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# Prudential Financial, Inc. (PRU)

Q1 2020 Earnings Call

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*Vice Chairman, Prudential Financial, Inc.*

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## OTHER PARTICIPANTS

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**Thomas Gallagher**

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**Ryan Krueger**

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*Analyst, Goldman Sachs & Co. LLC*

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*Analyst, Morgan Stanley & Co. LLC*

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**John Barnidge**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Ladies and gentlemen, thank you for standing by. Welcome to Prudential's quarterly earnings conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, with instructions being given at that time. [Operator Instructions] As a reminder, today's conference is being recorded.

I would now like to turn the conference over to your host, Mr. Darin Arita. Please go ahead.

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### Darin Arita

*Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.*

Good morning and thank you for joining our call. Representing Prudential on today's call are: Charlie Lowrey, Chairman and CEO; Rob Falzon, Vice Chairman; Andy Sullivan, Head of US Businesses; Scott Sleyster, Head of International Businesses; Ken Tanji, Chief Financial Officer; and Rob Axel, Controller and Principal Accounting Officer. We will start with prepared comments by Charlie, Rob, and Ken, and then we will take your questions.

Today's presentation may include forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, this presentation may include references to non-GAAP measures. For a reconciliation of such measures to the comparable GAAP measures and the discussion of factors that could cause actual results to differ materially from those in the forward-looking statements, please see the slide titled Forward-Looking Statements and Non-GAAP Measures in the appendix to today's presentation, which can be found on our website at [investor.prudential.com](http://investor.prudential.com).

Also, due to circumstances created by the COVID-19 pandemic, we have decided to cancel our Tokyo Investor Day that was scheduled for September.

With that, I'll hand it over to Charlie.

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### Charles F. Lowrey

*Chairman & Chief Executive Officer, Prudential Financial, Inc.*

Thank you, Darin. Good morning, everyone, and thank you for joining us today.

I would like to start this morning by recognizing the extraordinary circumstances created by the COVID-19 pandemic and by expressing our gratitude to all of those on the front lines who are fighting this crisis around the world. For those individuals and their families directly affected by the pandemic and particularly those who have lost loved ones, we extend our deepest sympathies. At Prudential, we're guided by our purpose, to make lives better by solving the financial challenges of our changing world, and that includes being there for our employees, our customers, and our communities, especially in times like these.

We are completely focused on ensuring that we take the right course of action for the business, mitigating the impact of COVID-19 while investing for the future in order to emerge from this crisis stronger than before. The strength of our balance sheet enables us to manage our business for the long-term growth while dealing with short-term business realities.

Before we get into the first quarter performance, I'll cover some of the key steps we have taken as a company to support our employees, customers, and communities in response to COVID-19.

First, turning to slide 3, ensuring the health and well-being of our employees and their families is our top priority. As the pandemic emerged, we initiated new policies and actions to ensure their safety and security, including additional family care support. This included implementing a wide-scale remote work environment, with approximately 98% of our employees and most of our international employees now working remotely. I'm pleased to report that all our businesses and operational functions continue to run smoothly.

Prioritizing the well-being of our employees enables us to address the evolving health and financial needs of our customers as the pandemic and its economic impact reverberate more broadly. We've also provided customers with assistance, such as premium deferrals and fee waivers as well as enhanced digital tools.

I'm also incredibly proud of the work our employees have done to support our local communities, including in Newark, El Paso, Hartford, and multiple international locations. These efforts include the donation of more than 150,000 face masks, including 75,000 N95 respirators for healthcare workers in New Jersey.

In addition, the American Nurses Association and Prudential recently entered into an agreement for Prudential to sponsor ANA events and outreach initiatives in 2020. This agreement will include offering Prudential's financial wellness services and solutions to ANA members and the broader nursing community. We're pleased to be of assistance to those serving on the front lines of this pandemic.

Turning to our financial strength on slide 4, our rock-solid balance sheet provides the foundation for our employees to serve our customers and our communities. We're confident in our ability to successfully manage in this environment, in large part due to the robust operational and financial risk framework that we put into place after the Great Recession of 2008. This framework prepared us with a playbook to address multiple stress scenarios, including pandemics and economic conditions that are more severe than what we are currently experiencing. In addition, we benefit from our recurring revenue model and mix of complementary businesses, which offset risk and produce capital benefits, giving us confidence about Prudential to navigate the current environment.

We began 2020 with a strong capital and liquidity position, and our capital ended the quarter exceeding AA financial strength levels. As the pandemic unfolded and in light of uncertainty in the global markets, we executed our playbook. We successfully issued \$1.5 billion of senior debt in early March while spreads were still attractive. This included a \$500 million green bond issuance, the first of its kind for a US company in our sector. These actions pre-funded our opportunities through the end of 2021 and enhanced the liquidity of our businesses. As part of the playbook, we further enhanced the liquidity of our businesses and also paused share repurchases at the end of the first quarter to see how the economic environment develops.

