

EDUCATION AND EXAMINATION COMMITTEE
OF THE
SOCIETY OF ACTUARIES

COURSE 8 INVESTMENTS STUDY NOTE

COURSE 8 INVESTMENT CASE STUDY

Copyright 2000 by the Society of Actuaries

The Education and Examination Committee provides study notes to persons preparing for the examinations of the Society of Actuaries. They are intended to acquaint candidates with some of the theoretical and practical considerations involved in the various subjects. While varying opinions are presented where appropriate, limits on the length of the material and other considerations sometimes prevent the inclusion of all possible opinions. These study notes do not, however, represent any official opinion, interpretations or endorsement of the Society of Actuaries or its Education and Examination Committee. The Society is grateful to the authors for their contributions in preparing the study notes.

**COURSE 8 - INVESTMENTS
CASE STUDY**

LifeCo

**Charles Gilbert
Joe Koltisko
Jean-Francois Lemay
Chris Macklem
Peter Tilley
Keith Drzal**

BACKGROUND AND HISTORY

LifeCo is a multinational stock life insurance company and has general account assets totaling \$5 billion supporting three main lines of business: Individual Life and Annuity, Institutional Pensions and Group Benefits. Its assets are internally segmented in eleven major portfolios defined below. Each portfolio is fully integrated in the accounting databases with full income statements and balance sheets produced monthly. LifeCo has recently implemented guidelines for Asset Liability Management and is in the process of identifying strategies for mitigating its exposure to interest rate and other risks.

LINES OF BUSINESS

Individual Life and Annuity

- Traditional Life
- Non Traditional Life
- Accumulation Annuity
- Equity-Linked GIC
- Separate Account for Variable Annuity and Variable UL

Institutional Pensions

- Payout Annuity
- GIC
- Separate Account for Institutional GICs

Group Benefits

- Long Term Disability
- Medical, Dental, Group Term

Surplus Account

- Surplus Capital

DESCRIPTION OF LIABILITIES

Individual Life and Annuity

Traditional Life includes all non-interest-sensitive individual life products and is predominantly comprised of non-par term and whole life. Guaranteed interest on whole life policies ranges from 3% to 6%. Policyholders can take out policy loans against any cash surrender value. A maximum loan rate of 7% exists on older policies. The duration of the traditional life liability cash flows tends to be fairly long. It has been difficult to find assets with suitable characteristics to effectively match these liabilities. The liabilities in the traditional life segment are supported by \$300 million of assets.

Non Traditional Life consists entirely of universal life. Universal life policyholders can direct their investments into a number of interest bearing or equity-linked accounts.

Interest accounts generally credit a portfolio average rate and have a minimum credited interest guarantee of 4% across the board. Because LifeCo incurs significant costs associated with the acquisition of this business, even though the present value of future fund profits exceeds the present value of all future benefits and expenses, it will not have the hard assets to invest at issue in order to match the interest rate exposure of the liabilities. This situation creates significant reinvestment rate risk. To further complicate matters, the embedded options present in universal life mean that the liability cash flows will not be fixed and will vary with interest rates. The liabilities in the non traditional life segment are supported by \$400 million of assets.

Accumulation Annuity contains all individual flexible and single premium deferred annuities. Assets total \$1.5 billion. Most funds are available for withdrawal at a book value basis. Surrender charges decline to 0% over a 5-7 year period. Minimum guarantees are generally in the 3-4% range but there is a \$500 million block of annuities that have a 5% minimum guarantee. This latter block was sold with a 6% cliff surrender charge and will be reaching the end of the surrender charge period in the next year (i.e. the surrender charge will go from 6% to 0). There is also a \$250 million block of MVA (market value adjusted) annuities included in this segment. The Accumulation Annuity portfolio has been the subject of much modeling scrutiny over the years to better understand the product profitability and risk profile. Actuaries at LifeCo have internally flagged each asset purchase in the portfolio to a particular product in order to support a more detailed level of analysis.

Equity Linked GICs offer the return of principal after five years, plus 75% of the percentage increase of the S&P 500 total return index over that five year period (if positive) As at December 31st, 1999:

- assets total \$55 million
- remaining term to maturity of GICs is 4.5 years
- current percentage increase of the S&P 500 total return index since issue is 6%
- volatility of the S&P 500 index equals 18%
- interest rate is 5.5% continuously compounded
- S&P 500 total return index is expected to grow at 15% / year

Variable Annuities include a guaranteed minimum death benefit, which, upon death of the policyholder, will pay the maximum of the current account value and the deposits accumulated at 5%. Upon surrender, the market value less surrender charges is paid.

Separate Accounts for Variable Annuity and Variable UL are invested in various, externally managed, mutual funds. Policyholders may transfer between the funds offered, make new deposits, and withdraw money, subject to a surrender charge.

Institutional Pensions

Payout Annuity contains pension buyout annuities in both immediate and deferred status, supplementary contracts arising from life or annuity contracts and structured settlement annuities. This segment was established to hold intermediate to long term income

payment streams that may or may not include life contingencies. Structured settlement annuities contain standard and substandard annuities, non life contingent streams and some COLA (cost of living adjustment) escalators. Assets total \$700 million.

Guaranteed Investment Contract (GIC) include both single deposit and window GICs. This segment holds \$1.5 billion of assets. \$200 million of the portfolio consists of funding agreements that are puttable with 60 days notice. The remainder are benefit-sensitive contracts with institutional pension plans, which mature over the next 5 years.

Separate Account Institutional GIC offers single deposit and window GICs to larger institutional clients. For accounts larger than \$150 million, the company will offer to set up a separate portfolio for one client, with its own asset allocation targets. Administrative fees are reduced for the commingled accounts, which are available to clients with at least \$25 million. While the institutional client owns the market value of its share in the separate account, the individual participants receive interest credited to the book value of their individual accounts. LifeCo annually resets the crediting rates, so that the market value gains and losses in the commingled account are shared with participants. The general formula used to set the credited rate is as follows.

Credited rate

$$\begin{aligned} &= \text{Market yield of separate account} \\ &- \text{Administration fees} \\ &+ (\text{MV separate account} - \text{BV individual accounts}) / (\text{Duration of separate account}) \end{aligned}$$

In addition, LifeCo guarantees that the market value of each separate account will never be less than 80% of the book value of the individual accounts associated with it. LifeCo does not offer synthetic GICs.

Group Benefits

Group Long-Term Disability pays up to 70% of an employee's salary prior to the disability claim. Premiums are paid through payroll deduction. Premium rates are guaranteed for 2 years. Claims incurred stay with LifeCo even if the employer changes insurance carrier for new business. The current product provides "own occupation" benefits generally for two years from the date of incurral, after which payments continue only if the claimant is unable to work at all. LifeCo offers rehabilitative services and counseling where it may be effective, usually through the first four years of a claim. Claim runoff is such that reserves at claim duration 10 are expected to be about 10% of the reserve at date of incurral. There is no cash surrender benefit to either individual claimants or group policyholders. The claim liabilities and unearned premium in respect of the group LTD segment are backed by \$500 million of assets.

Other A&H includes short term group medical, dental, and term life products. These products are sold through the same group benefits general agents who distribute the company's LTD product. The company competes on strong underwriting and customer service. The products are repriced at least annually to meet profitability targets. While investment margins are material, they are seen as independent of underwriting margins.

Earned premium to surplus leverage is low, at about 4/1. The claim reserves and unearned premium in respect of the other A&H segment are backed by \$100 million of assets.

Surplus Account contains the excess surplus capital. The Surplus Account is managed to maximize total rate of return growth over time subject to a series of constraints related to liquidity, bond ratings and operating income versus surplus income concerns. Company guidelines require an asset mix of 10-70% in equities, 0-50% in real estate, and 5-90% in bonds. The target asset mix is 50% equities, 35% real estate, and 15% public and private bonds.

RATINGS OF COMPANY

Mud & Poor's (M&P) Rating Agency uses the following rating categories:

AAA, AA, A, BBB, BB, B, etc

LifeCo is currently rated "AA-". One year ago, M&P raised concerns about LifeCo and placed the company under ratings review. LifeCo was not downgraded at that time.

M&P's report at that time included the following rationale for the review:

- Capital: LifeCo's capital position of 3.6% of assets is weak relative to the other insurers rated "AA-".
- Liquidity: LifeCo's liquidity position appears weak. Given that the GIC's will mature over the next few years and that a significant portion of the new sales are directed to separate account products, the company would appear to have a higher than usual liquidity risk.
- Credit Risk: LifeCo is exposed to C1 risk because of its investments in: below investment grade bonds, commercial mortgages, equity, and real estate. LifeCo also has a high percentage of total assets invested in CMO's which exhibit cashflow volatility.
- Growth/Profitability: LifeCo's business mix is shifting to less capital intensive lower margin products.

PERFORMANCE HISTORY

LifeCo was established in 1945; however most of LifeCo's growth has taken place in the last ten years

Although LifeCo has been profitable on both a Statutory and GAAP basis for the past 6 years, profits have fluctuated. Return on Equity (ROE) has averaged 8% over the past 5

years compared to an ROE of 12% for the industry. LifeCo's Stock, on a total return basis, has returned 10%, on average, over the past 3 years.

ENVIRONMENT

In surveys, the company has generally received positive reviews from its customers for service and for value. One weakness of the company has been its public relations department. Early in 1999, LifeCo took steps to deal with this weakness by hiring the one of the top public relations specialists in the country.

The insurance industry in general has received some bad press of late due to perceived market conduct problems. As a result, financial service companies that are not perceived as insurers have taken business away from companies perceived as insurers. LifeCo is definitely viewed as an insurer.

Because of the rapid changes in product design, LifeCo has 16 products running on 6 different administrative systems. With the strong stock market and declining interest rates, money has been moving from the fixed account to the variable accounts for both the variable annuity and the variable life products. The variable life market has been growing in recent years. The variable annuity market has also been growing, but it has been adversely affected by recent tax law changes. Additionally, recent changes in regulation have allowed banks to underwrite variable annuities, and several large banks are offering low load versions of this product. These changes have resulted in a dramatic slowing of variable annuity sales for LifeCo. At the same time, many reinsurers have taken a second look at offering reinsurance for the risk associated with the investment guarantees offered on these products and are now either not willing to provide reinsurance on this business at all or, if they do, at a much higher cost than was previously assumed in pricing.

DESCRIPTION OF ASSETS

General Fund Assets Backing Individual Life & Annuity and Institutional Pensions

LifeCo invests in private placement bonds, public bonds (including CMO's), commercial mortgages, equities and real estate. For private placement bonds, LifeCo tries to maintain a 75% investment grade, 25% below investment grade mix. The current mix is worse than these percentages because of downgrades in the portfolio. 30% of the private placement bonds are callable.

For public bonds LifeCo tries to maintain an 80% investment grade, 20% below investment grade mix. Currently, LifeCo maintains a higher credit quality for the public bonds to offset the current mix for the private placement bonds. 75% of the public bonds are callable.

