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Prudential Financial, Inc. (PRU)

Investor Day

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MANAGEMENT DISCUSSION SECTION

Darin Arita

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

[Foreign Language] (00:00:23) All right. I think, we need a little more energy here. I know there's the jet lag for some of you, but wonder, if the English speakers can be louder than the Japanese speakers, or vice versa. So, we'll try it one more time. Good morning. [Foreign Language] (00:01:17). All right, all right. That's much better.

Well, welcome to our 2018 Tokyo Investor Day. I'm Darin Arita, the Head of Investor Relations. When you're in a new situation, sometimes it's hard to figure out what to say. And so, I look back at past transcripts of our Investor Day. And in 2010, the Head of Investor Relations, Eric Durant, opened up by stating that he had a dream. He stood up here on this very stage, in front of a grand audience just like you, and he shard that dream. His dream was from the prior night about a cow-milking contest, a cow-milking contest. Now, I'm not sure if I've at that comfort level yet to share my prior night's dreams with all of you, especially about a cow-milking contest.

But with that said, I could not have dreamt of a better line-up for all of you today. Not only do we have our esteemed executives from our Japanese businesses here. For the first time ever, here we have Prudential's Chairman and CEO elect and Vice Chairman elect at our Tokyo Investor Day.

We're hoping that through today you'll come away with a better appreciation of three things. First, our differentiated business model; second, the sustainability of our growth and our returns; and third, our consistency in generating capital and deploying our capital.

Also joining us with the presenters to help with answering questions during the Q&A sessions or during the breaks are, we've got our next Head of International, Scott Sleyster. Scott, can you raise your hand there? We've got our next CFO of Prudential, Ken Tanji; and our CFO of International, Mark Finkelstein. We'll have a couple breaks here, there'll be one, it'll be after the first Q&A session, and another break after the second Q&A session. And maybe just – and at the end of the day, we'll end around 12:00, we've got lunch, it'll be up on the 51st floor.

Just a few housekeeping items. Wi-Fi is available, you'll be able to find it under the network Roppongi Hills. You've got these translation devices at your table. Channel 1 is for Japanese, channel 2 is for English. And then, if you could just take a moment and check your mobile phones and make sure it's on silent mode. Okay.

Now, to the most important part, I was instructed to read this to you. Please note that 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. 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 are included in today's presentation, which is available on our website at investor.prudential.com.

Not sure if anyone listened to that on Channel 1, but I'm curious how they translated non-GAAP measures. Okay. So, as I introduce you to your speaker, I thought I just share something personal about them with each of you. And given that, we are in – we're in Japan, this is the land of karaoke, or as we call it – as they call it here [Foreign Language] (00:02:04), that I shared with you each person's, their favorite music group that they like to sing when they're up on the stage there.

Actually, one of my colleagues said it was only fair that if I asked everyone to do that, then I should be sharing myself, so I warn you, I'm not a good singer, but if I'm up on the stage, I will sing Michael Jackson, and I'm Bad.

So, our first speaker, yeah, he is the Head of International. He is the next Chairman and CEO of Prudential. He's been with the company for more than 17 years now. As for his favorite music group, he loves Japanese culture, he loves Japan, everything here. But there're two Japanese things that he does not do. One is eating Uni, that's the raw sea urchin; and the second thing is karaoke. So, I'm giving him a pass, he is also the next boss. So, I think I should do that.

With that said, please join me and a warm welcome for Charlie Lowrey.

Charlie F. Lowrey

Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

Good morning. I don't know what a cow-milking contest is, but I don't think I really want to know what a cow-milking contest is. So, we have – I think we have, as Darin said, a good line-up for you today. We've actually added PGIM to the agenda this year because of its success in managing third-party distribution assets, which is significantly expanded our presence in Japan. So, you'll hear from Nitta-san later about PGIM in Japan and how it has grown and how it really has expanded our presence here in this country.

So, turning to first slide, there are three key messages that I'd like you – I'd like for you to take away from our presentation, or at least my presentation today.

