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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 Prudential's Quarterly Earnings Conference Call. [Operator Instructions] As a reminder, today's call is being recorded. I'll turn the call now over to Darin Arita. Please go ahead.

Darin Arita

Senior Vice President, Prudential Financial, Inc.

Thank you, John. 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, Bob 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 a 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 and the quarterly financial supplement, both of which can be found on our website at investor.prudential.com.

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

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Darin, and thanks to everyone for joining us today. As always, we hope you and your families remain safe and healthy. We reported strong financial results for the second quarter, reflecting robust investment performance and further progress in achieving our cost-savings target. We also made significant progress executing on our strategy to become a higher-growth, less market sensitive and more nimble company.

As an example, we announced an agreement to sell our full service retirement business last month. Second, our cost-savings program is progressing well and is ahead of our original plan. And third, with the support of our rock-solid balance sheet, we are thoughtfully redeploying capital both by increasing capital return to shareholders and by selectively pursuing acquisition opportunities. I'll now provide an update on each of these strategic initiatives, beginning with our recent divestiture activity.

Turning to slide 3. Following the sale of our Korea business last year, we successfully closed on the sale of our Taiwan business during the second quarter. And in July, we announced an agreement to sell our full service retirement business to Empower Retirement in a transaction which is expected to close in the first quarter of 2022. Including the announced full service sale and the completed sales of our Korea and Taiwan businesses, we expect net proceeds of approximately \$4.2 billion from these divestitures. Meanwhile, we continue to pursue opportunities to reduce the size of our legacy block of traditional variable annuities with guaranteed living benefits.

Moving to slide 4. As I mentioned earlier, we are progressing well and remain on track to generate \$750 million of cost savings by the end of 2023. To date, we have achieved \$515 million of run rate cost savings, which

exceeded our original target of \$500 million, and did so 18 months ahead of plan. These savings include \$130 million in the second quarter and a total of \$240 million for the first half of 2021. We have also identified new cost savings to replace those we had not yet realized in our full service retirement business, and as a result, continue to expect to generate \$750 million of cost savings.

Turning to slide 5. These initiatives are complemented by our thoughtful approach to capital redeployment, including through increased shareholder distributions. Last month, when announcing our agreement to sell the full service retirement business, we increased our share repurchase authorization by an additional \$500 million, our second increase of this amount since the beginning of 2021.

This brings our total shareholder distributions to a targeted \$11 billion through the end of 2023, up from the \$10 billion target we initially identified earlier this year. Year-to-date, we've returned \$2.2 billion to shareholders, including \$1.3 billion in the second quarter, comprised of \$875 million in share buybacks and \$460 million in dividend payments.

In addition, consistent with our disciplined approach to capital management and guided by our philosophy of being prudent stewards of shareholder capital, we intend to reduce leverage and enhance our financial flexibility by redeeming \$900 million of outstanding debt in the third quarter.

Meanwhile, we are being disciplined in executing on our programmatic M&A opportunities as we have done in the past with a focus on higher-growth areas, including asset management and emerging markets.

As evidence of this, earlier this year, our Africa joint venture partner closed on a minority stake in ICEA LION Holdings, a highly respected financial service market leader in Kenya with operations in Tanzania and Uganda. More recently, in July, PGIM announced a deal to acquire Montana Capital Partners, a European-based private equity secondaries asset manager, which will enhance PGIM's capabilities and further expand its \$250 billion alternatives platform.

These transactions are consistent with our strategy to add capabilities in PGIM and deepen our presence in emerging markets, enhancing our growth opportunity.

Our capital deployment is supported by our rock-solid balance sheet, including highly liquid assets of \$4.9 billion at the end of the second quarter and AA financial strength capital levels at our primary business subsidiaries.

Before turning it over to Rob, I'd like to provide an update on our environmental, social and governance commitments, which are integral to our business strategy and purpose of solving the financial challenges of our changing world.

This quarter, I'll focus on our environmental commitments. Last month, we took an important next step to integrate our ESG and financial frameworks with the renewal of a standing \$4 billion credit facility, which now directly links our financing costs to our progress in meeting previously established sustainability targets. These targets include reducing our greenhouse gas emissions as well as improving diverse representation among our senior ranks.

We also continue to make strong progress against other goals outlined in our 2019 global environmental commitment, including investing in sustainable companies and projects, issuing our inaugural green bond last year and by providing greater transparency around our general account investment allocations.

We are also reducing our reliance on paper documentation both internally and in the volume of letters and other mailings shared with our customers. In partnership with American Forests, we aspire to significantly reduce our paper use by the end of 2022.

