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Prudential Financial, Inc. (PRU)

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Prudential Quarterly Earnings Call. At this point, all lines are in a listen-only mode. Later, we will conduct a question-and-answer session; instructions will be given to you at that time. [Operator Instructions] And as a reminder, today's conference call is being recorded.

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

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.

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

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Darin. Good morning everyone and thank you for joining us today. To begin, I hope that you, your families and colleagues remain safe and healthy. As the global health pandemic continues, we remain intently focused as a company on caring for our employees and the communities in which we live and work, as well as serving the evolving needs of our customers and other stakeholders in the current environment.

We are also incredibly proud and grateful for the continued dedication and commitment that our employees have shown in fulfilling our company purpose, of making lives better by solving the financial challenges of our changing world.

I'd like to highlight a few of the ways in which we're serving the unique and evolving needs of our customers, who now more than ever are relying on Prudential to address their financial challenges.

Since the beginning of the pandemic, PGIM has focused on providing clients with timely portfolio updates and asset allocation ideas. Our operational resilience, diversified global business model, and strong performance has allowed us to support our clients.

One example of the success is the growth of our US mutual funds, where we are one of the top-ranked companies based on net flows this year. In our US businesses, we continue to pivot within annuities through our FlexGuard buffered annuity product, which offers downside protection and upside opportunity at a time when customers face new challenges in protecting and growing their retirement assets.

Following its accelerated launch to market in the second quarter, FlexGuard continues to gain momentum, accounting for 38% of our annuity sales this quarter. And in Japan, our Life Planner model, with its highly personalized and customized approach to engaging customers, continues to be resilient as demonstrated by our strong sales this quarter.

During the third quarter, we continued to successfully execute on our strategic priorities for 2020, despite the challenging macroeconomic backdrop, including taking additional steps to expand our cost savings program. We also continue to benefit from the strength of our rock-solid balance sheet, which places us on sound financial footing to navigate changes in the current environment.

Turning now to 2020 priorities on slide 3. On last quarter's call, we mentioned that we were exploring the potential to generate additional cost savings on top of our 2022 plan. Through the third quarter of this year, we have realized approximately \$135 million of our \$500 million cost savings program.

Based on our progress of accelerating the savings realized and creating new ways of working, we now expect to generate an incremental \$250 million in efficiencies by the end of 2023, bringing our total cost savings program to \$750 million. With respect to rotating the international earnings mix, during the quarter we announced an agreement to sell Prudential of Taiwan to Taishin Financial Holding and expect the transaction to close in 2021 subject to all regulatory approvals.

And we also closed on our transaction to divest Prudential of Korea and receive proceeds of \$1.6 billion. And finally, we continue to take additional steps across the company to reduce our exposure to changes in markets and rates by shifting sales momentum to less interest rate-sensitive solutions, while aggressively repricing certain existing products.

As an example, in annuities, we are focusing on our efforts on delivering protected outcome solutions like our FlexGuard product. And we're discontinuing all sales of our traditional variable annuities with guaranteed living benefits. We will also explore strategic opportunities for blocks of business, including reinsurance and other transactions.

Turning to slide 4. As we continue to execute against our strategic priorities, we remain grounded by our rock-solid balance sheet, including highly liquid assets of \$6.1 billion at the end of the third quarter. Prudential Financial and its subsidiaries continue to hold capital that exceeds a AA financial strength level.

The financial strength gives us the confidence and the flexibility to manage our business for long-term growth, while navigating the current and future market environment. We also continue to closely monitor conditions in the credit markets. While they have been developing better than previously expected, we don't intend to reinstate buybacks this year. We believe this is prudent as the duration and severity of the pandemic and its effect on the economy remain highly uncertain. We'll provide more details on our 2021 capital deployment plans once they have been finalized and approved by the board.

Turning to slide 5. I'll now take a moment to highlight our financial results for the third quarter. Pre-tax adjusted operating income was \$1.6 billion in the quarter. And after-tax adjusted earnings per share was \$3.21, which benefited in part from strong variable investment income across our businesses.

Our US businesses reported adjusted operating income of \$873 million due to higher net investment spread, offset by lower net fee income in our individual annuities business and less favorable underwriting driven by COVID-19-related net mortality experienced.

PGIM reported record adjusted operating income of \$370 million, driven by record assets under management of \$1.4 trillion and higher other related revenues. The 11% growth in assets under management reflects strong flows, robust investment performance and market appreciation.