During the quarter, our variable annuity hedging performed extremely well, with a 99% effective rate. Our approach to hedging the economic risk resulted in significant gains on our equity market and interest rate hedges to offset the increased liability. We feel comfortable about our ability to manage equity market fluctuations and continued low interest rates over time. We're also highly confident about the quality of our investment portfolio, which Rob will cover in more detail shortly. The strength of our financial position means our dividends to shareholders remain well covered by our income and free cash flow.

Turning to slide 5, we are on track to accomplish our strategic initiatives for the year, and in fact, are accelerating their execution in some cases. First, we are repricing our products more quickly and pivoting towards lower risk

and less capital-intensive products. Second, with respect to rotating our international earnings mix to higher-growth markets, in April we reached an agreement to sell our Prudential of Korea business. We also continue to pursue strategic alternatives for our Taiwan business. Finally, we continue to make progress on achieving our goal of \$500 million in cost savings, \$140 million of which should be achieved this year. We realized \$30 million in the first quarter through actions we completed before the start of 2020.

Turning to slide 6, while it seems like a lifetime ago, I'd like to spend a moment on our first quarter performance. We reported pre-tax adjusted operating income of \$1.2 billion or \$2.32 per share. The GAAP net loss was \$0.70 per share, driven largely by non-economic factors. Our US and international business earned lower variable investment income in the quarter. We also generated lower underwriting income in our US businesses. Higher asset management fees at PGIM were offset by lower other related revenues.

While the severity and duration of the pandemic and related economic impact remains unknown, we are confident about the strength of our company. Prudential has survived pandemics, wars, recessions, and the Depression, among other events in its 145-year history. We are resilient, we are strong, and we will continue to move forward to deliver sustainable value for all our stakeholders.

With that, I'll turn it over to Rob for a detailed look at our business performance for the quarter.

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**Robert M. Falzon**

*Vice Chairman, Prudential Financial, Inc.*

Thank you, Charlie.

As Charlie indicated, the results from our businesses in the first quarter were negatively impacted by two significant factors that we had not anticipated, adverse mortality and the impact of the pandemic, particularly on equity markets, interest rates, and credit spreads. Adverse market conditions resulted in \$150 million of lower variable investment income in our US and international businesses and also reduced other related revenues in PGIM by \$55 million, and the Chilean and [ph] Kahay (9:55) earnings in our international business by \$30 million. Overall mortality was \$60 million above our seasonal expectation.

We are continuing to work toward improving the profitability of our individual life business. We have strong life insurance, marketing, and distribution capabilities, which we've expanded with the acquisition of Assurance IQ. In aggregate, these factors reduced first quarter's adjusted operating income by about \$295 million or \$0.58 a share.

Lower interest rates and equity markets also challenged fundamentals across our businesses, and we are actively executing pricing and product actions to shift our business mix to less market-sensitive customer solutions.

With that in mind, I'll turn now to providing more color on how we are executing on our strategy within our US, PGIM, and international businesses, as well as on the outlook for these businesses considering current market conditions. I will also provide an overview of our investment portfolio given the increased focus on the risks associated with the potential near-term credit cycle.

Turning to slide 7, our US businesses consist of the workplace solutions, individual solutions, and Assurance IQ divisions that produce a diversified source of earnings from fees, investment spread, and underwriting income.

Our US businesses continue to execute on three key priorities, first and foremost, the financial strength of these businesses, which continues to be solid despite the impacts of COVID-19 and the broader economic conditions. We continue to take product actions, including steps to diversify our mix of business and maintain profitability.

Second, as the needs of our customers rapidly evolve, including in response to COVID-19 and its economic impact, we are leveraging our ongoing technology transformation and digital capabilities to enhance customer engagement. For example, within a matter of days in March, we introduced our fast-track automated underwriting process for COVID-19 related claims, with expanded e-capabilities for proof of death.

In just a weekend, we introduced new mobile apps and chatbots to help manage the surge in customer calls and inquiries, and we have expanded the use of electronic signatures across our businesses. We will continue to invest in transforming our capabilities by accelerating the use of technology to deliver a better customer experience and enhance the speed at which we operate.

And third, we remain committed to expanding our addressable market. The pandemic has amplified the financial wellness challenges that many US households face. To support our clients in these challenging times, we continue to invest in and expand our range of capabilities to meet their needs. For example, we completely transformed our flagship financial wellness offering pathways from an onsite to a virtual offering. In a matter of just weeks, we scheduled over 150 live web-based financial education seminars for our clients. And we introduced a new solution to help customers manage debt in partnership with GreenPath.

We're also shifting our focus to serving an expanded addressable market with lower risk and less market-sensitive solutions to address the changing market conditions. For example, in our individual annuities business, we are pivoting to less interest rate-sensitive products, including accelerating to May of this year the launch of our FlexGuard indexed annuity.

In our individual life business, we are also making product and pricing changes that will result in the continued pivot to variable life and other less interest rate-sensitive products. As a result of pricing actions, product pivots, and the disruptions to distribution from COVID-19, we expect sales to continue to decline for individual annuities in the near term, and we also expect reduced sales for individual life.