General account assets are segmented into portfolios supporting the liability lines. LifeCo's asset mix backing its pension business is: 83% bonds, 13% commercial

mortgages, 2% equities and 2% cash & short term. LifeCo's asset mix backing its individual life and annuity business, including the liability arising from the guaranteed minimum death benefit, is: 74% bonds, 10% commercial mortgages, 5% equities, 7% real estate, 2% policy loans and 2% cash & short term. LifeCo's asset mix backing its Group Life and Health business is: 85% bonds, 8% commercial mortgages, 5% equities and real estate, and 2% cash and other.

Separate Accounts Variable Annuities and Variable UL Policies

The overall distribution is 70% US equity, 15% US bonds, 5% money market, and 10% international bonds/equity for the variable annuity block. Assets total \$2.4 billion of variable annuities, and \$1.2 billion for variable annuities.

Correlation Matrix

Fund Type	Volatility	Equity	Bond	Mortgage	Asian	Global	Money Market	Balanced
Equity	18%	1	0.00%	0.00%	25.00%	70.00%	0.00%	95.00%
Bond	4%	0.00%	1	80.00%	0.00%	0.00%	0.00%	0.00%
Mortgage	3%	0.00%	80.00%	1	0.00%	0.00%	0.00%	0.00%
Asian	21%	25.00%	0.00%	0.00%	1	45.00%	0.00%	25.00%
Global	19%	70.00%	0.00%	0.00%	45.00%	1	0.00%	70.00%
Money Market	0%	0.00%	0.00%	0.00%	0.00%	0.00%	1	0.00%
Balanced	9%	95.00%	0.00%	0.00%	25.00%	70.00%	0.00%	1

	Unit Value	Variable Annuities			Variable UL (\$millions)
		Fund Value	Delta	Gamma	
Equity	18.2	1,042	(189,993)	5,287	258
Bond	13.1	294	(98,102)	4,263	460
Mortgage	11.1	37	(6,467)	66	0
Asian	9.5	49	(10,105)	130	0
Global Equity	14.8	343	(11,559)	6,992	56
Money Market	10	123	(470,985)	896	90
Balanced	15.2	564	(505,539)	30,797	258
Total		2,452			1,122

Note: The Delta and Gamma applies to the minimum guaranteed death benefit included in the variable annuity product.

	Reported Book Value	DAC	Net Book Value	PV of Cash-Flows
Variable Annuities	2459	(74)	2,385	2,360
Variable UL	1122	(28)	1,094	1,085

Separate Account Institutional GIC

In total this line of business holds \$1.2 billion in market value of assets. Each commingled account offers a different target asset allocation.

Account 1

Treasuries	5%
AA/AAA public corporates	35%
A public corporates	15%
BBB public corporates	10%
Federal/Agency MBS passthroughs	25%
High grade private corporate debt	10%

Account 2

Treasuries	5%
AA/AAA public corporates	10%
A public corporates	15%
BBB public corporates	15%
High yield public corporates	15%
Convertible securities	10%
Federal/Agency MBS passthroughs	15%
High grade private corporate debt	10%
Other private debt	5%

Group Long-Term Disability

The asset portfolio is designed to have relatively low liquidity and high total return, with a duration target of 7 years. The target asset allocation is as follows:

Treasuries	5%
Inv Grade public corporates	35%
Federal/Agency MBS passthroughs	20%
High yield public corporates	10%
Commercial mortgages	10%
High grade private corporate debt	10%
Other private debt	5%
Real estate partnerships	5%

Other A&H

Invested assets are managed for high liquidity and high total return.

Treasuries	10%
Inv Grade public corporates	50%
Federal/Agency MBS passthroughs	25%
High yield public corporates	10%
Public equities	5%

APPENDIX A

Total Company (excluding Separate Accounts)

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	202.4	5.97%	202.8	6.1	1.0
A1b	Public Corporate (Inv. Grade)	1573.7	6.76%	1621.0	9.2	23.6
A1c	Public Corporate (below Inv Grade)	399.8	7.21%	419.0	5.8	20.0
A1d	Private Corporate (Inv Grade)	790.3	6.99%	829.1	7.0	15.8
A1e	Private Corporate (below Inv Grade)	437.7	7.54%	470.1	5.4	30.6
A1f	Pass-throughs	274.2	6.88%	288.0	4.7	8.2
A1g	CMO's	219.2	6.60%	227.5	4.3	6.6
A1	<i>Bonds Subtotal</i>	<i>3897.2</i>	<i>6.90%</i>	<i>4057.5</i>	<i>7.5</i>	<i>105.8</i>
A2	Cash & short term	103.0	4.75%	103.0	0.1	0.3
A3	Commercial Mortgages	554.0	8.39%	595.0	5.4	27.7
A4	Derivative securities	0.0	0.00%	0.0	-	0.0
A5	Equities	249.3	1.66%	249.3	19.9	49.9
A6	Real Estate (unleveraged)	237.0	9.70%	274.1	10.0	35.6
	<i>Invested Assets Subtotal</i>	<i>5040.5</i>	<i>6.89%</i>	<i>5278.8</i>	<i>8.0</i>	<i>219.3</i>
A7	Accrued investment income	50.3	0.00%	50.3	-	0.0
A8	Policyholder Loans	52.5	7.17%	52.5	0.1	0.0
A9	Provision for asset default	0.0	0.00%	0.0	-	0.0
A10	Other	75.5	0.00%	75.5	-	0.0
A11	Total Assets	5218.8	6.73%	5457.1	7.7	219.3
Liabilities						
B1	Benefit liabilities	5030.8	6.27%	5220.0	9.8	155.5
B	Total Liabilities	5030.8	6.27%	5220.0	9.8	155.5
C	PreTax Equity	188.0		237.1	(38.62)	
Tax and Other Adjustments						
D1	Future tax payments	65.8		83.0		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	65.8		83.0		
Net Value (C-D)		122.2		154.1		

Surplus Account

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	0.0				0.00
A1b	Public Corporate (Inv Grade)	9.2	7.53%	4.3	2.20	0.14
A1c	Public Corporate (below Inv Grade)	4.9	9.17%	8.8	3.90	0.25
A1d	Private Corporate (Inv Grade)	3.5	8.01%	5.9	3.80	0.07
A1e	Private Corporate (below Inv Grade)	10.8	9.82%	18.4	5.30	0.76
A1f	Pass-throughs	0.0				0.00
A1g	CMO's	0.0				0.00
A1	<i>Bonds Subtotal</i>	28.4	8.74%	37.4	3.87	1.21
A2	Cash & short term	0.0				0.00
A3	Commercial Mortgages	0.0				0.00
A4	Derivative securities	0.0				0.00
A5	Equities	101.5	2.61%	101.5	9.50	20.30
A6	Real Estate (unleveraged)	58.0	7.23%	95.1	12.10	8.71
	<i>Invested Assets Subtotal</i>	188.0	4.96%	196.6	9.45	30.2
A7	Accrued investment income	0.0				0.00
A8	Policyholder Loans	0.0				0.00
A9	Provision for asset default	0.0				0.00
A10	Other	0.0				0.00
A11	Total Assets	188.0	4.96%	234.0	9.45	38.9
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	0.0				
B	Total Liabilities	0.0	0.0	0.0	0	
C	PreTax Equity	188.0				
Tax and Other Adjustments						
D1	Future tax payments	0.0				
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0				
Net Value (C-D)		188.0				

Individual Life & Annuity - Traditional Life

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	6.5	6.10%	6.45	13.9	0.03
A1b	Public Corporate (Inv. Grade)	51.6	6.90%	54.44	26.8	0.77
A1c	Public Corporate (below Inv Grade)	12.9	7.30%	13.61	12.0	0.65
A1d	Private Corporate (Inv Grade)	28.4	7.00%	29.94	17.2	0.57
A1e	Private Corporate (below Inv Grade)	15.5	7.50%	16.33	8.5	1.08
A1f	Pass-throughs	7.1	7.00%	7.45	5.5	0.21
A1g	CMO's	7.1	7.10%	7.52	6.5	0.21
A1	<i>Bonds Subtotal</i>	<i>129.0</i>	<i>7.01%</i>	<i>135.74</i>	<i>19.0</i>	<i>3.53</i>
A2	Cash & short term	6.0	4.75%	6.00	0.1	0.02
A3	Commercial Mortgages	39.0	8.00%	41.93	5.0	1.95
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	75.0	1.00%	75.00	28.0	15.00
A6	Real Estate (unleveraged)	21.0	10.50%	21.00	10.0	3.15
	<i>Invested Assets Subtotal</i>	<i>270.0</i>	<i>5.71%</i>	<i>279.7</i>	<i>18.4</i>	<i>23.6</i>
A7	Accrued investment income	3.0	0.00%	3.00	0.0	0.00
A8	Policyholder Loans	22.5	7.00%	22.50	0.1	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	4.5	0.00%	4.50	0.0	0.00
A11	Total Assets	300.0	5.66%	309.7	16.6	26.8
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	300.0	6.10%	318.00	31.9	2.00
B	Total Liabilities	300.0	6.10%	318.0	31.9	2.0
C	PreTax Equity	0.0		-8.3	600.59	
Tax and Other Adjustments						
D1	Future tax payments	0.0		-2.9		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0		-2.9		
Net Value (C-D)		0.0		-5.4		

Individual Life & Annuity - Non Traditional Life

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	13.8	6.20%	13.75	12.8	0.07
A1b	Public Corporate (Inv. Grade)	110.0	7.00%	114.95	27.9	1.65
A1c	Public Corporate (below Inv Grade)	27.5	7.50%	29.01	13.1	1.38
A1d	Private Corporate (Inv Grade)	60.5	7.10%	63.83	18.2	1.21
A1e	Private Corporate (below Inv Grade)	33.0	7.60%	34.82	9.1	2.31
A1f	Pass-throughs	15.1	7.00%	15.88	5.6	0.45
A1g	CMO's	15.1	7.30%	16.03	6.5	0.45
A1	<i>Bonds Subtotal</i>	<i>275.0</i>	<i>7.12%</i>	<i>288.27</i>	<i>19.8</i>	<i>7.52</i>
A2	Cash & short term	8.0	4.75%	8.00	0.1	0.02
A3	Commercial Mortgages	44.0	8.00%	47.30	5.0	2.20
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	5.0	1.00%	5.00	28.0	1.00
A6	Real Estate (unleveraged)	28.0	10.50%	28.00	10.0	4.20
	<i>Invested Assets Subtotal</i>	<i>360.0</i>	<i>7.35%</i>	<i>376.6</i>	<i>16.9</i>	<i>14.9</i>
A7	Accrued investment income	4.0	0.00%	4.00	0.0	0.00
A8	Policyholder Loans	30.0	7.30%	30.00	0.1	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	6.0	0.00%	6.00	0.0	0.00
A11	Total Assets	400.0	7.17%	416.6	15.2	19.1
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	400.0	6.30%	406.00	40.2	4.00
B	Total Liabilities	400.0	6.30%	406.0	40.2	4.0
C	PreTax Equity	0.0		10.6	(943.69)	
Tax and Other Adjustments						
D1	Future tax payments	0.0		3.7		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0		3.7		
<hr/>						
Net Value (C-D)		0.0		6.9		