We are committed to ensuring that sustainability runs through everything we do at Prudential. This also includes fulfilling the nine commitments to advance racial equity that we established one year ago this week, which are in addition to our ongoing diversity, equity and inclusion efforts. I look forward to updating you next quarter on the progress of this work as well as on our other social commitments.

With that, I'll turn it over to Rob for more specific details on our business performance.

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

Thanks, Charlie. I'll provide an overview of our financial results and business performance for PGIM, US and international businesses. I'll begin on slide 6 with our financial results for the second quarter.

Our pre-tax adjusted operating income was \$1.9 billion or \$3.79 per share on an after-tax basis and reflected the benefit of strong markets, business growth and lower than typical expenses, which exceeded the net mortality impacts from COVID-19.

PGIM, our global asset manager, had record asset management fees driven by record account values of \$1.5 trillion that were offset by lower other related revenues driven by a decrease in seed and co-investment income and higher expenses supporting business growth.

Our US business results were more than double the year ago quarter and reflected higher net investment spread results driven by higher variable investment income, higher fee income, primarily driven by equity market appreciation, and a more favorable impact from our annual assumption update, partially offset by less favorable underwriting experience driven by COVID-19 related mortality.

And earnings in our international business have increased 16%, reflecting continued business growth, higher net investment spread results, lower expenses and a more favorable impact of the annual assumption update. This increase was partially offset by lower earnings from required co-investment in our Chilean pension joint venture and less favorable underwriting results, primarily driven by higher COVID-19 claims in Brazil.

Turning to slide 7. PGIM continues to demonstrate the strength of its diversified active management platform as a top 10 global investment manager. PGIM's diversified global investment capabilities in both public and private asset classes across fixed income, alternatives, real estate and equities, position us favorably to capture flows. In addition, PGIM's investment performance remains attractive, with more than 93% of assets under management outperforming their benchmarks over the last three, five and 10-year periods.

Our diversified capabilities and strong investment performance helped contribute to more than \$5 billion of third-party net flows during the quarter driven by continued strong public fixed income flows with \$5.6 billion of institutional flows, partially offset by modest retail outflows. These retail outflows reflected continued positive inflows into PGIM's mutual funds, offset by outflows from sub-advisory mandates in US equities.

As the investment engine of Prudential, PGIM also benefits from a mutually beneficial relationship with our US and international insurance businesses. PGIM's asset origination capabilities and investment management expertise provide a competitive advantage, helping our businesses to bring enhanced solutions and more value to

our customers. And our businesses, in turn, provide a source of growth for PGIM through affiliated flows that complement a successful third-party track record of growth.

PGIM's asset management fees increased 16% compared to the year ago quarter to a record level as a result of market appreciation and continued positive third party net flows. This contributed to PGIM's adjusted operating margin of 33%, which is above our expectation of 30% across the cycle.

Now turning to slide 8. Our US businesses produced diversified earnings from fees, net investment spread and underwriting income and benefit from our complementary mix of longevity and mortality businesses. We continue to strengthen our businesses, transform our cost structure and expand our addressable markets while shifting away from low-growth, capital-intensive and interest rate-sensitive products and businesses.

Our product pivots have worked well, demonstrated by continued strong sales of our buffered annuity, FlexGuard, which were \$1.5 billion in the second quarter, representing 87% of total individual annuity sales. Over the past three quarters, FlexGuard sales have totaled \$4.3 billion. These sales reflect customer demand for investment solutions that offer the potential for appreciation from equity markets combined with downside protection. We have exercised discipline through frequent pricing actions, and our sales continue to benefit from having a strong and trusted brand and highly effective distribution team.

Our individual life sales continued to be strong with higher variable life sales compared to the year ago quarter, offset by lower sales of other policies, in particular universal life sales, consistent with our product pivot strategy.

In group insurance, financial wellness capabilities are core to our business success and continue to differentiate our value proposition, enhance benefit participation and accelerate growth in our targeted markets.

With respect to Assurance, total revenues, our primary financial metric as we concentrate on scaling the business, were up 92% over the prior year quarter. I would also note that similar to last year, we plan to increase the number of agents in the third quarter to help meet the seasonally higher expected demand of the Medicare annual enrollment period that occurs in the fourth quarter.

Turning to slide 9. Our international businesses include our Japanese life insurance operation, where we have a differentiated multi-channel distribution model as well as other operations focused on high-growth markets.

Sales across both Life Planner and Gibraltar operations held up well amidst the state of emergency in Japan. Life Planner sales were 49% higher than the year ago quarter, while Gibraltar sales were 33% higher than the prior year. We remain encouraged by the resiliency of our unique distribution capabilities, which have helped to continue the growth of our in-force business.

