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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. At this time, all participants have been placed in a listen-only mode. Later we will conduct a question-and-answer session. Instructions will be given at that time. [Operator Instructions] As a reminder, today's call is being recorded.

I will now turn the call over to Mr. Bob McLaughlin. Please go ahead.

Bob McLaughlin

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 a discussion of factors that could cause actual results to differ materially from those in the forward-looking statements. Please see the slides 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.

And now, I'll turn it over to Charlie.

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Bob, and thanks to everyone for joining us this morning. Prudential delivered strong financial results for the fourth quarter and the full year, reflecting favorable investment performance and continued high demand for the products we introduced during the pandemic to address our customers' evolving needs.

2021 was also a pivotal year for Prudential and our efforts to become a higher growth, less market-sensitive and more nimble company. First, we are repositioning our business mix to generate sustainable long-term growth with reduced market sensitivity. Second, we continue to advance our cost savings program. And third, we maintained our disciplined and thoughtful approach to deploying capital. I'll provide an update on each of these areas before turning it over to Rob and Ken.

Moving to slide 3. We are making significant progress repositioning our business for sustainable long-term growth with reduced market sensitivity through a mix of divestitures and strategic programmatic acquisitions. Following the successful completion of the sales of our Korea and Taiwan insurance businesses, which produced $1.8 billion in proceeds, we reached agreements to divest our full service business and a portion of our traditional variable annuities. We are on track to close both of these transactions in the first half of 2022 and generate additional proceeds of over $4 billion. We are redeploying capital in part through highly targeted acquisitions and investments in asset management and emerging markets.

Last year, PGIM acquired Montana Capital Partners, a European-based private equity secondaries asset manager; and Green Harvest, a separately managed account platform that provides customized solutions for high net worth investors. Meanwhile, on the emerging markets front, we closed on an investment in ICEA LION Holdings, a highly respected financial services market leader in Kenya with operations in Tanzania and Uganda.

Turning to slide 4. We continue to advance our cost savings program and are on track to achieve $750 million in savings by the end of 2023. To date, we have already achieved $635 million in run rate cost savings, exceeding our $500 million target for 2021. We have also taken steps to improve experiences around the world for our customers and employees through innovation. This includes using automation, artificial intelligence and other technology to expedite underwriting, reduce and simplify processes, provide faster, more convenient service options, and deliver meaningful financial advice in the ways our customers want it. I'll touch more upon how we're using technology in a moment.

Turning to slide 5. We have maintained a disciplined and balanced approach to deploying capital by enhancing returns to shareholders, reducing financial leverage and by investing in the growth of our businesses. We currently plan to return a total of $11 billion of capital to shareholders between 2021 and the end of 2023. This includes $4.3 billion returned during 2021 through share repurchases and dividends.

As part of this plan, the board has authorized $1.5 billion of share repurchases and a 4% increase in our quarterly dividend beginning in the first quarter. This represents our 14th consecutive annual dividend increase. We also reduced debt by $1.3 billion in 2021. In addition to the acquisitions I previously mentioned, we have also made investments in our businesses to drive long-term growth and to meet the evolving needs of our customers.

In PGIM, for example, we have significantly strengthened our suite of environmental, social and governance bond funds to better serve sustainability-focused investors. Meanwhile, in our insurance businesses, we continue to develop products that are less market-sensitive and have higher growth potential, such as our FlexGuard and variable life products, with a focus on improved customer experience and driving greater operational efficiency.

One example, as I mentioned earlier, is our use of artificial intelligence. We use AI to quickly and accurately assess risk in our life insurance businesses and to expedite the application and underwriting process. The application of innovative technology generated significant efficiencies for our global businesses during 2021, while delivering a dramatically better experience for our customers. We will continue to expand the use of AI and other emerging technologies across the firm. Our capital deployment strategy is supported by a rock solid balance sheet which includes $3.6 billion in highly liquid assets at the end of the fourth quarter and a capital position that continues to support our AA financial strength rating.

Turning to slide 6. Our ongoing efforts to transform the company in 2021 go hand-in-hand with Prudential's long-standing commitment to sustainability. This commitment is reflected in several significant enhancements to our environmental, social and governance framework last year.

We committed to achieve net zero emissions by 2050 across our primary global home office operations, with an interim goal of becoming carbon-neutral in these facilities by 2040. We are also reviewing our general account investment holdings and have restricted new direct investments in companies that derive 25% or more of their revenues from thermal coal.

On the social front, The Prudential Foundation surpassed $1 billion in grants to partners primarily focused on eliminating barriers to financial and social mobility around the world. This achievement follows another milestone that we reached in 2020 when our impact investment portfolio exceeded $1 billion.

We also continue to advance our nine commitments to racial equity through investments in funding for organizations committed to diversity, equity and inclusion, and through internal measures, including diversity training and our commitment to equitable compensation for our employees. Our governance actions reflected a shared commitment to diversity and inclusion, beginning at the top with over 80% of our independent board directors being diverse. It also includes the steps we are taking to improve diverse representation throughout Prudential and to provide greater transparency around the composition of our US workforce.