Our international businesses reported adjusted operating income of \$775 million as business growth, lower expenses and more favorable underwriting results were partially offset by lower earnings from joint venture investments and lower net investment spread.

With that, I'll turn it over to Rob for more specific details on our business performance during the third quarter. Thank you all for your time this morning.

Robert M. Falzon

Vice Chair & Director, Prudential Financial, Inc.

Thank you, Charlie. I'll provide an update on how we're executing on our strategy within our US, PGIM and international businesses, the outlook for these businesses and a brief update on our investment portfolio.

Turning to slide 6. Our US businesses produced a diversified source of earnings from fees, net investment spread and underwriting income. We made progress in the quarter executing on three key priorities: first, we continue to implement pricing and product actions to simplify and derisk our business mix, while protecting profitability.

For example, we are further pivoting to less interest rate-sensitive solutions in individual annuities by discontinuing sales of traditional variable annuities with guaranteed living benefits, including both our highest daily income and Prudential defined income products. In our individual life business, we are repricing products to mitigate the impact of low rates, in addition to suspending sales of our single life guaranteed universal life product in July.

As a result of these actions, we expect individual annuities and individual life sales to continue to move lower in the near term. In addition, we continued to adjust crediting rates in our retirement business.

Second, as the needs of our customers change, including in response to COVID and its economic impact, we're evolving the way we work. We continue to adapt and develop new ways of working effectively in remote locations and expect to recognize additional cost savings as we expand the use of technology, optimize our real estate footprint and benefit from a more efficient workforce.

As Charlie mentioned, these and other opportunities to further efficiencies and improve our customer experience have resulted in a 50% increase in our originally planned \$500 million earnings improvement target.

And third, we remain committed to expanding our addressable market. For example, we continued to see strong interest in our Assurance IQ platform from customers in the health care, life and P&C lines of business. In preparation for the Medicare annual enrollment period in the fourth quarter, we accelerated our agent onboarding

and training processes. While we are only three weeks into the annual enrollment period, we're pleased with the customer demand that we're seeing, which is driving considerable sales growth.

Now turning to slide 7. PGIM is a top 10 global investment manager that continues to demonstrate the strength and resilience of its multi-manager model. PGIM's strong investment performance and diversified global investment capabilities across public and private asset classes, especially higher-returning and income-generating strategies across fixed income, alternatives, real estate and equities, position us favorably to continue to capture flows amidst industry-wide dislocation.

Our assets under management reached a record level of over \$1.4 trillion, up 11% from the year-ago quarter, driven by strong flows, robust investment performance as well as market appreciation. PGIM's long-term investment performance remains strong, with more than 90% of assets under management outperforming their benchmarks. This strong investment performance, coupled with diversified investment capabilities across asset classes, regions and client segments, has led to continued growth. We generated over \$7 billion of third-party net flows during the quarter, including \$5.3 billion of retail flows and \$2 billion of institutional flows driven by a continued appetite for fixed income strategies, partially offset by moderating equity outflows.

Our public fixed income platform generated flows of \$11.6 billion as it continues to benefit from our broad suite of strategies and the leading position of our franchise. And the combination of customer demand, fund performance and investments in product development and distribution over the past several years has resulted in PGIM investments being ranked the second highest US mutual fund franchise based on year-to-date net flows.

PGIM's asset management fees were up 11% compared to the year-ago quarter, driven by the growth in average assets under management. In addition, an increase in other related revenues was driven by an increase in co-investment and seed investment earnings, record-high agency loan production and higher incentive fees. PGIM's operating margin exceeded 37% for the quarter, aided by the strong other related revenues as we continue to focus on generating efficiencies to fund growth investments and on delivering margin increases from operating leverage. While PGIM's operating margin will vary with market conditions, we expect margins to remain in the 30% range across the cycle.

Turning to slide 8, our international business includes our Japanese life insurance operation, where we have a differentiated multi-channel distribution model, as well as other operations focused on high-growth markets. Our sales this quarter demonstrated the strength of our distribution channels and the continuing customer demand for the protection and retirement products we offer.

Our distribution channels are also employing more virtual tools for non-face-to-face sales and have benefited from the easing of pandemic-related restrictions. Life Planner sales increased 57% compared to the year-ago quarter, reflecting the resilience of the Life Planner model, the easing of COVID restrictions in Japan, and higher sales ahead of US dollar-denominated product repricing in August. Life Planner head count increased 3% compared to a year ago, due to stable recruitment and lower resignations.