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 third quarter of 2021 relative to our second quarter results. Pre-tax adjusted operating income in the second quarter was \$1.9 billion and resulted in earnings per share of \$3.79 on an after-tax basis.

To get a sense of how our third quarter results might develop, we suggest adjustments for the following items. First, our annual assumption update and other refinements resulted in a net charge of \$34 million in the second quarter. Next, variable investment income outperformed expectations in the second quarter by \$365 million.

Third, underwriting experience is adjusted by a net \$30 million. This adjustment includes a placeholder for COVID-19 claims experience in the third quarter of \$25 million for our US businesses based on 30,000 COVID-19 related fatalities in the US and \$20 million for our international businesses. While we have provided this placeholder for COVID-19 related underwriting experience for the third quarter, the actual impact will depend on a variety of factors, such as infection and fatality rates, geographic concentration and the continued acceptance and effectiveness of the vaccine.

Fourth, we expect earnings will be lower in the third quarter by \$290 million, primarily due to the timing of expenses between the second and third quarters, and a make-whole fee of approximately \$90 million associated with the previously announced redemption of \$900 million of debt in the third quarter.

This also includes the reduction in adjusted operating income from the sale of our full service business, which will be reclassified to a divested business, as well as retained costs that will be reported in corporate and other.

Last, we anticipate net investment income will be reduced by about \$10 million, reflecting the difference between new money rates and disposition yields of our investment portfolio. These items combined get us to a baseline of \$2.59 per share for the third quarter. I'll note that if we exclude items specific to the third quarter, earnings per share would be \$3.

The key takeaway is that our underlying earnings power has increased from last quarter as the benefits from business growth, our cost-savings program and higher equity markets more than offset the reduction in earnings from the sale of the full service business. While we have provided these items to consider, please note that there may be other factors that affect earnings per share in the third quarter. I would also note that with the debt make-whole fee and retained cost of full service, we now expect the full-year 2021 corporate and other loss to be about \$1.65 billion.

Turning to slide 11. We continue to maintain a robust capital position and adequate sources of funding. Our capital position continues to support a AA financial strength rating, and we have substantial sources of funding. Our cash and liquid assets were \$4.9 billion, which is greater than 3 times annual fixed charges.

And other sources of funds include free cash flow from our businesses and other contingent capital facilities. The redemption of debt, as previously mentioned, will complete our plan to reduce financial leverage in 2021 and generate annual interest savings of approximately \$30 million while also enhancing our financial flexibility for the future as we execute on our strategic transformation.

Turning to slide 12 and in summary, we are executing on divestitures. We are ahead of schedule on cost-savings initiatives and with the support of our rock-solid balance sheet, we are thoughtfully redeploying capital.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And first with the line of Ryan Krueger with KBW. Please go ahead.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Hi, good morning. Could you provide an update on your progress towards a variable annuity transaction? And also, I think in the past, you had commented that the market tended to be interested in \$1 billion to \$2 billion in size VA transactions. Also curious if that's still the case.

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

Hi, Ryan. Good morning, it's Andy. I'll take your question. So let me start by reiterating what Charlie said in his prepared remarks at the top. We are committed to significantly reducing the earnings contribution from traditional variable annuities with guaranteed living benefits. And as you remember, we talked about this as a two-step process.

Step one is runoff, and we expect about 40% to 45% of the earnings reduction will come from runoff. And we're executing on what we consider to be a highly successful pivot. If you look at this quarter, we had 0% of our sales in those legacy products, those traditional variable annuities. And we experienced \$3.8 billion in runoff in those products in the quarter.

And we've pivoted to products that are much better balanced consumer value with shareholder value, and obviously, FlexGuard being the chassis product there, where we saw a 17% market share in the first quarter. And we were the number two provider of indexed variable annuity. So, step one is all about runoff.

Now having said that, step two is a transaction. And conducting a transaction does remain a priority for us. We have work in progress. And we're progressing that work forward. As you noted, I would say the \$1 billion to \$2 billion range, if you look at the transactions that have been done in the marketplace is a good precedent. And I would say that we continue to see tailwinds of capital coming towards the space. As we've articulated before, we have a very high quality block of business.

As always, as we continue to progress, we're going to be disciplined, to make sure we only do things that are shareholder friendly and have the right economics, much like you saw us do with the full service transaction. So, we're going to keep moving down the tracks. And we will share when we have something more to share.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you. And a follow-up is, other than variable annuities, what you've already said there and the full service retirement sale, are there any other businesses that you'd consider divesting at this point?

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Yeah. Hi, Ryan, it's Charlie. As Andy said and as I said in my opening remarks, we're making significant progress, I think, executing on becoming a higher growth, less market sensitive and more nimble business. And this includes the announced full service sale. But also the completed sales of some of the things we've done before, including the sale of our Korea, Taiwan, Italy and Poland businesses.