In 2021, we enhanced our diversity disclosures by publishing EEO-1 data and the results of our pay equity analysis for our US employees. We also expanded our policy of tying compensation plans for senior executives to the achievement of workforce diversity goals.

As I noted earlier, we believe our sustainability commitments and transformation to become a higher growth, less market-sensitive and more nimble business are closely connected. Together, they help us fulfill our purpose of making lives better by solving the financial challenges of our changing world by expanding access to investing insurance and retirement security for customers and clients around the globe.

Before turning it over to Rob, I'd like to thank all of our employees for their unwavering dedication to the customers and communities we serve, particularly in light of the continued challenges created by the pandemic. I am proud of the progress we made and the momentum we built in 2021 and look forward to making an even more meaningful difference in the lives of all our stakeholders in 2022 and beyond. Thank you for your time this morning.

And with that, I'll turn it over to Rob.

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

Thanks, Charlie. I'll provide an overview of our financial results and business performance for our PGIM, US and International businesses. I'll begin on slide 7 with our financial results. For 2021, pre-tax adjusted operating income was $7.3 billion or $14.58 a share on an after-tax basis. Results for the year included a benefit from the outperformance of variable investment income that exceeded target returns by about $1.6 billion, reflecting market performance, strategy and manager selection.

In the fourth quarter, pre-tax adjusted operating income was $1.6 billion or $3.18 a share on an after-tax basis, while GAAP net income was $3.13 per share. Of note, our GAAP net income includes realized investment gains and favorable market experience updates that were offset by a goodwill impairment that resulted in a charge of $837 million net of tax. This charge reflects two main drivers of a reduction in the estimated fair value of Assurance.

First, we acquired capabilities to increase access to more customers, and we've experienced good revenue growth. However, this growth has been slower than expected and we are now assuming it will take longer to monetize into earnings and cash flow. And second, we have seen a significant decline in publicly traded peer valuations, which is a key input in our assessment of fair value.

Turning to the operating results of our businesses. PGIM, our global asset manager, had record asset management fees, driven by record account values of over $1.5 trillion. Relative to the year-ago quarter, earnings reflected the elevated level of other related revenues last year as well as higher expenses supporting business growth in the current period.

Results of our US businesses increased 13% from the year-ago quarter and reflected higher net investment spread, including a greater benefit from variable investment income, higher fee income, primarily driven by equity market appreciation, partially offset by higher expenses driven by a legal reserve and less favorable underwriting experience due to COVID-19-related mortality. Earnings in our International businesses increased 5%, reflecting continued business growth, lower expenses and higher net investment spread.

Turning to slide 8. PGIM continues to demonstrate the strength of its diversified capabilities in both public and private asset classes across fixed income, alternatives, real estate and equities as a top 10 global investment manager.

PGIM's investment performance remains attractive with more than 95% of assets under management outperforming their benchmarks over the last 3, 5 and 10-year periods. This performance has contributed to third-party net flows of $11 billion for the year, with positive flows across US and non-US-based clients in both public and private strategies.

As the investment engine of Prudential, success and growth of PGIM and of our U.S. and International insurance businesses are mutually enhancing. PGIM's asset origination capabilities, investment management expertise and access to institutional and other sources of private capital provide a competitive advantage by helping our businesses to bring enhanced solutions, innovation and more value to our customers. And our businesses, in turn, provide a source of growth for PGIM through affiliated flows and unique access to insurance liabilities that complement its successful third-party track record of growth.

PGIM's sixth consecutive quarter of record asset management fees reflect strong business fundamentals and record assets under management. We continue to expand our global equity franchise to grow our alternatives and private credit business, which has assets in excess of $240 billion across private credit and real estate equity and debt and benefits from our global scale and market-leading positions. Notably, PGIM's private businesses deployed nearly $50 billion of gross capital, up 33% from last year.

Now turning to slide 9. Our US businesses produced diversified earnings from fees, net investment spread and underwriting income and also benefit from our complementary mix of longevity and mortality businesses. We continue to shift our business mix towards higher growth and less interest rate-sensitive products and businesses to transform our capabilities and cost structure and to expand our addressable markets.

Our product pivots have worked well, demonstrated by continued strong sales of our buffered annuities, which were nearly $6 billion for the year, representing 87% of total individual annuity sales. These sales reflect customer demand for investment solutions that offer the potential for appreciation from equity markets, combined with downside protection. We have also exercised discipline through frequent pricing actions and our sales benefit from having a strong and trusted brand and a highly effective distribution team.

Our Individual Life sales also reflect our earlier product pivot strategy, with variable products representing 71% of sales for the year. Our retirement business has market-leading capabilities, which drove robust international reinsurance and funded pension risk transfer sales, including a $5 billion transaction, which was the fourth largest in the history of the market during 2021.