Similar to Life Planner, sales across Gibraltar's life consultant, independent agent and bank channels also increased in total by 30%. We believe a degree of sales were pulled forward into the current quarter due to repricing actions. And therefore, we expect a lower level of sales in the fourth quarter, with sales returning to more normal levels over time beginning in 2021.

Current quarter adjusted operating income continue to be impacted by low interest rates, and we anticipate this trend to continue given Gibraltar's higher exposure to US dollar products. We have taken pricing actions, and we'll

continue to identify opportunities to become more efficient. In addition, we had \$15 million of COVID response costs primarily to support our life consultants in Gibraltar, which we expect will moderate in future quarters.

Now turning to slide 9, we have a conservative high-quality investment portfolio 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 long-standing experience in private placements and real estate.

There has been a slowdown in the pace of credit migration and impairments since the first quarter of this year, with year-to-date credit migration and losses below our expectations. For the third quarter, credit losses were just \$12 million. We remain confident that we're well capitalized to weather whatever might emerge in the future. And with that, I'll hand it over to Ken.

Kenneth Yutaka Tanji

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

Thanks, Rob. I'll begin on slide 10, which provides insight into earnings for the fourth quarter relative to our third quarter results. Pre-tax adjusted operating income in the third quarter was \$1.6 billion and resulted in earnings per share of \$3.21 on an after-tax basis.

We then adjust for the following items. First, variable investment income outperformed expectations in the third quarter, which is worth \$215 million. Second, we adjust underwriting experience by a net \$35 million. This includes seasonally lower reserve gains in retirement and an estimate of \$60 million for COVID-19 claims experienced in the fourth quarter.

Third, we expect expenses and other items to be \$70 million higher in the fourth quarter, primarily due to seasonal expenses and implementation costs. Fourth, we expect the net operating costs due to COVID-19 to be \$5 million lower in the fourth quarter.

Fifth, we anticipate net investment income will be reduced by \$15 million, reflecting the difference between new money rates and disposition yields of our investment portfolio. And last, we expect the fourth quarter effective tax rate to normalize for third quarter items. These items combined get us to a baseline of \$2.48 per share for the fourth quarter.

I'll note that if you exclude items specific to the fourth quarter, earnings per share would be \$2.93. The key takeaway is that our underlying earnings power increased slightly from last quarter, including the benefit from higher equity markets as of quarter end. While we have provided these items to consider, please note that there may be other factors that affect earnings per share in the fourth quarter.

In addition as we look forward, we have increased the expected benefits from our cost savings program by \$250 million by the end of 2023. We expect these benefits will be largely self-funded, with incremental net savings emerging in 2022 and 2023. We will provide additional details about this program on our earnings call in February.

On slide 11, we provided an update on the potential impact of the pandemic. The estimated sensitivity of operating income for 100,000 of incremental US deaths due to the pandemic remains unchanged at \$70 million. Based on our updated outlook, our fourth quarter baseline includes a net mortality impact of \$60 million due to COVID-19. The actual impact will depend on a variety of factors such as infection and fatality rates, geographic considerations and progress in testing and medical treatments.

Also, we continue to expect incremental operating costs due to COVID-19 to be \$5 million in the fourth quarter. This includes additional operating costs of \$25 million, partially offset by \$20 million of lower travel and entertainment expenses.

Turning to slide 12. We continue to maintain a robust capital position and adequate sources of funding. Our capital position exceeds our AA financial strength targets. And we have liquid assets at the parent company that are greater than 3 times annual fixed charges. And we have substantial sources of funding.

Our cash and liquid assets at the parent company were \$6.1 billion at the end of the quarter, which includes the proceeds from the sale of Prudential Korea. And other sources of funds include free cash flow from our businesses and other contingent capital facilities.

Turning to slide 13 and in summary. During the third quarter, we continued to successfully execute our strategic priorities for 2020. We have taken additional steps to expand our cost savings program. And we continue to benefit from the strength of our rock-solid balance sheet, which gives us the confidence and flexibility to navigate the changes in this economic environment.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question will come from the line of Erik Bass with Autonomous Research, and your line is open.

Erik Bass

Analyst, Autonomous Research LLP

Hi, thank you. Can you provide some more details on where you expect the additional expense savings to come from? And how much of the cuts are efficiency initiatives? And how much are reflecting a reappraisal of business volumes in the revenue environment?

