FINAL TRANSCRIPT

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MFC.TO - Manulife Financial Corp at National Bank Financial 2011 Canadian Financial Services Conference

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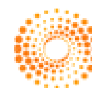

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PRESENTATION

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay. Our next interviewee is Warren Thomson, who is Senior Executive Vice President and Chief Investment Officer of Manulife Financial Corporation. Warren I also note is a member of Manulife's Executive and Management Committees.

He manages MFC's world-wide investment operations with assets in excess of $380 billion that is both general fund and third party managed money. Prior to becoming Chief Investment Officer in 2009, Mr. Thomson was responsible for managing MFC Global Investment Management, in addition to being responsible for Manulife Asset Management's fixed income and equity security management subsidiaries; he also had oversight of Manulife Real Estate, Hancock Timber Resource Group, Hancock Agricultural Investment Group, and NAL Resources.

Previously, he was also responsible for overseeing the management of the U.S. fixed income portfolios, public bonds and private debt for John Hancock. So Warren, before we start I will just mention that and remind investors that your comments may contain forward looking statements, and listeners should consult Manulife's disclosures filed with the Securities and Exchange, and on the Company's website for further detail. Thanks for being here.

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Thank you, Peter.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Warren, I will just ask the same question I ask all our interviewees, what key messages would you like investors to take away from today's session?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Well, I think probably one of the key things to understand that Manulife today is very well positioned for growth. Obviously we have been through some changes over the last couple of years, restructuring our liability portfolio businesses, and today we have a mix what we think is very well-balanced, and puts us in a very good position.

One of the things that people may not be aware of is the geographic contribution of our earnings, and basically our adjusted earnings from operations or business earnings from our three major territories is relatively well balanced. So each of Asia, Canada, and the United States roughly contribute 30% of our business, just earnings from operations. So that is in a very balanced position.

If you look at businesses that we are trying to push right now, virtually everything in Asia is in the push mode, with the single exception of our variable annuity block in Japan, which is a relatively small block for the total Asia story. So in Asia right now

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we actually have a combination of GDP, penetration of the products et cetera across that platform. So we think we got quite an exciting growth story in Asia.

In Canada, we have a very broad portfolio I think as many of you, since this is our home market, are aware that we do offer a much broader array of products, including on the individual as well as on the group side insurance and wealth management.

In the United States, we are a little bit more of a niche player, but what we have there is a superb brand in John Hancock, and that brand is linked with a superb distribution system. So as we actually shifted business in the United States, we will be able to go from a position where we had strong businesses from products that we are now constraining, and actually we have very strong sales in products we are now trying to push, and a good example would be John Hancock Mutual Funds.

Year-over-year our gross sales are up almost 48%. Year-over-year our net sales are up 130%. That gross sales number is about $9.6 billion; net sales number is over $3 billion. And that was our seventh consecutive year of net inflows in our mutual fund platform. So it is one of those things where I think I am very comfortable saying that we have a platform that is very well positioned to capture growth in each of the major markets we [participate] in, different products, different strategy, different distribution, but each tailored to a fundamental local understanding of that market.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay. I'm going to pick up on something you mentioned just about you talked about the liability side of the balance sheet, which you have done a lot of work restructuring. And one thing I think struck me coming out of the -- or living through the recession, was the performance on the left-hand side of the balance sheet. There was just -- to my mind there was a lot of granularity of risk on the left-hand side of the balance sheet, and Manulife has talked a lot about that. But maybe can you talk about over the last couple of years, how the management team has shifted that risk taking philosophy over to the right-hand side of the balance sheet. Could we get a little bit of colour behind that?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Yes, very much so. What our view is, much like the way we manage our asset portfolios, and looking to diversify all the underlying risk, and getting it in a balanced fashion. We are taking the same approach to our liability portfolios, and trying to look at the nature and type of risk that we are taking on, and to the degree that they are offsetting.

So a good example of how you can balance risk in a simple way in our insurance portfolio would be mortality and morbidity risk. One is a risk of people dying too early; another is the risk of people living too long. The reality is if you are writing the two businesses in a balanced way, you are effectively going to have a natural hedge there. Similarly we have to look at businesses, where we actually provide guarantees for market risk such as we have in the variable annuity, versus products where we take investment management piece with no investment risk such as a mutual fund.