The first is that the Life Planner and Life Plan Consultant model, focusing on death protection continues to be a real source of differentiation for us, and a source of competitive advantage. And as you'll hear from Kurashige-san, and Hamada-san later, and actually Soeda-san too in the Bank channel, you'll hear about the Life Planner model, and then from Yamauchi-san with the Life Plan Consultant model, and how it continues to be executed at a very, very high level, and what that does in terms of our ability to focus on and sell death protection. That provides us with both sustainable growth and profitable growth, while generating capital on a consistent basis, and Rob will talk you through that part of the equation.

And then, you'll see that we're investing in the businesses in a whole variety of ways. We continue to increase our geographic presence selectively, especially in emerging markets; we're going deeper into countries in which we already do business through expanding distribution in those markets; and finally, we're making investments in digital, data and mobile as we go forward to get closer to the customer.

So, in terms of our strategy, you may have seen this slide before, it hasn't changed, it's very consistent. We think of it as a stool with four legs. The center of the stool or the seat is superior execution that is key to how we operate our distribution models in the different countries. But the first leg is expansion of distribution, especially into third-party channels. So, now, about a third of all our distribution is through third-party channels, and the rest is through proprietary, through the Life Planner and Life Plan Consultant models.

Secondly is to develop new products. So, as you think about either the aging demographic in Korea, Japan and Taiwan, or you think about the emerging middle class coming up in the emerging markets, we're developing products, either retirement products or new life products for those different demographics.

The third, as I said, is investing in digital, data and mobile capabilities, and you'll hear about that. And the fourth is complementing organic growth that we enjoy with selective M&A as we go forward. What this leads to is sustained growth with strong returns and a very steady capital generation. What you see here is on a constant currency basis over the past five years we've growth AOI 4%, delivering a mid-teens return, and returning over $1 billion of capital a year. So, very consistent strategy, delivering consistent results.

The way we think about growth in the International business as we kind of chunk it up into three different time periods. So, you have near-term and you can think of this roughly as sort of zero to five years, 5 years to 10 years, and 10 years on. In the near-term, we'll see continued growth in Japan, Korea and Taiwan, so many of the developed markets. We then turn in the medium to developing markets, so Brazil, Chile, Argentina, Indonesia and India, where we have small but growing businesses. And finally, you can think about green shoots which are beginning to sprout in Africa and China and Mexico. So, we deliberately think about different time periods and what is going to add to PII's growth over time.

So, Japan; Japan remains a highly attractive market and we believe we'll be able to continue to grow in Japan for multiple reasons. One, we have a differentiated distribution strategy, two-thirds of which is proprietary, and that proprietary distribution, as you'll hear from Kurashige-san and then from others, is highly trained and therefore enables us to sell very sophisticated product, obviously U.S. dollar product, but others as well, to our clientele on a needs-based basis.

Second, we do focus on death protection. Others are shying away from that. That is our core competency, that is what we do really well. We know how do it and there is lots of opportunity to continue to sell death protection.

Third, we have four distinct channels, each of which has room to grow. We enter into further product innovation, and Rob will give you an example of that in his presentation, and then we're investing in technological efficiencies which will affect over time both top- and bottom-lines.

And finally, our target market will continue to grow for another 40 years, if you look at the demographic charts. So, we think we'll be able to continue to grow this business in the low- to mid-single-digit range with low volatility and good margins for the foreseeable future.

In addition to that, we continue to have success in select emerging markets and we've chosen two here. First, Brazil, and here you see the growth in the LP model and the in-force, but we're only in the individual life insurance sector, which is about 10% of the market. The other 90% is bank, Bancassurance and Group Insurance. And recently, we've entered into the Bancassurance market and we purchased a small Group Insurance business. So, there is a lot of room to grow in the sector in which we're already competing, the Individual Life sector. But now we're also going to enter into and penetrate both Bancassurance and the Group Insurance business, so there is a lot of room to continue to grow in Brazil.

The other is Chile, where obviously we own 40% of Habitat, which is doing exceptionally well. It's gaining market share, it's a number one company, and remains by far the lowest cost provider, it also has exceptional investment performance. Next slide.

