

# Consolidation of the Canadian Financial Services Sector in the Public Interest

A Submission to the Government of Canada

December 31, 2003

*“Our goal is to put Canada at the forefront of a world that is moving quickly ...  
... we build best when our businesses gain markets throughout the world.”*

Prime Minister Paul Martin  
(December 2003)

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# Summary

In its paper of June 23, 2003, the Government of Canada identified and sought input on key policy issues with respect to the consolidation of the financial services sector in Canada. This is the submission of Sun Life Financial specifically addressing those issues.

In summary:

- In our view, Government policy must achieve two critical public policy objectives:
  - ▶ fostering the international competitiveness of Canadian financial institutions, and
  - ▶ fostering vigorous competition between, and diversity of, financial institutions in our domestic market.
- The ability of Canada's life insurance companies and banks to continue to play a vital role in our economy depends above all on their international competitiveness. This is the teaching of leading business thinkers analyzing how companies successfully compete in a global economy and this theory is supported by the course of development of Canada's leading financial institutions to date. Most importantly, it is confirmed by consideration of the potential of our financial institutions for further development. Based in a small country whose market is mature and affords limited potential for substantial domestic expansion or growth, Canada's large life insurers and banks must look abroad.
- In a globalizing economy, financial institutions are consolidating and many are becoming enormous. To compete internationally with maximum effectiveness, Canada's financial institutions need the flexibility to increase their scale through significant acquisitions of, or mergers with, foreign financial institutions, but even participating in these transactions requires that Canadian financial institutions be of sufficient size. In this regard, Canada's life insurance companies are in general better positioned since, especially in comparison to industry leaders in the United States, they are relatively large. The following table shows the ranking of the largest life insurance companies in Canada and the United States by market capitalization.

## NORTH AMERICAN LIFE INSURERS - MARKET CAPITALIZATION

<i>Life Insurer</i>	<i>Market Capitalization</i> <small>(in billions of U.S. dollars)</small>
1. AIG	\$ 164.0
2. Met Life	25.2
3. Manulife (with John Hancock)	25.1
4. Prudential	22.0
5. Hartford	16.1
6. Great-West Lifeco	14.7
7. Manulife (without John Hancock)	14.6
8. Sun Life Financial	14.4
9. Principal	10.5
10. John Hancock	10.5
11. Lincoln National	7.0
12. Jefferson-Pilot	6.9

- In the particular case of Sun Life Financial, our business strategy requires us to achieve a more competitive position in the United States. Enhanced scale in the life insurance industry both in the American market, the world's largest (and more than 20 times the size of Canada's), and generally is critically important. It will allow us to increase our investment in product development, to enhance distribution and to achieve efficiencies, especially with respect to technology costs. Increased scale in the United States will, moreover, benefit our customers in Canada. Competing more vigorously in the United States will improve our ability to bring the best products and services to the Canadian market. Similarly, the benefits of enhanced technology and distribution will also be deployed here.

The precise effect on our scale of a significant transaction in the United States would, of course, depend on the business of the American life insurance company involved. Assuming, however, that we would acquire a United States life insurer that is engaged in lines of business similar to those in which we engage in the United States and that is half the size of Sun Life Financial as a whole, the effect of such an acquisition could be to boost our market positions in several key American market segments from those in the top 25 to those in the top 10.

From the time of our demutualization in 2000, we have generated very significant value for our shareholders: our market capitalization has grown from the \$5 billion created at that time to \$19 billion now, accounting for approximately 3.4% of the aggregate market capitalization of all companies included in the S&P/TSX 60 Index. The Canadian economy has also greatly benefitted in many ways from this creation of wealth. We are confident that, by pursuing our strategy of achieving a more competitive position in the United States, we can continue to generate significant additional value for our shareholders and the Canadian economy.

- Having analyzed its business merits, our conclusion is that a merger with a large Canadian bank would be adverse to the long-term interests of Sun Life Financial and its shareholders. Internationally, many large mergers between banks and life insurance companies have encountered difficulties and on an overall basis results are mixed. That experience is cautionary. The negative judgment of stock markets in Europe, the leading area for those mergers, is particularly significant. On those markets, merged bank-life insurance companies trade at a conglomerate discount – i.e., at a price/earnings multiple that is lower than the blend of the multiple for the banking component and the multiple for the life insurance component. That means that those markets value those mergers as synergistically negative. In addition, our conclusion from those valuations is that those mergers are seen as reducing the potential of the merged financial institution subsequently to enter into a merger with, or to make an acquisition of, a bank or a life insurance company.
- Canada's banking and life insurance markets are highly concentrated, leaving limited scope for consolidation. Moreover, the potential adverse consequences of domestic consolidation are not limited to those reviewed under competition law. In financial services, as well as other key sectors of our economy, Canada must avoid concentration of economic power in a very small number of very large institutions. And concern cannot, in our view, be merely limited to numbers. Diversity is highly desirable, if not essential: having different types of financial institutions enhances the competitive landscape and the structure of the financial services sector.
- Canada has an efficient and effective financial services sector that is functioning well. As a result, it is essential that caution be exercised in making fundamental changes to policy. This is particularly the case with respect to the acceptance by the Government of the consolidation of large financial institutions. After significant consolidation over the last 20 years, the financial services sector now has only

two pillars – banks and life insurance companies – and eight large financial institutions; any phase of consolidation now may be the last one. If permitted domestic consolidation proves to be excessive – a matter that can only be established over time – it will be impossible to reverse. If a measured approach to consolidation is adopted, however, further consolidation can, with the benefit of experience, be permitted over time.

- In addressing the key policy issues identified in the Government’s paper, we have analyzed in public interest terms a significant “cross border” transaction involving a Canadian life insurance company and a foreign insurance company as compared with a “cross pillar” merger of a large Canadian bank and a large Canadian insurance company in which the bank is the dominant party. Our analysis leads to a clear conclusion: significant cross border transactions are highly desirable and large cross pillar mergers are not. In particular, from a public interest perspective significant cross border transactions are superior to large cross pillar mergers in:
  - ▶ immediately enhancing international competitiveness and long-term growth prospects,
  - ▶ maintaining and improving access to and choice among financial products and services for Canadian consumers and other customers,
  - ▶ preserving diversity in Canada’s financial services sector and avoiding concentration of power in the banks, and
  - ▶ maintaining high quality head office jobs in Canada and increasing the potential for growth in Canadian employment.

In addition to likely reducing choice among financial products and services, large cross pillar mergers would put at significant risk the maintenance of separate life insurance agent distribution channels as alternatives to bank branches (which is especially relevant as demographic and technological trends make those channels more important to Canadians). In addition, a large cross pillar merger is unlikely to result in the achievement of significant efficiencies and synergies and, as the life insurance company is absorbed as a business unit of the bank, high quality head office jobs relating to the management of the life insurer would be eliminated. Most importantly, a large cross pillar merger would have no immediate effect on the international competitiveness of either the bank or the life insurance company involved. In terms of market share, the combined enterprise would remain, internationally, a medium-sized bank and a medium-sized life insurer, without enhanced potential for long-term growth.

The consequences for Government policy are equally clear: large cross pillar mergers should continue to be prohibited and significant cross border transactions should be encouraged.

- In recent years Canada’s leading life insurance companies have made great progress towards becoming Canadian champions capable of competing globally. Balanced Government policy has fostered this development. Demutualization was encouraged and an appropriate degree of consolidation – exemplified by Sun Life Financial’s acquisition of Clarica and GreatWest Lifeco’s acquisition of Canada Life – was approved. While allowing banks the flexibility to enter the life insurance industry, the Government maintained a considerable degree of separation between banking and life insurance by restricting the distribution of life insurance products through bank branches and by prohibiting large cross pillar mergers. This multi-faceted Government policy has been an outstanding success. We

strongly endorse the Government's decision not to consider changes to the restrictions on the distribution of insurance through branch networks of banks. Having achieved so much and approaching the realization of its policy objectives, the Government should not reverse the process by permitting large cross pillar mergers.