Individual Life & Annuity - Accumulation Annuity

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	58.7	6.20%	58.69	5.0	0.29
A1b	Public Corporate (Inv Grade)	469.5	7.00%	481.24	4.9	7.04
A1c	Public Corporate (below Inv Grade)	117.4	7.50%	120.90	5.6	5.87
A1d	Private Corporate (Inv Grade)	258.2	7.10%	267.26	5.3	5.16
A1e	Private Corporate (below Inv Grade)	140.9	7.60%	148.60	5.0	9.86
A1f	Pass-throughs	64.6	7.00%	67.14	4.6	1.94
A1g	CMO's	64.6	7.10%	67.46	5.2	1.94
A1	<i>Bonds Subtotal</i>	<i>1173.8</i>	<i>7.11%</i>	<i>1211.28</i>	<i>5.2</i>	<i>32.10</i>
A2	Cash & short term	30.0	4.75%	30.00	0.1	0.09
A3	Commercial Mortgages	135.0	8.00%	143.10	4.3	6.75
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	18.8	1.00%	18.75	20.0	3.75
A6	Real Estate (unleveraged)	105.0	10.50%	105.00	8.0	15.75
	<i>Invested Assets Subtotal</i>	<i>1462.5</i>	<i>7.31%</i>	<i>1508.1</i>	<i>5.5</i>	<i>58.4</i>
A7	Accrued investment income	15.0	0.00%	15.00	0.0	0.00
A8	Policyholder Loans	0.0	0.00%	0.00	0.0	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	22.5	0.00%	22.50	0.0	0.00
A11	Total Assets	1500.0	7.13%	1545.6	5.3	74.2
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	1500.0	5.90%	1575.00	5.3	15.00
B	Total Liabilities	1500.0	5.90%	1575.0	5.3	15.0
C	PreTax Equity	0.0		-29.4	4.21	
Tax and Other Adjustments						
D1	Future tax payments	0.0		-10.3		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0		-10.3		
Net Value (C-D)		0.0		-19.1		

Institutional Pensions - Payout Annuity

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	16.9	6.40%	17.26	10.4	0.08
A1b	Public Corporate (Inv Grade)	135.4	7.20%	144.20	9.2	2.03
A1c	Public Corporate (below Inv Grade)	33.9	7.60%	36.56	8.3	1.69
A1d	Private Corporate (Inv Grade)	74.5	7.40%	80.06	8.0	1.49
A1e	Private Corporate (below Inv Grade)	40.6	7.90%	44.28	7.2	2.84
A1f	Pass-throughs	18.6	7.10%	19.55	6.5	0.56
A1g	CMO's	18.6	7.30%	19.83	7.5	0.56
A1	<i>Bonds Subtotal</i>	<i>338.5</i>	<i>7.33%</i>	<i>361.73</i>	<i>9.0</i>	<i>9.26</i>
A2	Cash & short term	14.0	4.75%	14.00	0.1	0.04
A3	Commercial Mortgages	286.0	8.75%	308.88	6.0	14.30
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	44.0	1.00%	44.00	28.0	8.80
A6	Real Estate (unleveraged)	0.0	10.50%	0.00	10.0	0.00
	<i>Invested Assets Subtotal</i>	<i>682.5</i>	<i>7.46%</i>	<i>728.6</i>	<i>9.0</i>	<i>32.4</i>
A7	Accrued investment income	7.0	0.00%	7.00	0.0	0.00
A8	Policyholder Loans	0.0	7.00%	0.00	0.1	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	10.5	0.00%	10.50	0.0	0.00
A11	Total Assets	700.0	7.28%	746.1	8.8	32.4
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	700.0	6.75%	759.50	9.5	2.00
B	Total Liabilities	700.0	6.75%	759.5	9.5	2.0
C	PreTax Equity	0.0		-13.4		
Tax and Other Adjustments						
D1	Future tax payments	0.0		-4.7		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0		-4.7		
Net Value (C-D)		0.0		-8.7		

Institutional Pensions - GIC

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	71.6	5.60%	71.63	2.5	0.36
A1b	Public Corporate (Inv. Grade)	573.0	6.40%	584.46	2.8	8.60
A1c	Public Corporate (below Inv Grade)	143.3	6.75%	146.83	3.0	7.16
A1d	Private Corporate (Inv Grade)	315.2	6.80%	329.33	4.3	6.30
A1e	Private Corporate (below Inv Grade)	171.9	7.30%	181.35	4.0	12.03
A1f	Pass-throughs	78.8	6.80%	83.51	5	2.36
A1g	CMO's	78.8	5.80%	79.58	1.3	2.36
A1	<i>Bonds Subtotal</i>	<i>1432.5</i>	<i>6.58%</i>	<i>1476.69</i>	<i>3.4</i>	<i>39.18</i>
A2	Cash & short term	30.0	4.75%	30.00	0.1	0.09
A3	Commercial Mortgages	0.0	8.00%	0.00	5.0	0.00
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	0.0	1.00%	0.00	28.0	0.00
A6	Real Estate (unleveraged)	0.0	10.50%	0.00	10.0	0.00
	<i>Invested Assets Subtotal</i>	<i>1462.5</i>	<i>6.54%</i>	<i>1506.7</i>	<i>3.4</i>	<i>39.3</i>
A7	Accrued investment income	15.0	0.00%	15.00	0.0	0.00
A8	Policyholder Loans	0.0	7.00%	0.00	0.1	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	22.5	0.00%	22.50	0.0	0.00
A11	Total Assets	1500.0	6.38%	1544.2	3.3	39.3
Liabilities						
B1	Benefit liabilities	1500.0	6.60%	1537.50	3.1	7.50
B	Total Liabilities	1500.0	6.60%	1537.5	3.1	7.5
C	PreTax Equity	0.0		6.7		
Tax and Other Adjustments						
D1	Future tax payments	0.0		2.3		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	0.0		2.3		
Net Value (C-D)		0.0		4.4		

Group Business

Assets		Reported Book Value	Book Yield	PV Cash Flows	Modified Duration	Req Capital
Bonds (total)						
A1a	Gov't	35.0	6.00%	35.00	8.9	0.18
A1b	Public Corporate (Inv. Grade)	225.0	6.70%	237.38	20.9	3.38
A1c	Public Corporate (below Inv Grade)	60.0	7.20%	63.30	7.0	3.00
A1d	Private Corporate (Inv Grade)	50.0	6.80%	52.75	11.9	1.00
A1e	Private Corporate (below Inv Grade)	25.0	7.30%	26.38	7.5	1.75
A1f	Pass-throughs	90.0	6.80%	94.50	3.9	2.70
A1g	CMO's	35.0	6.70%	37.10	5.8	1.05
A1	<i>Bonds Subtotal</i>	<i>520.0</i>	<i>6.77%</i>	<i>546.40</i>	<i>13.7</i>	<i>13.05</i>
A2	Cash & short term	15.0	4.75%	15.00	0.1	0.05
A3	Commercial Mortgages	50.0	8.00%	53.75	5.0	2.50
A4	Derivative securities	0.0	0.00%	0.00	0.0	0.00
A5	Equities	5.0	1.00%	5.00	28.0	1.00
A6	Real Estate (unleveraged)	25.0	10.50%	25.00	10.0	3.75
	<i>Invested Assets Subtotal</i>	<i>615.0</i>	<i>6.92%</i>	<i>645.2</i>	<i>12.7</i>	<i>20.3</i>
A7	Accrued investment income	6.3	0.00%	6.31	0.0	0.00
A8	Policyholder Loans	0.0	0.00%	0.00	0.1	0.00
A9	Provision for asset default	0.0	0.00%	0.00	0.0	0.00
A10	Other	9.5	0.00%	9.46	0.0	0.00
A11	Total Assets	630.8	6.75%	660.9	12.3	24.1
Liabilities		Reported Book Value	Req Interest	PV Cash Flows	Modified Duration	Req Capital
B1	Benefit liabilities	630.8	5.90%	624.00	7.0	125.00
B	Total Liabilities	630.8	5.90%	624.0	7.0	125.0
C	PreTax Equity	30.8		36.9		
Tax and Other Adjustments						
D1	Future tax payments	10.8		12.9		
D2	Other adjustments					
D	Subtotal, tax and other adjustments	10.8		12.9		
Net Value (C-D)		20.0		24.0		

ASSET LIABILITY MANAGEMENT POLICY STATEMENT

I. Overall Objective for the ALM Function

ALM is the ongoing process of formulating, implementing and monitoring strategies in respect of assets and liabilities to attain our financial objectives for a given set of risk tolerances and constraints.

As with all financial services companies, risk is an inherent part of doing business. Over the normal course of business LifeCo is exposed to credit risk, interest rate risk, foreign exchange rate risk, off-balance sheet risk, pricing risk, liquidity risk, as well as other various market risks. ALM is a vital ongoing process that requires the management of all these risks.

The principal risk management objectives are to eliminate excessive and unacceptable risk and optimize the risk/return profile of the total company. A key focus of the ALM function at LifeCo is **interest rate risk**.

As a result of timing differences in the repricing of assets and liabilities, fluctuations in market interest rates can affect both accounting earnings and the market value of assets, liabilities and off-balance sheet items and hence the economic value and net worth of LifeCo. The objectives in managing interest rate risk are to:

- Maximize the economic value of LifeCo subject to stated risk tolerances and constraints (see ALM Guidelines).
- Support the achievement of business strategies while protecting earnings and liquidity.
- Minimize the potential for significant loss as a result of changes in interest rates.
- Manage interest rate risk of current and future earnings to a level that is consistent with the mix of businesses and that limits such exposure to a percentage of the book value of assets.

Another key focus of the ALM function at LifeCo is **market risk**. Market risk arises whenever financial results can be adversely affected by changes in the equity markets. The most extreme exposure to market risk occurs when investment guarantees are offered. The risk exposure associated with these guarantees is managed by using dynamic hedging.

Liquidity risk is the risk that LifeCo will be unable to maintain cash flows that are adequate to fund its operations and meet all present and future financial obligations on a timely and cost effective basis.

A separate Liquidity Policy details the management of LifeCo's liquidity risk.

Foreign exchange rate risk arises whenever future payments in a foreign currency are made or received. A loss occurs if there is an appreciation (in the case of foreign dollars owed) or depreciation (in the case of foreign dollars due) of the local currency relative to

the foreign currency. The objective is to eliminate any foreign exchange rate risk. This is accomplished through the use of currency swaps.

Credit risk includes the risk of default on scheduled payments of either interest or principal. Credit quality guidelines are determined by the Investment Department of LifeCo, approved by the Board of Directors and are specified in the Investment Policy. The credit quality of the assets is monitored the Investment Department of LifeCo and reported to the Board of Directors.

Off-balance sheet risk refers to the risk associated with derivative instruments. The Operational Guidelines for Use of Derivatives provides control procedures and details the management of LifeCo's exposure to derivatives risk.

II. ALM Process

The ALM process consists of four fundamental steps:

Identify the level of risk exposure

It is a requirement that at all times the exposure to all risks be known. This is accomplished by regular measurement and monitoring of the exposure to various risks.

Decide whether the risk exposure is appropriate

The purpose of ALM is not necessarily to eliminate or even minimize risk. The level of risk will vary with the return requirement and financial objectives. Return objectives and risk tolerances are determined by LifeCo and reviewed from time to time.