So we'll continue to pursue opportunities to reduce the size of our legacy block, as Andy said, of traditional variable annuities with guaranteed living benefits. But as we've noted in the past, we're looking at life insurance blocks of business as well. So we've accomplished a significant amount, but we still have a lot more work to do. And we're going to be very thoughtful about how we execute on the dual goals of fulfilling our purpose on the one hand and creating value for shareholders on the other.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you.

Q

Operator: Our next question is from Erik Bass with Autonomous Research. Please go ahead.

Erik Bass

Analyst, Autonomous Research

Hi. Thank you. Last night, we saw another jumbo PRT transaction, and one of your competitors is talking about this being potentially a record year for industry volumes and Pru's historically been the dominant competitor in the jumbo market. But now we've seen some others take the lead. So was just hoping you could talk about your appetite for PRT business going forward, and the competitive dynamics in the market currently.

Q

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

Yeah. Thanks, Erik. This is Andy. I'll take your question. And thank you for your recognition. We absolutely have been a pioneer and a leader in the space of pension risk transfer. We have a great brand. We have very strong capabilities. And we believe that we have a unique and distinguished track record of execution.

A

We also are seeing strong market opportunity. The market size in the second quarter was about \$4.5 billion. That was similar to what we saw in the first quarter. We expect the back half of the year to be very healthy. If you look at the average funding rate is 99%, and sponsors still have a high desire to transact.

That being said, this has become a more competitive market, both from the perspective of the number of competitors competing in it, but also the number of competitors that are seeking larger deals. So, very consistent to what we've told you in the past, we're going to be disciplined in our approach, and we're going to pick our spots. And that is what you're seeing from us, and you should expect to see quarter-to-quarter variation.

But if you combine the strong pipeline that we see going forward with the strengths of our business, number one, we feel comfortable we could take this approach and number two, we expect that we'll be a net winner over time and experience good flows.

Erik Bass

Analyst, Autonomous Research

Q

Thank you. And then for – next question is you highlighted two examples of programmatic M&A that you've done year-to-date. Can you give a sense of how capital was allocated to these transactions? And will deals of this size be enough to meet your capital reallocation targets? Or do you expect to potentially do something bigger?

Charlie F. Lowrey*Chairman & Chief Executive Officer, Prudential Financial, Inc.*

A

Yeah. I'll jump in on that one. We're not going to talk about the specific size of some of these transactions. But it is fair to say that we are taking a very disciplined approach and balanced approach to M&A and that with programmatic M&A, you can expect us to do more of this type of deal going forward.

Erik Bass*Analyst, Autonomous Research*

Q

Okay. Thank you.

Operator: Next, we'll go to Humphrey Lee with Dowling & Partners. Please go ahead.

Humphrey Lee*Analyst, Dowling & Partners Securities LLC*

Q

Good morning and thank you for taking my questions. Just a follow-up on M&A, I understand some of the transactions you've done year-to-date. But just thinking about the impact of the full service sale and the stranded costs being left behind, like, is the priority going to be something focused more on the mature businesses that provide more solid earnings so that you can absorb and offset the stranded costs from the full service sale?

Charlie F. Lowrey*Chairman & Chief Executive Officer, Prudential Financial, Inc.*

A

Yeah. Humphrey, it's Charlie. Let me take that one. First of all, again we're going to take a very disciplined and balanced approach to this. But when we think about acquisitions, we think about them both from a strategic and a financial perspective, right. So from a strategic perspective, we look to add capabilities, such as product or distribution or increased scale in a market or country.

And from a financial standpoint, we look at a variety of metrics when assessing potential acquisitions. And that can be earnings contribution, it can be growth. It's going to be a number of factors that we consider. But most importantly, our focus is on becoming a higher growth, less market sensitive and more nimble business. And we're going to continue to be very thoughtful and disciplined about how we execute with the goal of creating value for shareholders.

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

A

And maybe, Charlie, I'll just add. In terms of, Humphrey, what you described as a stranded cost or the retained costs from the transaction. As we've sort of demonstrated across the company, we've made excellent progress in transforming our operations, gaining efficiencies but also including capabilities. We have an institutionalized process and structure, and it's accelerating our progress on our cost objectives. We're focused on meeting the cost-saving objectives of \$750 million by 2023. And as we reallocate and redeploy capital, we'll look to reallocate overhead across our businesses as well.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Got it. Shifting gears, so you talked about using some of the proceeds from the full service sale to lower your leverage. Can you just talk about the rationale behind the decision since the sale doesn't really trigger any issue with your leverage, especially given the expected gain from the sale?