Kenneth Yutaka Tanji

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

Hey, Erik, this is Ken. I'll start. And just by way of background, earlier this year we put in place a transformation office, and it's led by one of our senior business leaders, Phil Waldeck. And it's given us the capabilities to identify, prioritize and implement with a continuous improvement mindset. It involves all of our US businesses and all of our functions. And so we're finding efficiencies through combining client service centers, process engineering, automation, through procurement strategies. And so it's a culmination of transformation across the company. So that's generally what's driving that.

Andrew Sullivan

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

And Erik, it's Andy. I would just add, it's really not related to business volumes or revenues. It is core efficiency improvement, where we're applying process and technology and able to hit a number of cost reduction levers. So, it's becoming more efficient at the business that we have.

Erik Bass

Analyst, Autonomous Research LLP

Q

Got it. Thank you. And then you've talked about all options being on the table for your in-force individual life and annuities blocks, and we've started to see an increase in transaction activity across the industry. So hoping you could talk a little bit about what you're seeing in terms of buyer interest for liabilities like yours and maybe the current bid-ask spread in the market?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. This is Charlie. Let me take it, kind of, at a high level and then turn it over to Andy. But Erik, over the past couple of years, we've been really active in beginning to change our business mix. So as you know, we sold our operations in Poland, Italy and Korea, now have agreement in Taiwan. And we continue to focus on rotating our earnings mix to higher-growth markets internationally.

Now looking at the US, in terms of changing the focus within the business, we're on a path to derisking. And have made major pivots to less interest rate-sensitive and more capital-light solutions in our individual annuities and in our life business. And specifically, you've seen us pivot away from VAs with lifetime income guarantees to less market-sensitive products. And at the same time, you've seen us in our life business pivot to simpler nonguaranteed products. But what we've also said is that we want to accelerate the transformation.

And I've said that we'll explore reinsurance and potentially the sale of certain blocks. But I'd add the caveat that these type of transactions are complex and they take time. And as we explore our options, we want to make sure that we're making good economic decisions that are in the best interest of shareholders. So we're going to take all these things into account as we go forward.

Andy, I don't know if you want to add on to that.

Andrew Sullivan

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

A

Yes. Maybe I would just add, Erik, you also I think asked about what's the marketplace for these types of transactions. And while we will not quote on any specific deals that are going on, I think there are two important takeaways that we should discuss.

One is, I think we've generally believed that a number of these blocks of business and our block of business, its value is not fully appreciated in the marketplace. And I think if you look at the recent transactions, that certainly has been, I think proven out.

The other thing is that there is capital moving towards these types of deals and that there's capacity. So as Charlie said, we've begun to work on these alternatives. And when we have something more to report, we'll certainly do so.

Erik Bass

Analyst, Autonomous Research LLP

Q

Right. Thanks for the comments.

Operator: Thank you. Our next question will come from the line of Humphrey Lee with Dowling & Partners. Your line is open.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

Good morning and thank you for taking my questions. I'm just trying to bridge the comment or your kind of sentiment towards the decision to not reinstate your share repurchase this year, given the credit concern and your – at the same time, your confidence about your balance sheet. I guess what kind of – what would – do you need to see now to make yourself comfortable to resume buyback?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So Humphrey, it's Charlie. Let me take a stab at that one. In line with the risk framework that we have in place, we paused share repurchase in the second quarter. But it's really about this: Until we have better visibility into the depth and the duration of the pandemic, a possible recession and the credit cycle, which still may be before us, we're going to maintain our financial flexibility and the resiliency. And when we get clarity into those issues that I just mentioned, we'll share the timing with you of our plan to resume share buybacks and by how much. But until then, we're going to focus on maintaining our financial strength with many of the unknowns still in front of us.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

I guess just for a quick clarification, so you suggest you do not intend to reinstate buyback this year. But does it preclude you from using some of your capital strength for acquisitions?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Not necessarily. But again, we're going to take a very measured approach to that because we want to maintain our financial flexibility. So we're not going to comment about any business or a specific transaction. But if I can take this step back for a moment again and just make a more general comment on how we think about capital allocation and particular optimization. As we look across our businesses, both domestically and internationally, we want to ensure that we're optimizing capital employment. And you've seen us do that with some of the sales we've done internationally, but we're going to continue to look for ways to optimize capital and capital deployment to maximize outcomes for shareholders.