Modify the existing risk

This is accomplished by rebalancing the portfolio or through the use of interest rate swaps, currency swaps or other hedging techniques to assume offsetting risk.

Optimize the risk/return profile of the business

For a given level of risk financial objectives are maximized. Optimization ensures that portfolios lie on the risk/return efficient frontier for LifeCo's stated return objectives, risk tolerances and constraints.

III. ALM Committee Purpose

Risk tolerances are determined by the ALM Committee and approved by the Board of Directors. Asset-Liability strategies as well as the policies and guidelines for the management of the aforementioned risks are established by the ALM committee. The ALM committee sets limits on potential earnings fluctuations that could arise from interest rate risk as well as on- and off- balance sheet accrual positions. The ALM committee monitors exposures in view of market developments and LifeCo's financial condition, sets guidance for interest rate risk management decisions and monitors liquidity and capital adequacy. ALM policy is established by the ALM Committee, reviewed by the Board of Directors at least annually and is implemented by Corporate

Actuarial in conjunction with the Investment Department of LifeCo and the Finance division of LifeCo.

IV. ALM Committee Composition/Frequency of Meetings

The ALM committee meets monthly and consists of the CEO, CFO, Chief Actuary, CIO, VP Risk Management and includes representation from functional areas as appropriate. Committee proceedings are chaired and recorded by the VP Risk Management.

V. ALM Guidelines

LifeCo's exposure to interest rate risk is quantified by calculating price sensitivity statistics such as modified duration, dollar duration, convexity, and partial durations and by performing scenario testing and cash-flow analysis. A pure dedication strategy of matching asset and liability cash-flows is widely recognized as costly, unnecessary and would not be appropriate for LifeCo. Negative net cash flows are identified and assessed from a liquidity perspective only. Exposure to interest rate risk is monitored for each product line and for all major products. Although ALM is performed at both the product and product line level, specific guidelines are set for Accumulation Annuities in total, Traditional Life Products in total, Non-Traditional Life Products in total and total company surplus

(a) Accumulation Annuities

Dollar Duration of Assets less Dollar Duration of Liabilities	< 30% x book value of assets
Key Rate Sensitivity	< 0.02% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 0.50% x book value of assets

(b) Variable Annuities

Delta of liability less delta of assets	<10% of delta of liability
Gamma	Unhedged
Vega	Unhedged
Rho	<5% of rho of liability
(Rho of liability less rho of assets)	

(c) Traditional Life Products

Dollar Duration of Assets less Dollar Duration of Liabilities	< 100% x book value of assets
Key Rate Sensitivity	< 0.10% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 5.00% x book value of assets

(c) Non-Traditional Life Products

Dollar Duration of Assets less Dollar Duration of Liabilities	< 100% x book value of assets
Key Rate Sensitivity	< 0.10% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 5.00% x book value of assets

(d) Institutional Pension - Payout

Dollar Duration of Assets less Dollar Duration of Liabilities	< 100% x book value of assets
Key Rate Sensitivity	< 0.10% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 5.00% x book value of assets

(e) Institutional Pension - GIC

Dollar Duration of Assets less Dollar Duration of Liabilities	< 30% x book value of assets
Key Rate Sensitivity	< 0.02% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 2.00% x book value of assets

(f) Group Business

Dollar Duration of Assets less Dollar Duration of Liabilities	< 100% x book value of assets
Key Rate Sensitivity	< 0.1% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 5.00% x book value of assets

(g) Total Company

Dollar Duration of Assets less Dollar Duration of Liabilities	< 100% x book value of assets
Key Rate Sensitivity	< 0.05% x book value of assets for any and all key rates
Worst Case Scenario at 95% Confidence Level	< 2.00% x book value of assets

(h) Surplus

Dollar Duration of Actual Assets less Dollar Duration of Benchmark	< 100% x book value of assets
--	-------------------------------

Where the modified duration of benchmark is assumed to be 10 years and the present value of the benchmark is assumed equal to the present value of the assets.

In order to ensure that the above guidelines are met for each product line, it may be necessary to rebalance the portfolio by trading assets or through the use of financial engineering. Rebalancing is performed monthly for Accumulation Annuities and quarterly for Life Products. In addition to meeting the above guidelines, for rebalancing purposes, each asset segment shall have assets that do not exceed the liabilities by more than +/- \$2,000,000.

The Investment Department has the discretion to position the exposure of the company to the worst case scenario that it deems least likely to occur within the above guidelines for mismatch provision.

ASSET LIABILITY MANAGEMENT PROCEDURE MANUAL

I. Reporting

Corporate Actuarial reports on LifeCo's ALM position to the Investment Department and the ALM Committee on a quarterly basis. For Accumulation Annuities the ALM position is monitored on a weekly basis and reflects all asset commitments from the time at which they are priced. Corporate Actuarial reports on LifeCo's ALM position to the Board of Directors at each of its meetings.

The quarterly reports include a discussion of our exposure to interest rate risk, changes in market interest rates during the period, the results of scenario testing and various technical notes. Attached to the report are the following:

- price sensitivity statistics including dollar duration, modified duration, convexity, and key rate sensitivity analysis
- cash flow analysis
- a comparison of the mismatch provision for the past 12 months
- book values and market values of assets and liabilities
- a comparison of the term structure of interest rates for the current and prior periods

Appendix A contains a sample ALM report

II. Allocation of Asset Commitments

Status of Commitments

Corporate Actuarial receives a weekly report on the status of asset commitments from the Investment Department which contains information on the following stages of commitment:

- 1 Under Review/Negotiation
- 2 Under Application/Recommended for Investment
- 3 Internal Approval - Not Yet Committed
- 4 Committed - Not Yet Priced
- 5 Priced
- 6 Funded

Allocation of Commitment to Product Lines

Once an asset reaches the committed stage, Corporate Actuarial reviews each of the product line portfolios in terms of the liability characteristics and ALM guidelines and recommends allocation of the commitment to the most suitable product line. Once an asset reaches the committed stage the Investment Department and Corporate Actuarial will determine whether a hedge transaction will be needed between the time the commitment is priced and the time it is funded.

Determination of Method of Funding

The committed asset is added to the portfolio for purposes of measuring exposure to interest rate risk. Corporate Actuarial examines the impact of various funding

alternatives and recommends the sale of asset(s) that optimizes the portfolio with respect to LifeCo's financial objectives within the approved ALM guidelines.

Priced Commitments

Committed assets are not reflected for ALM purposes until they become priced. Until this point there is no exposure to interest rate risk. If a hedge transaction was previously deemed necessary, it will be effected once the asset becomes priced.

III. Hedging

Measurement

A hedge is the assumption of an additional risk exposure that offsets an existing risk. The intended effect of a hedge is to reduce the overall portfolio risk (e.g. currency or interest rate risk). Thus the impact on the overall risk exposure of the portfolio is examined for all hedges. Although hedges are examined at the portfolio level, care must be taken to ensure that any derivatives transactions are appropriately arranged to qualify for hedge accounting treatment where intended.

IV. Priced Commitments

A new priced commitment will add exposure to interest rate risk to a portfolio. Before a hedge is effected for this transaction the overall impact on the portfolio must be examined.

V. Portfolio Rebalancing

From time to time, portfolio rebalancing will be required to keep the assets in balance with the liabilities and in order to ensure that all ALM guidelines specified in the ALM Policy Statement are adhered to. Formally, all portfolios are reviewed quarterly with the exception of the Accumulation Annuities portfolio which is reviewed monthly. Optimization is also performed in order to maximize LifeCo's financial objectives subject to its risk tolerances and constraints. Portfolio rebalancing and optimization may involve asset trades and/or the use of financial engineering. Any asset trades between asset segments must be done at market value and requires the physical sale and purchase of assets. Transfers at book value are strictly prohibited.

VI. Interest Rate Sensitivity

A number of tools are used to measure the interest rate sensitivity of the assets and liabilities.

Dollar duration provides a measure of the interest rate sensitivity in dollar terms of the market value of the assets and liabilities for a parallel change in interest rates. For example, if the dollar duration of assets is \$100,000,000 greater than the dollar duration of liabilities, then for a 100 basis point increase in interest rates for all terms to maturity across the yield curve, the market value of assets will decrease by approximately \$1,000,000 more than the market value of liabilities.

Modified duration provides a measure of the interest rate sensitivity in percentage terms of the market value of the assets and liabilities for a parallel change in interest rates. For

example, if the modified duration of an asset is 4, then for a 100 basis point increase in interest rates the market value of the asset will decline by approximately 4%.

Convexity measures the rate of change of duration. Duration only provides an approximation of the price sensitivity to changes in interest rates. The precision of the approximation deteriorates as the change in interest rates increases. Including convexity improves the approximation. In general, assets with greater convexity are more desirable than assets with less convexity. This is because as interest rates decrease the increase in the market value of the assets increases at a faster rate. Conversely, as interest rates increase the decrease in the market value of the assets decreases. It is therefore desirable to have assets which have higher convexity than the liabilities.

Key rate sensitivity analysis measures the impact on market value of changes in interest rates at each term to maturity along the yield curve. This is a valuable tool as interest rates seldom move in a parallel fashion.

Cash flow analysis assumes no renewal or reinvestment of cash flows and must be interpreted with care. It is not necessary or advisable to be perfectly cash flow matched; however, large net cash outflows must be considered in the context of liquidity available in the portfolio.

Scenario testing is performed on a deterministic basis and involves measuring the sensitivity of economic value to both parallel and non-parallel yield curve shifts.

Asset Quality

Credit quality guidelines are contained in the Investment Policy and specify maximum holdings of individual credits which decline as credit quality declines, as well as an average quality constraint on the total portfolio. It is the philosophy of LifeCo that the credit risk exposure of the Company's assets should be highly diversified, actively managed, and under continuous review by the Investment Department. The ALM committee will be informed by the Investment Department of the credit risk exposure of the Company's assets to ensure compliance with the credit quality guidelines.

VII. Liquidity

Cash flow analysis is performed which provides an indication of the potential liquidity requirements of the portfolio. In addition, asset mix is monitored with respect to renewal and surrender experience to ensure that sufficient liquid assets exist to meet anticipated cash outflow requirements.

VIII. Capital Adequacy

Target capital is 150% of regulatory capital required.

IX. Profitability

Profitability is measured in terms of return on total company surplus. Economic value is the central focus of ALM.

X. Specific Responsibilities

ALM Committee

The ALM Committee is responsible for overall policy formulation as detailed in the Policy Statement. The ALM Committee is also responsible for monitoring the ALM position of LifeCo and ensuring that all ALM guidelines are adhered to.

ALM Sub-Committees

Portfolio Rebalance Subcommittee

All asset trades affect the statutory reserve and mismatch provision under GAAP, the measurement of profitability, the economic value of surplus, key rate sensitivity, capital requirements and the return on capital. In addition to determining whether a trade increases the yield to maturity - or even the total rate of return - of a portfolio, the aforementioned considerations need to be taken into account whenever asset trades are contemplated. The function of this subcommittee is to examine portfolio changes, quantify the impact of derivatives and asset trades, monitor and measure the exposure to interest rate and other risks and perform optimization and rebalancing of all portfolios. This subcommittee meets a minimum of once per quarter and consists of a representative from the Investment Department of LifeCo, Corporate Actuarial and Finance.