Kenneth Yutaka Tanji

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

A

Yeah. Humphrey, this is really part of our regular review of capital and liquidity profile. And given our current position, we thought it was a good time to redeem the debt. That redemption will have a near-term earnings benefit, but it's also going to provide debt capacity and flexibility for the future. So it really just reflects, we thought it was a good way and a good time to reduce our debt in an efficient way.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Okay. So I shouldn't read it as like a potential VA transaction that may have an impact on your book value or you may be to a more leaning towards lever up down the road, but adjusting your kind of periodic, your regular review and just finding is a good time right now.

Kenneth Yutaka Tanji

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

A

Yeah, exactly. I wouldn't connect it directly to any specific transaction. It's we're overall regularly reviewing where we are, and we thought it was a smart thing to do.

Humphrey Lee

Analyst, Dowling & Partners Securities LLC

Q

Got it. Thank you.

Operator: Our next question is from Andrew Kligerman with Credit Suisse. Please go ahead.

Andrew Kligerman

Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, good morning. I'm thinking about Assurance IQ and that superb 92% year-over-year growth in revenue. But then you had a loss pre-tax of about \$38 million, which was up materially year-over-year. Could you talk a little bit about, a, the growth rate, can you keep it at this pace? And b, when might we think about a timeframe for when you get to breakeven?

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

So thanks, Andrew. It's Andy. I'll take your question. As we've discussed in the past, we are very intentionally building out the business and the platform. And we're doing that because as we brought this business into Prudential, we saw just real opportunity and incredible customer demand. We saw, again, 7 million shoppers in the quarter, and we're looking at hundreds of thousands of policies that were going to have sold. And these are customers that we would have never reached at Prudential. So very much part of expanding our addressable market.

As you look at those investments, there is, I'll call it, a J-curve to those investments, where as we're adding agents, as an example, they will become more and more productive over time. And a number of these investments are fixed expense. So that's why we say the predominant metric is scale. We have to scale up to, I'll use the word overcome, that fixed expense. And we're seeing great progress.

That we're also, we're very pleased with the \$112 million and the 92% growth rate. We believe that we have a lot of continued room in front of us to grow. To specifically answer your question, as to a specific timeframe around achieving the long-term economics, we're not going to provide more exact guidance.

Andrew Kligerman

Analyst, Credit Suisse Securities (USA) LLC

Okay. Fair. That was helpful. And the buffered annuity market, now that was, I think, 87% of your total segment sales there. Do you see a point where you could get to the volumes even of what you were doing on the legacy products? And how do you see the competition there? I mean it seems like a lot of players have been jumping into the buffered annuity market. Is that going to kind of impede your growth?

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

Yeah so, thanks for the question on the buffered annuity market and on FlexGuard. Let me start by saying the driver of our success has a lot to do with we're a very well-established brand that's very well respected. We have just an outstanding distribution system and distribution partners. And we came to market with a very differentiated product from the indexing strategy perspective. All of that has enabled us to have one of the best launches in probably the history of the industry. So we're very, very proud of it.

The market itself is growing. So we're seeing more and more volume industry wide shift from more traditional-type product designs over to the index variable annuity area. And I would think of this as more of a chassis. It's really a pretty broad area of accumulation-oriented products that have upside and downside buffering. So we see a good bit of room still to run. Having said that, we have at this time, rolled it out to all of our third-party relationships, and we're in all of our key geographies. So quite pleased with how we've done. As far as its ability to get to some of the very high levels that we saw five to 10 years ago, I'm not going to put a prediction on that.

Andrew Kligerman

Analyst, Credit Suisse Securities (USA) LLC

Thanks a lot.

Operator: Our next question is from Tracy Benguigui with Barclays. Please go ahead.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Thank you. I have another Assurance IQ question. It looks like there is changing of the guard. I understand the original founders are not there anymore and have left before a potential earn-out, which would have been on meeting performance targets anyway. What is the new strategic direction under new management that we should anticipate?

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

So thanks, Tracy, it's Andy. Let me hit the tail end of your question first. There is zero change in strategic direction or change in strategy with the Assurance platform and with its fit with Prudential and what we're trying to accomplish. As you would expect, we have been adding to the team and deepening the talent as the business matures.

You rightly identified at the top of the house, Mike Rowell, a founder, has moved over to a strategic adviser role to me. That enables me to take a broader use of his experience and expertise. In addition to that, we promoted Allison Arzeno, who was the Chief Data Scientist, to be the CEO. I'm very excited by that. She is a fantastic leader and has jumped in and has continued the momentum.