But at the same time, we're going to take a hard look at the environment in which we're operating. And make sure that again we maintain our financial strength, our financial flexibility and our resiliency as we go forward.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

That makes sense. And then my next question is related to Assurance IQ. So I think in the prepared remarks, you talked about you're excited with the activities so far in the quarter, granted it's still very early in terms of the customer demand. I think last year, the challenge was you see – you saw similar – you saw strong demand, but then you were not able to cope with the processing of those kind of incoming demand. So maybe can you talk about like how – like in terms of the demand relative to your current capacity, where do you stand so far for the enrollment period?

Andrew Sullivan

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

A

Yeah, Humphrey, it's Andy. So I'll take your question. And as we discussed, sort of, from a lessons-learned perspective from last year, we've done a lot this year to make sure that we were better prepared for the annual enrollment period.

We direct contracted with the health carriers, which gives us a lot more flexibility and agility. We invested much more heavily in agent recruiting, licensing and training. And we began to bring on agents this year in the month of July, which was much earlier than last year. So repeating what Rob said, we're only about three weeks into the season, but we certainly see evidence that our investments are paying off and that we're having stronger performance than we had in 2019.

Having said that, about 50% of industry-wide Medicare Advantage transactions occur in the last two weeks of the annual enrollment period, and that's the first two weeks of December. So while we like what we see from a growth perspective in these early days, it's certainly too early to draw definitive conclusions.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

Do you feel like, given the activities that you're seeing and some of the preparedness you have already in place, do you think Assurance IQ could turn positive for the fourth quarter?

Andrew Sullivan

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

A

Yeah. And I think in our materials, we had given a walk to about \$25 million for the fourth quarter.

Humphrey Hung Fai Lee

Analyst, Dowling & Partners Securities LLC

Q

Got it. Thank you.

Andrew Sullivan

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

A

Oh, actually, I had that number wrong. It was \$15 million, Humphrey. Sorry, I was off, looked at the wrong line.

Operator: Thank you. And our next question comes from the line of Tom Gallagher with Evercore. Your line is open.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Charlie, just wanted to circle back on capital deployment, that's my first question. If we think about 2021, at this point, do you have a preference of buybacks or M&A? And I ask in particular, because if you do free up capital from a risk transfer deal, there also happens to be, let's say more activity, more things on the market now than they were recently. So curious, what your view is, if you're more likely to want to do M&A or buybacks at this point?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Tom, thanks for the question. I guess a couple of things. One, again, I would caution the people in thinking we're going to free up capital immediately. These transactions take a long time, and therefore we have to think through that. Secondly, I think it depends on the deal. What we have said before is given where our stock price is, there's a fairly high hurdle, right?

On the other hand to your point, there could be some very interesting things on the market. So we're going to have to balance, if you will, short-term accretion from stock buybacks and long-term growth. And we'll have to weigh those two against the opportunity set that's out there and the stock purchase price at the time.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

That's helpful. And would defined contribution be on the wish list of M&A interest from your perspective? Because I know you've done more international than you did Assurance IQ in recent times.

Andrew Sullivan

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

A

So, Tom, it's Andy. I'll take your question. We've been very focused on strengthening out our value proposition in our full-service retirement business. We've talked a lot about over the last couple of years, the work that we've done in financial wellness. We've pretty heavily invested in digital and mobile, and that has resulted in very good organic growth on that platform.

If you look at our net flows over time, it's been very positive. We're completing our third year of record sales. We had our largest corporate client ever in the quarter. So we've seen great success – even though we certainly pay attention to the consolidation of the space, we've seen great success, organically growing the business. And that maintains our focus.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Okay. Thanks. And then just as a quick follow-up, the elevated level of non-backable expenses at Gibraltar, is that like – and I guess for the guide for 4Q, is that likely to continue into 2021? Or is there something that's more, I would say, temporary regarding, the lower earnings and higher expenses at Gibraltar?

Scott Garrett Sleyster

Executive Vice President and Head of International Businesses, Prudential Financial, Inc.

A

Hey Tom, this is Scott. The Gibraltar run rate base has been impacted by really two factors. And one here, this first one is more permanent. We adjusted our compensation structure for life consultants to better balance, policyholder servicing, things like, customer visits, persistency and so forth, with new business production.

And then, this led to a lower level of deferrable commissions. Overall, the commissions have not actually changed, but our immediate run rate was impacted by roughly \$10 million a quarter. And we view this as permanent. Now we recapture that, over the life of the products, but that takes quite a while to pickup.