In our retirement business, while the longevity reinsurance market remains active, we expect that current market conditions will impact the funding levels of pension plans, and therefore result in lower pension risk transfer transactions.

Now turning to slide 8, PGIM is a top-10 global investment manager with \$1.3 trillion of assets under management and continues to leverage its diversified multi-manager model to serve investors. Our robust infrastructure and investments in technology have allowed employees to seamlessly transition to working from home. This operational flexibility has allowed us to support clients with portfolio information and insights and address their questions, even as we work in a virtual environment.

While significant market fluctuations in the month of March affected our three-year performance, PGIM's long-term track record remains strong. Seventy-nine percent of assets under management have outperformed their benchmarks over the last five years and 94% over the last 10 years, and we have seen some recovery of performance in our short-term track record in April.

Despite clients temporarily rebalancing into cash, we generated \$2.9 billion of net third-party flows during the first quarter. This reflects the resiliency of PGIM's diversified platform across asset classes, regions, and client segments.

Net flows included \$4.2 billion of institutional inflows, partially offset by \$1.3 billion of retail outflows. Public fixed income experienced both retail and institutional inflows. And of note, PGIM was the highest ranking US mutual fund franchise across active and passive asset managers based on net sales in the quarter.

PGIM's asset management fees were up 8% compared to the year-ago quarter, driven by growth in average assets under management and a stable fee rate. Other related revenues declined, primarily due to the effect of mark-to-market losses from credit spread widening in the first quarter.

We expect near-term sales across the industry to be impacted by volatile public market conditions, reduced transaction volume in private asset classes, and a slowdown in client activity. Despite this, we expect PGIM to emerge well-positioned vis-à-vis our competitors, driven by its diversified global platform.

Turning to slide 9, our international businesses include our Japanese life insurance operation, where we have a differentiated multichannel distribution model, as well as other operations focused on high-growth markets. Life planner sales decreased 5% compared to the year-ago quarter, driven by lower corporate product sales following the Japan tax law change, partially offset by replacement US dollar protection products. Life planner head count, however, reached a record level, increasing 5% compared to a year ago.

Sales for Gibraltar were also 5% lower, primarily reflecting the continued trend of lower single-pay US dollar fixed annuity sales in our life consultant and independent agency channels. In addition, as we continue to focus on quality distribution, the number of life consultants has declined.

In Chile, we are the leading pension provider via our joint venture with Habitat. We earn fees on assets and realize mark-to-market gains or losses on the capital that we are required to invest in the funds. Our investment performance has outperformed over time as well as in the first quarter. Returns in the quarter, however, were down across the industry, and that contributed to approximately \$30 million of lower than expected operating income.

As we look to the second quarter, we expect international sales to decrease significantly, reflecting the effect of social distancing protocols that limit in-person engagement with customers across our distribution channels. This will also affect recruiting of new life planners and life consultants.

We're actively taking measures, including appropriate sales support, to protect and care for our captive distribution during this difficult time. Over the longer term, we believe COVID-19 may result in heightened interest in protection products, particularly the death protection products throughout the core of our needs-based selling approach.

With respect to the current interest rate environment, we have successfully managed through decades of low interest rates and other market challenges in Japan. As you've seen in the past, we adjust to meet the needs and preferences of our customers while also achieving our return expectations. We have already taken actions and will continue to do so as needed as we move forward.

Also, as Charlie stated, in April we announced that we have entered into a definitive agreement to sell Prudential of Korea. This business represented less than 10% of international business sales.

Now turning to our investment portfolio on slide 10, we have a conservative, quality-focused approach to our investment portfolio construction and management that reflects our robust asset/liability management practices, commitment to broad diversification, and a disciplined interest rate risk management framework. We also

leverage PGIM's expertise across multiple asset classes, including its deep and longstanding experience in private placements and real estate.

With respect to our investment portfolio, here are a few key points. We have a high allocation to government securities, which is primarily comprised of US Treasuries and Japanese government bonds. About half of our BBB and below rated corporate securities are private placements, with financial covenants and structural protections that have consistently resulted in lower losses than comparable public securities. In past cycles, the loss experience of our BBB private placements has been comparable to single-A public credits, or about half the losses of similarly rated BBB public credits.

Our commercial mortgage loans are well-protected with a loan-to-value on the entire portfolio of 56% and debt service coverages in excess of 2.4 times. We are overweight in more defensive sectors, such as industrial and multifamily and underweight in both office and retail. We also have a low exposure in our investment portfolio to currently more vulnerable sectors like energy, retail, and other at-risk corporates.

The quality of our portfolio was demonstrated by its performance during the financial crisis in 2008 and 2009, where our credit loss experience compared favorably to peers. Since then, we have decreased our exposure to structured securities and BBB corporates and increased our holdings of government bonds and single-A and above rated corporates.