The other thing I'd mention is we've been very pleased that through the combination of Prudential's brand and the unique and attractiveness of the Assurance platform, we've been able to attract top, top industry talent specifically for our product P&L roles. So as an example, we recruited a gentleman by the name of Chris Hakim, who has deep health expertise both in core health but also was a key leader at eHealth, and he's leading our under 65 health and Medicare Advantage. So we're pleased with the talent situation, and we're confident that we have the right team and the right talent to take it forth.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Maybe moving on to your assumption update. I see that you did not change your long-term rate assumption, and I get that interest rates are at a higher spot now than this time last year. But I guess my thinking was that insurers would still want a grade into lower reversion to the mean assumptions to prepare for LDTI. Is that part of your thinking at all? Or is it more near-term when you conducted your review?

Kenneth Yutaka Tanji

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

A

Yeah hey, Tracy, it's Ken. As you know and we've talked about, we have a very established process for setting our long-term rate assumptions. And in doing so, we look at a variety of forecasts for long-term rates both internally and externally. And when we did that this year, we saw very little movement in those forecasts. And therefore, we didn't see it appropriate to change our long-term rate assumptions. So we look at it very consistently, the way we've done it in the past. In terms of long-duration target improvements, that's still 1.5 years away. But we're making great progress in implementing that, and we'll be ready to adopt that on time. But it won't be a transition. It's an adoption date. And that's the method that we think is appropriate.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Okay, great. Thank you.

Operator: Next, we'll go to Tom Gallagher with Evercore ISI. Please go ahead.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Hey, Charlie, when you mentioned you were looking at life insurance risk transfer deals as well as VA, can you provide a little bit of color on the process here? Is that a dual-track process, where you're sort of simultaneously

looking at both VA and life deals so you could get either/or transaction and the timing is unclear between the two? Or any way of sort of handicapping whether you're more likely to do life insurance over VA first?

And then, just relatedly, now that you do have those two lines you're looking specifically at doing risk transfer on, are we now looking closer to maybe the high end of the \$5 billion to \$10 billion of freeing up of capital that you guys had laid out?

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So let me start and then Rob can elaborate. So right now, we said that we're at sort of \$4.2 billion, if you include Korea, Taiwan and the full service business. We won't make predictions. We said \$5 billion to \$10 billion because we're going to take a very prudent approach to doing this. We don't have to do anything, but if it makes sense for shareholders, we will do things. And we'll see where we fall out in there. But that's an intentionally wide band.

In terms of annuities versus life insurance, I think we have said that we're focused on annuities right now, but we will also think about life insurance as we go forward. Rob, do you want to add to that?

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

A

Yeah just, Tom, that we have distinct teams focused on each of those initiatives. But as Charlie indicated, the more important initiative from the standpoint of the impact, we believe, on valuation to shareholders and overall valuation of the company is to get the VA transaction done first. And so it's been a priority but not necessarily to the detriment of having resources that are dedicated to looking at the opportunities within the life sector as well.

Thomas Gallagher

Analyst, Evercore Group LLC

Q

Okay. That's helpful, guys. Thanks. Just a quick follow-up. Based on the guidance you've given out for 3Q, it looks like you're estimating virtually all of the COVID impacts are going to come on group and not individual life. Is that what you saw in this quarter also? And you could provide a little color about what you're seeing from COVID impacts for group versus individual.

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

Yeah. Tom, it's Andy, I'll take your question. So we saw in second quarter COVID mortality impacts in both individual life insurance and group insurance. And going forward for 3Q, similarly overall, we estimate that we will continue to see impact from COVID mortality in both group insurance and in life. But I would note that that COVID impact and trend is beginning to moderate as we go into 3Q. I think what you're picking up there in ILI is the COVID impact is being partially offset by the fact that third quarter is the highest quarter for our seasonal underwriting results. So that's why that looks a little different in the exhibit.

Scott Garrett Sleyster

Executive Vice President & Head-International Business, Prudential Financial, Inc.

A

And Tom, this is Scott. On the international front, we're continuing to see really modest impacts across the board in Japan. We are seeing more of our impact in our Brazil operations. And similar to the US, we are seeing a mix across both group and individual lines.

Thomas Gallagher
Analyst, Evercore Group LLC

Q

Okay. Thanks, guys.

Operator: And next, we'll go to Elyse Greenspan with Wells Fargo. Please go ahead.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good morning. My first question, when you guys announced the full service sale, you did up your buyback by \$500 million for this year. So as we think about additional transactions with VA and perhaps life insurance, should we think about some portion of the capital potentially going to incremental repurchases as well as for the M&A bucket?