On the medium- and long-term basis, we have other companies and other countries that will provide growth. As an example, our JV in India has risen from number 22 to number 8 in the market over the past few years, so it's had significant growth in the market. And in Indonesia, we have a partner who is conglomerate whose companies touch over half the Indonesian population, enabling us to establish over time a very strong affinity marketing program. Now, all four of these operations are very small at this point, but bode well for the future.

So, I'll come back to the same points I made at the beginning of the presentation. We have a very, very strong backbone around the world in the LP and LC model, which is augmented by our growing third-party distribution.

This foundation enables us to grow profitably while still generating significant amounts of capital. And finally, we're making strategic investments that enable us to continue that growth as we go forward. So, I hope today you come away feeling like these messages ring true.

And let me now turn it over to Kurashige-san or back to Darin, are you going to – okay, back to Darin, who will introduce Kurashige-san. Thank you.

Darin Arita

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

Thank you, Charlie. So, our next speaker is the Chairman and CEO of Prudential Holdings of Japan, which oversees all of our Japanese insurance businesses. He's been with Prudential for more than 27 years and his favorite music group is One Direction. Please join me and a warm welcome for Kurashige-san.

Mitsuo Kurashige

Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

Good morning. [Foreign Language] (00:12:34). My target is $100 for karaoke by year. Anyway, I will present the overview of Prudential Insurance Businesses in Japan. Prudential has established a strong presence in Japanese market. I would explain why we have been successful and expect to continue to grow. Please turn to the next slide.

Let me start with the three key messages I want you to take away from my presentation. First, our customer-focused and differentiated distribution model results in attractive returns. Second, our needs-based sales approach and the quality people drive our leading market position. And lastly, we are adapting to market change through multiple growth opportunities.

Let me explain each message in more details in the following slide. Next page, please. I would like to talk about why the Japanese market remains highly attractive for us with room to grow. Japan is the second largest Asia's market in the world next to the U.S. based on the volume of life insurance premiums, with a market share of 13.5% followed by China and UK. Regarding household wealth and the investable asset pool, household asset in Japan amount to about $17 trillion, of that amount over 50% is held as deposit. That is the largest amount of deposits in the world.

With an aging populations, the retirement market is expanding. A growing awareness over the need for self [indiscernible] (00:14:43) efforts to prepare for post-retirement living expenses attract customers to retirement product. As for the product trend, Japanese customer prefer safer product such as life insurance product in managing their money rather than riskier product such as equity investments.

Also, in this low interest environment, there have been an increasing need for non-yen product. Regarding distribution trends, captive agent still remain our most significant distribution tariffs, while bank and Independent Agency charges represent additional growth opportunities. Our business model is well-suited to meet those characteristics of the market, as you will hear later.

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Next slide, please. The slide shows our mission, vision, and core values, all of which represent our customer focus. Our mission is to provide the highest quality service, as well as financial security and peace of mind to customers. Our vision is to revolutionize the life insurance business and become the most admired partner to customers. And our core values are worthy of trust, customer focused, respect for each other, winning and integrity. With this focus, we have successfully established our differentiated quality people, quality product, and quality services.

Next slide, please. Now let me explain how our businesses and distribution are organized to sell products to a broad cross-section of Japanese customers with different income, asset levels and varying insurance need. We benefit from the multi-channel approach including our captive agent channel with Life Planners or LPs, and Life Consultant or LCs, as well as our third-party Bancassurance and Independent Agency channels.

In the Life Planner channels, our LPs, they brought and expand their market through their own networking effort and [indiscernible] (00:17:29) including those that they get from their customers. Their primary target is the high net worth market as well as the business and professional markets.

The LC channel targets a broad middle income clientele, and notably it has a strong presence in affinity market, particularly with Teachers' Associations. In our Independent Agency channel, we target the mass affluent independent market mainly in urban areas, as well as the business and professional markets. We seek to grow through the active engagement of our marketing representatives and sales representatives, who support our partner agencies.

