OPTIMIZING CAPITAL

An Evening with Halina von dem Hagen

By: Anne Maggisano & Lisa Ritchie

In June 2019, Women of Burgundy hosted an interactive conversation with Halina von dem Hagen, Global Treasurer and Head of Capital Management at Manulife Financial Corporation. Manulife is the largest insurance company in Canada by market capitalization and a global leader, with operations in the United States and Asia. Halina shared her fascinating journey from Poland to an international and monetary economics doctorate at the University of Toronto, followed by a career that includes senior leadership roles in Canada's financial industry. In conversation with Halina, an expert in managing global capital and liquidity for large and complex financial companies, we learned about risk management, the role of regulators and long-term growth opportunities.

Lisa Ritchie: You grew up in Poland, but chose to leave home and immigrate to Canada at a young age. Tell us about your journey.

Halina von dem Hagen: I left Poland in my early twenties to intern for six weeks at a bank in Bologna, Italy. It was a difficult time for Poland, still under communism and martial law at that time. My internship was extended to one year and the more I stayed in the West, the more I appreciated the taste of freedom. To put things into context, I had a colleague who was arrested in Poland for carrying "clandestine literature," which was George Orwell's *1984*.

Because of the political instability in my homeland, we had opportunities to immigrate. There were five countries to choose from: Australia and New Zealand were too far, South Africa was still under Apartheid, and that left the U.S. and Canada. I chose Canada.

This caused a big family debate between my mother and grandmother. My father was sick and I was his legal guardian. My grandmother was adamant that I should return. I was single and they could not help me if anything happened to me in the West. Her view was that, "We may be in misery, but together," to which my mother replied, "If in misery, why together?" I think of this lesson to this day because you can have two people who care deeply about a cause or a person and yet come to completely different conclusions. It has made me empathetic and open to a variety of views.

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A second lesson came from my mother, who very much wanted me to return home. But citing love greater than motherly love, she told me to go: "You can always come back."

All of us have a multitude of roles that we play in each other's lives. We are parents. We are children. We are siblings. We are bosses. We are leaders. We are colleagues. And yet, in each of these roles there is also a person. The ability to see the needs of that person, as my mom did in such a heroic way, impressed me tremendously, and gave me courage, a sense of security and the drive to go and see what happens.

Lisa Ritchie: Once in Canada you earned your PhD in economics. How has that background helped you in capital management and treasury at Manulife?

Halina von dem Hagen: I am a big believer in the benefits of studying economics, whether or not you go into finance. It teaches you about how the economy works and how money moves. But there is more to it. It is all about modelling and stating your assumptions very clearly. Let's assume there is perfect competition. Let's assume there is monopoly. You need to be very rigorous about your starting point and what you are assuming because very often in politics, and in life, we debate conclusions. And yet, it's very important to be clear on what we are assuming as a starting point because the rest is logic.

The second lesson that I find very valuable about economics is that it teaches you flexibility to shed your assumptions in a non-emotional way. There is nothing emotional about whether it's a monopoly or perfect competition, or how you want to model things. There may be different worlds functioning differently in different markets. Philosophy teaches a similar way of thinking, but in philosophy we tend to be invested emotionally about certain fundamental assumptions, whereas nobody is emotionally invested in economics.

This way of thinking reflects how I think about capital management, about which I am very passionate. To me, capital management is a window through which I see the whole company, and, in fact, the industry. You have to understand the business on and off the balance sheet. You have to understand accounting and taxation, the laws and the regulatory framework. It's a multi-faceted optimization against many constraints. Economics taught me that capital is a scarce resource that you never have enough of. It's the same with your own money: you never have enough. Not in the sense of greed, but in the sense of optimizing what you have toward multiple uses.

People often ask me if one needs a doctorate to do my job. It depends. In a technical sense, no, because I could have studied finance or many other subjects to end up where I am. But research gives you the confidence to ask questions, even when you don't fully understand the question. It's this famous search for the elephant—if somebody touches the trunk, they think it's a snake. If they touch the body, they think it's a warthog. Nobody sees the elephant until they are ready to ask, "What is this?" You reconcile all those apprehensions or misgivings to crystalize the question. It may be a very different question from where you started. I think independent research gives you this trust and confidence in the process. If you are open-minded and you start your journey, you will land somewhere useful, despite not necessarily knowing where you are heading right away.

Lisa Ritchie: In your capacity as head of global capital management, regulators play a very large role. They are critical for the business, for society and for a stable financial system. How do you approach this relationship?

Halina von dem Hagen: I have a constructive relationship with regulators. They are very well-intentioned people who try to keep our system stable, who seek to ensure that we deliver on all the promises we've made. But at the same time, they may not know our business as well as we do—particularly the risks, but also the consequences of certain decisions.