Charlie F. Lowrey
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah, Elyse, it's Charlie. I'll take your question. We've said all along, we want to be good stewards of capital. And we have and will continue to demonstrate a disciplined and a balanced approach to the redeployment of capital within our businesses and to our shareholders. So that's the overriding concept. And to date, we've already returned a significant amount of capital to shareholders. We've returned over \$2 billion and have increased both the dividend and the share repurchase authorization. So we plan over the next three years or through the end of 2023 to return \$11 billion of capital.

But stepping back, let me share with you how we think about capital allocation, and in particular optimization of that capital. Because we look across all our businesses, both domestically and internationally, to ensure that we're optimizing capital deployment. And we'll continue to look for ways to optimize that capital to maximize outcomes for shareholders. And as we've stated, to the extent we cannot find attractive capital deployment opportunities to meet our strategic and financial criteria, then we'll return excess capital to shareholders, as you've seen us do in the past.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

That's helpful. And then when we think about corporate costs, I guess I'm thinking more beyond 2020 – 2021, sorry, into 2022 and 2023. Can you give us a sense of how corporate costs could come in as you think about both implementation costs and how we should see those trending in the out years? And then also the stranded costs from the full service retirement business. So I know the guide was \$1.5 billion and was like up this year, but how should we think about corporate costs over the next couple years?

Kenneth Yutaka Tanji
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Elyse, it's Ken. As I mentioned earlier, we're making great progress with our transformation effort, including gaining efficiencies. And it is a ongoing and institutionalized and continuous improvement process at this point. So we continue to expect to make progress towards our \$750 million cost-savings objective by 2023, and we think we're well on track to continue with that. Again, as we reallocate capital and redeploy capital, we'll reallocate some of our overhead costs, and you can expect that to continue as well. So overall, we continue to make good progress with our cost objectives. And I think you should expect us to continue to make progress like we have in the past.

Elyse Greenspan

Analyst, Wells Fargo Securities LLC

Okay. Thank you.

Q

Operator: And our next question is from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge

Analyst, Piper Sandler & Co.

Thank you. With the group disability loss ratio coming down for two straight quarters, how should we thinking about the relationship with the administrative expense ratio as that's been elevated for a few quarters to handle those increased cases?

Q

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

So thanks, John. It's Andy. Yeah, as you rightly noted, we have had enhanced staffing levels in our group insurance business. I think we talked about this on previous quarters. Given the nature of the pandemic and the morbidity effects, we have seen an enhanced level of STD and absence claims. And we've been maintaining higher staffing levels to make sure that we provide the right level of service. We also have been making sure that we maintain our long-term disability claims staff at higher levels. So you're definitely seeing that as a contributor to the elevated administrative ratio.

A

The other thing I would mention is, and then we've talked about this on previous conversations, we have entered into a strategic relationship with Accenture to do some of the operations for us. And the nature of that, we are implementing that as we speak, and there's some transition costs basically that are doubling up. But that's a onetime effect. And over time, we expect everything we're doing in our group business will bring down the admin ratio as part of our transformation efforts.

John Barnidge

Analyst, Piper Sandler & Co.

Okay, and then second question. Have you developed a sense of maybe vaccination rates of insured life blocks versus that of the general population?

Q

Kenneth Yutaka Tanji

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

Generally, John, we believe that the vaccination rate of the insured population is higher than the general population. And that reflects a variety of factors between age, geography and a number of things. But yes, we generally feel that the insured population has a higher vaccination rate.

A

John Barnidge

Analyst, Piper Sandler & Co.

Thanks for the answers.

Q

Operator: Next, we'll go to Jimmy Bhullar with JPMorgan. Please go ahead.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Q

Hey, good morning. So first, had a question on your Japan, your outlook for the operating environment in Japan. Your sales were obviously pretty strong in 2Q, but it was mostly because of easier comps. To what extent are you seeing an improvement in trends in the market as businesses are opening up versus sort of ongoing challenges given the increase in the case count in the country?

Scott Garrett Sleyster

Executive Vice President & Head-International Business, Prudential Financial, Inc.

A

Thanks, Jimmy. This is Scott. As you pointed out, current quarter sales were well ahead of the prior year, but that was significantly impacted by COVID really ramping up at that time. But this quarter was only slightly below the first quarter. And as you know, our typical first quarter sales are quite strong because that's when we're closing out our annual incentive measurement cycle. Although the situation with COVID and its related impacts remains fluid, dynamic, whatever you want to call it, we are pleased with our strong underlying business performance this quarter, particularly considering the ongoing challenges of the global pandemic.

The demand for our products remain strong, I'd even say somewhat elevated because of awareness of threatening life issues. And we continue to focus in Japan on our needs-based selling approach, and that's anchored by recurring premium death protection. And then we add on to that supplemental other products like accident, health and retirement to meet our evolving customer needs.