Rate Setting Subcommittee

The function of this subcommittee is to determine crediting rates for both Life and Accumulation Annuities. This subcommittee meets weekly and consists of a representative from the Investment Department of LifeCo, Corporate Actuarial, Finance, Marketing Actuarial and Accumulation Annuities Marketing.

Product managers

The Life and Investment Product vice-presidents are responsible for the execution of business strategies decided at ALM Committee.

Corporate Actuarial

Corporate Actuarial is responsible for implementing ALM policy and ensuring that ALM guidelines are adhered to. Corporate Actuarial projects asset and liability cash flows, calculates all price sensitivity statistics, performs key rate sensitivity analysis and scenario testing, determines reserves and mismatch provision. Corporate Actuarial, together with the Investment Department of LifeCo, suggests assets trades or the use of financial engineering for the purposes of rebalancing the portfolio in order to ensure that LifeCo's financial objectives are maximized and that all ALM guidelines are met.

Investment Department

The Investment Department is responsible, with input from Corporate Actuarial, for the determination and execution of all trades, financial engineering and hedging strategies in accordance with the guidelines specified in the ALM Policy Statement. the Investment Department communicates all transactions including forward

commitments to Finance and Corporate Actuarial and distributes a weekly report on the status of mortgage and private placement commitments and related hedging arrangements.

Finance

Finance is responsible for recording all transactions and keeping the asset accounting system up to date. Finance provides electronic files of bond and private placements on quarterly basis.

OPERATIONAL GUIDELINES FOR USE OF DERIVATIVES

I. Overview

LifeCo, by the nature of its business activities and products, is routinely exposed to risks such as those described in sections V through VIII.

LifeCo purchases derivatives to manage these risks that are identified by the liability product managers and/or Corporate Actuarial. Derivatives may not be purchased for speculative purposes

The guiding principle in the use of derivatives is that LifeCo is a limited end-user acting primarily to reduce risk Strategies that involve the writing of options by LifeCo are specifically excluded, with the exception of options embedded in LifeCo's products.

II. Definition of Derivatives

For purposes of these guidelines, derivatives are defined as contracts that the company enters into with a counterparty, where the contract value derives from the value of an underlying asset or underlying reference rate or index. Such indices include, but are not limited to, LIBOR, U.S. Treasury instruments, and the S&P 500 index. This definition of derivatives includes instruments as described in section IX. This definition does not include asset classes such as mortgage-backed securities, collateralized mortgage obligations, asset-backed securities, and other structured assets that are treated as bonds for accounting and regulatory purposes.

III. Responsibilities

The ALM Committee is responsible for recommending the type and amount of each derivative purchase. The Investment Department is responsible for the purchase of derivatives. The Finance Department is responsible for derivatives accounting and reporting. The ALM Committee is responsible for all board reports relating to derivatives activity.

IV. Objectives

The objective of derivatives use at LifeCo is to reduce potential volatility in the future operating earnings of the lines of business. Depending on the source of the volatility and the type of derivative purchased, the derivative may reduce both upside and downside earnings volatility, or may reduce only downside earnings volatility.

V. Business Exposures Managed

LifeCo's life insurance and accumulation annuity products have minimum interest guarantees. In an extended period of low interest rates, profit margins would be reduced, and possibly even be negative.

The life insurance and accumulation products allow surrenders at book value, possibly with a book value surrender charge. In periods of rapidly rising interest rates, the assets backing these products would not support a credited rate that is competitive with new money rates. If the company chose to maintain competitive credited rates, then profit margins would be reduced or even be negative. If the company chose to maintain profit margins with an uncompetitive credited rate, then policy surrenders could increase, leading to a loss of future profit margins and market value losses on asset sales to pay the surrender benefits.

LifeCo's equity-linked GIC credits an interest rate that is linked to the performance of the S&P 500 equity index. This product also guarantees the return of principal. LifeCo's investments must meet both of these guarantees.

VI. Mismatch risk

The company's assets and liabilities are not cash flow matched.

In time periods where the company's asset cash flows exceed the liability cash flows, there is reinvestment risk. For example, the assets allocated to the payout annuity business are shorter than the liability cash flows. Since the payout annuity benefits cannot be changed, reinvestment risk would be realized if interest rates were low at the time of the asset reinvestment.

In time periods where the company's liability cash flows exceed the asset cash flows, there is funding risk. For example, if assets have to be sold to pay excess benefits at a time when interest rates are high, market value losses will be realized on the asset sales.

There is also potential mismatch risk in LifeCo's equity-linked GIC. If the assets allocated to this business do not match the performance guaranteed relative to the S&P 500 index, then the profits may vary substantially from the product's pricing assumption.

VII. Mortgage commitment risk

LifeCo's Investment Department commits to funding commercial mortgage loans weeks in advance of disbursing funds for the loan. These commitments require a loan rate to be locked in at that time for the mortgage. If interest rates rise between this commitment date and the disbursement date, then the earned rate on these assets acquired on the disbursement date will be lower than the earned rates that the liability pricing areas would expect the Investment Department to be able to achieve in the current interest rate environment.

VIII. Foreign exchange risk

The Investment Department may invest in assets denominated in foreign currencies. In addition, the multinational nature of the operations of LifeCo produces operating earnings denominated in more than one currency. As currency exchange rates fluctuate, the value

of LifeCo's investment income and operating earnings will also fluctuate unless the currency risk is hedged.

IX. Approved Derivative Classes

The Board of Directors has currently approved the purchase, subject to the guidelines detailed below, of interest rate swaps, currency swaps, interest rate caps, interest rate floors, and equity options indexed to the S&P 500. Derivatives not in these categories may be purchased only with the prior approval of both the Chief Investment Officer and Chief Executive Officer of LifeCo.

Interest rate swaps: interest rate swaps are bilateral agreements between LifeCo and the counterparty to exchange a series of cash flows at specified intervals. The cash flows may be fixed or floating. Floating cash flows would be calculated based on a set formula and reference index. Swap terms and conditions such as a reference index, frequency of payments, expiry date of the contract, and notional amount of the contract are set at the time of the swap purchase.

Government bond futures: a futures contract obligates its owner to buy a specified amount of a specified government bond at a specified price on a specified date. These contracts are used by LifeCo in either "long" positions (an agreement to buy a government bond) or "short" positions (an agreement to sell a government bond). Futures contracts are entered into directly with an exchange clearinghouse.

Purchased options on government bond futures: these options give LifeCo the right, but not the obligation, to buy (or sell, depending on the type of option) government bond futures at a set price on a set future date. These options allow LifeCo to benefit from favorable price movements in government bond futures. LifeCo's loss on unfavorable price movements is limited to the premium paid to purchase the option.

Forward rate agreements: these agreements are similar to the futures described above, but they are negotiated with other financial institutions rather than an exchange clearinghouse. They are agreements that a certain interest rate will apply to a certain principal amount for a certain time period in the future.

Foreign currency swaps: these are bilateral agreements between LifeCo and the counterparty whereby interest and principal in one currency are exchanged for interest and principal in another currency.

Foreign currency forward rate agreements: forwards are transacted over-the-counter, typically with a domestic Schedule I bank. LifeCo agrees to buy or sell a specific amount of foreign currency at a specified rate of exchange on a specified date.

Foreign currency futures: LifeCo agrees to buy or sell a specific amount of foreign currency at a specified rate of exchange on a specified date. The actual currency transaction being hedged seldom coincides with the maturity of the futures contract. The futures are usually sold prior to maturity and the gain or loss on the contract is used to offset the increase or decrease in the value of the currency transaction being hedged.

Purchased interest rate caps and floors: interest rate caps protect LifeCo in rising interest rate environments by paying the excess, if any, of a prevailing reference rate at a future date over the strike rate in the contract. The contract has a set notional amount, maturity date, payment dates, and reference rate. Since only positive differences are paid to LifeCo, LifeCo's only outlay is the premium paid for the cap. Interest rate floors are

similar to caps, but protect LifeCo in falling rate environments by paying the excess, if any, of the contract's strike rate over the prevailing reference rate at a future date.

Equity index options: European call options on the S&P 500 index give LifeCo a payment at maturity equal to the excess, if any, of the value of the index over the option's strike price. Each call option contract is for \$100 times the value of the index. LifeCo's only outlay is the premium paid for the call option.

X. Acquisition of Derivatives

Interest rate swaps may be purchased in combination with a floating rate asset to achieve a fixed rate of return. The procedures and policies are then the same as the procedures and policies for acquiring fixed rate assets. If an interest rate swap is purchased for other ALM purposes, the ALM Committee must submit a written request for the purchase to the Investment Department.

Interest rate caps and floors purchases and equity option purchases must be in the form of a written request from the ALM Committee to the Investment Department. The Investment Department must obtain a minimum of two quotes from approved counterparties.

XI. Transaction Approval

Each derivative purchase will result in a written sheet with the terms and conditions (the "confirmation sheet") of that derivative. This sheet must be signed by the Investment Department employee responsible for that purchase.

XII. Exposure Limits

The net market value exposure of all interest rate and currency swaps with any one counterparty will not exceed \$250 million. The market value of all equity call options with any one counterparty will not exceed \$100 million. The market value of all interest rate caps and floors with any one counterparty will not exceed \$100 million.

XIII. Transaction Documentation and Control Procedures

Each derivative purchase results in a confirmation sheet (see section XI). A copy of this sheet is sent by the Investment Department to the Finance Department. The Finance Department maintains a file for all derivatives. The Finance Department documents all payments made and received under swap contracts and verifies the calculation of these payments. The Finance Department also verifies the amounts of payments, if any, due from the counterparty on all caps and floors each time a payment, if any, is due. The Vice President of Finance reviews and initials all of these payment calculations.

XIV. Accounting and Disclosure

LifeCo will follow all required accounting practices for derivatives and disclose the balance sheet effect of derivatives in all shareholder reports and other required reports for securities regulators.

XV. Communication of Purchases

The Board of Directors will be notified of each derivative purchase at the next scheduled board meeting following such purchase.

XVI. Approved Counterparties

Counterparties must have a credit rating of at least BBB from Moody's Agency. LifeCo must have a master ISDA agreement signed with the counterparty prior to the derivative purchase. Each agreement is subject to the approval of LifeCo's Secretary and General Counsel.

XVII. Market Valuation

Each December 31st, the Investment Department will obtain market valuations for each derivative from the counterparty for that derivative. A report showing the market values and market values from the prior December 31st will be provided to the ALM Committee.