And our Group Insurance business reflected strong persistency and revenue growth in 2021 across all segments. With respect to Assurance, our digitally enabled distribution platform, total revenues for the year were up 43% from last year.

Turning to slide 10. Our International businesses include our Japanese life insurance companies, where we have a differentiated multichannel distribution model, as well as other businesses focused on high-growth emerging markets. We remain encouraged by the resiliency of our unique distribution capabilities, which have maintained the stability of our sales and our in-force business, despite the pandemic.

In Japan, we are focused on providing high-quality service, growing our world-class sales force and expanding our geographic coverage and product offerings. Our needs-based approach and mortality protection focus continue to provide important value to our customers, as we expand our product offerings to meet their evolving needs.

In emerging markets, we are focused on creating a carefully selected portfolio of businesses and regions where customers' needs are growing, where there are compelling opportunities to build market-leading businesses and partnerships and where the Prudential enterprise can add value.

As we look ahead, we're well positioned across our businesses to be a global leader in expanding access to investing, insurance and retirement security. We plan to continue to invest in growth businesses and markets, deliver industry-leading customer experiences and create the next generation of financial solutions to better serve the diverse needs of a broad range of customers.

And with that, I will now hand it over to Ken.

Kenneth Yutaka Tanji

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

Thanks, Rob. I'll begin on slide 11, which provides insight into earnings for the first quarter of 2022 relative to our fourth quarter results. Pre-tax adjusted operating income in the fourth quarter was $1.6 billion and resulted in earnings per share of $3.18 on an after-tax basis.

To get a sense for how our first quarter results might develop, we suggest adjustments for the following items: First, variable investment income outperformed expectations in the fourth quarter by $440 million.

Next, we adjust underwriting experience by a net $90 million. This adjustment includes a placeholder for COVID-19 claims experience in the first quarter of $195 million, assuming 75,000 COVID-19-related fatalities in the US. While we have provided this placeholder for COVID-related claims experience, the actual impact will depend on a variety of factors such as infection and fatality rates, geographic and demographic mix and the effectiveness of vaccines.

Third, we expect seasonal expenses and other items will be lower in the first quarter by $105 million.

Fourth, 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.

And last, we expect the first quarter effective tax rate to normalize.

These items combined get us to a baseline of $2.73 per share for the first quarter. I'll note that if you exclude items specific to the first quarter, earnings per share would be $3.17. The key takeaway is that the underlying earnings power per share continues to improve and has increased 9% over the last year, driven by business growth, the benefits of our cost savings program, capital management and market appreciation. While we have provided these items to consider, please note there may be other factors that affect earnings per share in the first quarter. As we look forward, we have also included seasonal and other considerations for 2022 in the appendix.

Turning to slide 12. 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 $3.6 billion and within our $3 billion to $5 billion liquidity target range. And other sources of funds include free cash flow from our businesses and contingent capital facilities.

Turning to slide 13 and in summary, we are executing on our plans to reposition our businesses and we are on track to achieve our targeted cost savings. And with the support of our rock solid balance sheet, we are thoughtfully deploying capital.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Ryan Krueger from KBW. Your line is now live

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. Good morning. The recent acquisitions that you've talked about have not utilized a material amount of capital. I guess, given the amount of capital that you are freeing up from the full service retirement and variable annuity block sales, would you consider deals that were a bit larger in size if they're available and they meet the opportunities you're looking for?

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

A

Hi, Ryan, this is Charlie. I'll answer that question. And let me proffer a couple of comments. First, one of the major tenets of our strategy is to be prudent stewards of capital. And we're doing that by balancing three factors. One is investment in our existing businesses to achieve business growth. The second is programmatic M&A, and the third is returning capital to shareholders.

But with regards specifically to your question in terms of acquisitions, what we can say is though they're going to be consistent with our stated strategy of growing PGIM and emerging markets, by which we can expand and extend our capabilities or our distribution or increase the scale of our existing businesses. And to your point, we'll be looking at a variety of opportunities in different sizes.

But what we can also say is that regardless of size, we will evaluate the strategic and financial merits of each transaction with the obvious observation that the larger the transaction, the more financially compelling that transaction needs to be. And as we've said, we will have a programmatic approach, right, as demonstrated by the three acquisitions we did last year and as we've actually done for a couple of decades in both areas where you've seen us make numerous acquisitions in both emerging markets and asset management at various scales.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks. And then from a divestiture standpoint, are you still looking to do more, whether it be in US Individual Life or more in variable annuities?

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

A

Yes. Sure. Ryan, it's Charlie again. I'll take that. So first of all, we're focused on closing the existing transaction that you referred to. And that we've signed – and with just as an update, we're on track to close both those transactions in the first half of 2022.

But we continuously seek opportunities within the businesses and the existing blocks that we have to optimize capital and reduce market sensitivity while improving the consistency and the predictability of our financial results with the goal of creating additional value for shareholders. But as we've said in the past, we'll continue to be thoughtful as we progress towards the goal of becoming a more nimble, less market-sensitive and a higher-growth company. So we'll continue to look for opportunities as they arise and execute accordingly.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you.