- On the key policy issues relating to the consolidation of the financial services sector in Canada that were specifically raised by the Government, we recommend that Government policy:
  - ▶ prohibit mergers between all large life insurance companies,
  - ▶ prohibit mergers between all large life insurance companies and large banks,
  - ▶ if large cross pillar mergers and mergers between large life insurance companies are permitted, subject them to public interest review,
  - ▶ require the maintenance of a minimum of three large life insurance companies and three large banks and define "large", for purposes of current policy, by reference to the current eight large banks and life insurance companies, rather than by quantitative measures,
  - ▶ establish a period of 60 days during which, after a first proposal for a merger between two large financial institutions is made, other proposals for mergers could be made on the basis that all the merger proposals would be considered concurrently,
  - ▶ not deal with divestitures in the context of the public interest review of mergers of large financial institutions, leaving that matter to be dealt with under competition law, and
  - ▶ continue to foster the enhancement of competition in the Canadian financial services sector by all means available.

# I. Introduction

In its paper of June 23, 2003, the Government of Canada identified and sought input on key policy issues with respect to the consolidation of the financial services sector in Canada. This is the submission of Sun Life Financial addressing specifically those issues, which primarily relate to the structure of, and competition in, the sector.

The Government's paper is based on a fundamental premise:

*The Government believes that there is a need for a broad public interest review of any bank merger proposal that goes beyond OSFI and Competition Bureau reviews... (p. 5)*

We agree completely with this premise and, for the reasons explained in this submission, support broad public interest review of all permitted consolidations among large financial institutions. In any particular transaction, ensuring that there is no substantial lessening of domestic competition and maintaining financial safety and soundness are necessary but not sufficient conditions for Government approval. Canada's financial institutions are of enormous importance to all Canadians – from our largest businesses to individuals of modest means – and assessment of consolidations among them must take into account all public interest considerations.

Each financial institution must decide for itself whether any type of consolidation or particular transaction makes good business sense (as the Government's paper acknowledges) and it is desirable that all financial institutions have the flexibility to make the business decisions that are right for them. The Government must, however, develop its policy on consolidation of the financial services sector in general, and with respect to structural issues in particular, on the basis of public interest considerations. Of necessity, those considerations will in certain circumstances impinge on the achievement of business objectives. That is not only unavoidable but also appropriate in the financial services sector. And where it is necessary to vindicate the public interest, particular types of consolidations must be prohibited and proposals for permitted consolidations must be subject to broad public interest review.

***“Canada's financial institutions are of enormous importance to all Canadians...assessment of consolidations among them must take into account all public interest considerations.”***

Above all, our submission emphasizes the need for Government policy to achieve two critical public policy goals:

- fostering the international competitiveness of Canadian financial institutions, and
- fostering vigorous competition between, and diversity of, financial institutions in our domestic market.

Our submission focuses primarily on large “cross pillar” mergers – mergers between large banks and large life insurance companies – and other mergers between large financial institutions. We also address related issues to the extent that we believe that we can provide useful input. Much of our analysis deals with a comparison of cross pillar mergers with significant “cross border” acquisitions or mergers in the life insurance industry – combinations between Canadian and American or other foreign insurers. In that connection, we explain what we consider to be the relevant business aspects, which inform our strategy. In addition, and more importantly, our submission analyzes in public interest terms the relative merits of significant cross border transactions and large cross pillar mergers.

## II. Key Public Policy Goals

### A. International Competitiveness

As the Government's June 23 paper recognizes, financial services are one of the most important components of the Canadian economy and they will play a critical role in Canada's continued economic growth. Life insurance companies and banks perform a vital function of financial intermediation by linking providers of capital (such as consumers making bank deposits and purchasing life insurance

*"...nearly 18 million people in more than 20 countries owned life insurance policies issued by Canadian insurers with an aggregate amount payable of approximately \$2 trillion."*

policies or annuities) with consumers of capital (such as large and small businesses that borrow or issue equity), in doing so providing products and services that are central to Canadian commerce. In this process of financial intermediation, life insurance companies are leading investors in the Canadian economy, holding assets of approximately \$280 billion in Canada at the end of 2002. They are

thus one of our country's most important sources of long term financing for Canadian businesses of all sizes. In addition, financial institutions make significant economic contributions as employers of large numbers of people in high quality jobs, purchasers of goods and services, taxpayers, corporate citizens and philanthropists. And they play a key role in Canada's very important export trade: at the end of 2002, nearly 18 million people in more than 20 countries owned life insurance policies issued by Canadian insurers with an aggregate amount payable of approximately \$2 trillion.

The ability of Canada's life insurance companies and banks to continue to play this role in our economy depends above all on their international competitiveness. This is the teaching of leading business thinkers analyzing how companies can successfully compete in a global economy and this theory is supported by the course of development of Canada's leading financial institutions to date. Most importantly, it is confirmed by consideration of the potential of our financial institutions for further development.

Michael Porter, the Harvard Business School professor who has advised many of the world's largest corporations on competitive advantage and the Government of Canada on our country's competitiveness, has explained in a number of publications why, as businesses increasingly compete globally, a company must use its leadership position in its own country as a platform for

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development abroad or risk not sustaining its success. Competitive advantage emanates from a home base but over time successful global firms usually combine advantages drawn from their home base with others arising from activities in other countries or their worldwide network. These advantages are mutually reinforcing, offsetting home-based or foreign disadvantages.

Applying this general theory to Canada, Professor Porter, in *Canada at the Crossroads: The Reality of a New Competitive Environment* (1991), emphasized the need for leading Canadian companies to compete globally, not only in the United States but beyond:

*[Competing globally] involves penetrating foreign markets both through trade and, ultimately, foreign investment. If Canadian firms are to be successful in selling in international markets, they must address the needs of foreign buyers, establish foreign sales and service channels, and have the patience to make the investments necessary to build foreign market positions, including assembly facilities and selective foreign acquisitions.*

...

*Competing globally also can bring other advantages. No nation has unique advantage in all of the determinants of competitive advantage. Firms can selectively tap into sources of [foreign] advantage... both to compensate for deficiencies at home and to exploit unique characteristics abroad. The essential foundations of innovation must be present in the home base, however, and the role of foreign nations can only be selective.*

*Canadian firms will benefit by serving the most sophisticated and demanding buyers in foreign nations in order to keep apprised of the direction of global needs and to stimulate the development of better products and services. Given the relative ease of access to the U.S. market and the cultural similarity between Canada and the U.S., Canadian companies have an unusual ability to benefit from American buyers. For example, Canadian life insurance companies have historically adopted technologies from the U.S. market, where they have established branch offices to serve some of the world's most demanding buyers of insurance. (pp. 370-371)*

Canada's large life insurance companies, including Sun Life Financial, and Canada's large banks have already achieved considerable internationalization. In particular, Canada's large life insurers are among Canada's most international businesses, competing vigorously with foreign insurance and wealth management companies in key markets around the world. The following table contains for 2002 the percentage of revenues generated and income earned in Canada, the United States and elsewhere by Canada's three largest life insurance companies and the Canadian life insurance industry as a whole, as well as comparative figures for the Canadian banking industry; they demonstrate the international character of our own business and that of the Canadian life insurance industry generally.

**CANADIAN LIFE INSURERS AND BANKS -  
DOMESTIC AND FOREIGN REVENUE AND EARNINGS IN 2002**

<i>Revenue</i>	<i>Percentage of Total<sup>1</sup></i>		
	<i>Canada</i>	<i>US</i>	<i>Other</i>
Sun Life Financial <sup>2</sup>	29%	60%	11%
Manulife	31	38	31
Manulife (with John Hancock)	24	57	19
Great-West Lifeco (with Canada Life)	56	33	11
Canadian life insurance industry	40	44	16
Canadian banking industry	65	20	15
<i>Earnings</i>			
Sun Life Financial <sup>2</sup>	24%	55%	21%
Manulife	27	34	39
Manulife (with John Hancock)	22	53	25
Great-West Lifeco (with Canada Life)	44	42	14
Canadian life insurance industry	32	42	26
Canadian banking industry	93	-14	21

<sup>1</sup> Source: publicly available information.

<sup>2</sup> As a result of its May 2002 acquisition of Clarica and current market conditions, the portion of Sun Life Financial's revenues and earnings that is attributable to Canada is significantly higher in 2003.