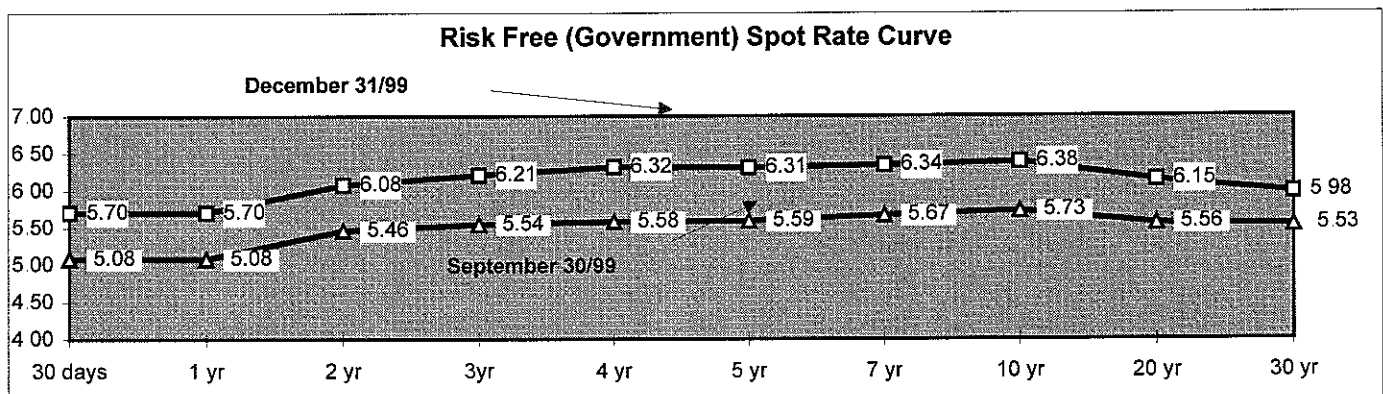
XVIII. Administration

All derivatives will be maintained where possible on LifeCo's Investment Administration System. If a derivative cannot be administered on this system, it will be identified in an exception report, which will be submitted by the Finance Department to the ALM Committee each December 31st. This report will show, for each derivative not administered on the Investment Administration System, the type of derivative, the counterparty, the purchase date, the notional amount, and the current market value as provided by the Investment Department.

Asset Liability Management Report for December 31, 1999

This report details the ALM position for all of LifeCo's products and focuses on the company's exposure to interest rate risk. The ALM guidelines specified in the company's ALM Policy Statement and Procedure Manual reflect the company's tolerance to interest rate risk.

Interest Rates



Summary of ALM Position

At December 31, 1999, significant mismatches existed in the Life and Group Benefit portfolios, all other portfolios were within the guidelines specified in the ALM Policy Statement and Procedure Manual. Various ways are being investigated to reduce asset liability mismatches. It is anticipated that extensive rebalancing of the affected asset portfolios will be required. A summary of the ALM position for LifeCo follows.

	Book Value ('000)	Present Value ('000)	Modified Duration	Dollar Duration ('000)
TRADITIONAL LIFE PRODUCTS				
Assets	300,000	309,700	16.6	5,138,000
Liabilities	300,000	318,000	31.9	10,144,000
Difference	0	-8,300	-15.3	-5,006,000
Guideline	< 2,000			< 300,000
NON-TRADITIONAL LIFE PRODUCTS				
Assets	400,000	416,600	15.2	6,348,000
Liabilities	400,000	406,000	40.2	16,321,000
Difference	0	10,600	-25.0	-9,974,000
Guideline	< 2,000			< 400,000
ACCUMULATION ANNUITIES				
Assets	1,500,000	1,545,600	5.3	8,224,000
Liabilities	1,500,000	1,575,000	5.3	8,348,000
Difference	0	-29,400	0.0	-124,000
Guideline	< 2,000			< 450,000
INSTITUTIONAL PENSION – PAYOUT				
Assets	700,000	746,100	8.8	6,535,000
Liabilities	700,000	759,500	9.5	7,215,000
Difference	0	-13,400	-0.7	-680,000
Guideline	< 2,000			< 700,000
INSTITUTIONAL PENSION – GIC				
Assets	1,500,000	1,544,200	3.3	5,067,000
Liabilities	1,500,000	1,537,500	3.1	4,766,000
Difference	0	6,700	-0.2	300,000
Guideline	< 2,000			< 450,000
GROUP BENEFITS				
Assets	630,800	660,900	12.3	8,157,000
Liabilities	630,800	624,000	7.0	4,368,000
Difference	0	36,900	-0.1	3,789,000
Guideline	< 2,000			< 630,000
SURPLUS ACCOUNT				
Assets Target	188,000	243,020	9.5	2,211,000
Difference	188,000	243,020		
Guideline	< 2,000			
TOTAL COMPANY				
Assets	5,218,800	5,457,100	7.7	42,006,000
Liabilities	5,030,800	5,220,000	10.2	51,162,000
Difference	188,000	237,100		-9,157,000
Guideline	< 2,000			

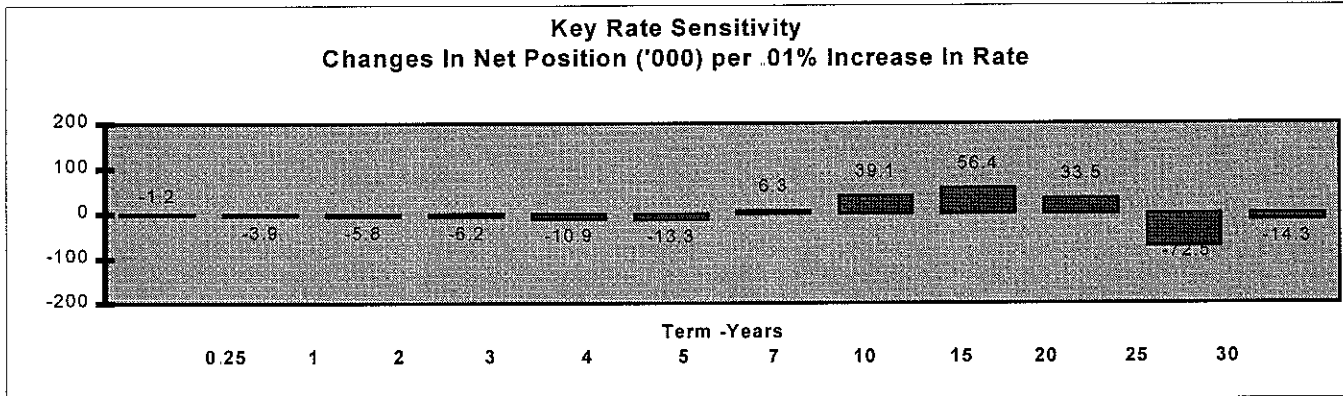
ACCUMULATION ANNUITIES

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of assets is longer than the duration of liabilities by less than 0.01. The difference between the dollar duration of assets and liabilities is (124,000,000). This is within the approved guideline of +/- 450,000,000.

Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

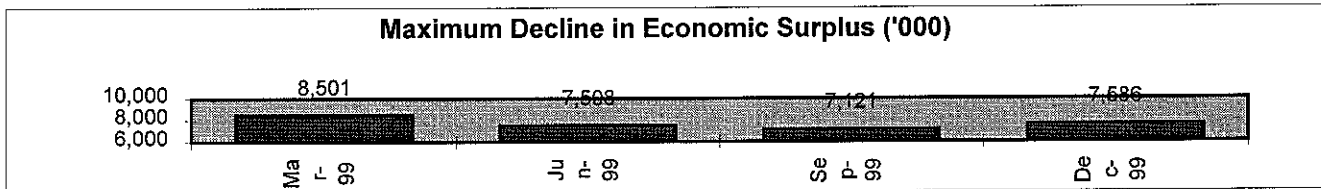
For all points along the curve key rate sensitivities are within the approved guideline.



Scenario Testing

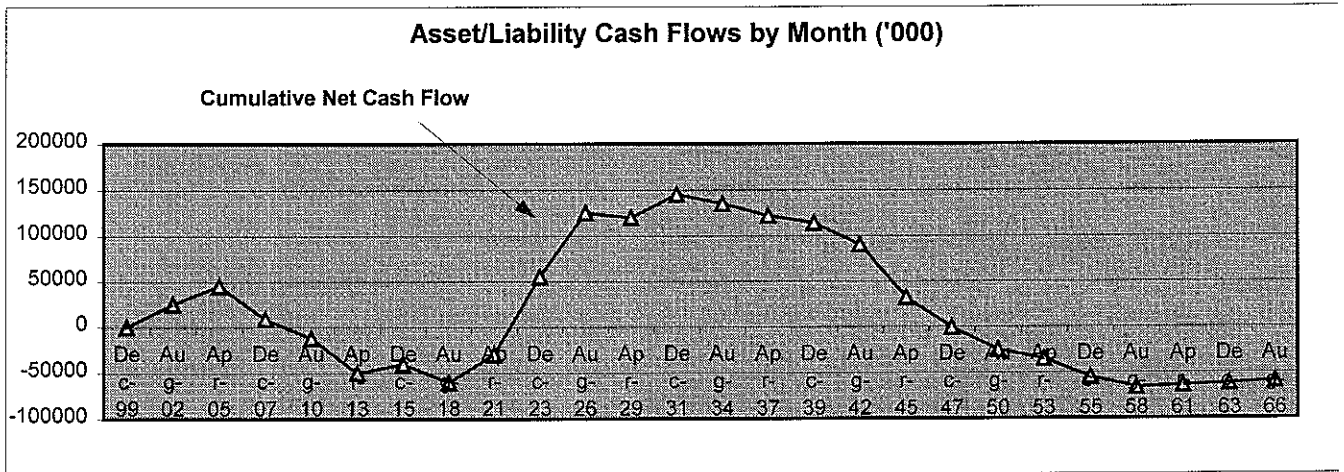
Worst Case Scenario

The worst case scenario that was tested was a increase followed by a decrease in interest rates. If this scenario were realized, it would result in a loss of \$7.6 million in economic surplus.



Cash Flow Analysis

The accompanying graph does not represent actual cash outflows but rather interest rate reset dates for the assets and liabilities. No renewals or new sales are projected and asset maturities are not reinvested. Thus the usefulness of this analysis is limited to studying interest rate risk exposure. This would represent an extreme adverse scenario for measuring liquidity risk exposure.



Portfolio Rebalance

Rebalancing is performed on a monthly basis for Accumulation Annuities. At the end of December, except for cash reallocation there was no rebalancing required for Accumulation Annuities.

Asset Mix

The target mix calls for more bonds and private placements and less mortgages. The C1 capital requirement for the Accumulation Annuities portfolio excluding additional requirements for troubled assets is approximately \$11.7 million at the end of December. In comparison, the C1 requirement based on the target asset mix would be \$11.2 million.

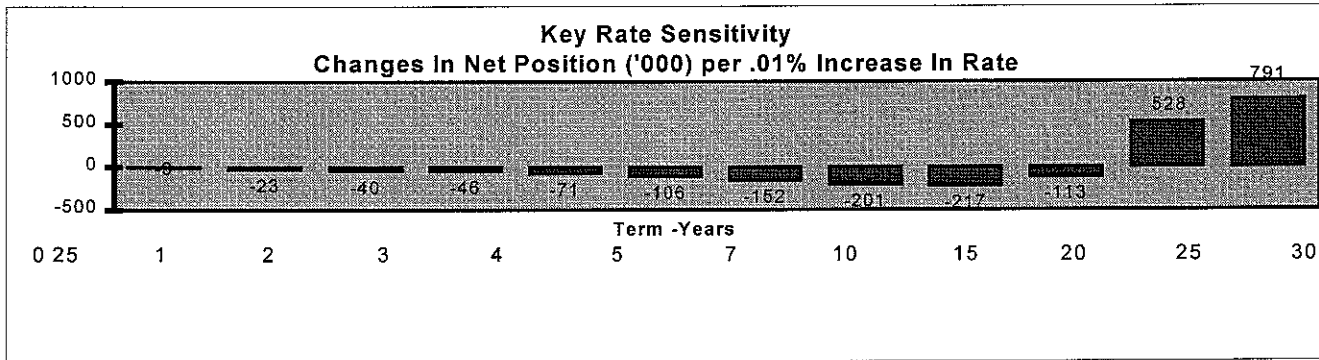
TRADITIONAL LIFE PRODUCTS

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of assets is shorter than the duration of liabilities by 15.3 years. This reflects the difficulty in finding assets that matches the extremely long duration of liabilities. The difference between the dollar duration of assets and liabilities is (5,006,000,000) which exceeds our approved guideline of +/- 300,000,000.