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

A

Hi, Ryan, it's Andy. Let me just add in. We're making great progress on derisking in our annuities business. And as we've talked about before, that's a two-step process to derisk the legacy. Step one is all about runoff, and we are very much on track. We're seeing the expected runoff. We saw $3.8 billion in runoff in the quarter and we saw over $18 billion in runoff in the year. So runoff is a significant contributor to derisking.

As Charlie said, step two was about doing the derisking transaction. And obviously, we're very pleased with the PALAC sale and that represents about 20% of our legacy account values. So as Charlie said, we're going to continue to explore how to further derisk the remaining legacy, but we are very focused right now on closing the Fortitude Re deal in a high-quality manner.

Ryan Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you.

Operator: Thank you. Next question is coming from Elyse Greenspan from Wells Fargo. Your line is now live.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good morning. My first question is on the write-down that you guys took within Assurance IQ. Can you just give us a sense of the contributions? You mentioned lower earnings and cash flows as well as public peer valuations. Can you give us a sense of the contributions of each when you came up with the goodwill write-down that you took in the quarter?

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

Yes. It was – Elyse, it's Ken. It is a good combination of both. So we – each quarter, we assess the conditions and the fair value of the business. We've been doing that since we've acquired it. We incorporated the recent experience from the Medicare annual enrollment and we looked at the updated values for multiples of peers and so that all went in. And so it was both a combination of our updating for recent experience as well as the recent multiples in the market for peers.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Okay. Thanks. And then maybe a follow-up on the capital side. So you guys mentioned that the PALAC and full-service retirement transactions are on track for a half year one close. At some point, if M&A transactions either don't materialize or don't materialize to a higher magnitude, would you guys consider raising the repurchase authorization for 2022 above the $1.5 billion?

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

So Elyse, this is Charlie. I think what we've said and what we'll continue to say is, again, we're going to be prudent stewards of capital. And to the extent that we can't find opportunities to execute on our strategy, we'll consider returning capital. And if you saw what we did last year, we actually increased the share buybacks by $1 billion in two $500 million segment. So we've done it in the past, and we will continue to be prudent stewards of capital as we go forward and consider all our opportunities.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Okay. Thank you.

Operator: Thank you. Next question is coming from Erik Bass from Autonomous Research. Your line is now live.

Erik Bass
Analyst, Autonomous Research
Q

Hi. Thank you. Can you talk about flow trends at PGIM in the new business pipeline heading into 2022? And are you seeing much shift in demand for fixed income given the rise in interest rates?

Andrew F. Sullivan
Executive Vice President & Head-US Business, Prudential Financial, Inc.
A

Hi Erik, it's Andy. I'll take your question. As we've discussed in the past, obviously, PGIM flows will vary quarter-to-quarter. And in the fourth quarter, we experienced overall flat flows. As you saw, our retail outflows were $3.6 billion. Market volatility really led to client rotation out of our sub-advised equities and out of our core and core plus fixed income into shorter duration strategies. That was counteracted by very strong inflows on the institutional side and in particular, in fixed income, as many pension plans allocations rotate in in this type of an environment.

I would say it's important to note, if you look at our fixed income business overall, across both institutional and retail, overall, we had positive flows in the quarter despite facing the rising rate environment. That is a real testament to the diversification of our distribution and of our portfolio. As we've always said, we think it's very important to look at the long term track record when it comes to flows. We've done $60 billion in flows over the last five years and we did $11 billion in 2021.

Specific to your question around the retail side and what we're seeing from a fixed income perspective, we've seen $27 billion in retail flows over the last five years and our retail assets under management have doubled in that timeframe, really driven by the positive flows that we've seen, the alpha performance that we've seen and end markets. So we've been very successful there. Flows are an outcome of having outstanding capabilities, exceptional investment performance and great distribution, and we feel very strongly we have all of those. And we'll be a net winner over time, and we've proven our ability to succeed across all different market conditions.

Erik Bass
Analyst, Autonomous Research

Q

Thank you. And then maybe can you provide some more color on your group results this quarter, both for Group Life and Disability?

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

A

Sure, Erik, it's Andy. I'll keep going, and I'm going to split this out between Group Life and Group Disability. I'll start on the Group Life side. As we've all seen Delta and now Omicron are having a big impact on the country. US deaths were higher than 3Q. So we saw 126,000 US deaths in 4Q versus 94,000 in 3Q.

As a top three life carrier, we have a big broad book of business. There's two effects really on the Life side that I would note. The first is very similar to third quarter. And that's we have a high concentration of large retail and health care employer accounts. And if you think about it, those are employers that have a high number of frontline workers that are out and about and exposed on a daily basis. And also many of those workers are in low vaccination geographies.

The second effect we saw is while in this quarter, we did see a slight shift to older age, we're still seeing significant increase in incidence rates in the under 55 population. And that population tends to have larger dollar amount policies.