Moreover, based in a small country whose market is mature and concentrated and affords limited potential for substantial domestic expansion or growth, it is essential that Canada's large life insurers, including Sun Life Financial, look abroad. The following table both places the Canadian life insurance market in context within the global market and shows the attractive market size in the United States and several other foreign countries.

**LARGEST LIFE INSURANCE MARKETS AS PERCENTAGE OF GLOBAL MARKET IN 2002<sup>1</sup>**

<b>Country</b>	<b>Rank</b>	<b>Amount</b> <i>(in billions of U.S. dollars)</i>	<b>Global Market Share</b>
United States	1	\$ 480	31.3%
Japan	2	355	23.1
United Kingdom	3	160	10.4
France	4	80	5.2
Germany	5	61	4.0
Italy	6	52	3.4
South Korea	7	39	2.6
China	8	25	1.6
Spain	9	24	1.6
Switzerland	10	23	1.5
Canada	13	21	1.4

<sup>1</sup> By premiums. Source: Swiss Re Sigma No. 8 / 2003.

***"...Canada's life insurance companies are in general better positioned [to become global champions] since, especially in comparison to industry leaders in the United States, they are relatively large."***

If Canada's large financial institutions are to be internationally competitive, they must deal with the obvious challenge of scale. In a globalizing economy, financial institutions are consolidating and many are becoming enormous. The world's largest bank, Citigroup, and the world's largest life insurer, AIG, have market capitalizations of U.S. \$247 billion and U.S. \$164 billion, respectively. To compete internationally with maximum effectiveness, Canada's

financial institutions need the flexibility to increase their scale through significant acquisitions of, or mergers with, foreign financial institutions, but even participating in these transactions requires that Canadian financial institutions be of sufficient size. In this regard, Canada's life insurance companies are in general better positioned since, especially in comparison to industry leaders in the United States, they are relatively large.

The following table shows the ranking of the largest life insurance companies in Canada and the United States by market capitalization:

**NORTH AMERICAN LIFE INSURERS – MARKET CAPITALIZATION<sup>1</sup>**

<i>Life Insurer</i>	<i>Market Capitalization (in billions of U.S. dollars)</i>
1. AIG	\$ 164.0
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9. Principal	10.5
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<sup>1</sup>These and other market capitalization numbers in this submission are as of December 15, 2003.

Canada's large banks are significantly smaller than leading American banks and thus may have to increase their scale before participating in a significant American or other foreign transaction. For example, Canada's largest bank, Royal Bank of Canada, has a market capitalization of approximately U.S. \$40 billion, ranking it, by that measure, ninth among North American banks.

***B. Domestic Competition and Diversity***

Vital as the international competitiveness of Canada's financial institutions is, fostering it cannot be the sole primary goal of Government policy for the financial services sector. Especially since the achievement of international competitiveness is likely to involve consolidation, Government policy must simultaneously foster vigorous competition between, and diversity of, Canadian financial institutions in our country's market.

*“...Government policy must...foster...diversity of Canadian financial institutions in our country's market.”*

As the Government's June 23 paper shows, Canada's banking and life insurance markets are highly concentrated in absolute terms and relative to those of other comparable countries. Five large banks and three large insurance companies dominate, leaving limited scope for consolidation in Canada. Moreover, the potential adverse consequences of domestic consolidation are not limited to those reviewed under competition law by the Competition Bureau. In financial services, as well as other key sectors of our economy, Canada must avoid concentration of economic power. Even if there is, for competition law purposes, sufficient competition in all financial services products and services, it is unacceptable if too much economic power is in the hands of a very small number of very large financial institutions. Such concentration creates the possibility that those financial institutions with excessive power will misuse it, by behaving arbitrarily or unfairly, operating inefficiently or exercising undue influence.

This is not, in our view, merely a matter of the number of large financial institutions in Canada. As the Government's paper states with reference to the particular context of seeking a commercial loan, it is highly desirable that there be “multiple service providers” exhibiting “diversity” in, among other things, their

*“Having different types of financial institutions enhances the competitive landscape and the structure of the financial services sector.”*

lending philosophy and credit assessment (p.7). Diversity of financial institutions is itself highly desirable, if not essential. Having different types of financial institutions enhances the competitive landscape and the structure of the financial services sector. Life insurance companies and banks, the two

remaining pillars of the sector, have different business philosophies and cultures; they have different products and services and will develop new ones differently. This benefits consumers and other customers, especially by enhancing choice among both competing and non-competing products and services. Thus, however many large financial institutions this country has after any period of consolidation, Canadians are better served if a significant number are independent banks and a significant number are independent life insurance companies than if all institutions are combinations of banks and life insurers, whether bank-owned or life insurer-owned.

Canada’s experience with respect to the acquisition of full service securities dealers by banks is illustrative of the consequences of a reduction in diversity. Banks have typically integrated these securities dealers operationally by, among other things, combining lending with debt underwriting for public companies in one department with a unified credit committee; as a result, there is less choice for business customers. In Canada’s capital markets, these bank-owned securities dealers have remained key intermediaries but the largest American investment banks are highly successful in Canadian corporate finance and mergers and acquisitions. Most importantly, these bank-owned securities dealers have not become Canadian champions internationally.

### **C. Other**

In addition to balancing the goals of international competitiveness and domestic competition and diversity of financial institutions, Government policy with respect to consolidation of the financial services sector should be developed with due regard to existing policy and the current structure of the financial services sector. As the variety of ways in which financial services sectors have evolved in other comparable countries illustrates, there is no single approach that is obviously superior in all circumstances. Debate can go on endlessly as to what system is best and as to what system Canada should adopt if we were working from a blank slate. But we are not. Canada has an efficient and effective system of financial intermediation, with banking and insurance industries that are functioning well and with robust competition both within and between those industries. As a result, it is essential that caution be exercised in making fundamental changes to policy. The benefits that Canada currently enjoys should not be sacrificed without a clear demonstration that a changed policy would bring improvements. This is particularly the case with respect to the acceptance by the Government of the consolidation of large financial institutions in current circumstances. After significant consolidation over the last 20 years, the financial services sector now has only two pillars and eight large financial institutions; any phase of consolidation now may be the last one. If permitted consolidation proves to be excessive – a matter that can only be established over time – it will be impossible to reverse. If a measured approach to consolidation is adopted, however, further consolidation can, with the benefit of experience, be permitted over time.

*“The benefits that Canada currently enjoys should not be sacrificed without a clear demonstration that a changed policy [on consolidation] would bring improvements.”*

*“After significant consolidation over the last 20 years, the financial services sector now has only two pillars and eight large financial institutions; any phase of consolidation now may be the last one.”*

The Government’s approach to review of consolidation of financial institutions should also take appropriate account of the differences between friendly, negotiated transactions and unsolicited or hostile ones. The latter are particularly problematical for financial institutions. In addition, this distinction is relevant to the question of the exercise by the Minister of

Finance of his power to waive the application of the widely held ownership rule in relation to Sun Life Financial or Manulife. In the current and any foreseeable state of consolidation of the financial services sector, we assume that the waiver would in any event not be granted in the case of an unsolicited or hostile transaction. This approach would in effect treat demutualized life insurance companies more like large banks, for which ownership rules may only be changed by statutory amendment.

Finally, in its June 23 paper, the Government has determined one important policy matter with respect to the financial services sector that is particularly relevant to life insurance companies. The Government does not intend to consider changes to current restrictions on insurance networking that limit the ability of banks to sell insurance through their branch networks. We strongly endorse that approach. With that policy established, the Government’s overall policy on consolidation in the financial services sector must be consistent with it.

### III. Sun Life Financial Business Strategy

Sun Life Financial is a leading international financial services organization providing a diverse range of wealth accumulation and insurance products and services to individuals and corporate customers in key markets worldwide, including Canada, the United States, the United Kingdom, Hong Kong, the Philippines, Japan, Indonesia, India, China, Bermuda and Chile. In 2002, we acquired Clarica, strengthening our position in Canada and broadening the domestic life insurance industry base that is essential for our continued international development.