By the way, we do not expect this to have any impact on Gibraltar's cash flow. Second, Gibraltar does have a large block of US dollar business, which is experiencing spread erosion, due to declines in US dollar interest rates. So it's really those two factors, combined with the biggest being the first.

Thomas Gallagher
Analyst, Evercore Group LLC

Q

Okay. Thanks.

Operator: Thank you. [Operator Instructions] Next, we will go to the line of Suneet Kamath with Citi. Your line is open.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Thanks. I wanted to circle back to Assurance IQ. If we assume your placeholder of \$15 million for the fourth quarter is right, I think it would still put you at a loss for the year versus your original guidance of EPS accretion in 2020.

So just curious, what's driving that? And then should we – do you think we can get back on track to your – I think you had guided to \$0.30 to \$0.35 in 2021. Should we assume that you can kind of get back on track there? Or do you think, it's sort of more of a challenge to get this back to profitability for the full year – for a full year? Thanks.

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

A

So, Suneet, its Andy. I'll take your question. And let me maybe raise it up a level. So we're very pleased that we bought this business model. And this set of capabilities, a model that's not sensitive to interest rates or equity markets. Obviously, with what happened in the March timeframe, we're even more pleased to have this as part of the fold.

We immediately got very focused on building out and expanding the business model. So that we could care for more needs in the mass market and middle market consumer set. So, as we've really worked on the business internally, success for us is not about near-term AOI.

Success for us is very much about continuing to expand the reach and breadth of the platform. And is very much measured in how we grow our revenues. It's very much measured in the products that we have on the platform. So, we began with life, you saw us immediately lean into Medicare Advantage. And then more recently, we've leaned into property and casualty. And again, I always remind, this is from a distribution perspective, not from a manufacturing perspective. And these bring fee-based earnings that are very capital efficient. So our focus is really expanding this out as rapidly as we can.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then I guess a bigger picture question on your financial wellness initiative. When you guys talked about this at your latest Investor Day, we spent a lot of time talking about marketing at the work site, reaching the employees of your corporate customers. So if we assume that we're going to be in this work-at-home environment for longer, how are you modulating that initiative to make sure that you're still capturing the growth opportunity that you guys talked about, when you can't do these group meetings that you guys discussed at the Investor Day? Thanks.

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

A

Yes. Suneet, it's Andy. And I guess right up front, I'll draw a very sharp distinction in our financial wellness work from what I would call worksite marketing, which I know a number of voluntary products are more worksite marketing with feet on the street in the employer. Ours was very much about building a set of capabilities that could really reach people when, where and how they want it. So there was a real digital focus to what we've built. We've had accelerating success. If you remember, there were sort of couple of stages to what we were trying to accomplish.

At this point, we've had a large portion of our employers adopt our capabilities. We have 20 million individuals that have access to the platform. That's ahead of our goals for 2020. We've what my word's permissioned 12 million individuals that they can access, we get access to market our retail solutions. That is also ahead of our goals. And at this point, we've put 15,000 retail customers into Prudential through the platform. As COVID came in, the base capabilities were such that we were able to pretty quickly even expand upon, as an example, our Prudential Pathways program and make it purely digital with webinar capabilities. And at this point, that's now reaching about 8.5 million folks. So we don't see the current environment actually hindering us at all, and it's really about how we built the whole platform.

Suneet Kamath

Analyst, Citigroup Global Markets, Inc.

Okay. Thanks, Andy.

Q

Operator: Thank you. Our next question will come from the line of Ryan Krueger with KBW. Your line is open.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Good morning. I had a couple of annuity questions. One, in recent years, you've been sending dividends up to the holding company from the annuities subsidiary. It seems like in kind of the roughly \$1 billion range, give or take. I guess so first question is to what extent was that negatively impacted by new business streams associated with writing VAs with living benefit guarantee? So I guess should we see some improvement there? And do you view the roughly \$1 billion per year as sustainable in the current interest rate environment?

Q

Kenneth Yutaka Tanji

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

Ryan, it's Ken. Our annuity business, as we've mentioned in the past, has been very well hedged and very well capitalized, and, yes, as you mentioned, providing a regular source of dividends to the holding company. Now that has moderated over time as our sales have been below our outflows. The business has been getting smaller. And although we're quite happy with the launch of our FlexGuard product, it won't be in the near term sufficient to outpace the outflows that we have on our in-force block. So over time, that will decrease our level of earnings and cash flow, and you can see that as a moderating trend.