If I shift over to the Disability side, I'd start by saying most of our impact in the quarter in the business was on the Life side. But we are seeing some impacts on the Disability side as well. I would frame this, it's what we expected to see and what we prepared for, for the disability business. Our benefit ratio was 87.3%. That was 320 bps better than a year ago.

There's really two effects. On the STD absence side of the business, we are seeing increased volumes. If you think about the impact that Omicron has had as an example and the isolation rules, that drives the STD in absence. But that's a fee-based business. So the effect we're seeing there really is enhanced expense showing up in the admin ratio. We staffed up to make sure that we're there for our customers because that's job one.

On the LTD side, much like third quarter, we continue to see about a 10% increase in incidents and about a 10% increase in severity. But again, it's what we expected, and it is what we prepared for from a claims management perspective. So we're just proud to be able to deliver on our promises to our customers. And as the pandemic subsides or as it flows into being more of an endemic, we know that our benefit ratios will come back into the normal range.

Erik Bass

Analyst, Autonomous Research

Q

Thank you, appreciate the color.

Operator: Thank you. Next question is coming from Andrew Kligerman from Credit Suisse. Your line is now live.

Andrew Kligerman

Analyst, Credit Suisse Securities (USA) LLC

Q

Hi. Thanks a lot. Want to kind of shift back to M&A. As I think about the Prudential over the last two decades, the company has done a lot of excellent M&As. But the Assurance IQ, which – with this write-down today, kind of puts a little bit of a shade on it. And Charlie, you've talked about programmatic M&A, being prudent. So what I'd like to know is how does the Assurance IQ acquisition – how does that make you think about acquisitions going forward, particularly in terms of accretion dilution?

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. It's Charlie. So let me take that, Andrew. Let me take a step back and explain exactly why we did the Assurance transaction and the function it plays within our business mix. Assurance is a young and innovative company that it is completely aligned with our purpose and our strategy. It's helping us expand our addressable market, which is something we want to do and increase access to more customers, especially a customer base that's traditionally been underserved by our industry, and that's absolutely aligned with our purpose.

Secondly, it's a digitally-based platform, frankly in which we were underinvested and is a new space for us, but one that we wanted very much to be in. And third, from a strategic perspective, it's helping us to reduce market sensitivity by increasing our mix of fee-based earnings, which is entirely consistent with what we talked about of becoming a more nimble, less market-sensitive and higher-growth company.

Now, as we look forward, as I mentioned earlier in the call, at the acquisitions we'll be making, they are going to be in PGIM and emerging markets, and they'll be focused on – will be focused on acquiring more mature businesses, again, by which we can expand and extend our capabilities or our distribution or our scale over time. And this is absolutely in our wheelhouse, right? This is what we've been doing for decades in both emerging markets and asset management. And have made, I won't say hundreds, but tens of successful acquisitions over that time period. So, we feel very comfortable with where we're going, but we also feel very good about the strategic merits of the Assurance deal and the role it plays within our company.

Andrew Kligerman

Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks, Charlie. And any comment on accretion dilution you might add to that?

Charlie F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. Let me talk about the metrics that we use for a moment. So when we think about acquisitions from both – we think about them both from a strategic and a financial perspective. And from a strategic perspective, we look to add capabilities, as I said, such as product or distribution or increasing scale in a market or country. And from a financial standpoint, we look at a variety of metrics when assessing potential acquisitions such as earnings contribution and growth, et cetera.

Now obviously, the larger the transaction, the more compelling the financial aspects of the transaction has to be. But importantly, I think our focus is on becoming a higher growth, again, less market-sensitive and more nimble business, and we're going to continue to be extremely thoughtful and disciplined about how we execute with the goal of creating value for all our stakeholders.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Got it. And just real quickly on the expenses. It looks great that you're targeting $750 million in savings by 2023. And that's – I think you've completed $635 million so far per the slides, and that's up from an initial $500 million. Do you think beyond that, you could do more in expense saves?

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

A

Hi, Andrew, it's Ken. We've made excellent progress, both in terms of not just gaining efficiencies and lowering costs, but also building capabilities, and as we have done that on an accelerated basis relative to our initial targets. We remain certainly focused, again, both on building capabilities, but also gaining efficiency to drive growth going forward. We're very much on track to achieve $750 million by 2023. And at this point, we've really institutionalized both capabilities but also a mindset across the company of continuous improvement. And we're getting good payback on our initiative costs. So we expect to maintain a budget for that and also maintain this discipline going forward. Right now, we're focused on achieving that $750 million by 2023, and that's our main objective.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

Operator: Thank you. Our next question today is coming from Tom Gallagher from Evercore. Your line is now live.

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. Just a question on sort of sources and uses of capital. How should we think about the $4.5 billion of proceeds plus coming from the deals? How much of that do you think is free and clear for you to use? How much do you think you might need to use to bolster capital levels, if any of it is? I ask only because just looking at the HoldCo levels, I guess you're getting closer to the low end of the target now. I'm wondering if you want to bolster that back up to the top end. And also maybe any comments you have at any subsidiary levels that you'd like to strengthen capital, if at all, or you find across the board there and any debt reduction?