From 2008 through the first quarter of 2020, our annual fixed maturity credit losses averaged just 13 basis points of our portfolio. Slide 23 in the appendix provides more detail on our investment portfolio to exposures currently in focus. While we expect credit losses to emerge, the main takeaway is that we feel comfortable that our exposure is quite manageable and that we are well capitalized to absorb such losses.

Turning to slide 11, to help you assess potential credit losses on our investment portfolio over a three-year recession cycle, we provide a framework using publicly available rating agency and other third-party data for the underlying assumptions. This framework provides potential impairments, defaults, and ratings migration. The output suggests impact to PICA's RBC ratio and the solvency margin ratios in Japan would be very manageable and consistent with our expectations.

Credit losses on an after-tax basis would total approximately \$2.4 billion over a three-year period. To put that into perspective, that will be less than one year of our free cash flow. Also, if we used experiences from the prior recession in 2008 as the underlying assumptions for this framework, the after-tax credit losses would be much smaller at about \$1.6 billion.

And with that, I'll hand it over to Ken.

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## Kenneth Yutaka Tanji

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Thanks, Rob.

I will begin on slide 12, which provides insight into earnings for the second quarter of 2020 relative to our first quarter results. We begin with pre-tax adjusted operating income in the first quarter, which was \$1.2 billion, and resulted in earnings per share of \$2.32 on an after-tax basis. Then we adjust for the following items. First, we expect variable investment income in the second quarter to be \$150 million lower than in the first quarter. This is primarily driven by lower returns from private equity investments resulting from the decline in values in the first quarter reported on a one quarter lag in the second quarter.

Next, in the second quarter, we will have lower seasonal expenses, partially offset by higher implementation costs, which will result in a net benefit of \$50 million.

Third, there are other items that combined may be \$45 million more favorable in the second quarter relative to the first quarter. This includes the normalization of PGIM's other related revenues and our Chilean joint venture income, which were lower in the first quarter due to the mark to market of assets for equity markets and credit spreads. This normalization is partially offset by classifying our Prudential Korea business as a divested business.

Fourth, we expect fees to be lower on a run rate basis in the second quarter. This reflects account values starting the second quarter at a lower point than the average level in the first quarter. Next, we included a placeholder for potential COVID-19 related claims and expenses totaling \$250 million. I will provide additional details of these items on the next slide.

And last, we anticipate net investment income will be reduced by \$15 million, reflecting the difference between new money rates and disposition yields on our investment portfolio.

These items combined get us to a baseline of \$792 million of operating earnings and \$1.53 per share for the second quarter. Please note that this baseline includes items specific to the second quarter that reduce EPS by approximately \$1.22 per share. While we have provided these items to consider, there may be other factors that affect earnings per share in the second quarter of 2020.

Given the extraordinary circumstances created by COVID-19, on slide 13 we provide estimates for the potential operating earnings impact directly associated with the pandemic in 2020. As part of our risk management process, we model many potential stress scenarios, including a pandemic scenario. We have substantial reserves and highly liquid assets to ensure we are well positioned to readily satisfy all policyholder claims and continue to be well capitalized. We also benefit from the diversification of our businesses, and specifically the complementary nature of our retirement longevity business and our mortality businesses.

Although the extent and duration of the COVID-19 pandemic remains uncertain, we thought it would be helpful to provide estimates for the potential impact on net mortality and cost in 2020. The estimate for the impact on net mortality assumes 100,000 deaths across the total US population and 40,000 deaths across the total population in Japan.

After considering the profile of our insured policyholders, we estimate the impact on earnings from net mortality may be approximately \$200 million in 2020. Also, assuming the spread of COVID-19 is substantially contained in the second quarter, we estimate approximately \$135 million of earnings impact may occur in the second quarter with possibly lower impact in the second half of the year.

Also, as we continue to support our employees and families during this difficult time, we expect to incur additional costs, primarily related to sales support, employee health protection, technology, and other expenses. In 2020, we estimate these costs may be approximately \$230 million, with \$115 million of these costs in the second quarter.

Turning to slide 14, we continue to maintain a robust capital position and adequate sources of funding. Our capital position exceeds our AA financial strength targets, and we maintain liquid assets at the parent company that are greater than three times annual FICC charges.

Our financial leverage ratio is at our target, and our regulatory capital levels at our insurance companies remain higher than the targets. In addition, we have substantial sources of funding. Our cash and liquid assets at the parent company were \$5.3 billion at the end of the quarter. As previously highlighted, we expect to receive net proceeds of approximately \$1.7 billion from the sale of Prudential of Korea business following the close of the transaction, which is expected in the second half of 2020. And another source of funding is free cash flow from our businesses, which represents approximately 65% of earnings over time.

In addition, we have readily available off-balance sheet resources. This includes a \$4 billion credit facility with 23 banks and a syndicate structure across the US, Europe, and Asia. We also have access to \$1.5 billion of funding from a contingent capital facility with the right to issue debt in exchange for US Treasury securities held by a trust. And we have a Japan Bank facility with ¥100 billion available to Prudential Holdings of Japan.