Looking ahead, our business strategy requires us to achieve a more competitive position in the United States through transactions focused on selected businesses and markets. Although we do not seek size for the sake of size alone, enhanced scale both in the American market, the world’s largest, and generally is critically important. It is possible to grow in the United States through a series of smaller transactions but the likeliest means of achieving our objective is for us to enter into one or more significant transactions with large United States life insurers.

Increased scale in the United States market will give us numerous competitive advantages, including with respect to our ability to invest in our business, to achieve efficiencies and synergies and to enhance distribution of products and services. In particular:

- Enhanced scale will allow us to increase our investments in product development, brand development, marketing and technology. Continued innovation in the development of products and services is critical to competitiveness. Development of a strong brand is required to differentiate ourselves from a large number of competitors in the fragmented and cluttered American financial services market.

- Enhanced scale will allow us to reduce our unit costs, particularly with respect to technology. Spreading the cost of technology over a larger business lowers unit costs, making technology investment more cost-effective.
- We offer a wide range of financial products and services in the United States. Acquiring additional distribution capabilities will enable us to sell our products and services more effectively and extensively, producing growth.

The precise effect of a significant cross border transaction on our scale would, of course, depend on the business of the American life insurer involved. Assuming, however, that we would acquire a United States life insurer that is engaged in lines of business similar to those in which we engage in the United States and that is half the size of Sun Life Financial as a whole, the effect of such an acquisition could be to boost our market positions in several key American market segments from those in the top 25 to those in the top 10.

Increased scale in the United States will, moreover, benefit our customers in Canada. Competing more vigorously in the United States will improve our ability to bring the best products and services to the Canadian market. Similarly, the benefits of enhanced technology and distribution will also be deployed here.

Finally, while any acquisition poses integration risks, they are reduced when an acquiror expands in businesses in which it currently operates rather than diversifies. Having in recent years successfully integrated major acquisitions in Canada and the United States in the wealth accumulation and insurance businesses, we have proved we can manage integration risks in a significant cross border transaction.

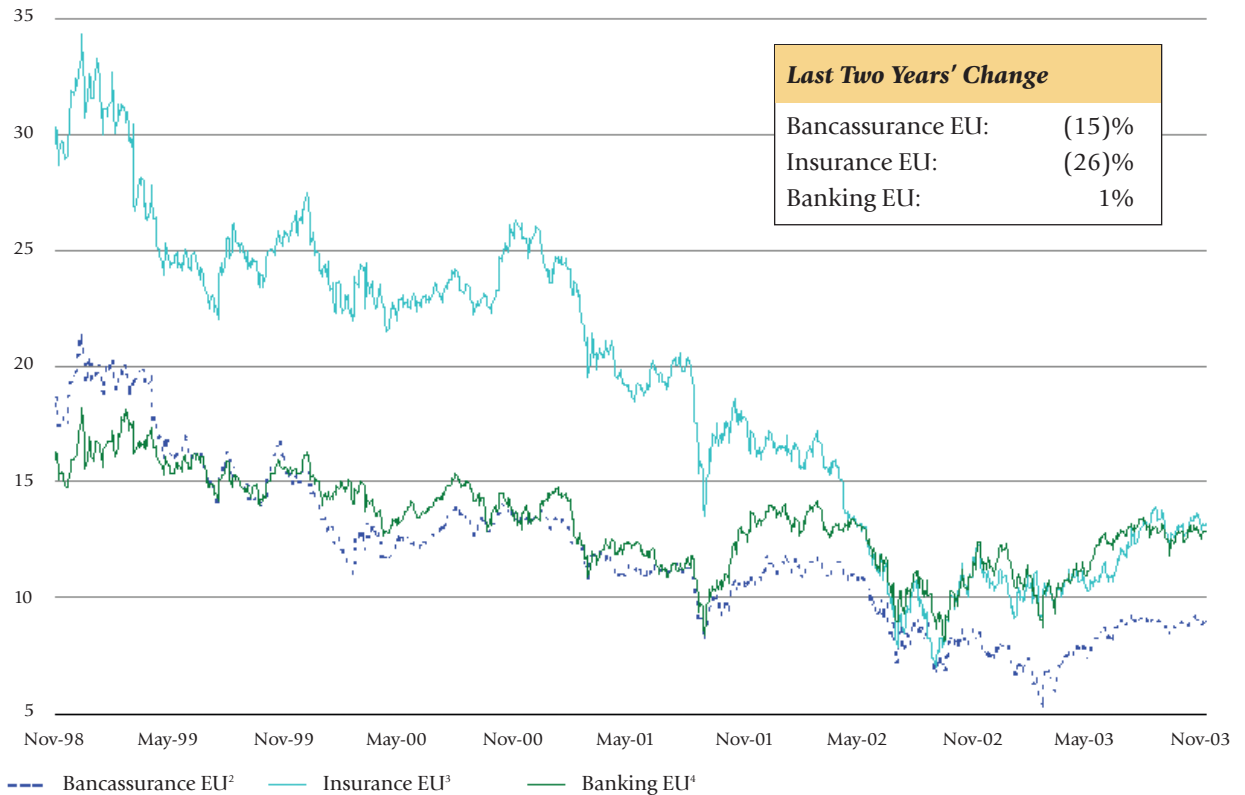
In developing our strategy, we have carefully analyzed the business merits of a large cross pillar merger with a Canadian or foreign bank. Our conclusion is that such a merger would be adverse to the long-term interests of Sun Life Financial and our shareholders. Although it would increase market capitalization, there would be few advantages of scale or improvements in market position because banks and life insurance companies compete directly only to a limited extent. In the case of a merger with a Canadian bank, for example, the combined financial institution would have increased market share in mutual funds in Canada but our other lines of business would not be significantly enhanced, either internationally or in Canada. Efficiencies would be relatively modest; in particular, since the technology of a financial institution is tailored to specific applications that support particular lines of business, systems-related overlaps between banks and insurance companies are severely limited, affording little potential for expense savings. A merger with a bank would, in addition, be imperiled by substantial integration risks attributable to evident cultural differences between banks and life insurance companies.

*“...a [cross pillar] merger would be adverse to the long-term interests of...our shareholders...there would be few advantages of scale or improvements in market position...”*

In analyzing the potential afforded by large cross pillar mergers, we considered the experience with these combinations in other countries. Many of those mergers have encountered difficulties and on an overall basis results are mixed. That experience is cautionary. The negative judgment of the European capital markets is particularly significant. As the following chart indicates, on stock markets in Europe, the leading area for cross pillar (or, in European terminology, “bancassurance”) mergers, merged bank-life insurance companies trade at a conglomerate discount – i.e., at a price/earnings multiple that is lower than the blend of the multiple for the banking component and the multiple for the life insurance component. That means those markets value those mergers as synergistically negative.

**RELATIVE VALUATION —  
PRICE/EARNINGS (P/E) COMPARISON ACROSS SECTORS<sup>1</sup>**

*P/E Development for Banking, Insurance and Bancassurance in Europe  
(Rolling 2 Year Forward P/E Multiples)*



1. Source: publicly available information; IBES Estimates.
2. Bancassurance EU includes: Fortis, ING, KBC, Lloyds TSB.
3. Insurance EU includes: Aviva, AEGON, AXA, Generali, Legal & General, Prudential.
4. Banking EU includes: ABN AMRO, Barclays, BNP Paribas, Credit Suisse, BBVA, Deutsche Bank, HSBC, Société Générale, UBS, UniCredito.

***"...bancassurance mergers are seen as reducing the potential of the merged financial institution subsequently to enter into a merger..."***

overall exposure to adverse developments in either the banking or life insurance industry. And ultimately, bancassurance mergers are seen as reducing the potential of the merged financial institution subsequently to enter into a merger with, or to make an acquisition of, a bank or a life insurance company. Because those bancassurance companies trade at inferior price/earnings multiples, they are unattractive as participants in those transactions.