So the reality is what we need to do is put all our global businesses in more of a balanced situation, and that is when we do talk in our materials we talk about businesses we push, and businesses that we constrain. And in our Q4 release you will see that we have a slide in there, where it highlights those things in green versus red, and you will see the bulk of what we offer globally is still in the push category.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Now, another part of your repositioning, risk-taking and the balance sheet on the right-hand side has been really getting rid of your downside exposure to equity markets and interest rates, now we are probably and hopefully in a period where we get more shareholder friendly movements in equity markets and interest rates. And a critique that has emerged over the last couple

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of months is that sort of suffered the pain of the downside, and then the company is giving up some of the upside, so maybe respond to that?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Sure. I would actually say that that is actually probably a little bit of an unfair criticism, because what people really have to look at is what we did; we first fortified our balance sheet. I mean the decision was made immediately post the volatility that CGAAP made us flow through on a mark-to-market basis that we would actually fortify our capital and give ourselves the resilience and ability to take action as we thought was in the best interest of our shareholder, at the same time maintaining adequate capital levels to meet our policyholder obligations.

So it is really sort of keeping that balance. What we have done is we have obviously taken off now, risk, and again we've disclosed at levels in our Q4 results the hedging that we have done. And basically what we have done is if you looked at the market that have recovered the most, so obviously in places like the TSX, S&P, and to some extent the EV excluding the topics, where there has been stronger recovery, we have actually laid in more hedging there.

But we do it through two programs, a macro program and a dynamic program. The dynamic program is what I will call our end state of hedging, and that is where we're actually doing a combination of equity and interest rate hedging. Macro hedging is dealing with our broad equity risks, and is sort of a temporary position. So we really transition ultimately from macro hedging to dynamic hedging. And we have basically taken off the risk, where we think -- the dynamic program we do it when we realize the target go forward profitability. On the macro program, it is where we think the rev markets have risen to a level where the risk-return trade-off for shareholder protection and for all sort of protection is reasonable.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Just staying on that, a part of dealing with the interest-rate risk side was term out your assets, and you did a lot of that in the last couple of quarters, or at least most of 2010. As the head of investments, I mean, it seemed to be you are buying long-term bonds may be at a point in time when their value was at sort of a cyclical or secular high. Do you see it that way?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

No, and I do understand how that view can be developed. But again you have to look at our position in total. We still do disclose a meaningful interest rate sensitivity. So we are a long way away from having closed out the position. But we did observe that the market was not appreciating as retaining the position fully open. So given the actions we have taken over the last couple of quarters, and how the markets have responded to that, our perception would be that the markets do appreciate taking some of the risk, and some of the volatility off the table.

There is also a big cost to carry and staying short in the current yield curve environment. Obviously at the front end of the curve we are getting paid almost nothing for staying in cash. If you go along you are going to pick up something. So we would actually want to enhance our earnings in the shorter term, clearly you have got interest rate risk with that call, but it is more than offset by our still, net position and the liabilities.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

You also mentioned Asia in your opening statement. and I don't think anyone can question that Manulife has a very attractive Asian distribution platform and in particular, in a variety of countries. That is a young emerging sector of the economy, is that in earnings and young people who are building wealth, typically who aren't big consumers of life insurance products? So is that an upside that maybe will be ten years down the line as opposed to next couple of years?

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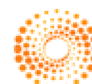

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Well, right now again we have got some balance in our Asian operation. I mean, I think the key thing to remember is we have got a couple of -- probably three mature markets, in two of which we have a meaningful presence with Singapore, Hong Kong and Japan in the more mature market scenario.

And we have got stronger penetration in Hong Kong and Japan on a relative basis facing meaningful contributions, but as I said at the outset, roughly a third of our global earnings right now are coming out of Asia, but with those two, but actually the third most profitable country we have there right now is Indonesia.

So we actually have earnings coming off that block, but we also have tremendous growth, and there is a fact sheet that we added that we dropped off with respect to our China operations, and today we have actually operations in 45 cities and 11 provinces. We have over 13,000 employees and agents in China. We serve over 600,000 clients.