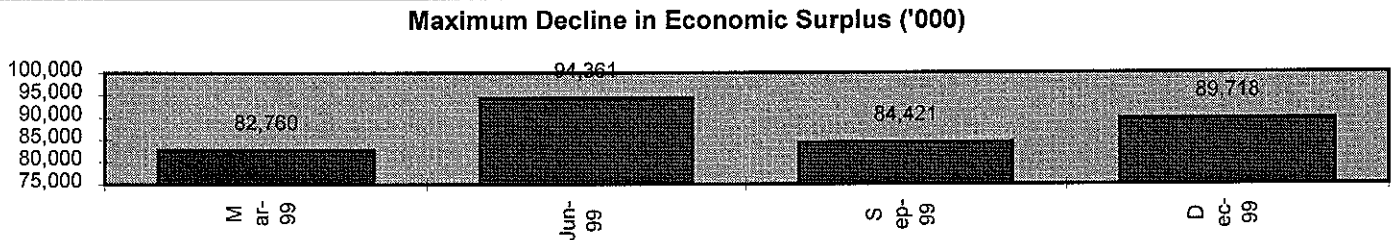
Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

We are exposed to rates falling at the 25 and 30 year terms and to rates increasing at the 10, 15 and 20 year terms. Exposure is large and exceeds guidelines.



Scenario Testing

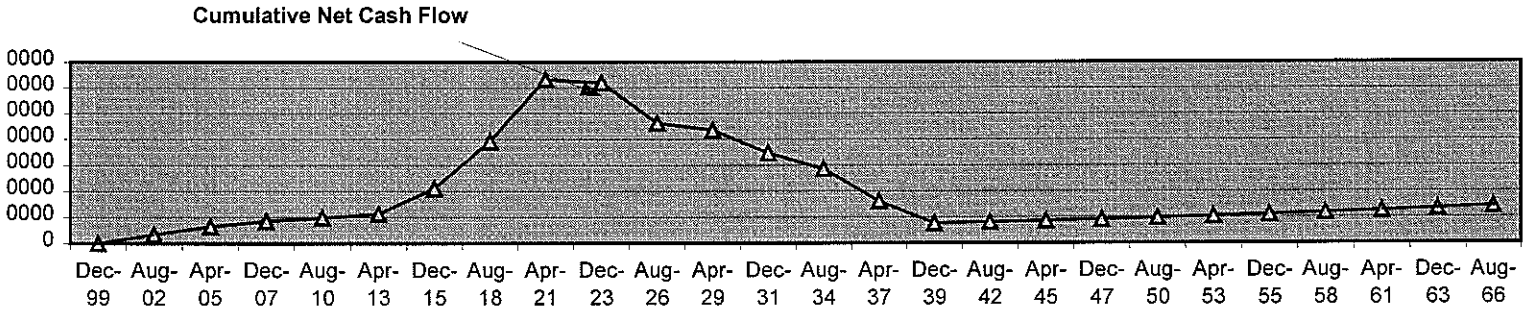
The maximum decline in economic surplus at the 95% confidence was \$89.7 million at the end of December. The scenario that gives rise to this exposure is a decrease in long term interest rates.



Cash Flow Analysis

The large positive spikes represent the maturity of the long zero coupon bonds that were purchased to extend the duration of the assets.

Asset/Liability Cash Flows by Month ('000)



Portfolio Rebalance

At the end of December rebalancing was necessary as a result of the lengthening of the liabilities due to assumption changes.

Asset Mix

The target mix does not reflect policy loans, calls for more government bonds, and less private placements. The C1 capital requirement for the Traditional Life Products portfolio excluding additional requirements for troubled assets is approximately \$0.5 million. In comparison, the C1 requirement based on the target asset mix would be \$0.5 million.

The asset mix does not reflect the assumed equity position.

NON-TRADITIONAL LIFE PRODUCTS

Projection of Cash Flows

Based on December 31, 1999 assets and liabilities, net cash flows are projected to be an average of \$1.3 million per month going forward.

Margin Squeeze

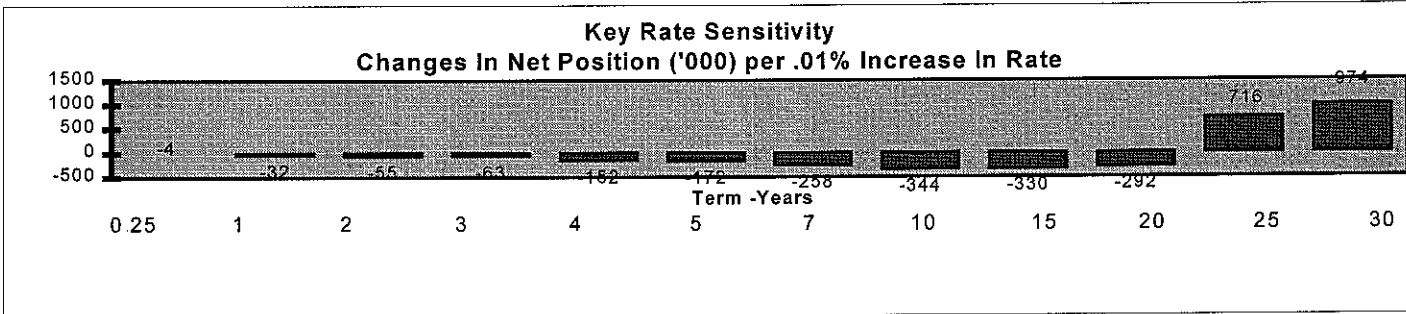
Interest sensitive cash flows have been modeled to vary for given changes in interest rates (i.e. the margin squeeze will be reflected in the price sensitivity statistics). The impact of the margin squeeze for a 1% decrease in interest rates is a \$10.3 million loss in economic value.

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of assets is shorter than the duration of liabilities by 25.0 years. The difference between the dollar duration of assets and liabilities is (9,974,000,000). This significantly exceeds the guideline of 400,000,000.

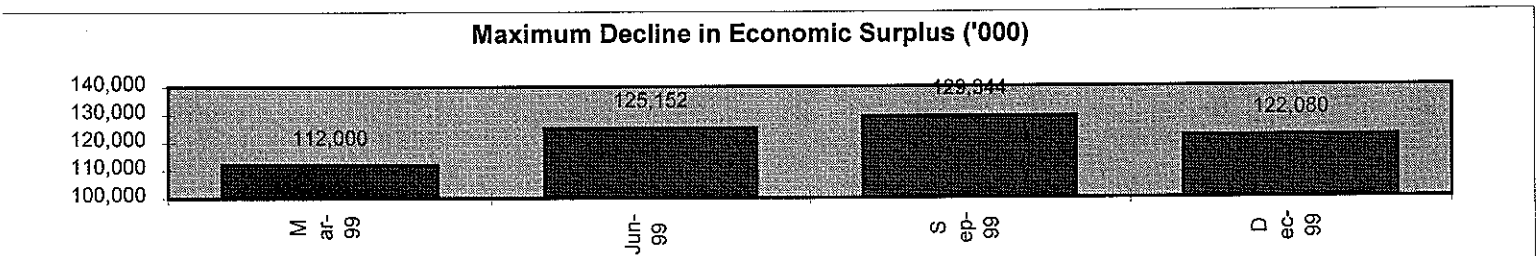
Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

Significant exposure exists to a decrease in interest rates at the long end of the curve, a result of the duration mismatch between the assets and liabilities. The company is exposed to increases in interest rates for the other points on the curve.



Scenario Testing

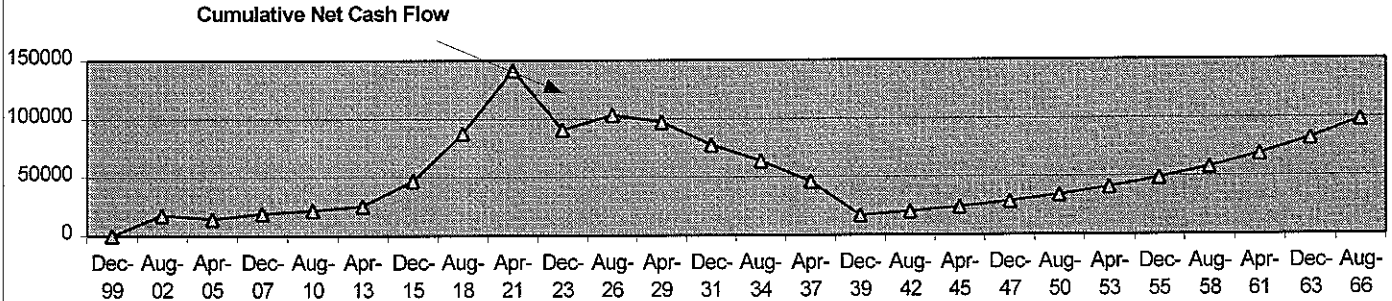
The maximum decline in economic surplus at the 95% confidence level decreased from \$129.3 million to \$122.1 million at the end of December. The scenario that gives rise to this exposure is a graduated decrease in long-term interest rates.



Cash Flow Analysis

Note that both fixed and variable cash flows are shown together.

Asset/Liability Cash Flows by Month ('000)



Portfolio Rebalancing

At the end of December rebalancing was necessary to counteract the lengthening of the liabilities due to assumption changes. It was assumed that the majority of Surplus assets were sold to fund the purchase of long bonds in this portfolio.

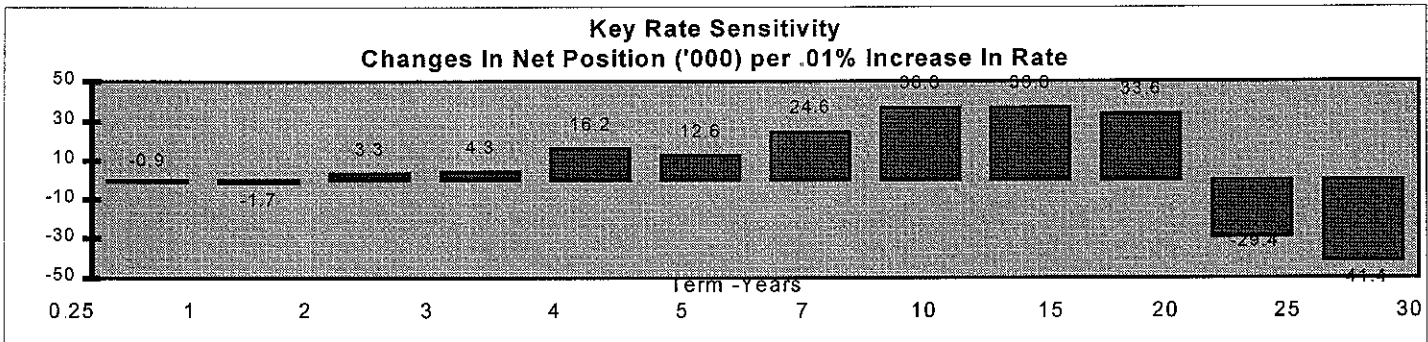
INSTITUTIONAL PENSION - PAYOUT

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of assets is shorter than the duration of liabilities by 0.70 years. The difference between the dollar duration of assets and liabilities is (680,000,000) and is within the approved guideline of 700,000,000.