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

A

Yes. Hi, Tom, it's Ken. I'll take that. You should think of that $4 billion of or more proceeds coming in from our two transactions as free and clear and readily deployable. It'll quickly move to the holding company upon the close of the transaction. And just in general, we've had a very consistent approach to capital management. Our businesses are generating free cash flow. And also last year, we reduced debt.

So that we thought it was a good time to reduce debt. And so we just did that. We certainly have debt capacity as well. And now we also have the $4 billion of proceeds coming in. So we feel really good about our capital position and our liquidity and our flexibility and including being well positioned to meet our objective of returning $11 billion to shareholders over the three-year period 2021 to 2023.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got you. Thanks, Ken. And then my follow-up is just I was looking at your supplement and saw that you had operating debt of $5.6 billion that was issued out of the holding company. Now I guess I've always typically thought about operating debt getting issued out of the operating subs, not out of the holding company because it's kind of higher-rated entity. But can you talk a little bit about what is that exactly, the operating debt that's issued out of the holding company?

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

A

Yes. So we consider operating debt to be funding that fund sort of a specific asset or structure that where the cash flows from that asset or structure will pay off the debt. And some examples would be within our PGIM business. We do co- and seed investments that are funded both with capital to support the risk of those investments, but also operating debt. And we find that efficient to do that from the holding company.

Our PGIM business also has an agency mortgage business, where we fund loans from time to time, again, where those loans would support that operating debt. So those are two examples. But again, it's where specific assets or structures will support that debt.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got you. Thanks.

Operator: Thank you. Next question is coming from John Barnidge from Piper Sandler. Your line is now live.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you, very much. My first question, is there any way to bifurcate VII between marks and realized gains?

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

A

Yes. We do look at that and you should think of it as variable investment income is both balanced between cash coming from distributions as well as appreciation in the mark-to-market. Usually, it's pretty balanced. Last year, a little bit more appreciation than cash just given the move in the market.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Great. Thanks. And my follow-up, given the focus on large and jumbo within group, how much of the contracts there have seen pricing increases since COVID emerged?

Andrew F. Sullivan
Executive Vice President & Head-US Business, Prudential Financial, Inc.
A

So John, it's Andy. I'll take your question. So I don't have the exact percentage at my fingertips, but I'll make some high-level commentary. So, as I think you're very aware, those contracts renew anywhere from every two years to say, every five years, and it's very much based on the size of the business with the smaller cases renewing more frequently every two years and large national accounts renewing approximately every five years. 80% of our group insurance block of business is national accounts. So, our renewal cycle, they would tend to be more towards the longer end of that spectrum.

From a pricing perspective, now that we're entering the third year of the pandemic and it's probable at least that this will go from pandemic to endemic, we very much felt that we needed to take our COVID experience from the last 24 months and to put it into our new business and renewal business pricing. And we have done that on both the Life and Disability side. So that business will reprice over the next few years.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you. Best of luck.

Operator: Thank you. Our next question is coming from Tracy Benguigui from Barclays. Your line is now live.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Thank you. I wanted to circle back to your comment about completing a $5 billion PRT deal, the fourth largest in market history. If I recall, Andy, in a group meeting, you mentioned that more competitors have entered the space something like 15 to 20, and probably 6 or 7 of those are consistently trying to do these over $1 billion transaction. So, I'm just wondering, if pricing is getting too frothy for these mega deals and have your view of IRR changed due to competition?

Andrew F. Sullivan
Executive Vice President & Head-US Business, Prudential Financial, Inc.
A

Yes. Tracy, so it's Andy. Thank you for your question. So yes, we did two transactions in the fourth quarter for $210 million. And as you noted, that was on the heels of a very successful transaction in 3Q, which ended up being the largest transaction of the year and we were one of the top writers of the year.

I guess I'd make two comments. One, the market outlook here for the size of the market remains very strong. The funding levels are at the strongest they've been in 10 years; funded status at the end of November was at 98%. So, we believe that the market is going to stay large.

And as a pioneer and a leader in this space, to your point, despite it becoming more competitive, there are more competitors, we are still seeing that we – by being disciplined with underwriting and pricing, we could pick our spots. And we could pick our spots. And given the size of the market, we'll win our fair share and we'll be able to continue to grow that business, thanks to our brand and our capabilities.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Thank you. That's very helpful. And here's like, I guess, a bigger picture question on wage inflation. I guess, on one hand, that could maybe boost sales but on the other hand, there are these talent shortages. So I'm wondering how that may also impact expenses, if you could provide some color.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Tracy, it's Rob. I'll take a first stab at that. And Andy, if you want to jump in, please feel free to do so. I guess, Tracy, I'd start by bringing it up a level, which is the most significant impacts of inflation would be on rates. And that would be – and if inflation actually leads to higher rates, that's a good thing for the industry and for us included as a part of that.