In our view those stock market valuations have other negative implications. Our conclusion from them is that, at least in Europe, those bancassurance companies are viewed as having no significantly enhanced stability of earnings through diversification of activities and as having disproportionate

In addition, foreign cross pillar mergers have for the most part been implemented under regulatory regimes and in business environments that differ significantly from those of Canada. In our view, those differences make it highly unlikely that a large cross pillar merger in Canada would be in the long-term best interests of Sun Life Financial and our shareholders. In particular:

- Cross pillar mergers are above all dependent on rationalization of the distribution channels of the bank and the life insurance company, including utilization of bank branches to distribute insurance products, and cross selling of products and services. The Government of Canada's adherence to the insurance networking restriction limiting the utilization of bank branches, which is sound policy, precludes achievement of this key component of cross pillar mergers.
- Banks have done best in selling insurance products where they are in substance tax-favoured savings products (such as deposit substitutes or retirement accounts) or are credit insurance rather than life insurance or other protection products. These products are common, for example, in European countries. In Canada, most life insurance products are protection-oriented and, for tax and other reasons, are less attractive for purely savings purposes.
- Cross pillar mergers are most successful in markets in which products and services continue to be sold through branches and other conventional means of distribution rather than through the use of technology. Conversely, where technology has been embraced by consumers of financial services, cross pillar mergers have been less successful. Canadian consumers are sophisticated users of technology, including the Internet and ABMs, and are much less reliant on traditional means of distribution than are consumers in many other countries.

From the time of our demutualization in 2000, we have generated very significant value for our shareholders: our market capitalization has grown from the \$5 billion created at that time to \$19 billion now, accounting for approximately 3.4% of the aggregate market capitalization of all companies included in the S&P/TSX 60 Index. The Canadian economy has also greatly benefitted in many ways from this creation of wealth. We are confident that, by pursuing our strategy of achieving a more competitive position in the United States, we can continue to generate significant additional value for our shareholders and the Canadian economy.

*"...by pursuing our strategy...we can continue to generate significant additional value for our shareholders and the Canadian economy."*

## IV. Public Interest Analysis

### **A. Introduction**

In addressing the key policy issues identified in the Government's June 23 paper, we have focused in particular on large cross pillar mergers and, in relation to them, other mergers between large financial institutions. In public policy terms, we think that the most relevant analysis is a comparison between significant cross border transactions in the life insurance industry and large cross pillar mergers. (Cross border transactions in the banking industry would have many similar attributes to those in the life insurance industry and thus our analysis is capable of broader application.)

In making this comparison, we have applied in an adapted form the public interest considerations made applicable to the review of large bank merger proposals under the Government's June 23 paper. We have adapted those criteria to take appropriate account of differences between mergers between two banks and those between a bank and a life insurance company or two life insurance companies. These adapted public interest considerations differ from those provided for in the Government's paper only in matters of degree and accordingly our public interest analysis of significant cross border insurance transactions and large cross pillar mergers is fundamentally consistent with the Government's approach.

For purposes of analysis of large cross pillar mergers, we have in effect assumed that, in business terms, the bank, rather than the life insurance company, is the dominant party and, after the merger, the life insurance company is operated as a unit controlled by the bank. This assumption is consistent with the Canadian banks' general superiority in size and with the general pattern of international large cross pillar mergers. If they were to occur, however, multiple large cross pillar mergers resulting in control by the life insurance company would have a similar effect.

## ***B. Significant Cross Border Life Insurance Transactions***

### ***International Competitiveness/Long-Term Growth Prospects***

If a Canadian life insurance company were to enter into a significant cross border transaction with an American or other life insurance company, it would be acting to enhance its international competitiveness and long-term growth prospects in precisely the way contemplated in the Government's June 23 paper. Expansion in the United States will produce direct benefits to Canadians in the form of enhanced access to wealth accumulation and life insurance products and services of the highest international standard and, for Canadian businesses expanding abroad, the convenience and efficiency of relying on their Canadian life insurance company for products and services they need elsewhere. In addition, the importance of timely implementation of a cross border strategy cannot be overestimated in a period characterized by rapid change, consolidation and globalization. Among other things, continued consolidation in the American financial services sector – including both banking and life insurance – puts a premium on timing. And change is currently under way. Manulife's proposed acquisition of John Hancock is an example of a leading Canadian life insurance company seizing the initiative to become more competitive internationally.

***“...the importance of timely implementation of a cross border strategy cannot be overestimated in a period characterized by rapid change, consolidation and globalization.”***

***“Significant cross border transactions should also contribute directly to...the deepening of relations between Canada and the United States.”***

Significant cross border transactions should also contribute directly to the realization of another public interest benefit, the deepening of relations between Canada and the United States. Much effort of the Government of Canada is directed at this policy objective and major Canadian cross border businesses can assist. As Canadian companies expand in the United

States, they increase understanding between Americans and Canadians – both employees and those who interact with these companies – of each other's country in general and of their similarities and differences in particular. This is conducive to improved cross border economic dealings but its effects should be more extensive, embracing a wide range of relationships between Canadian and American institutions, businesses and individuals.

### *Access to Financial Services*

Canadian life insurance companies distribute their products and services through various channels that are based on agents who typically deal with their clients at their homes or places of business. Some, including Sun Life Financial, operate networks of sales forces of independent career advisors who primarily sell their products and services, while others utilize agents who sell the products and services of a variety of life insurers. Mutual funds and many other wealth accumulation products are sold through securities brokers. Canadian life insurance companies typically offer the customers they serve convenient access through a nearby agent. In our case, the map and related list of locations that are attached as *Appendix A* show the bases of our Clarica independent career advisors and illustrate our comprehensive coverage of Canada and the ready access we provide to wealth accumulation and life insurance products and services. This access is available to all Canadians, including those living in rural and low-income communities and those with special needs.

*“...our Clarica independent career advisors... [are] available to all Canadians, including those living in rural and low-income communities and those with special needs.”*

*“[After a cross border transaction,] separate life insurance agent distribution channels will...be maintained as the most significant alternative to bank branches.”*

A significant cross border transaction will preserve existing channels of distribution of financial services in our country. Separate life insurance agent distribution channels will thus be maintained as the most significant alternative to bank branches. That has long been advantageous to Canadian consumers and other customers but it is especially important as our markets

for financial products and services change in response to key demographic and technological trends. As life expectancy and average age increase, so do the need for savings for retirement and demand for savings-related products and services. These products and services are often complex and are ones that are typically handled by life insurance agents. At the same time, day-to-day banking transactions, such as transfers of funds and making of deposits, have increasingly been effected electronically.

### *Choice among Financial Services*

A significant cross border transaction will enhance a Canadian life insurance company's ability to contribute to the maximization of choice among financial products and services for Canadian individuals and businesses. Not only will no reduction in competition in the domestic financial services sector be involved but the Canadian life insurance company will also be able to apply for the benefit of Canadians its expanded experience in international markets. Increasing the strength of a Canadian life insurance company in Canada, which a significant cross border transaction will accomplish, will serve to preserve the institutional diversity that remains in the Canadian financial services sector: that between life insurance companies and banks. That diversity is advantageous for consumers and other customers, who can purchase a wide range of products and services offered and developed by different types of financial institutions. Both in competing and non-competing products and services, by applying a diverse approach, life insurance companies and banks enhance choice.

### *Concentration of Economic Power*

Significant cross border transactions will strengthen Canadian life insurance companies, making them still more vigorous participants in Canada's financial services sector. Viewed as an alternative to large cross pillar mergers, significant cross border transactions will avoid adding to the existing concentration of power in the banks.

### *Efficiencies and Synergies*

Intra-industry combinations typically afford considerable potential for the achievement of efficiencies and synergies and that will be the case with respect to a significant cross border transaction involving a Canadian life insurance company. Cost savings are achieved through economies of scale and cost efficiencies, including the elimination of duplicate functions, rationalization of office locations and combination of technology in a reduced number of platforms. Spreading the cost of technology over larger lines of business lowers the unit costs of existing and subsequently developed technology, which in turn makes investment in technology more cost effective and facilitates continuous innovation. Although efficiencies and synergies are achieved in substantial part by reductions in employees, this is beneficial not only to shareholders (in the form of increased earnings and higher share prices) but also to customers (to the extent that lower costs result in lower prices for products and services). Moreover, a Canadian life insurance company that has successfully implemented a significant cross border transaction and in the process achieved a more efficient work force will as a result be better positioned to achieve long-term growth.