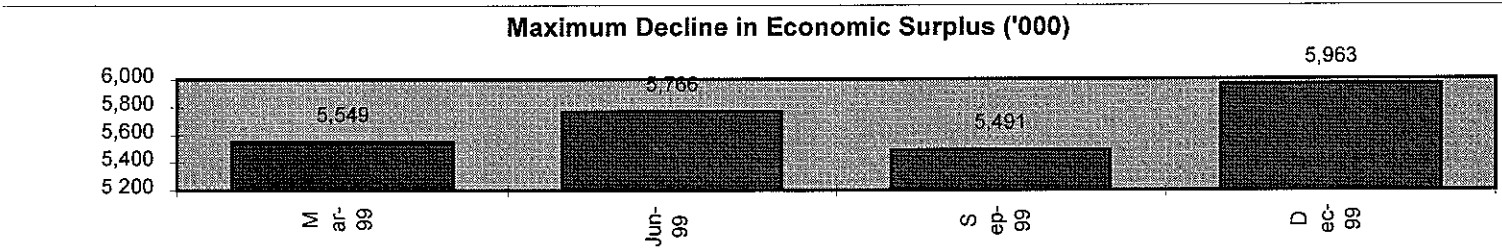
Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

Due to the efficiency of the immunization strategy, no significant interest rate exposure exists on that line of business.

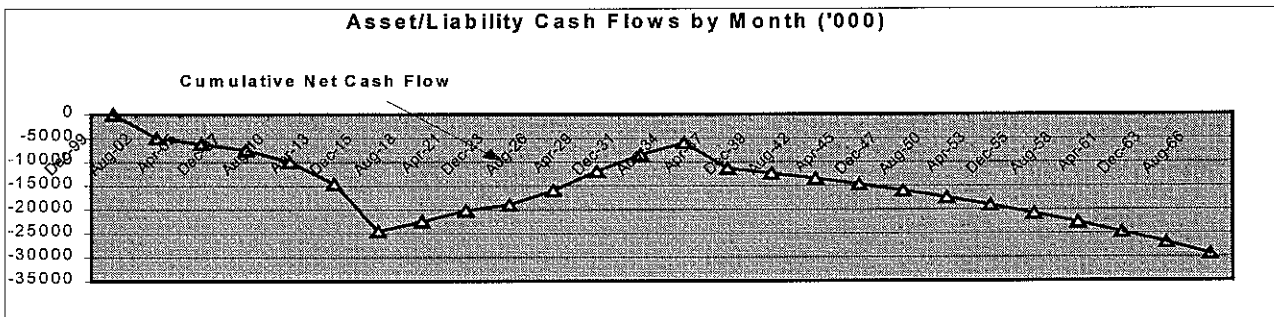


Scenario Testing

The maximum decline in economic surplus at the 95% confidence level decreased stands at \$5.96 million, and is the result of a increasing interest rate for the first 20 years followed by a sharp increase.



Cash Flow Analysis



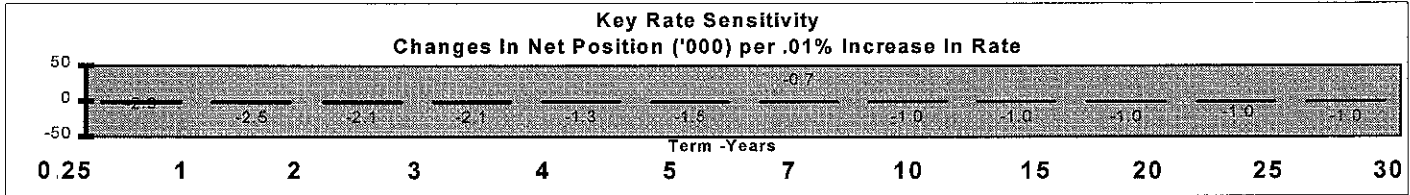
INSTITUTIONAL PENSION - GIC

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of assets are longer than the duration of liabilities by 0.20 years. The difference between the dollar duration of assets and liabilities is 300,000,000.

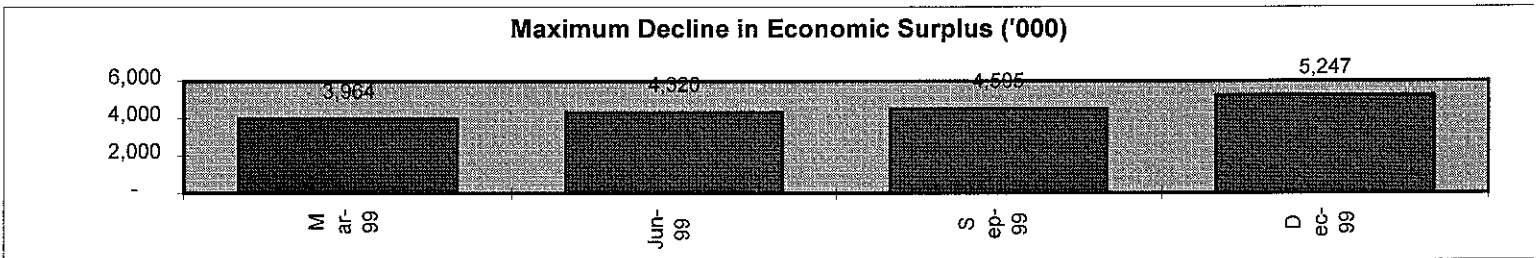
Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

Due to the efficiency of the immunization strategy and the short duration of the liabilities, no significant interest rate exposure exists on that line of business.

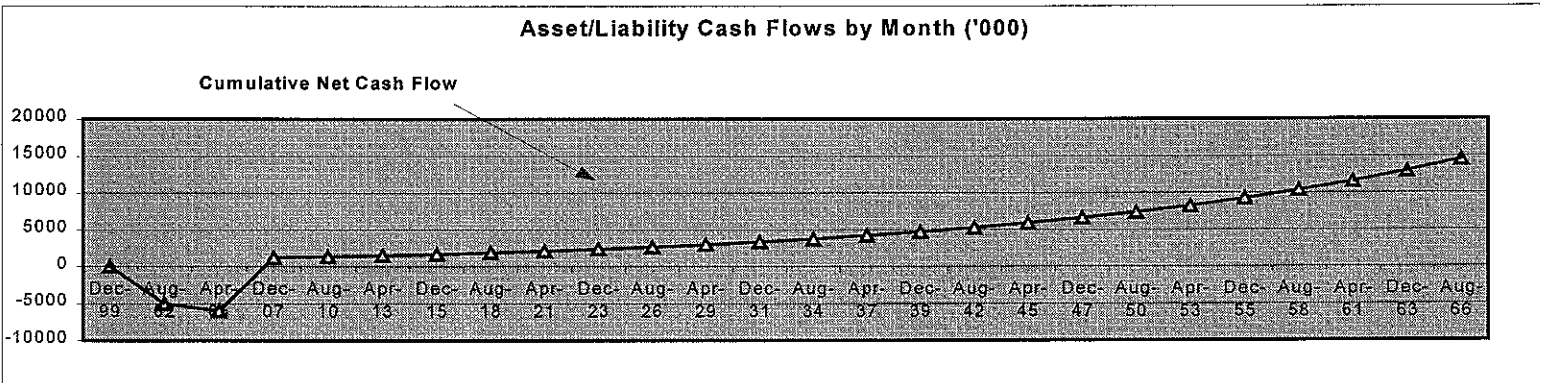


Scenario Testing

The maximum decline in economic surplus at the 95% confidence level decreased stands at \$5.2 million, and is the result of an immediate, large increase in interest rates.



Cash Flow Analysis



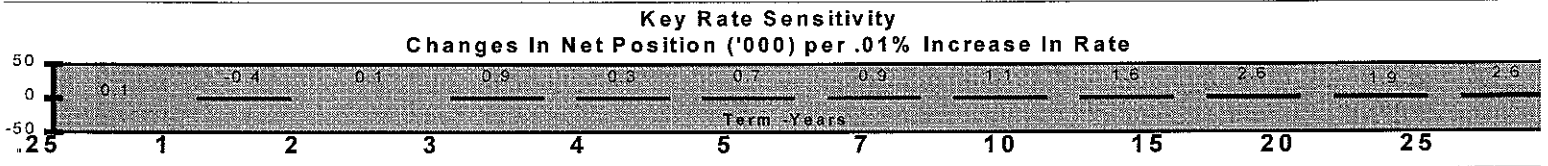
GROUP BENEFITS

Dollar Duration (Price Sensitivity to Parallel Shifts in the Yield Curve)

The modified duration of liabilities exceeds the duration of assets by 0.10 years. The difference between the dollar duration of assets and liabilities is 3,789,000,000. This greatly exceeds the guideline of 630,000,000.

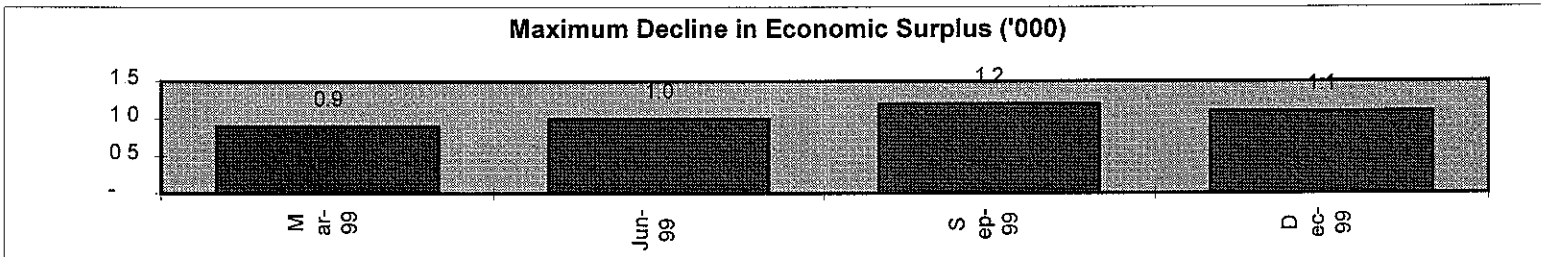
Key Rate Sensitivity Analysis (Price Sensitivity to Specific Rate Changes)

The exposure tends to be at the longer durations, where a decrease in interest rates will create a loss.



Scenario Testing

The maximum decline in economic surplus at the 95% confidence level decreased stands at \$1.1 million, and is the result of a slow decrease in interest rates.



Cash Flow Analysis