Turning to slide 15 and in summary, we are committed to fulfilling our purpose to make lives better by solving the financial challenges of our changing world. We maintain a rock-solid balance sheet with a robust capital and liquidity position, and we remain on track with our objectives for the year as we accelerate the execution of our initiatives.

Now I'll turn it over to the operator for your questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] It looks like our first question comes from the line of Erik Bass of Autonomous Research. Your line is open.

**Erik Bass**

*Analyst, Autonomous Research LLP*

Hi, thank you. First, can you provide a bit more color on how you're coming up with your estimated COVID impacts and how you're thinking about the interplay between mortality and longevity exposures? And then also just to clarify on the expenses, is that just related to COVID, or is that a net impact factoring in other things such as lower T&E expense?

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Hi, Eric, it's Ken. I'll take your questions. On the COVID estimates, first, I'd like to recognize that these are placeholders. These are based on an estimate of 100,000 deaths in the US and 40,000 deaths in Japan. Now we have yet to see how things play out, and there's likely a range of outcomes around that for the US and Japan. So I just want to recognize that we've done our best to give a placeholder, but it's predicated on a number of assumptions.

What we do then is we then make considerations for lower fatality rates for the insured population versus the general population. We certainly have taken into consideration higher fatality rates for the older population. And then we took into consideration the geography of our insured population, which tends to have a little bit higher concentration in New Jersey and New York, California and Washington. So when we put that all together, we've applied those to our average profile and provided those estimates. And again, we'll likely have a good range around some of those assumptions.

In terms of our retirement business, it does provide an offset to some of our life insurance, as we've expected and designed. It offsets about 30% of our exposure, and that's just kind of how the modeling plays out.

And then your second question was around the expenses. We've looked at the steps that we need to take in order to care for our employees for crisis care as well as compensation for sales professionals, particularly in our international locations, if our sales were to decline. And we've estimated that is the appropriate thing to do given the situation. We haven't included in that estimate potential offsets for the fact that travel and conferences and entertainment will be lower. We would expect if things return at some point to normal that some of that might come back, to sort of rebound. But I would estimate if we're going to have savings here in the next quarter or so that you can think of that in the tens of millions, but that's not included in the estimate.

**Operator:** [Operator Instructions] Next, we have the line of Suneet Kamath of Citi. Your line is open.

### Suneet Kamath

*Analyst, Citigroup Global Markets, Inc.*

Thanks. I wanted to go to long-term care. Earlier this week, one of your competitors announced a regulatory review of long-term care reserves resulted in a pretty sizable increase to stat reserves. So I was just curious if any of your regulators are contemplating or conducting similar reviews. And maybe over what timeframe would we expect any resolution, if there are such reviews in place? Thanks.

### Kenneth Yutaka Tanji

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Hi, this is Ken, Suneet. Just in ordinary course, we review our reserves with our regulators. And they have not indicated any concern about our level of reserves related to long-term care, and there's no special review underway.

**Operator:** Next in queue, we have the line of Tom Gallagher of Evercore ISI. Your line is open.

### Thomas Gallagher

*Analyst, Evercore Group LLC*

Good morning. The \$2 billion of debt that PRU issued in 1Q is I think being counted as operating debt. So just curious why that's counted as operating debt, I think, which is excluded from the leverage calculation and what your plan is with those proceeds.

And then let's see, the other question I had is just on the GAAP breakage you had on the variable annuity side this quarter. Was there also a similar statutory level of breakage? I realize it's uneconomic based on the accounting differences between the assets and the liabilities, but just curious if you had a similar impact on statutory? Thanks.

### Kenneth Yutaka Tanji

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Hey, Tom, I'll take those. The \$2 billion of debt included the \$1.5 billion that we issued at the HoldCo. You can think of that as we would ordinarily have issued, say, \$0.5 billion earlier in the year and \$0.5 billion towards the end of the year. But we decided to do \$1.5 billion in March. We were worried about how the conditions were developing and thought it would be prudent to do \$1.5 billion, which essentially will take care of any maturities in

2020 and 2021. So it's about \$1 billion more than we would ordinarily have done perhaps, but we thought it was an appropriate thing to do.

In terms of why we call it operating debt, right now those proceeds sit at the holding company in cash. And we follow sort of the way that our rating agencies think about classifications of debt. And the plan proceeds, again, we have it available at the holding company. And it would – it's used – it's available for paying off the debt again for this year and next year.

In terms of the non-AOI item for the quarter, our variable annuity business is very well hedged, and we like to align our outcomes for GAAP and stat and economics. And as Charlie mentioned in his comments, it was highly effective at 99%.

The way we hedge interest risk, again, which was highly effective in the quarter, is with both derivatives that are mark-to-market and recorded in the P&L, but also by holding 30-year US Treasuries, which had a \$1.7 billion gain and would have offset the non-AOI item in the quarter. But the gain on the US Treasuries is recorded to OCI and not to the income statement. So economically and from a stat standpoint, we were very well aligned, just with a little bit of difference between where our gain is recorded for GAAP.