### *Capital Markets*

Life insurance companies typically participate only to a limited extent in the capital markets activities that are the core functions of securities dealers. Their most important activity is the origination of mutual funds and other wealth accumulation products and services on which retail investors depend. A significant cross border transaction should enhance a Canadian life insurance company's participation in wealth accumulation activities, especially if the American life insurance company involved has (as will often be the case) material wealth accumulation business. This in turn will be beneficial for Canada's capital markets. In other respects, however, a significant cross border transaction in the life insurance industry will not materially affect those markets.

### *Employees*

Since a significant cross border transaction can be expected to result in efficiencies and synergies achieved in part through reduction in employment levels and enhanced work force productivity, the Canadian and foreign life insurance companies that participate in these transactions should be held to the requirement that they treat their employees fairly and reasonably in accordance with corporate best practices during the transition period. There is every reason to expect that this will be the case, as it was, for example, in the treatment of employees in connection with Sun Life Financial's acquisition of Clarica.

Moreover, significant cross border transactions in the life insurance industry should be beneficial in terms of employment for two reasons. First, under the regulatory regime applicable to Canadian life insurance companies (which requires, among other things, that head offices be in Canada and that chief executive officers be ordinarily resident in Canada), high quality head office jobs will remain in Canada. In addition, in the long term, an internationally competitive Canadian life insurance company can be expected to enjoy substantial growth and as a result employment levels in Canada may well rise.

*"...cross border transactions...should be beneficial in terms of employment...high quality head office jobs will remain in Canada."*

Our experience with international expansion and acquisitions is illustrative of these employee-related benefits. Although each of our business segments has its own, nationally-based operational management, as we have expanded, both before and after demutualization, we have continued to manage our group of companies on an enterprise-wide basis from our head office in Toronto and the number of high quality

jobs there has increased. In addition, executives from our head office or our Canadian operations have worked in our United States operations, which has enhanced their career development and has served to internationalize the business thinking of managers in both countries.

### ***C. Large Canadian Cross Pillar Mergers***

#### ***International Competitiveness/Long-Term Growth Prospects***

By implementing a cross pillar merger with a large Canadian life insurance company, a large Canadian bank would increase its size, as measured by market capitalization. The combined enterprise would not, however, significantly increase scale in either the banking industry or the life insurance industry: with respect to market share or other key operational measures, the combined enterprise would remain, in international terms, a medium-sized bank and a medium-sized life insurer. More importantly, a cross pillar merger would have no immediate effect on the international competitiveness of either the bank or the life insurance company involved. It could only have the potential for a possible later effect, if the overall increase in size enabled the bank eventually to make an acquisition of, or participate in a merger with, a foreign bank that otherwise would not have been practicable. Yet for any such purpose, a Canadian bank could likely be far better positioned if, in a preparatory transaction in Canada, it achieved not only increased size but also the increased scale available through a merger with another bank.

***“...[after a cross pillar merger], the combined enterprise would remain, in international terms, a medium-sized bank and a medium-sized life insurer.”***

In addition, from the perspective of a life insurance company that is acquired in a large cross pillar merger, the effect of the merger would surely be to reduce its actual and potential international competitiveness, at least in the short and medium term. Immediately after a cross pillar merger, the acquiring bank would inevitably be focused primarily on absorbing the acquisition of the life insurance company in the Canadian market. Canada's large life insurance companies are well on their way to achieving optimal international competitiveness but within a more domestically oriented group controlled by a bank, a life insurance company's international focus would be diffused. Finally, the higher integration risk associated with cross pillar mergers, which is attributable to cultural differences between banks and life insurers, is also likely to threaten the potential for long-term growth.

#### ***Access to Financial Services***

After a large cross pillar merger, a bank would face a significant challenge with respect to the operation of its distribution channels. It would need to rationalize those channels in order to realize an appropriate return on investment but its flexibility would be constrained because of the Government's maintenance of the insurance networking restriction that limits the ability of banks to sell insurance through their branches. Inevitably, banks would pressure the Government to modify substantially or abrogate that policy. Whatever the result of that pressure, the Canadian public interest would be harmed. If the banks were successful, traditional insurance industry channels of distribution through agents would be put at significant risk. If the banks failed, either they would have to accept operating inefficiencies or they would have to rationalize distribution in other ways, such as increasing the closure of branches. Neither the inefficient operations of banks nor the weakening of channels of distribution of financial services that currently function well is in the Canadian public interest.

### *Choice among Financial Services*

A large cross pillar merger is likely to reduce choice among financial products and services for Canadian consumers and other customers. There is no reason why, as a result of the merger, the number of products and services offered by the bank and the life insurance company involved would increase or their quality would improve to the extent that would be the case if the bank and the life insurance company were separate and competing. Moreover, there would be no appreciable efficiencies or synergies that could provide an economic impulse to innovation.

*“A large cross pillar merger is likely to reduce choice among financial products and services for Canadian consumers...”*

Rather, existing competing products and services and any potential for the development of new ones would be eliminated. For example, life insurance companies, especially Sun Life Financial, now participate in certain types of lending to mid-sized Canadian companies (those with annual revenues of less than \$500 million), mostly in the manufacturing sector, and in doing so provide those companies with sources of funding additional to those available from banks; a cross pillar merger would not only curtail actual competition but would ensure that the acquired life insurance company did not expand the scope of its lending activities that are competitive with those of the bank. In addition, it must be expected that diversity among Canadian financial institutions would be reduced as the business character of the acquired life insurance company conformed over time to that of the bank. Finally, in a cross pillar merger, the bank and the life insurance company must emphasize the cross selling of each other's products and services and that would likely be detrimental to customers. As the primary source of loans and other credit facilities, banks are in a position to exert substantial influence over the choices made by their customers with respect to other financial services. This influence exists even in the absence of overt pressure from the bank, since it is reasonable for customers to assume that they will be better placed to secure credit if they volunteer to purchase other products and services from a bank or its life insurance subsidiary. Thus, choice for consumers and other customers is restricted, even where the bank does not engage in the prohibited practice of tied selling. Inevitably, there will be a need for rigorous enforcement of the tied selling rules and ultimately it can be anticipated that there will be pressure from banks that have implemented cross pillar mergers to relax those rules.

### *Concentration of Economic Power*

*“Less than 20 years ago, Canada's financial services sector comprised four separate pillars...Since that time, the large banks have acquired all significant trust companies and the largest securities dealers.”*

Less than 20 years ago, Canada's financial services sector comprised four separate pillars: banks, insurance companies, trust companies (and loan corporations) and securities dealers. Since that time, the large banks have acquired all significant trust companies and the largest securities dealers. That happened as a result of economic developments which also led to changes in policies of various Canadian governments, including the

Government of Canada. In the case of securities dealers, both the need for capital (among other things to enable them to compete against very large and well capitalized foreign investment banks) and the convergence of private and public debt markets led to Canadian banks acquiring Canadian securities dealers. Similarly, both the assets and liabilities of trust companies came over time to be equivalent to those of banks and the distinctive fiduciary activities of trust companies became a more natural adjunct to banking. Government policy accommodated these economic developments, albeit with accompanying concentration of economic power in the banks.

The relationship between life insurance and banking in Canada has also changed fundamentally in this period. Banks have been permitted to enter the life insurance industry, breaking down the complete separation between the two pillars. And many banks have taken advantage of this opportunity by acquiring or establishing life insurer subsidiaries. In the process, competition in the already highly competitive Canadian life insurance market has been increased. Government policy has, however, been balanced, allowing flexibility of entry into the life insurance business while maintaining a considerable degree of separation between the banking and life insurance industries. The Government has achieved the latter objective primarily by restricting the distribution of life insurance products through bank branches and by prohibiting large cross pillar mergers.

In the context of reformulating policy with respect to consolidation of the financial services sector, one key issue is whether the Government should make the further change of permitting large cross pillar mergers. As the Government's June 23 paper notes, policy with respect to life insurance company consolidation should only be changed if circumstances warrant. They do not. In addition, permitting cross pillar mergers risks increasing the concentration of economic power in banks.

There are no recent fundamental economic developments justifying the combination of large banks and large life insurance companies. Banks and life insurance companies have very different assets and liabilities and there has not been substantial convergence of core products and services. Large Canadian life insurance companies are well capitalized and there is no need to turn to bank ownership for a source of capital.