I see it as my responsibility to engage in dialogue with Canadian and international regulators. I worked for 12 years at the Royal Bank of Canada, where I was the head of capital, globally, for my last three years there. Then I came to Manulife to build the capital management function. I appreciate the critical differences between the banking and the insurance industries.

This critical difference is in the time horizon. Banking is much shorter-term. To appreciate this, imagine a situation in which there's a run on the bank when everybody withdraws their money. Short-term liquidity is critical for a bank. In contrast, the insurance business is truly long-term. We make promises that we will support you 30, 40 years from now, should you become ill. We make promises to your descendants that, should anything happen, we will pay under the insurance policies you purchased. These are two different businesses with different time horizons, so they will invest differently.

You can imagine this in your own lives. If I told you to assume that you will pass away tomorrow, or a week from now, or a year from now, or 10 years from now, or 30 years from now, you would behave differently tomorrow, a week from now, a year from now. You would certainly make very different investment decisions, depending on the time horizon.

I find, as an economist, that the trend in mark-to-market accounting treats all businesses as if they could be traded tomorrow. This may be true for banking, but it does not align with the fundamental long-term economics of the insurance business. If there is a run on the insurance company, normally nothing would happen. Mark-to-market reporting requirements introduce a lot of volatility into the reported results of insurance companies.

There are implications. Global insurers have been withdrawing from offering long-term products and scaling down long-term investments. I think from a public policy perspective and in terms of societal needs (especially for aging societies, globally), it is important to engage in critical dialogue with the regulators on this issue.

Lisa Ritchie: Mark-to-market, just to put it into context, means valuing capital assets every day, basically, and checking this against regulatory capital ratio requirements. If there is a rough quarter in the capital markets, even though the liability might be 30 years from now, it's recorded as a "loss." A really significant example of volatility was the 2007–2009 financial crisis. What happened and what were the lessons learned?

Halina von dem Hagen: I consider myself lucky because I joined Manulife in January 2007. I had 18 months to learn the ropes and then it all started. The first thing I would say is that in no way was there any shortage of cash liquidity. Manulife, as is

true of all insurance companies, generates strong cash inflows. We have $20 billion and more of investible money that comes in every year.

What the company realized very clearly during the financial crisis is the impact of volatility. We offered long-term segregated fund guarantees that were tied to equity markets. With the drop of equity markets, our reported liabilities for those guarantees increased on paper significantly, thus reducing our reported earnings and regulatory capital. But those reported liabilities were for obligations to be paid in 30 to 40 years. We learned that, although we are in a long-term business, we are subject to quarterly disclosures of our earnings and of our reported regulatory capital. And the prevailing markets introduce tangible signals to which analysts, regulators and investors react. Hence, we cannot ignore the environment in which we operate.

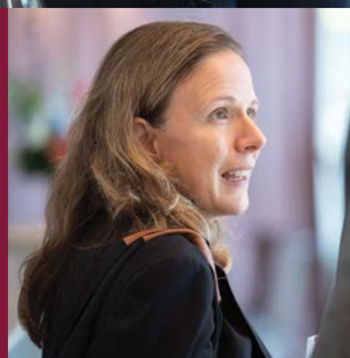
Eventually, economics wins. But in the

insurance industry, it may take quite a few decades to materialize, so that sensitivity to the regulations, disclosures and the commercial side of reporting must be considered. We learned this lesson very harshly; today, the company has a hedging program that provides significantly more stability than was the case a decade ago.

Lisa Ritchie: You are in a business that has fixed liabilities—some due very soon, some that are five-, 10-year liabilities. How are you protecting the policy holders, the business and the shareholders in your investment strategy?

Halina von dem Hagen: This should give comfort to everyone in this room. We don't take material risks with equity markets or non-fixed-income assets with what we consider short-term horizons. For context, in the insurance business, five years is actually short-term.

We are fully matched in terms of fixed-income instruments for the first 10 to 20 years of what we think we will owe you and creditors. And the company is very disciplined when it comes to the credit quality of fixed-income assets. Why 10 to 20 years? First, prudence, but also pragmatism. The markets, especially in North America, are quite deep—in 10-year fixed-income in particular. You have 10-year durations and then you have longer government offerings as well.



Left: Halina von dem Hagen and Lisa Ritchie. Top to bottom: Angela Bhutani; Robyn Ross; Charles Walker.

One might ask, "What assets would you hold against those longer-term cash flows, 20 years and longer?" Many decades ago, the company decided to specialize in a well-diversified portfolio of non-fixed-income assets.

Some of these are just pure public equities, around 6% of our total $360 billion or so invested assets, and 10% is alternative long-duration assets, such as real estate, infrastructure, utilities, agriculture and timberland. The assets are well-diversified by industry and by geography, and they carried us extremely well through the financial crisis. In addition to financially holding those assets, we own and operate the underlying businesses. This is based on the philosophy that we should buy what we know and know what we buy. We operate our buildings. We are the biggest institutional manager of timberland in the world. The competency is so high and the returns are so attractive that we started constructing third-party fund offerings based on those assets. They perform very well, but there is volatility in our reported results, which, at this point, given the magnitudes, we are prepared to accept.