Now this business to Peter's point is just hitting critical mass in the sense that our AUM has just gone over $1 billion. This is after 15 years of being in China, and we have hit all the numbers I just gave you, but our last year premium was $300 million. So you can see that the growth trajectory of that businesses were significant. So we think we have got a balance of mature businesses that we can grow in those countries, as well as very strong growth stories in the places that are developing, and that we will capture more share over time.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Just while we are in Asia, maybe you can give us an update on Manulife's Japanese subsidiary, you have given us - the company has given us guidance on the reinsurance segment, but just the actual core business that you have--

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Sure. Actually I'm grateful to report at this particular moment, all of our employees and agents in Japan have been reported as being safe. So we are very pleased to see that at a high level. We do have some real property holdings in Japan. They have all been reported as being structurally sound at this point.

Our portfolio there represents about 3.5% of our on balance sheet assets in total; the largest position is with respect to Japanese government bonds. Our individual bonds, corporate positions, much like the rest of our portfolio is very granular, very well diversified and there are almost exclusively still investment-grade rated, including the actions that have occurred to date.

We would expect mortality claims potentially obviously coming out of the damaged area, but again you got to remember, while we have a better share in terms of new business sales, our actually in-force business in Japan I think is in the zone of a 1% market share. So, working out how many people in that area are insured, and then how many might be insured by Manulife et cetera, there could be something occur there, but we really don't know.

But our operations which are in a suburb of Tokyo called Kakuriyo. I can report it is back to business as usual. Our employees are all working, are processing claims, processing new business, and most, not all, most of our sales offices are back up and running. There are a few that are obviously in the damaged areas that we're relocating, but the staff in those places are all safe.

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Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay, good. Maybe we will turn to your division, the investments division, and I guess we've had a crash course in market bubbles, and what they can do over the last couple of years, so you know does the possibility of future financial market bubbles represent the greatest risk facing your division, and where do you think the risk is highest right now?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Well, at this particular juncture, and again what has been core to us through the financial crisis is the fundamental diversification of our own portfolio. We tend to not work on an origination basis in any meaningful way in the below investment grade market, with the exception of those sovereign jurisdictions in which we carry out business. So, by definition if you are in a country that has got a below investment grade rating, you have to carry below investment grade bonds in connection with that business.

But instead of being in the riskier end of the credit market, what we have tended to do is add to our portfolio yield by looking at our long-tailed liabilities, and investing in long-term real return assets, which is where things like our timber, real estate, agriculture, oil and gas assets all come into play.

We do think we keep a very diversified view, and we are very disciplined value investors. So basically including on our credit book, we will shut down -- a good example would be US commercial mortgages. We actually debated closing. We stopped buying any CMBS in about 2005. We always underwrote to the underlying, and for the most part we didn't like what we were seeing coming out of the market.

Because of the terms they were offering and moreover, as we couldn't actually compete in our direct origination, the bulk of our mortgage business in the commercial side in the U.S. is directly originated. We couldn't originate what we thought were appropriate risk-adjusted returns so we literally stopped issuing new mortgages. We debated actually exiting the market, fortunately and unfortunately when things did turn, our mortgage operations became one of the more significant underwriters and issuers of new commercial mortgage in the U.S. on terms that we thought were appropriate, spreads that were properly priced, and LTV ratios, and cash flow I thought was appropriate, and the mortgage portfolio has performed very well through the cycle.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Maybe we will just stop for a minute and see if there is any questions here from the floor. Okay, I'm going to stay on, you mentioned alternative assets, sort of a sensitivity you provide in your public statements about what would happen if the assumed return from these assets were to drop 100 basis points, and the big number is $2.9 billion. I guess what is behind that number, and how likely you get a event like that occurring, or you have say right, our returns on timber and like assets are going to be lower than what we currently expect, and therefore we are going to take a charge?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

First of all, I think it is -- a couple of things to note about that number. That first of all is the assumption if you have an across the board 100 basis point permanent decline, and our expected returns for all of our alternative asset classes. I can report that over the past five years so to the end of 2010, our aggregate return was very modestly below our long-term assumptions, but we still believe our long-term assumptions are appropriate, because if we go back to ten years, things look much more in line.