Moreover, in recent years Canada's leading life insurance companies have made great progress towards becoming Canadian champions capable of competing globally. Balanced Government policy has fostered this development, aiming, as the Government's June 23 paper states, at "ensuring strong independent insurance companies in Canada" that would ultimately achieve global success (p. 18). Demutualization was encouraged and an appropriate degree of consolidation – exemplified by Sun Life Financial's acquisition of Clarica and GreatWest Lifeco's acquisition of Canada Life – was approved. This multi-faceted Government policy has been an outstanding success. Policyholders and shareholders have benefitted greatly but the economic benefits of these developments have been wide-ranging. The five recent Canadian life insurance company demutualizations created approximately \$20 billion in value at the time, with a resulting increase in GDP. Having achieved so much and approaching the realization of its policy objectives, the Government should not reverse the process by permitting large cross pillar mergers.

***"Having achieved so much and approaching the realization of its policy objectives, the Government should not reverse the process by permitting large cross pillar mergers."***

Increased concentration of power in the banks potentially involves many adverse consequences. Two, discussed above, are the restriction of choice with respect to financial products and services and the pressure for the relaxation or removal of the restriction on distribution of life insurance products through bank branches. Another relates to privacy concerns, which are of ever-increasing importance to Canadian customers of financial institutions. Enhanced privacy laws and restrictions on sharing of personal data without consent provide protection but the maintenance of the separation of ownership of large banks and large life insurance companies will be an additional bulwark against invasion of privacy.

### *Efficiencies and Synergies*

It is very unlikely that economies of scale and cost savings available with respect to intra-industry combinations can be achieved to any significant extent in a cross pillar merger. This is well illustrated by the critical area of technology. While cost savings might be achieved by combining infrastructure systems of banks and

***“It is very unlikely that economies of scale and cost savings available with respect to intra-industry combinations can be achieved to any significant extent in a cross pillar merger.”***

life insurance companies that are required to be enterprise-wide, those savings would be modest. Most systems, however, are specific to products and services and because systems-related overlaps between core banking products and services and core life insurance products and services are very limited, so is potential for technology-related efficiencies and synergies.

Similarly, efficiencies and synergies attributable to the elimination of duplicate functions are not significant in a cross pillar merger. While this will result, in the short term, in the preservation of jobs for bank and life insurance company operating personnel, ultimately the limited potential for international competitiveness will reduce long-term growth prospects as well as the potential for long-term increase in high quality Canadian jobs.

### *Capital Markets*

A cross pillar merger would not materially affect Canada’s capital markets. Only in the combination of mutual funds and other wealth accumulation activities of the bank and the life insurance company would there be any effect at all and that would not involve deepening or broadening of Canadian capital markets.

### *Employees*

A cross pillar merger would make the life insurance company a business unit of the acquiring bank and thus eliminate the need for many high quality head office jobs relating to management of the life insurer.

Since a cross pillar merger is unlikely to result in other significant reduction in employment levels in Canada, the issue of whether the merging bank and life insurance company treat their employees fairly and reasonably in accordance with corporate best practices during the transition is unlikely to be a serious one. Ultimately, however, since a cross pillar merger does not enhance international competitiveness, long-term growth, including growth in aggregate Canadian employment levels, cannot be expected.

***“...since a cross pillar merger does not enhance international competitiveness... growth in aggregate Canadian employment levels cannot be expected.”***

### ***D. Conclusion***

This comparison in public interest terms of significant cross border transactions involving a Canadian life insurance company and cross pillar mergers of a large Canadian bank and a large Canadian insurance company leads to a clear conclusion: significant cross border transactions are highly desirable and large cross pillar mergers are not. In particular, significant cross border transactions are superior to large cross pillar mergers in:

- immediately enhancing international competitiveness and long-term growth prospects,
- maintaining and improving access to and choice among financial products and services for Canadian consumers and other customers,
- preserving diversity in Canada's financial services sector and avoiding concentration of power in the banks, and
- maintaining high quality head office jobs in Canada and increasing the potential for growth in Canadian employment.

The consequences for Government policy are equally clear: significant cross border transactions should be encouraged and large cross pillar mergers should continue to be prohibited.

A significant cross border transaction can be implemented in various ways, ranging from a straightforward acquisition of shares to more complex structures. Given the importance of these transactions, we believe that the Government should provide a statutory and policy framework that accommodates the full range of structural options and that the Office of the Superintendent of Financial Institutions should regulate, in particular with respect to holding companies of Canadian life insurance companies, on a correspondingly accommodating basis.

## V. Recommendations on Key Issues

The following are our views and recommendations on the key policy issues relating to the consolidation of the financial services sector in Canada with respect to which the Government sought input in its June 23 paper. They respond specifically to those issues in the order and on the terms raised in the Government's paper.

### *Large Life Insurance Company Mergers*

In addition to prohibiting large demutualized life insurance companies from merging with banks, Government policy also prohibits them from merging with each other. Although it is appropriate to review this policy in conjunction with the reconsideration of other policies relating to the consolidation of large Canadian financial institutions, in our view this policy should not be changed, for two reasons. First, since there are only three large life insurance companies in Canada, in current circumstances there is only a limited possibility that the merger of two of them would be permitted under competition law on terms acceptable to the parties. Second, even if these mergers were permitted under competition law, allowing one of Canada's most significant industries to be dominated by two companies cannot be in the public interest. The life insurance industry in Canada is already highly concentrated and further concentration involving the three large companies is indefensible.

It follows that any policy with respect to mergers of large life insurance companies should apply to all three of them, not just to the two that have recently demutualized. Here as elsewhere, there is nothing to distinguish the two demutualized companies and Government policy must accord with current economic reality rather than be determined, even in part, by history.

**Government policy should prohibit mergers between all large life insurance companies.**

### *Large Cross Pillar Mergers*

For the reasons we have explained in this submission, we think it is essential that the Government continue its policy of prohibiting large cross pillar mergers. Analysis from the public interest perspective demonstrates that large cross pillar mergers result in little benefit and considerable detriment. Government policy in recent years has fostered the development of a thriving, independent life insurance industry in Canada and that policy has been highly successful. If the Government were to permit mergers between large life insurance companies and large banks, Canada would lose the benefit of what the current Government policy has achieved. With respect to consolidation in the financial services sector – whether involving life insurance companies or not – the Government should be cautious. Excessive consolidation will be difficult, if not impossible, to remedy while over time, with the benefit of experience, an appropriate degree of consolidation can be permitted. Finally, a prohibition on large cross pillar mergers should apply to all large banks and all large life insurance companies (whether recently demutualized or not).

**Government policy should prohibit mergers between all large life insurance companies and large banks.**

### *Application of Public Interest Review*

The Government's June 23 paper reaffirms its commitment to the need for broad public interest review of any proposed merger between two large banks and clarifies the public interest considerations that will apply in the review. We completely agree with this approach and support broad public review of all consolidations between large financial institutions that are permitted under Government policy. In our view, Government policy should continue to prohibit large cross pillar mergers and mergers between large Canadian life insurance companies. If Government policy with respect to these mergers were to change, it is essential that any permitted mergers be subject to a public interest review process comparable to that already applicable to mergers between large banks.

**If large cross pillar mergers and mergers between large life insurance companies are permitted, Government policy should subject them to public interest review.**

### *Definition of Market Structure Characteristics*

There has been much debate as to whether, assuming any consolidation among Canada's five large banks is permitted, Government policy should require a minimum number of large banks and, if so, what that number should be. The Government's June 23 paper broadens this debate in two ways, by seeking input with respect to market structure characteristics generally and by addressing the issue with respect to all large financial institutions.

We believe that Government policy must explicitly define all relevant market structure characteristics. That said, we do not think that this is a difficult process. Canada now has five large banks and three large life

insurance companies. We do not see how, in any circumstances, it would be appropriate to have fewer than three large banks or three large life insurance companies and we accordingly recommend that the Government adopt these minimums. As far as the definition of “large” is concerned, we think that Government policy can deal with the eight financial institutions concerned by name rather than adopting quantitative measures that include them. It is unnecessary and artificial in the current circumstances to choose any particular quantitative measures with the sole objective of including those institutions and excluding others. Over time, the Government can change its policy to the extent that the eight concerned financial institutions are no longer perceived to be the large ones.

