that shows up in corporate, because it is not allocated to a specific block of business. It is a macro hedge that basically says, as a Company, we think we've got too much equity risk.

Joanne Smith - *Scotia Capital - Analyst*

Got it. Okay, I completely understand.

So now my strategic question. This is for Jim Boyle. So we are about -- what -- like a year into the strategy change at John Hancock now? And I would just like to get some type of an assessment of where you think you stand in the progress and where you think it is going to go from here in terms of market position and thoughts of what you want to be at the end of the day in the US. Do you want to be in the variable annuity market? Do you want to be a variable life player? Only do you want to be a term life player? What exactly is it?

I understand where you are going on the group side, but I am still a little unsure of what it is that you want to be when you grow up in the US at this point. And I don't mean to be derogatory in that.

Jim Boyle - *Manulife Financial Corporation - SEVP and President of John Hancock Financial Services*

No, Joanne, that's fine, and it is a very reasonable question. If you look at our businesses today, the categories of business are roughly the same as they were three years ago.

What we were endeavoring to do was to get more balance across our lines of business. Three years ago, our businesses were dominated by the variable annuity business and by the universal life guaranteed life insurance business. And frankly, they were disproportionate.

And so we want to continue to be in all the businesses, but with better balance. So what you are seeing is a move to sell more mutual funds, and we've had great success there. It is a higher ROE business, lower capital, less interest rate and equity risk. Same with our 401(k) business.

And so as those businesses grow, it will give us opportunities to again expand businesses like variable annuities and life. But for now, we are very comfortable with the strategy and we fully intend to participate in all the segments go-forward, as we have historically, just in different proportions.

Joanne Smith - *Scotia Capital - Analyst*

Okay. I guess just as a follow-up to that. Just in the VA market, I think that it is a decent strategy to say, well, I don't necessarily have to be in that top five. Because I think people are starting to worry about the top five at this point. It is an awful lot of market share for a few players to hold.

And so -- but I'm also thinking about this market, that there is a huge opportunity for a player to come in and grab some of that share. And with a brand like Hancock, I would think it would be really easy for you to go back into that market. And since you've spent all this money building this very expensive and elaborate hedging platform, you could prove to us that you are doing this correctly by kind of not going full force into that market again, but perhaps showing a little bit more conviction or commitment to it.

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Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

We have a number of people queued here that we really have to get to. But all the answers to the strategic questions are outlaid in the plan that we outlined for you at Investor Day. The beauty is our people are executing to that plan brilliantly, and we are well ahead of schedule generally on all fronts.

But as we said at that time in relation to the VA business, it is impossible to hedge all aspects of the business. Hedging is not a perfect business. And our strategy, while we are well aware of the opportunity -- we could write a gigantic amount -- we could take number one market share and we would be very comfortable with the quality of our hedging.

But because of all the unhedgeable risks in that business, we do not choose -- it's not that we can't -- we choose to not let it dominate our business. We are quite happy writing the VAs, though. We like the VAs; we are going to grow them. But we are not going to let it dominate our business. It will be roughly in the proportions that we have now. And that was all laid out in the strategy plan, and it's a very deliberate attempt to have, as Jim said, a balance of the businesses. That in and of itself is a virtue that we are trying to achieve.

Joanne Smith - *Scotia Capital - Analyst*

I agree. Thank you.

Operator

Doug Young, TD Newcrest.

Doug Young - *TD Newcrest - Analyst*

Good afternoon. I guess three quick questions, hopefully. Jim, I do appreciate that you've reduced your No-Lapse Guarantee UL sales quite significantly. I guess my question is why even be in that market?

Second, I guess, Bob, you're first in the SIP, so I should throw a question or a few at you as well. You have done a great job, it would appear, expanding your Asian sales force. I'm just curious as to what are the key drivers from a competitive perspective that you are seeing that is allowing you to do that. And can you update us on how close the Chinese operation is to hitting profitability? And I'll leave it at that. Thanks.

Jim Boyle - *Manulife Financial Corporation - SEVP and President of John Hancock Financial Services*

I'll take your first question, Doug. We like the pricing. We've raised prices and reduced the risk on our guaranteed business, so we will sell less of it because, competitively, there are people out there with products that are more competitively priced. And frankly, as you saw the changes we made on our distribution platform on the wealth side, keeping your distribution outlets comfortable with your full range of products allows you to pivot. And so we didn't pull out of the VA business and close it down. That allowed us to pivot into mutual funds and 401(k)s.

Similarly, on the life side, we want to keep a full distribution platform there. So we like having the full suite of products. We like the pricing on the guaranteed business today. But the market will drive a lot of that, too. We are not going to price it at levels others are.

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Doug Young - *TD Newcrest - Analyst*

Just quickly to follow up, Jim, so that is meeting your return target, the new pricing?

Jim Boyle - *Manulife Financial Corporation - SEVP and President of John Hancock Financial Services*

Yes.

Doug Young - *TD Newcrest - Analyst*

Okay.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

And actually, Jim touched on something which I hope people realize. It goes back to Joanne's question. It is not like we have a whole bunch of VA wholesalers that are sitting idle on their hands.

What the management team in the United States has done is switch them over to selling mutual funds, which is one of the phenomenal -- one of the reasons we are having such phenomenal success in the mutual fund side. You need product and distribution. And what they've been able to do is reallocate that incredibly talented resource to selling mutual funds, which, as Jim said, a high ROE product and with much less market risk associated with it.

Bob, there is a question for you.