A

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Got it. And I guess from a legal entity standpoint, I know you're probably – it sounds like you're more likely to pursue reinsurance. But just in general, is there any ties legally between the Prudential Annuities subsidiary and PICA or other life insurance subsidiaries? Or is it really completely separate?

Q

Kenneth Yutaka Tanji

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

A

Our annuity business, is actually involves a couple of major legal entities. One would be our Pruco life of Arizona Company, which is a subsidiary of PICA. That had been historically been the legal entity that we use to underwrite annuity business. But you may recall, many years ago, we acquired an annuities company from American Skandia. That's what we call Prudential Assurance – Life Assurance Company (sic) [Prudential Annuities Life Assurance Corporation] (00:40:20) or PALAC. And that also has a variable annuity business in it. And so it's in a couple of different legal entities that are involved.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Got it. Thank you.

Operator: Thank you. Our next question will come from the line of John Barnidge with Piper Sandler. And your line is open.

John Barnidge

Analyst, Piper Sandler & Co.

Q

Thank you. You didn't really address this in the commentary on cost cutting. But when adding \$250 million and pushing out to 2023, is this real estate savings that is far out enough that it could address leasing?

Andrew Sullivan

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

A

So John, its Andy. This is really just an expansion of our program to, as Ken said earlier, every business and every function. So, it is – real estate's part of it, but there are a number of different buckets. It really is across real estate. It's across better vendor management and procurement, more efficiency from a travel perspective. So it really goes across a number of areas. It's – we learned a lot in the first 12 to 18 months of this program. We saw a lot of what was possible and feasible, and we basically expanded it to every corner of the organization. So, it's not one particular category. It's just from the success of the overarching program and accelerating it.

John Barnidge

Analyst, Piper Sandler & Co.

Q

Okay. Thank you very much. And my follow-up would be the products within annuities and life that you suspended this year, can you talk about the amount of assets associated with that that were suspended respectfully? Thank you for your answers.

Andrew Sullivan

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

A

So from an annuities perspective, I'm not going to get this exactly right, but I think it's in the \$110 billion, \$120 billion range. And I don't have the guaranteed universal life in front of me.

John Barnidge

Analyst, Piper Sandler & Co.

Q

Thanks for your answers.

Operator: Thank you. Our next question comes from the line of Jimmy Bhullar with JPMorgan. And your line is open.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Hi, thanks. So, first, I just had a question on your disability loss ratio. It's actually – margins in the business have been pretty good. Are you starting to see, or expecting to see any impact from sort of higher unemployment and just a weaker economy on your benefits ratio in the disability business?

Andrew Sullivan

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

Hi, it's Andy. I'll take your question. So we've actually been very pleased. We have not seen an uptick in incidents in either our short-term disability business or our long-term disability business. That being said though, obviously, we've operated this business for many, many decades, and we know that in recessionary environments that is generally somewhere in the neighborhood of a year lag from when that incident shows up. So we have invested to make sure that our claims teams have low, what we call desk loads, so that if and when that incident starts to tick up, we're well prepared for it. But we have not seen evidence of that yet.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Okay. And then on – just on Japan sales, obviously, you benefited this quarter from sort of front-ending prior to a price increase. But so I'm assuming you expect sales to decline a decent amount next quarter. And then also, if you could just talk about how the conditions are in that market in terms of agent's ability to meet with prospects and like, given social distancing and everything else that's going on?

Scott Garrett Sleyster

Executive Vice President and Head of International Businesses, Prudential Financial, Inc.

Sure. Thanks, Jimmy. This is Scott. Well, as Rob noted in his remarks, with a significant decline in US interest rates, we implemented pricing changes in August across all of our US dollar products in Japan. As you know, it's common for salespeople to use such a pricing change to stimulate client contact. And that tends to accelerate sales from maybe the quarter ahead prior to such a change.

Sales in 3Q also did benefit from the relaxation of social distancing requirements in Japan that were implemented in the beginning of June. And I think you also asked on that question. We expect that such enhanced demand will taper off in the following quarter, but then we are expecting things really to normalize as we head in to 2021. Overall, our distribution in Japan is largely operating in kind of a back-to-normal mode and I think that really reflects the strength of our differentiated business model.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Okay. Thanks.

Operator: Thank you. Our next question comes from the line of Josh Shanker with Bank of America. Your line is open.