With respect to operating costs, your specific question, one, I would note that our ongoing efficiency initiatives will help to mitigate any impact that we would have on increases that come through. Secondly, we are quite comfortable that we have sufficient pricing power in our most material products and markets that to the extent there's a residual impact, we'll be able to incorporate that into pricing.

And I'd add that while inflation is a macro factor that we're very much looking at how it influences the upcoming year, there are a number of other things happening from a macro standpoint beyond inflation. And we believe that there'll be drivers actually to tailwinds that will get created for our businesses, things like higher rates and an improving outlook for COVID.

Andy, I don't know if you want to add anything more specific on a business level basis.

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

A

Maybe the only thing I would add is, Tracy, both our US Insurance and Retirement businesses and our PGIM business, we're big, we're broad, we're well diversified. And there are plenty of spots in our business system where this environment is very good. And I just mentioned, we are one of the largest real estate investors in the world, number three by assets under management. And obviously, an inflationary environment could be very helpful for that business.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you.

Operator: Thank you. Our next question is coming from Humphrey Lee from Dowling & Partners. Your line is now live.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Good morning and thank you for taking my question. I just have a question related to Group Disability. In the slide deck, you talked about you looking to diversify your Group Insurance portfolio and looking to expand into Group Disability and Voluntary product. Can you just talk about how you are planning to do that, especially with some of the industry disability results recently seeing some pressure? How do you balance growing market share at the same time achieving adequate pricing?

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

A

Sure, Humphrey. It's Andy. So let me first bring it up a level to talk about how do we think about this strategically. So as we've talked about expanding our addressable market and bringing more solutions to more people, we continue to believe that the workplace is a great place to grow because of the reach and access that it gives us.

We've been executing on a strategy in our group business very consistently over the last five years to grow and in particular, to grow in certain spots, to grow in middle market, so smaller cases, to grow our disability block and to grow our voluntary capabilities in block so that we diversify the business further. And that makes a lot of sense because a lot of clients in the group space are bundled.

As I said earlier, the majority of our business at Group Insurance is large national account and the majority is life. So we feel we have a lot of room to grow. And in essence, we're going to stay the course on our value prop. We've invested quite significantly in strengthening our overall value prop, both our financial wellness capabilities, but also our core fundamental capabilities in both Life and Disability.

Your question about how do you do it in an environment like we're in, it's all about discipline, right? It's about being disciplined in pricing and underwriting and making sure that you – especially on the Disability side, that you maintain strong disability claims expertise and staffing so that you could properly manage the business in an environment where we're seeing increased incidence and severity.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

So my follow-up to that is, in kind of your strategic review, you talked about M&A area would be asset management and emerging markets. But given your interest now in expanding disability and voluntary benefits in the work site, is now Group Insurance be another area of potential M&A? Or are you still sticking to kind of asset management in emerging markets?

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

A

So Humphrey, this is Charlie. For now, our concentration is going to be on asset management and emerging markets. Those are two areas where we think we have, we can benefit significantly from the increase in capabilities and scale in the markets in which we already are doing business. And so, that's going to be our focus in the – certainly in the near to medium term.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Got it. Thank you.

Operator: Thank you. Our next question today is coming from Suneet Kamath from Jefferies. Your line is now live.

Suneet Kamath
Analyst, Jefferies LLC

Q

Great. Thanks. Charlie, a year ago, we talked about wanting to increase the earnings contribution from growth businesses from, I think the math was 18% to over 30%. And I'm just wondering, is that still on the table because it would seem that, that might be difficult without M&A, but I just wanted to get your thoughts on whether you can get there organically?

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

A

Sure. That remains our goal in two to three years. But as you point out, we'll be doing it through a combination of a couple of things. One is – or three things, really. One is organic growth. So we will be continuing to invest in our businesses. One is inorganic growth because we'll have to do some M&A to get there. And the third is really the dispositions of either lower growth or market-sensitive businesses. And you've seen us begin to execute on that with the two transactions that we're going to close this year.

And that's all within, again, the context of being prudent stewards of capital, of investing in our business, having programmatic M&A and returning capital to shareholders. So, the short answer of your question is, yes, that still remains our goal and we'll do it through a combination of factors.

Suneet Kamath
Analyst, Jefferies LLC

Q

And is it fair to say that the M&A piece might need to be the biggest of the three? Or do you think it's sort of evenly distributed across the three?

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

A

It's hard to say whether – what the percentages will be. It will depend on the opportunities we see, both organically and inorganically, and the dispositions that we make. So, it's sort of a multivariable equation, if you will, but we're looking to balance that equation and do it thoughtfully and prudently.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. Makes sense. And then I just wanted to ask about international sales, if we focus on Japan and Gibraltar. It looks like sales have kind of been flattish. Just wondering if – or is the reason, sort of, the COVID impacts and lack of face-to-face or do you have to do some more work in terms of the product set that you guys are offering, both in Gibraltar and the Life Planner model.