And finally, through our Bank channel, we are able to efficiently access high net worth customers and address the death protection, retirement and inheritance needs. Our one key point across all of our channels is, we need this recurring premium death protection solutions. It is required a high scale distribution, which is difficult for others to deprecate. We have differentiated strategies in each channel, which you'll hear later from each company's CEOs.

Next slide, please. Now I'll talk about how we meet customer needs over their life cycles. This chart is just for illustration purpose. Among relatively young families in their 30s, the need for protection against premature death is high. For these people, term insurance combined with Whole Life is an effective solution. As people age, risk of income loss due to the injuries and illness or the risk associated with the medical treatment expenses increase. We offer medical policies and riders as the solution. Among pre-retirement people and retirees in their 50s and 60s, the need for asset accumulation for post-retirement income is higher. We offer products such as Whole Life or retirement income as a solution. Our experienced sales agents have built lifetime relationship with customers to address their evolving needs.

Next slide, please. The chart shows the expected change in Japanese demographic over time. While the population is decreasing, if you look at our target market, which is the top two sections of the bar chart, the proportion of the population for this market will grow over the next 40 years. The 65-and-above market wants significant needs for post-retirement income and the ability to fund healthcare expenses, as well as tremendous need for transfer of wealth. These needs require a sophisticated sales force, which is exactly what our business model provides.

Next slide, please. The chart on the left shows the number of our LPs and LCs that are a member of the Million Dollar Round Table, a very prestigious group that represents the top agent in the Japanese market by sales levels. Of significance, POJs and Gibraltars account for over one-third of the top membership in Japan. POJ has had the highest number of MDRT members for 21 consecutive years. Gibraltar has also significantly increased its membership in the past two years, and is now too close to the second position.

Gibraltar has been working to improve the quality of LCs through a more selective recruitment process and training. In addition, MDRT members of Gibraltar LCs and POJ LPs are very self-motivated and voluntarily hold workshops to encourage each other to further improve skills. The quality of our people lead to strong productivity. We believe the productivity of our captive agent is very strong and sustain our growth.

Next slide, please. This slide shows the strong market position Prudential holds in the Japanese market. Based on 2017 data, Prudential became number one in new business face amount, and number four in in force face amount. These rankings reflect our successful exclusion in providing these protections. Our market share has been increasing, and our expect – we expect this trend to continue as a result of our merchandize, our broad solution set and our highly productive distributions.

Next slide, please. [indiscernible] (00:23:50) shows a breakdown of annualized premium by product type categories. Our primary focus is to provide death protection, which contribute to our earnings stabilities. The business has strong mortality margin and our high quality distribution fosters our excellent policy persistency. Death protection product made up over 60% of our annualized new business premiums, while sales over other products categories were well-balanced across the remainder. Our annualized premiums in force have a similar composition, with the majority of our in force book of business focused on death protection.

Next slide, please. This chart shows the in force face amount of our Japanese business on a constant currency basis over the past five years. We have generated stable growth sustained by providing death protection through need-based sales to our customers. This would create AOI growth higher than in in force growth.

Next slide, please. We have been successful at adapting the change in the market. As a result of prolonged low interest rates, we have been introducing a new product to meet customer needs and successfully shifting our sales to U.S. dollar product, which have attractive profitabilities. We also replace our product in response to regulatory change to valuation interest rate and statutory mortality rate.

With increasing compliance standard and growing competition, our third-party channels remain focused on selective growth by seeking sustainability and [indiscernible] (00:26:02) based on need-based sales. Demographic change has resulted in more opportunity to provide product, that meet our customers' retirement solutions and estate plannings need.

We're also expanding the – diversifying our captive distributions. For example, we are increasing the number of female Life Partners in response to increasing opportunities to provide solutions for women in Japanese society. We're also focusing on digital, data and mobile solution, which you will hear about later in my presentation.