Joshua Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

Yeah. Thank you. If we go back in time maybe three years ago, I think that you would have said that, individual variable annuities is a core competency of the company that a lot of your competitors don't understand or are backing away from the market. Many of them pivoted to buffer annuities and whatnot. With you discontinuing sales of variable annuities with living benefits, can you talk about what the return characteristics of that product have been over the past three years, where they stand today? And what it means for the back book?

Andrew Sullivan

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

A

So Josh, its Andy. I'll take that. So our HDI and PDI block of business is a very high-returning block business. As Ken talked about earlier, it's a well-capitalized block and well-hedged block and creates good cash flows. It's more of a go-forward perspective, if you think about the decision-making around our product pivot. We're working towards more of what I would frame as an all-weather portfolio, where we're taking less fully on ourselves the interest rate and equity market risk.

The HDI is our most sensitive product in that regard. So we think from a go-forward perspective, as you noted, we are very, very good in the annuity space. We believe there still is a deep-seated need to help people with cumulation and to help them with decumulation from a longevity insurance perspective. And we think our go-forward product portfolio does that, it does that well, but does it in a way that's more shareholder-friendly.

Joshua Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

Do the financial advisers, who work with you, need a product like that in their silo from you for you to remain competitive with them?

Andrew Sullivan

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

A

No. If you're asking about do they need the sort of the HDI, PDI types of product, no, we've actually – I think we benefit from our brand and our strength of our distribution. And I think that's really why you see such a strong start to our FlexGuard buffered annuity. It was 38% of our sales here in the third quarter, and we recently went through \$1 billion in sales. And we haven't even finished fully rolling it out to all states and all advisers. So, we think our portfolio will meet the needs of the advisers and we'll see good growth in it.

Joshua Shanker

Analyst, Bank of America Securities-Merrill Lynch

Q

Thank you for the answers.

Operator: Thank you. Our next question will come from the line of Elyse Greenspan with Wells Fargo. Your line is open.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Hi, thanks. Good morning. My first question is going back to the capital conversation. You guys mentioned you have over \$6 billion of capital at the holding company. That's around 3 times your fixed charge. And so can you remind us what you typically like under normal times to keep at the holding company?

And then, as we think about 2021, and you mentioned reevaluating capital return, once we kind of get out of COVID will you go back to what you view as kind of that normal level of fixed charges at the holding company? Or do you think that you're going forward after this will look to hold on to an extra buffer as well?

Kenneth Yutaka Tanji

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

A

Elyse, it's Ken. Our target for highly liquid assets in typical times is \$3 billion to \$5 billion. And we think that's a good level to carry to have the flexibility that a company like ours needs. So we are above that. We think these are different than typical times. And I think as Charlie mentioned, that's a prudent thing to do. And we'll continue to evaluate a number of factors, including the credit markets as we go forward. But again, our target is typically \$3 billion to \$5 billion. That gives us ample flexibility in ordinary times, and we think now is a good time to be above that.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Okay. And then, I was hoping to get more color on the PRT environment. Obviously with rates lower, did the deal activity slow in the third quarter? Typically, volume does pick up in the fourth quarter as we close years out. Could you just give us some color on the pipeline there and thoughts about transactions that we could potentially see in the fourth quarter?

Andrew Sullivan

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

A

Yeah. Elyse, it's Andy. I'll take your question. So you're absolutely right. If we look at sort of 2020, the size of the marketplace versus 2019, 2020 is definitely going to be down. We think it's going to be somewhere in the neighborhood of 20%-ish or so. Third quarter was relatively quiet.

We are seeing a building pipeline in 4Q, but I would point out that, with a lower overall market size, we also have talked about in the past that we're now probably up to five-plus competitors that can do deals of a billion-plus. So, we think it's going to be a very competitive environment in the fourth quarter. We're going to be very disciplined about how we approach the marketplace, and we're going to pick our spots.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Q

Okay. Thank you very much.

Operator: Thank you. And with that, I'd like to turn it back over to Mr. Charles Lowrey for any closing comments.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you very much. So in closing today, I hope today that we've demonstrated our commitment towards and the ongoing momentum we have to transforming our business and financial performance in ways that deliver meaningful outcomes to our customers as well as to our investors and other stakeholders. We continue to move with urgency and conviction to execute on and be true to our purpose of solving the financial challenges for more people. So, thanks again for joining us today. We appreciate it.

Operator: Thank you. And ladies and gentlemen, that does conclude your conference call for today. Thank you for your participation and for using AT&T Executive Teleconference service. You may now disconnect.

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