**Operator:** [Operator Instructions] Next, we'll go to the line of Ryan Krueger of KBW. Your line is open.

#### Ryan Krueger

*Analyst, Keefe, Bruyette & Woods, Inc.*

Hi, thanks. Good morning. Can you help us think about I guess interest rate sensitivity within the balance sheet, both GAAP and stat? I think previously you provided sensitivity for 10-year rates in the 2% to 2.5% range. But given where they are today, I was hoping for some additional sensitivity.

#### Kenneth Yutaka Tanji

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Sure, maybe I'll start with stat, Ryan. We have had sensitivity to our stat financials, primarily around asset adequacy testing. Last year, given the decline in rates, we increased our asset adequacy testing reserve by about \$0.5 billion. Now we had derivatives that offset that, so we were with a gain. So we had a stable RBC outcome. But it's also important to know that sort of at this level of very low interest rates that the way the testing works is when rates are so low, the shock is much lower. So we'll have less sensitivity to lower rates from this point forward.

From a GAAP standpoint, our sensitivity really hasn't changed. And as you know, we have a process, or I'll remind people that we have a process where we look at our long-term rate assumption. And that includes doing a survey of economist banks and other managers. And we also look at the implied forward curve, and we look to be at the median of all that. And that's the process that we're going through.

I'd also note that the way our interest rate assumptions work for GAAP is we start at current rates and we grade to a long-term assumption over 10 years. So as a result, the 10-year Treasury under the next seven years is less than 3%. So we're going through our process as we typically would, and that will be finalized by our risk management committees in late June. So no change in our – significant change in our GAAP sensitivity, and we'll be doing our usual process in the second quarter.

**Ryan Krueger**

*Analyst, Keefe, Bruyette & Woods, Inc.*

Thank you.

Q

**Operator:** Next in queue, we have the line of Alex Scott of Goldman Sachs. Your line is open.

**Alex Scott**

*Analyst, Goldman Sachs & Co. LLC*

Hi, thanks for taking the question. First one I have is just to follow up on the stat rate sensitivity comments that you made. I just wanted to make sure I interpreted it correctly. I guess, as you go through your actuarial review and if the ultimate rate is set lower, does that reduced sensitivity sort of apply now? Would we – if it is sort of the 3% to 4% book value type impact on GAAP, would that not necessarily all translate to statutory?

Q

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

Again, the way asset adequacy testing works is we don't set a long-term rate. Those are prescribed by GAAP. And we're going through our – and so it's a little bit of a different framework. And we'll also – so we're working through that.

A

**Operator:** [Operator Instructions] Next in queue, we have the line of Nigel Dally from Morgan Stanley. Your line is open.

**Nigel P. Dally**

*Analyst, Morgan Stanley & Co. LLC*

Great, thank you. So I had a question on buybacks. You spent a fair amount of time running through the strength of your current capital position and also what appears to be quite a manageable stress scenario. Clearly a number of moving factors, but what are you looking for? What are sort of like some of the things that you're looking for to be comfortable in resuming buybacks? Should we assume that buybacks are suspended through the end of the year, or potentially could it be somewhat sooner than that, any color there as to kind of how you're looking at that?

Q

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

I think the primary thing we're looking at is the economic cycle, and we're seeing substantial impact given the situation that we're in. We like the quality of our investment portfolio and we think it's manageable, but we want to see how this credit cycle emerges. So I don't know if I can put a timeframe on that. I think time will tell.

A

**Operator:** Next in queue, we have the line of Humphrey Lee of Dowling & Partners. Your line is open.

**Humphrey Hung Fai Lee**

*Analyst, Dowling & Partners Securities LLC*

Good morning and thank you for taking my questions. My first question is related to Assurance IQ. The losses for the quarter looks a little bit larger than expected. How should we think about those losses will trend? Should we expect for the next couple quarters we'll be kind of in the \$30 million range before seeing a recovery in the fourth quarter when activity started to pick up due to enrollment period?

Q

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

Humphrey, good morning. It's Andy. And thanks for your question, and I'll give Ken a little bit of a break here. So on Assurance IQ, I would characterize the results for quarter one as modestly worse than what we expected. We have started to lean in from an investment perspective to building out the platform more broadly and to bringing new product solutions onto the platform, as we think the first-mover advantage is very, very important.

As we talked about last quarter as well, we learned some lessons from a Medicare Advantage perspective, and we are investing ahead of Q4 to make sure that we have the right number of agents and that they are fully and properly trained and we're ready to go in the fourth quarter. So I think you could think about performance similar in the next couple quarters. And obviously, the large opportunity is in Medicare Advantage in Q4.

**Humphrey Hung Fai Lee**

*Analyst, Dowling & Partners Securities LLC*

Q

Got it.

**Operator:** [Operator Instructions] Next, we have the line of John Barnidge of Piper Sandler. Your line is open.

**John Barnidge**

*Analyst, Piper Sandler & Co.*

Q

Great, thanks. If we were to assume the disease's seasonal nature and returns at the very least in 1Q 2021, could you help me dimension how many of these non-mortality and morbidity CV-19 costs would remain on a go-forward basis?