Next slide, please. Slide 13 shows the annualized new business composition by currency in 2013 and 2017. As you can see, we have experienced a shift from yen-denominated product to U.S. dollar-denominated product. The annual growth rate since 2013 to – of U.S. dollar recurring premium product sales has been 21%. Our introduce – we introduced much of our new U.S. dollar recurring pay product in past two years that provides greater customer value in this low interest environment, while also having a higher profit margin for the company.

Next slide, please. In response to the rapid technological advancement and increasing opportunities to utilize digital tools in our business, we continue to enhance digital, mobile and data analytic capabilities. We have massive strategic initiatives that we plan to execute.

First, expansion of the communication entry point for our customers to interact with Prudential through omni-channel service offering such as Internet service, a contact center for which chatbot capabilities will be deployed, and face-to-face sessions with our LPs and LCs as our customer desire convenience through [indiscernible] (00:28:40) at any time.

Second, digitalization of sales support process. For example, we are introducing electronic applications for new business. We'll then expand the capability to cover the post issue and claims. This will reduce the administration burden for both customers and our LP and LC sales forces.

At the same time, additional data would be created for data analytic use and artificial intelligence, for which we continue to execute proof of concept.

Third, digitalization of back office processes. This would increase operational efficiencies and create additional data for analytics, similar to the approach taken for the sales support processes. Data, as each company's CEO present, will – you will hear more specific about our digital, mobile and data initiatives.

Next slide, please. In closing, I'd like to leave you with these key messages. Our customer focus and differentiated distribution models result in attractive returns. Our needs-based sales approach and quality people drive our leading market position. And we are adapting to market change through multiple growth opportunities. We are confident that without our differentiated strategy and quality people, we continue to grow while protecting financial soundness.

Thank you very much.

Darin Arita

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

Thank you, Kurashige-san. So, we'll start-off our first Q&A session with Charlie and Kurashige-san. Just a few friendly reminders for everyone, our presentations, they are being webcast. So, if you could just wait for the microphone to get to you. And then when you receive it, identify yourself, also your company name before you ask your question.

Second, just please speak slowly there, as the questions they are being translated, and ask your questions one at a time. Finally, be considerate of others as well, and limit yourself to one question and one follow-up question when it's your turn. You may also want to have your headsets on as the answers to some of the questions could be in Japanese and they'll be translated for you.

So, with that, we can begin the Q&A. We'll start in the front there with Nigel.

QUESTION AND ANSWER SECTION

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

It's coming.

Nigel P. Dally
Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Nigel Dally, Morgan Stanley. You talked about a number of different geographies beyond Japan that you've expanded into, possible to get some sort of sense of the earnings contribution from those other countries?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

So, it depends on the region. So, if you think about Korea and Taiwan, those are developed countries. We've been in them a long time. They are significant contributors to PII. Most of the other regions at this point are small and relatively immaterial to our AOI.

The good news is that, we have a tremendous business in Japan. The alternative side of that is, it takes a while for the businesses that are growing to become contributors and diversify the AOI away.

So, what I said a couple of years ago was probably the same thing, which is, for Brazil, as an example, probably come and talk to me in about five years and we hope that that will become a material contributor. Habitat is growing nicely and there are a number of others that are as well. So, this is – we're playing the long game. So, I think you'll see over time, as I said, between the sort of short-term, medium-term and long-term, and the growth of the markets that we're in and the companies we have in those markets over that period of time, that probably reflects the AOI contribution as well.

Nigel P. Dally
Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

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

A

Maybe we'll stay in the middle there. Go to Jimmy. Jimmy? Thank you.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

Hi. Jimmy Bhullar, JPMorgan. I had a question just on the shift in your distribution as you're going more towards third parties. How do you think – how does that bode for your margins, ROEs overall, because it is sort of opening you up to competition from other providers in those channels?

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

A

Just I'll repeat that question. So, the shift towards the third-party distribution, what's the effect on that on the margins and ROEs?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

The answer is, very little. In other words, we have the same discipline on profitability that we have in the LP and LC channel in our other channels. And the other channels augment our proprietary distribution and we see those as variable, and that pricing can get away from you really quickly in, say, a Bank channel. And so, you have to be extraordinarily careful about the products you sell and the pricing of those products over time.