The reality is part of the reason why that sensitivity looks larger is well, particularly if you would compare to exposure in public equities, the disclosure as we reported, we do not assume any new investments in public equities. But the actuaries are assuming that we will make future investments to match future cash flows with alternative non-fixed income assets. So you will be assuming that all of those future premiums will also get this permanent reduction in yield. Our long-term assumptions have

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actually historically like I say, prove to be conservative, and we feel very comfortable. And it is something I sit down with our chief actuary, and we go through each year in great detail, and we are very comfortable with where we sit right now.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Just on that asset class, it seems to be interesting because you have got this sort of actuarial rule. You are going to make assumptions about reinvestment, which can penalize you in a period of low interest rates where we are now. Yet the merits of the asset class for a liability structure that does have a long-term component to rather a long-term 20-year, 30-year component to it. The asset seems to match that liability structure well.

In addition, it gives you some diversification benefits you talked about, so you have investments at Manulife, aren't you getting unduly penalized by the actuarial rules for managing your book in an economic way?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

We don't think we are. We do believe the rules right now on balance due largely -- the mark-to-market for both the equity and interest rate in the context that those claims aren't really generally cash callable. One of the things that sort of contrary like in lot of the financial institutions if there was a call, because of a run on the banks, so to speak, you would expect the financial institution to lose money, and a lot of life products because they have long-term guarantees or surrender charges that would actually be a positive variable annuity that was in the money, and you surrender it, we would have a gain as a result of that -- action for instance.

So we do think the rules, as long as they are internally consistent, are fine. Our apprehension is really more prospective. So I would say in terms of if there is regulatory accounting reporting changes prospectively, the costs have not matched your internal asset and liability assumptions on a reasonable basis. That would be to a degree problematic, but we do believe fundamentally, our approach would be to take an economic view, which we believe our current asset mix is the appropriate economic view for the businesses that we are in.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay. Maybe we can look at your fixed income portfolio, spend some time on your fixed income portfolio, I guess one of the distinguishing characteristics of Manulife's fixed-income book was just the rather low level of credit loss, and I take that as due to a fairly granular bond portfolio. Can you give us a sense of your thinking, your organization's thinking and control processes that sort of produce a portfolio like that?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Sure. It is a combination of a top-down, bottom up approach. I will give the top-down view, and then I will give you the bottom up perspective after that. From a top-down point of view, we have some policy committees like our corporate -- our global ALCO, asset liability committee, which will establish various asset liability management policies. I mean it will have our corporate risk, credit risk committee, and they will establish limits for individual names, for industries, sectors, geographies, by credit quality, by asset class. So you basically get very granular set of rules that are sort of the top down view.

From a bottom up perspective, maybe while you see an example of our John Hancock bond portfolio in the United States, because that is where we have got our largest credit exposure, and our largest team, to give you a sense how we operate. We actually have a number of industry sector specialists, teams, and they underwrite across all asset classes. So they do publics, privates, as well as private equity, non-fixed-income assets within their asset classes.

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We have a specialist equity team that works in conjunction with them on that basis. Those teams are lead by sector leaders that on average have more than 20 years credit experience, and they are backed by analysts that on average there is about 50 analysts in our U.S. bond team, and they have on average more than 10 years experience.

So the teams at the actual credit level have been through this cycle. They know their industries, they know their names, and they are seeing what is happening. And that combined with what I will call the top-down sort of limits, puts us in a very good position, and finally to the point you alluded to earlier, around how we intersect with our liability businesses. We will stop underwriting or issuing new business if we don't think we are getting risk-adjusted returns on the asset side that are appropriate. So there is a continuous dialog around what we are seeing in the market, how we're pricing and what we are selling.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay. I mean can you give us, has that ever manifested itself in an actual decision, where you said, right, in the U.S. we are going to pull back from this product class because we don't like the returns we are getting in asset X. I mean is that --

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Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Well, a light example I can give is, so that we frequently in the last while not had competitive GIC rates in a Canadian context. Again we look at sort of where things are being priced like our shorter term investment contract et cetera, because again we're just not able to see the spreads in the market that the market seems to be pricing off of.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

I'm going to return to the floor here to see if we have any questions. Okay, I do, and I'm particularly interested in your strategy for third-party asset management, again maybe a business that doesn't get as much focus from the investor community, but you made a number of acquisitions and hires in Asia, particularly focused on Greater China, how does the outlook for this business in that region differ from your insurance outlook in the region?