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

I don't think we want to try to forecast that far, given the situation. Eventually, I think we will operate differently given the changes in environment and the way we're going to have to conduct business, but that's a bit out there. So I don't think we want to start to look through that far at the moment.

**John Barnidge**

*Analyst, Piper Sandler & Co.*

Q

Okay. And then could you maybe provide average age on the products where you have some CV-19 exposure, please?

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

This is Andy. So obviously, the two predominant areas there are really our individual life business and our group life business, and then obviously offsets in the longevity business that we have in retirement. So actually, in individual life and in group insurance, the average age across the whole book is relatively similar in the – about 55. In group insurance in particular, though, 95% of that business is under the age of 65. As far as of the longevity risk transfer business and the pension risk transfer business, our average age is in 74 to 75 range.

**John Barnidge**

*Analyst, Piper Sandler & Co.*

Q

Thank you.

**Operator:** And next in queue, we have the line of Elyse Greenspan from Wells Fargo. Your line is open.

**Elyse Greenspan**

*Analyst, Wells Fargo Securities LLC*

Q

Hi, thanks. My first question is on the group business. Can you just discuss your outlook for the margins within that business for the rest of the year, just given that I think COVID-19 could impact some of those businesses, or do you think that we might not see an impact there maybe until 2021?

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

Elyse, this is Andy. So I'll take that question, and there are a number of impacts. So maybe I'll start more on the claims side of things. And we do expect, and it was in the estimates that Ken walked through, that we will see increased mortality in the book of business. Obviously, in the group business, as I just referenced, that's somewhat mitigated by the average age, but we do think that that will go up. We also believe and have seen evidence that we'll see an uptick in short-term disability incidence. So that will serve to depress margins throughout this year.

We see a couple other impacts that I just mentioned from a sales and flows perspective. Most of our book of business is medium and large size employers. So actually, most of our sales for 2020 are already baked in that business, and any slowdown we're seeing is more of a 2021 impact.

I guess the last thing I'd mention is a lot of the impacts that group insurance will feel, we actually are mitigated against from the perspective that we're not in the under-100 lives segment business. So we don't have exposure to the small segment employers. And obviously here, early days, that's where a number of the impacts have been.

**Elyse Greenspan**

*Analyst, Wells Fargo Securities LLC*

Q

Okay, great. And then my second question, you guys in your prepared remarks went through shifting the business to less interest rate-sensitive products. How should we think about the capital that you have to put forth to write some of the new business that's less interest rate-sensitive versus some products that maybe required more capital? Is there kind of a capital arbitrage there as you kind of shift your writings in this low interest rate environment?

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

I'll take that. The products that we are shifting towards do have less interest rate sensitivity, things like variable life, things like we're looking to release a structured variable annuity. And so they will be less capital-intensive and less interest rate-sensitive. I don't think there's anything more to the dynamic than that.

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

And this is Andy. Maybe I'll just add some color commentary. So in the individual life business, as Ken referenced, we've been shifting towards variable life. We're very pleased in Q1 that our sales were \$187 million, which was up 15% from Q1 of last year, and near 50% of those sales were variable life.

We've also in April launched a product that is much less sensitive to interest rates and equity markets tuned to the RIA channel. And our buffered annuity, we're very excited about that launch. That has become a robust market. And 60% of the volumes in that marketplace are going through independent broker/dealers, and we have very, very strong relationships there. So we think to be very promising for us.

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**Operator:** Next in queue, we have a follow-up from the line of Suneet Kamath of Citi. Your line is open.

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**Suneet Kamath**

*Analyst, Citigroup Global Markets, Inc.*

Q

Yes, thanks for the follow-up. On the individual life business, in the past you guys have talked about using reinsurance to either dampen down the earnings volatility or actually free capital, so I want to get an update on that. And is that strategy still effective or still possible given all the uncertainty around COVID-19?

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

A

Suneet, it's Andy, and maybe I'll take that question up a level first. As we talked about last quarter, we are leaned into performing the overall – to improving the overall performance of that book of business in that business. We have three levers. First, we are very much leaned into improving the expense profile of the business. A lot of our future of work, energy, and effort is aimed in that regard. And we actually saw a reduction year over year in our expenses in the business. So we like the progress we're seeing there.

The second lever is leaning into and growing the business with profitable business that we're putting on the books. And as I mentioned, our sales are up year over year. And we are comfortable with the pricing and the profitability of the business that we're selling.

As far as the third lever, and it's the lever that you referenced, it really is looking at the ability to reinsure the block of business. We continue to explore solutions. Obviously, we're looking very carefully about what is the right economic favorability for us. And if and when we take action on that, we will report out on it, but nothing to report as we sit here today.

**Suneet Kamath**

*Analyst, Citigroup Global Markets, Inc.*

Q

I just have one quick follow-up for Ken. I guess a follow-up to Elyse's question on capital. You cited in your prepared remarks pretty significant declines in sales, both in the US as well as Japan. So any sense of how much capital or lower strain could you guys experience relative to a normal year based on that sales decline?