Our operations are also increasing and enhancing and adapting to the use of digital and virtual tools to support sales activities amid the social distancing restrictions. So that, maybe that's a longer answer than you wanted. I would say we feel pretty good about the level that we're at. We feel that we've adapted to the technology. I have to acknowledge that it is still difficult to recruit at past levels in both LPs and LCs amid the COVID environment. But right now, we feel pretty good, actually quite good about how the business is performing in Japan.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Q

Thanks. And on Assurance, when you had announced the deal, I think you had mentioned that there was the potential for up to \$1.2 billion of earn-outs. Can you discuss how results have tracked versus the metrics that the business would have had to hit for the earn-out payments?

Kenneth Yutaka Tanji

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

A

Hey, Jimmy, it's Ken. When we set that earn-out, you may recall that it was above what we set as a baseline for the performance of the business. It was to provide compensation if they were to exceed our original expectations. So that's the way we thought about it when we did the deal, and that's, continues to be the way that earn-out is positioned.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Q

But you're not – I'm assuming that you don't think that the likelihood of you having to pay anything out is high, right?

Kenneth Yutaka Tanji

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

Again, it was there to provide upside if they outperformed our expectations, and that's still the way it's designed.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Okay. And when can you – so when would you have clarity on whether or not you're going to have to pay anything?

Kenneth Yutaka Tanji

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

It extends to the end of next year. So we're midway through it at this point.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Okay. And is based on the results so far? Any color on like yes or no, or sort of halfway toward the total goal?

Kenneth Yutaka Tanji

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

I think we've been, Jimmy, I think we've been pretty transparent with the results so far. They're separately disclosed, so you can evaluate them for yourself.

Jimmy S. Bhullar

Analyst, JPMorgan Securities LLC

Good. Okay. Thank you.

Operator: And next, we'll go to Mike Ward with UBS. Please go ahead.

Michael Ward

Analyst, UBS Securities LLC

Hi, good morning. Thanks for taking my question. I was just wondering on the retirement segment net flows, there was some pressure. My understanding is that it's being driven in part by some seasonality in PRT flows coming through mostly in the second half. So I guess what I'm just wondering is, should we be thinking about that phenomenon becoming more prevalent going forward with full service being divested?

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

So, Mike, it's Andy. I'll take your question. As I think you're aware, the PRT and LRT business, they're transaction-oriented businesses, which means by definition, on the sales inflow side, that it's going to be episodic. But on the outflow side, it's going to be more steady and consistent. And we're obviously have pretty large blocks given our past success. So I do think it's right to think of that that that will produce quarter-to-quarter variation. But I would repeat what I said earlier in the call, we are a pioneer and a leader in this. It has been quite competitive, and we plan to be disciplined. But given the opportunities in front of us and given the strength of our platform, we think over the long term, we'll see good flows and we'll be in that winner.

Michael Ward

Analyst, UBS Securities LLC

Q

Great. Thanks. That's helpful. And then I was just wondering about the organic earnings mix change within the transformation, specifically annuities. I know you've mentioned the natural VA value running off, but just wondering what we should be thinking for the trend in the dollar amount of earnings from annuities organically. Do you have a placeholder that you use to think about what you expect just from the trend in organic earnings from annuities ex any deals? Thanks.

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

So, so, sorry.

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Andy, go ahead.

Andrew F. Sullivan

Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

Okay. So, Mike, what I would say is we expect that, as we said, we're going to be very committed to reduce the earnings from traditional variable annuities and that the runoff effect will produce 40% to 45% of the overall result. And obviously, we would look to do transactions to get the remainder of the impact.

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

A

So, Mike, it's Rob. I think the number that we've given out is that the legacy book runs off at about \$3 billion a quarter. And so you can use that as a sort of a metric for thinking about that runoff against the sales that we're doing on our newer products, which are less market sensitive and very attractive from a return profile. You can look at the offset between those two to get a sense for how the earnings profile would run off absent anything happening with markets. Obviously, what you've seen is despite that net runoff, our accounts as are up as a result of continued depreciation in the market.

Michael Ward

Analyst, UBS Securities LLC

Q

Thanks very much.

Operator: And with no further questions, I'll turn the call over to Charlie Lowrey for closing remarks.

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

All right. Thank you very much. Thank you for joining us today. I hope our performance this year, the progress we're making on repositioning the portfolio, advancing our cost-savings program and our thoughtful consideration to capital deployment confirms that our strategy to transform Prudential remains on track. We will continue to act with conviction and with speed to evolve our company and deliver greater financial opportunity to all of our stakeholders. We look forward to keeping you updated on our progress, and thanks again for your time today.

Operator: Ladies and gentlemen, that concludes your conference call for today. You may now disconnect.

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