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

A

Hi Suneet, this is Scott. Let me give a little more context on why the sales are down, and then I can talk about what we're doing. First of all, our bank channel is subject to a higher level of variability and given when there are shifts in the competitive market. And given both COVID-related headwinds, but also higher US dollar interest rates, the regional banks have shifted to easier to sell investment products.

As you know, we maintain a strong pricing discipline on deposit products, and we've always concentrated our efforts on selling recurring premium death protection products in that channel. There was a second factor during the fourth quarter, where we're making some product shelf adjustments in our Life Consultant channel, and we're in the process of updating our US dollar annuity offerings and we expect the majority of the new products to be in place by the end of the first quarter. So I think that explains why we were down.

The actions that we're taking, in the bank channel, look, we intend to maintain our discipline, but we do think the market will evolve over time, especially as COVID restrictions are relaxed. Additionally, in Japan, we continue to go front and center with our death protection products. But increasingly, we've been adding to our product line with more retirement, wealth transfer and health products. And we believe, given those product line increases, coupled with really high-quality distribution there in Life Planners and Life Consultants, we'll be able to counteract this. We're actually pretty optimistic about going forward there.

Suneet Kamath
Analyst, Jefferies LLC

Q

Okay. Thanks.

Operator: Thank you. Next question is coming from Alex Scott from Goldman Sachs. Your line is now live.

Alex Scott
Analyst, Goldman Sachs

Q

Yeah. I guess for my first one, I just had a follow-up on International. When I think through sales and persistency, it seems for at least the near-term, I think premium growth will kind of continue to be the same or if not a little lower than you've had. And when I look at earnings over the last few years, it seems like G&A expenses declining has allowed for you guys to defend earnings in a pretty strong way. And I just wanted to probe there a little bit and understand what have you been doing to take expenses out? And is that something you can continue to do to help earnings in international?

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

A

Yes. There's a couple of different comments I'll give there. First of all, just like the US transformation, the International Business, Japan and others have been looking for ways to be more efficient and to use automation and other activities to control costs.

Also in some of our emerging markets, we're experiencing faster growth, so we're starting to see some scale benefits. And then finally, we've done a good job of cost control at the corporate center level. That being said, I think our opportunities to grow earnings internationally are much more driven by the revenue actions that I alluded to and the product actions and the distribution force actions that are taking place in both LP and LC.

So we're always going to be disciplined on the expense front, but I think it's more of the product and the emerging market growth areas that we think will be more important going forward. Lastly, I would say, of course, COVID has made it more challenging to recruit Life Planners and Life Consultants. And we do expect that to ease as the pandemic eases or turns into an endemic.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. And then maybe for a follow-up, there was a long-term care insurance underwriter that had a pretty sizable gross charge associated with the reimbursement policies and the impacts of inflation. And I just wanted to find out from you all, what do you feel like your exposure is to that? And will that have any impact on your in stat filings and the required reserves? And is there any material impact to cash flow we should consider?

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

No. The short answer is no. We do factor in inflation into our assumptions, and we're well positioned for an elevated level of inflation in the near term. And we continue to see claims experience consistent with our assumptions and actually a little bit more favorable.

Alex Scott
Analyst, Goldman Sachs Q

Thanks.

Operator: Thank you. Next question is coming from Mike Zaremski from Wolfe Research. Your line is now live.

Mike Zaremski
Analyst, Wolfe Research LLC Q

Hey, great. Just one question and a follow-up on the pension marketplace comments. You mentioned that funding levels at their highest levels looks like since the great financial crisis, but not above 100% yet. Just curious, is there kind of like a magic number, given there's costs associated with it, pension funding levels, let's say, we have a good market in macro market in 2022, if they got to like 103%, 105%. Or is there a magic number that would kind of cause sales to an uplift? Thanks.

Andrew F. Sullivan
Executive Vice President & Head-US Business, Prudential Financial, Inc. A

Mike, it's Andy. I'll take your question. And the answer is, we don't believe so. At 98%, plan sponsors are very willing to lean in and to transact. I think plan sponsors, when they're in this range and they see the volatility in the marketplace, it really drives the desire to transact and to derisk their pension plan. So there's no magic number. Having said that, we think at these levels, we're going to continue to see robust markets.

Mike Zaremski
Analyst, Wolfe Research LLC Q

Thank you.

Operator: Thank you. We reached end of our question-and-answer session. I'd like to turn the floor back over to Mr. Lowrey for any further or closing comments.

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

Thank you, and thank you for joining us today. 2021 was a year of transformation for Prudential in which we reached a record high level of after-tax operating earnings, distributed a record amount back to shareholders and made real progress towards becoming a more nimble, less market-sensitive and higher-growth company.

As we look ahead to 2022 and beyond, we are focused on creating and driving growth and becoming a global leader in expanding access to investing insurance and retirement security. We are both excited about and confident in our strategy and our ability to create value for all our stakeholders by building even further upon our progress. We look forward to sharing more with you along the way, and thank you again for joining us today.

Operator: Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time, and have a wonderful day. We thank you for your participation today.