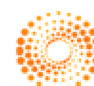
Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Well, clearly again as the economic prosperity of the individual and region progresses, the first protection you will be typically looking for in the developing or emerging markets is insurance. As they get past the basic needs of protecting their family, they get into the wealth accumulation phase.

So we think it is a normal progression that we would have the opportunity to do that as well. We do run our asset management business as a global enterprise. And this is an important thing to understand about what we do. We take our best managers and we try and make some of our products available globally. So if we've got strategies in Asia, last year we got [QFII] qualified foreign institutional investor allocation to do domestic investments. And we took the -- so this should be managed in Asia, but sold globally.

So we sold some of that mandate back into Canada for instance. We also sold extensively throughout the Asian region. Similarly we get the opportunity to take our strategies over there. So, I got a good example again of a strategy we have taken to couple that we have taken around the world would be our strategic income strategy at the United States. It is a global fixed income strategy. It actually outsold in Canada last year. It is one of our top-selling funds in the United States, but Canada actually outsold it. And it is on our Asian platform as well in Hong Kong.

So again we take our strategies around the globe and we try and figure out what we can bring from Asia to North America, and from North America to Asia, and capture that growing wallet in Asia as they move up the economic ladder.



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Peter Routledge - *National Bank Financial - Equity Research Analyst*

In the United States, on the third-party fund management side, do you need to do an acquisition there to get scale, why or why not?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Again, the third-party asset management business is a business that is largely about scale. But what I would observe again is in 2010 in our mutual fund platform, as I reported earlier, our sales year-over-year were up significantly, and if you look at where our gross and net sales, or I believe our gross sales versus peers that we would be competing with next, rank us around 12th, and in our net sales rank us around 5th in the United States.

So we are getting critical mass, now the reality is your AUM takes a while, much like my China example earlier. So incremental AUM would be a good thing, if there was an appropriate value opportunity to present itself. And I think as we did last year when we acquired Manulife TEDA in China, we have added teams as well. So, we look to continuously figure out how we can actually maintain this accelerated growth path, because when we look at our investment operations, it is manufacturing the performance, for our wealth business is to actually sell. So, we sort of see ourselves on the manufacturing side of the equation. It is important that we keep enough product on the shelf for them.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

I am going to sort of since we just talked about the U.S., I will come back to the U.S. and talk about your business there, the ROE for the near term looks a little bit strained, and I might add that is under Canadian GAAP basis, which sort of prompts the question, which is, aren't you disadvantaged in the U.S. because you are a Canadian GAAP reporter, and have you ever sort of -- or has the management team or the board ever asked itself the question, should we just get out of this business and let a US GAAP reporter run it, and then we will take whatever proceeds we get from the sale and reinvest in Asia, or dividend them back to shareholders?

Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

I think there is two parts to your question. With respect to the CGAAP versus US GAAP, at the end of the day it is all about economics. So the reality is one accounting methodology may in the short term report more profits than the other, but in the long run you are still going to have the same economic outcome. So, in the very shortest term, there could be a disadvantage from a particular accounting regime superficially. But I think with fundamental analysis, you would conclude that there is really ultimately one right present value answer.

With respect to the value of the franchise, I think the two things you have too consider is A, the value of the John Hancock brand in the United States, and B, the distribution network that we have connected to it. So we were literally able to think of it as shifting gears going from the variable annuity business to the mutual fund business, and taking one from being a very meaningful and significant player in the US, and converting into the other, and doing it in a relatively short period of time. I mean it is really been over the last couple of years of that transition it has largely occurred. So it will take some time for this to reassert itself, but we do believe the inherent value there is worth it for us to stick with the platform.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Okay. Now if there is no further questions, I think I will thank you for your time, and wish you all the best.

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Warren Thomson - *Manulife Financial Corporation - Senior EVP, Chief Investment Officer*

Thank you very much, and I wish everyone a good day.

Peter Routledge - *National Bank Financial - Equity Research Analyst*

Thanks a lot.

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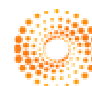

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