If any market structure characteristics other than size are to be applied to the review of mergers in the financial services sector, the Government should specify them at this time. We are, however, not aware of any others that should be applied.

We recognize, of course, that in recommending a minimum of three large life insurance companies and three large banks, we are advocating that mergers among Canada’s large life insurance companies be precluded while mergers among Canada’s five large banks be possible. That is not to say that we endorse any merger between two large Canadian banks. Any proposal for such a merger must be reviewed by the Competition Bureau and OSFI and, most importantly, must be assessed under the public interest review process; it may or may not be acceptable. We suggest only that market structure characteristics alone should not preclude a merger of two large Canadian banks, subject to the maintenance of a minimum of three large banks. Convinced of our own need to become increasingly competitive internationally, we understand how Canadian banks, with the same objective, will feel the need to consolidate banking operations in Canada and acquire domestic scale in preparation for a significant transaction outside Canada. Accordingly, we do not think that Government policy should continue to be to refuse to entertain all proposals for such mergers.

**Government policy should require the maintenance of a minimum of three large life insurance companies and three large banks and define “large”, for purposes of current policy, by reference to the current eight large banks and life insurance companies, rather than by quantitative measures.**

### *Review of Multiple Merger Applications*

Raising the issue of “first mover” advantage potentially available with respect to the first in a sequence of merger proposals, the Government asked in its June 23 paper whether it should “establish a window of time, say 60 days, following receipt of the first merger application, after which all applications received during that time period should be considered together” (p. 21). We agree with the Government that the merger review process should not create a “first mover” advantage and we are unaware of any means of ensuring that it does not which is superior to the one proposed. As the Government’s paper recognizes, the public interest review process for the first or any other merger proposal should not begin until the period for receipt of all merger proposals to be considered concurrently has been concluded and this has the effect of lengthening the overall merger review process. While this added length is in itself disadvantageous, we think it is unavoidable. Moreover, a period of 60 days appears to be the minimum for affording a realistic opportunity to other similarly situated financial institutions to negotiate and make a second merger proposal.

**Government policy should establish a period of 60 days during which, after a first proposal for a merger between two large financial institutions is made, other proposals for mergers could be made on the basis that all the merger proposals would be considered concurrently.**

*Divestitures to Enhance Competition*

Recognizing that more measures need to be implemented to increase competition in the financial services sector in Canada, the Government's June 23 paper asked how divestitures can be used to enhance competition and contribute to public interest objectives and whether specific divestiture policies can be devised. Divestitures are, of course, dealt with in the course of the Competition Bureau process. Beyond this, we believe it is unwise for the Government to contemplate, in the context of mergers of large financial institutions, consideration of further divestitures, with a view to strengthening an existing competitor or creating a new one. In the review under competition law, there is an objective basis for determining whether divestitures are or are not required; in a public interest review process, it is highly questionable that further objective criteria could be devised or justified in relation to those applicable under competition law. Moreover, the process of consideration of such divestitures seems likely to lead the Government into management on a quasi-business basis of the financial services sector, which is inappropriate.

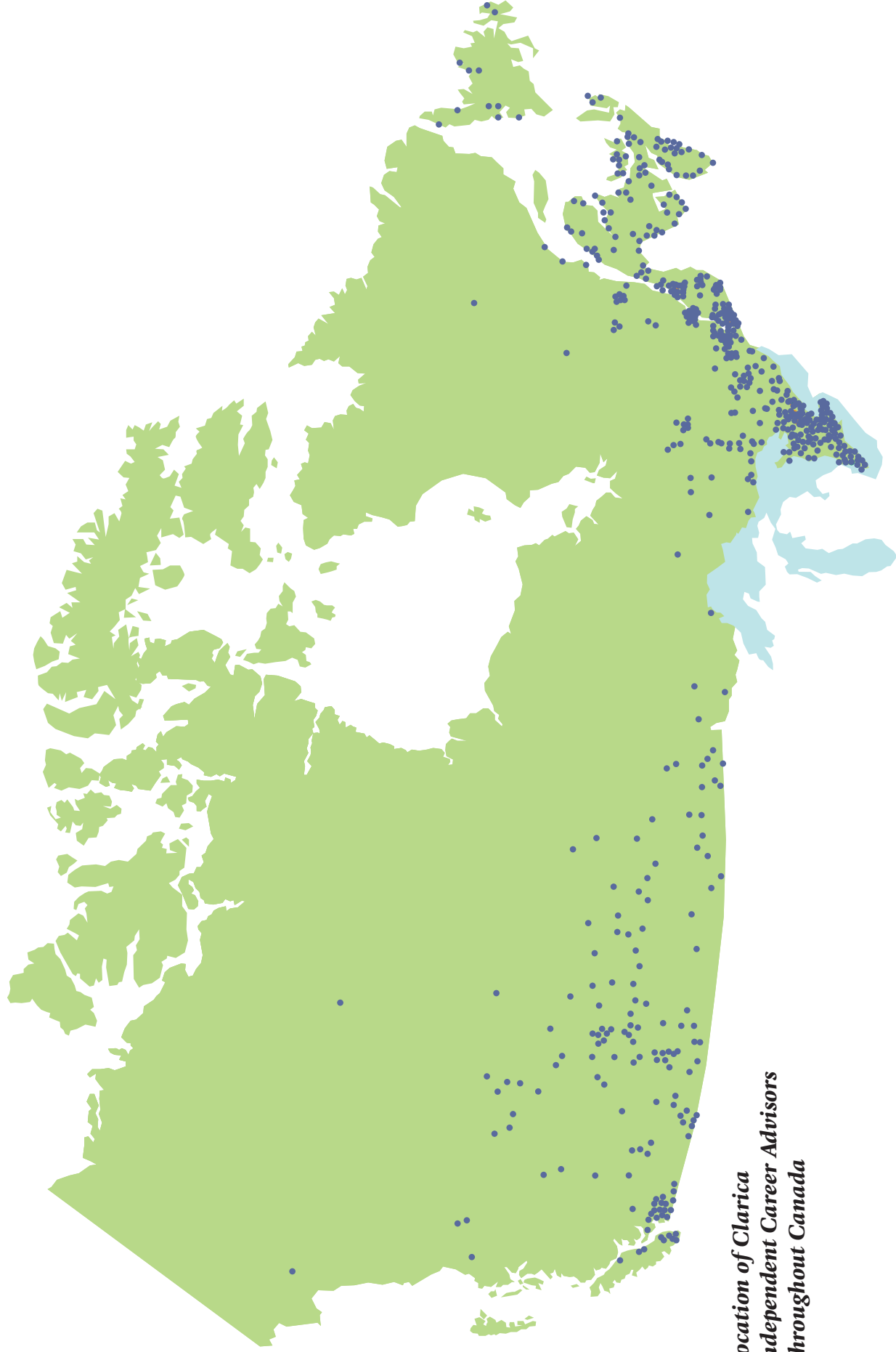
**Government policy should not deal with divestitures in the context of the public interest review of mergers of large financial institutions, leaving that matter to be dealt with under competition law.**

*Other Enhancement of Competition*

The Government's June 23 paper raises three other specific matters related to competitive aspects of the consolidation of large financial institutions: the need for, and means for achieving, full functionality of ATMs; steps for enhancement of the ability of credit unions to contribute to competition in the financial services sector; and the desirability of removing the restriction on foreign banks that operate in Canada through a branch rather than a subsidiary with respect to taking retail deposits. While doubtless significant in public policy terms, each of these issues is peripheral to our business and as a result, we do not consider it useful to comment specifically on them or make recommendations with respect to them. As the Government's paper emphasizes, however, these are only some of the measures by which the Government may enhance competition in Canada's financial services sector. We enthusiastically support the Government's continuing efforts to increase that competition.

**Government policy should continue to foster the enhancement of competition in the Canadian financial services sector by all means available.**

Appendix A  
Clarica Independent Career Advisors



*Location of Clarica  
Independent Career Advisors  
Throughout Canada*

# List of Clarica Independent Career Advisor Locations

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