Lisa Ritchie: Let's expand on your responsibility for capital allocation. How do you make decisions when competing business lines come to you and say, "This is the best investment to grow the business for shareholders"?

Halina von dem Hagen: Shareholders are very important. We use a similar framework to what one would use for evaluating investments. Namely, return on equity (ROE) numbers—both for shorter-term and longer-term strategic opportunities. It is our business in Asia and in wealth and asset management that are among the highest ROE businesses for Manulife and the two main pillars of Manulife's strategy to accelerate growth. We still have a large business in North America and we will continue to operate in both Canada and the United States.

We are also very innovative when it comes to behavioural economics and we try to offer insurance that engages policy holders and promotes healthy lifestyles. As an insurance company, we are invested, philosophically and commercially, in the well-being of our policy holders, in making sure you stay healthy and live much longer.

Lisa Ritchie: You recently returned from a trip to various countries in Asia. What are you seeing on the ground there?

> "This is based on the philosophy that we should buy what we know and know what we buy."

Halina von dem Hagen: I don't think many people appreciate how global Manulife is. We are the third largest Pan-Asian insurance company in the world. A decade ago, when I first came to visit our Hong Kong operations, I was looking for the address to the Manulife office and the cab driver already knew where to go. When you see the skyline around Victoria Harbour, the Manulife building is right there.

We operate in 12 jurisdictions in Asia. Around one-third of our earnings come from Asia and three-quarters of our insurance sales are in Asia. We are quite big in a number of markets. It's really a very balanced and diversified Asia story. We are very keen on Asia because the ROE is high and it has been high for a number of years.

What is unique about Asia is the emergence of the middle class and the high demand for life insurance policies, products and services that is growing with it. While the competition is intense, the fields also keep expanding. In general, we have not experienced the need to compete on pricing in Asia. We compete on quality and how you get the customer.

Historically, the levels of income in many of those countries have been quite low. When you don't have money, you have to live with the risks. But the moment you have some money, you want to make sure that your children are okay, that your parents are okay, that you can withstand an economic disaster. That's why the emerging middle class is increasing the demand for insurance products even faster than you would expect. People want to make sure that they provide for their loved ones and for themselves. One of our very popular products in Vietnam was designed to provide for your parents because this was a generation of the war that didn't have opportunities and didn't save. As much as it's about looking forward, it's also about looking to the generation behind.

Asia is "on fire." I heard this statistic that the household wealth in Asia is going to double between 2015 and 2025, reaching $120 trillion. North American household wealth is predicted to reach $95 trillion over the same period. We are looking at a region of tremendous opportunities and continually delivering on the potential. I believe every young and adventurous person should spend at least five years in Asia because this is where the future is

Top to bottom: Halina von dem Hagen; Meghan Moore and Sarah MacNicol; Julie Cordeiro.

being built. I come back so energized by the opportunities in the region.

Lisa Ritchie: Let's pivot to talk about women in business. I'm wondering about your experience and what you're seeing in the landscape now. How are we doing?

Halina von dem Hagen: I have to say that I have been either lucky or oblivious because I have not encountered the glass ceiling directly. However, I do have a few observations, as a working mother.

The first is cultural. I have often witnessed what I call "benevolent bias." *"Let's not ask Suzy, she just had a child. She would never take this assignment." "No, Halina would never go on this trip. She just got married."* It may be about showing kindness and not applying pressure, but it is a bias nevertheless. Being sensitive to this and making sure that women are offered the same opportunities as men is important. They should have the right to decide for themselves.

The second is flexible work arrangements, which I view as critical. Think of the practical aspects: Who picks up the child from daycare when they call and say the boy has a fever? Who usually goes to see the teacher at school? Who does the driving to the basketball game? And of course, we all have our own interest and hobbies for which we need time. Thankfully, technology is very helpful. It allows us to juggle.

I personally don't like the term work-life balance, because it positions work and life as a dichotomy. I prefer to think of it as managing the wholeness. It makes it easier psychologically. We live full lives from different angles, so it's important to give flexibility to both men and women. We and our partners are in it together.

I also believe that the so-called emancipation or liberation of women is actually liberating for men as well. The stereotypes about men only wanting to work are not true. They are fathers, they are husbands, they have their own hobbies. Achieving balance is a win-win for everyone.

We have seen more progress in achieving equality than ever before, so it's necessary to be vigilant in maintaining those equal rights. I recently concluded that I am in favour of quotas. I was timid to say so at first because it sounded so rigid and bureaucratic, but then I heard Christine Lagarde, Chief of the International Monetary Fund, say that she also likes quotas. It's one way of making sure that equality and equal access are always on the table and continually measured. **M**