**Kenneth Yutaka Tanji**

*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

So all things being equal, we would have less capital – if we're selling – when we sell a business, we capitalize it well. And if we're selling less, that means it's requiring less capital to support it. And so we would expect, all other things being equal, that would be the case.

I think it's too hard to quantify that right now. We'll see how our sales plays out. If we have opportunities to make sales in attractive business, we'll do that. If the conditions are such that either the returns aren't attractive or it's too difficult to conduct business, that would lower sales, and we would see some capital offset for that. So I think it's a little tricky to put a number on that right now.

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**Suneet Kamath***Analyst, Citigroup Global Markets, Inc.*

All right, thanks.

Q

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**Operator:** [Operator Instructions] We do have a follow-up from the line of Alex Scott of Goldman Sachs. Your line is open.

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**Alex Scott***Analyst, Goldman Sachs & Co. LLC*

Hi, thanks for taking the follow-up. I just wanted to see if you could provide an update on the mortgage loan book, and I guess specifically the commercial mortgage loans. I would be interested if you can offer anything up around like how much of it you've got forbearance requests on and what you'd expect there.

Q

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**Robert M. Falzon***Vice Chairman, Prudential Financial, Inc.*

Alex, it's Rob. Let me handle that one. We have received forbearance requests. The vast majority of that, as you would expect, is coming from hotel and mall tenants. Having said that, to date, through April in any event, we've actually granted forbearance on a little less than 3% of the portfolio. And that by and large almost entirely has been just with respect to principal amortization. The loans continue to remain current with regard to interest payments. We do expect that that will build over time to some greater amount. But having said that, we're actually quite comfortable.

A

If you look at the loan-to-value that we have across the mortgage portfolio, it's at 56% based on our internal appraisals. What we find is if we actually use external appraisals, that drops to around 46%. So being in a position to be able to provide forbearance on principal, we don't think actually puts at risk our ability to be repaid on those loans given the relatively low amount of leverage that we have on our properties, and combined with the fact that our mortgage portfolio is very concentrated in higher quality well located properties.

So we're feeling quite good about the status of the mortgage portfolio, and we expect it to be resilient through this crisis as it has been in fact through all prior of our recessions. If you look at the 2008 recession and you sort of take that and you roll that forward, we've had sort of a 1 basis point loss ratio on our mortgages from that period until now. So we actually feel pretty good about the way in which we've underwritten it, and we feel very good about the way we're positioned going forward.

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**Andrew Sullivan***Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

Alex, it's Andy. I was just going to add a point from our third-party managed fund business, very similar trends. We've to date seen low single-digit levels of forbearance. And clearly, that will rise over time, but very similar trends to what Rob covered.

A

**Alex Scott**

*Analyst, Goldman Sachs & Co. LLC*

Got it.

Q

**Operator:** [Operator Instructions] Next, we do have a follow-up from Humphrey Lee with Dowling & Partners. Your line is open.

**Humphrey Hung Fai Lee**

*Analyst, Dowling & Partners Securities LLC*

Thank you for taking my follow-up. Looking at PGIM, so other related revenue has always been a source of variability for that segment. I think this quarter you had some spread related kind of issue hurting some of the private credit. But looking forward, some of the strategies that you have in PGIM, whether it's real estate or private credit or some of the specialty products, they're likely to see lower activities. So how should we think about how other related revenue will trend for the balance of the year?

Q

**Andrew Sullivan**

*Executive Vice President and Head of U.S. Businesses, Prudential Financial, Inc.*

Humphrey, it's Andy. So you're correct. In first quarter, the predominant impact in other related revenue was from our strategic investment portfolio. That's where we have our seed strategies as well as where we co-invest alongside of our clients. The predominant impact was from credit spread widening on the fixed income portion of that portfolio.

A

In general, if you look back, we tend to have somewhere in the neighborhood of \$50 million to \$60 million coming from our ORR. We do think it is reasonable as you kind of look forward over the next couple quarters. Obviously, we think flows will be lumpier in general, and we do believe that there will be some slowdown in client activity and then transactions, so there may be some near-term pressure on that. But over the long run, you could think of that in the \$50 million to \$60 million range.

**Operator:** With no further questions here in queue, I'll be happy to turn it back to Charlie Lowrey for any closing remarks.

**Charles F. Lowrey**

*Chairman & Chief Executive Officer, Prudential Financial, Inc.*

Great, thank you very much.

We'd just like to say in closing that we'd like to take a moment to thank all our employees for the extraordinary steps they've taken to support our businesses, our customers, and our communities. Together, we remain financially strong, we remain resilient, and we remain committed to fulfilling our purpose of solving financial challenges of our changing world, including doing our part to contribute to an inclusive global recovery. Thank you all for joining the call. Please stay safe, and we look forward to talking to you soon.

**Operator:** Ladies and gentlemen, that does conclude today's conference call. You may now disconnect.

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