Bob Cook - *Manulife Financial Corporation - SEVP,and General Manager of Asia*

Doug, in terms of your two questions in terms of our expansion in Asia, again, as you remember from the Investor Day presentation, part of the Company's overall strategy and repositioning was a decision to, in essence, ramp up the degree of investment in Asia to take advantage of what we saw as tremendous organic growth opportunities due to the vast economic and improving demographic situation in Asia.

Essentially, we've just simply been executing that, both in our Asian channel and in our various bank channels in various countries. So the decision of the Company to make that investment is paying off.

In terms of the China profitability, as you know from our previous discussions, we are not seeking at this stage of the development of our Company in China to maximize the bottom line profitability, because we are still in the build out phase of that company. We've recently announced we've achieved now our 47th license and continue our national build out.

But as we've said before, our initial point of entry being Shanghai, and is still our largest operation, turned profitable after about six or seven years of operation. We are still finalizing the books on a local accounting basis, but it look like one or two other provinces probably have now reached the profitability stage too. So we have multiple parts of our company there that are now able to make the contribution to the continuing build out of our franchise in China.

Doug Young - *TD Newcrest - Analyst*

Any further progress on giving us embedded value or new business embedded value on your Asian business?

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Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Doug, as you can imagine, that is on the list to look at. I hope you would give us some credit for significantly expanding our disclosure over the next -- excuse me -- over the last two years, and that is certainly on the list to consider going forward.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

A lot of you guys know that I am a fan of embedded value as a concept. You wouldn't buy a company without doing the calculation. But what you get to do is you get to do it on assumptions that you are comfortable with.

I guess as we've done more work on it, I guess I find myself more and more horrified as I understand the differences in approach people use in the industry, companies do. And I guess -- we will do more with embedded value, but we are going to do it very carefully, because the last thing we want to be doing is putting us in what looks to be a competitive disadvantage relative to other companies by disclosing properly.

For instance, we use some of the same approaches reflecting current interest rates and other current assumptions in our products when we calculate embedded value. It is not apparent that other people do the same. So our numbers would give rise to quite different signals than other people's would. But I am not going to ask our people to publish numbers that we don't think are realistic appraisals of the business.

So those are some tough quandaries that we have. We are very familiar with the concept. We think it is actually an intelligent way of measuring the business. But you would think there would be some consistent standard how to do it, and there is not.

Doug Young - *TD Newcrest - Analyst*

Thank you.

Operator

Michael Goldberg, Desjardins Securities.

Michael Goldberg - *Desjardins Securities - Analyst*

If I could just first say, you start the call by saying you are going to limit people to two questions, but then you're not actually following up on that discipline.

So I do have a couple of questions. You said that you've gotten price increases in 15 states in your in-force Long-Term Care. But what portion of the overall in-force Long-Term Care where you've applied for price increases have you received those price increases?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

I would rather not get into that level of granularity. As we have said, there are some material states and some very important states in that list of 15. I would rather not get to the point where we are in percentages or we are going state-by-state to give you the details.

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Michael Goldberg - *Desjardins Securities - Analyst*

Okay. And separately, looking at your total experience gains of CAD789 million in the quarter, how much of that is actually market-related gains?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Certainly the vast bulk of that would be.

Michael Goldberg - *Desjardins Securities - Analyst*

Okay.

Donald Guloien - *Manulife Financial Corporation - President and Chief Executive Officer*

Michael, on your very first point, we take that -- you're absolutely right -- we are going to do a better job of making sure everybody gets a chance to get in the call earlier. I apologize for that.

Michael Goldberg - *Desjardins Securities - Analyst*

One other thing on the experience gains, just to clarify. When I add up the segment experience gains, it looks like there is about CAD250 million left over in corporate, and I guess about CAD140 million of that is the additional hedging costs that you referred to. What else would be in that?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

That is certainly the bulk, Michael, is the hedge -- is the macro hedge loss, over and above the expected cost in corporate. Again, it is not ringing true to me what else is in there, but we can certainly follow up with you on that off-line.

Michael Goldberg - *Desjardins Securities - Analyst*

Thank you.

Operator

Darko Mihelic, Cormark Securities.

Darko Mihelic - *Cormark Securities - Analyst*

Good afternoon. I don't want to ask too many excessively technical questions, so maybe I'll take most of mine off-line, Michael, if it's okay.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Sure.

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Darko Mihelic - *Cormark Securities - Analyst*

Just a real quick one on management actions and changes in assumptions. I can see the CAD100 million of cost for hedging in there. I could see the AFS bonds of CAD134 million and maybe CAD10 million for refinement. I am still short by about CAD90 million. What else is in that -- in that line item?

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

Yes, we did have, Darko, some refinements to the basis changes that would show up in the management actions. Those were roughly offset by some refinements on the data set. Cindy, remind me -- where did the refinement, the CALM...

Cindy Forbes - *Manulife Financial Corporation - EVP, Chief Actuary*

...It goes in investment gains.

Michael Bell - *Manulife Financial Corporation - SEVP and Chief Financial Officer*

It goes in investment gains. So you've got two offsetting pieces in the CAD8 million of refinements in assumptions and in models, a piece of it in investment gains and the other piece in management action, because it is considered a basis change.

Darko Mihelic - *Cormark Securities - Analyst*

Okay, I understand. Great. I'll follow up later. Thanks a lot.

Operator

There are no further questions registered on the telephone lines at this time, Mr. Ostler.

Anthony Ostler - *Manulife Financial Corporation - SVP, Investor Relations*

Thank you, operator. We will be available after the call if there are any follow-up questions. Have a good afternoon, everyone.

Operator

Thank you. The conference call has concluded. You may disconnect your telephone lines at this time, and we thank you for your participation.

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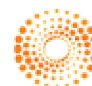

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