So, you'll see that our Bank channel sales have come down somewhat. That's because we are not competitive in certain products because we have a certain hurdle rate of profitability that we don't want to go below, and we're willing to have sales vary in order to retain that level of profitability. So, we feel very strong about retaining or maintaining a certain level of profitability in all the channels. Sales will go up and down as a result, but our profitability levels will not.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

And if I could ask one more just on your – the shifting sales mix towards U.S. dollar products, and you've seen that, I think, many other companies have seen that to an even greater extent than you have. What's the risk if the yen where to – if the currencies were to move and, let's say, the yen were to strengthen a lot of mis-selling issues or other issues for you and the industry, are these products being marketed properly as the disclosure and do people who want to buy them, do they understand what's going on for you and the rest of the industry?

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

A

Maybe that question for Kurashige-san. So, just the shift to the U.S. dollar products, what's the risk to us, the industry, especially if there is a strengthening of the yen?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

A

As for the dollar-denominated product, there is a currency risk for sure. But at Prudential, from 20 years ago, we have been selling the recurrent payment, U.S. dollar product. And in that sales process we have been able to explain to the customer the currency risk and also we have this so-called suitability call to check whether the customer understand the currency risk. In that sense, we have very long experience in that area and we have the process that we can confirm to the customer whether the customer can understand the currency risk. So, in that sense, we expect that we are meeting the customer's expectation.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

Have a little bit of a lower and sort of customer base, are those companies doing it properly as well and they're being diligent with disclosure?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

We won't – we can't comment on other companies and what they are doing.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

What is the industry in general?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

Let me just add to what Kurashige-san said on the – on this issue. And that is, we also have very strong control and compliance groups. We've been doing this for a long, long time. We've been selling dollar-denominated products. So, we know what we're doing, we know how to sell them, as Kurashige-san, with needs-based selling. And then, we also know how to monitor the suitability of those sales through control and compliance.

I'd also say that we have an excellent regulator in the FSA, and this is one of their focuses as well, and we have constant communication with the FSA over this issue.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

Thank you.

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

A

Now, we go to Ryan Krueger, right behind you there.

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

Q

Thank you. Ryan Krueger, KBW. Can you discuss how you've dealt with the change in the standard mortality tables from a pricing and product standpoint, and to what extent it's impacted your view of new business returns?

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

A

Kurashige-san, so just the effect in changing mortality tables.

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

A

Right. So, death protection products in mortality table, the mortality rate has reduced. So, premium declined. On the other hand, in our group, we'll look at the balance of source of earnings, so sometime we increase loading to adjust that. And two years ago, when standard valuation interest rate was changed, so credit rate was also decreased. So, we have well-balanced – in terms of profitability, we are well-balanced. And as to the third-party products, we have increased the premium. Some company approach differently, within the Prudential Group, we haven't touched much of the pricing.

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

Q

Thank you. And then, second question. Can you discuss how you're positioned from a IT standpoint in Japan and to what extent you've upgraded back-office systems, and how you're approaching that going forward?

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

A

Kurashige-san, so, just the IT and back-office.

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

A

Well, the Prudential and also operating the insurance business by the mainframe, but if we know that mainframe is reaching to the end of life, then toward that we may consolidate or we may wanted to upgrade the system. Especially at the Gibraltar, three companies merged and there were many mainframes. So, we consolidated those mainframes into one IT infrastructure. And we have been doing this from five years ago and we will take additional 10 years to consolidate the IT infrastructure.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

Thanks to that. And that is – there's really the back-office infrastructure, but then there's also the front-office infrastructure. And what's really exciting is, over the past few years, we've been working more and more closely with our U.S. counterparts in the customer office in the U.S. to learn what they are doing at being at the forefront of reaching customers when, where and how they want through the financial wellness programs and through much of what's going on in the – at the Workplace Solutions Group. So, there's a lot of innovation going on in the U.S. and we're beginning to share that.

Most recently, a whole contingent of our Japan colleagues went to our Palo Alto office to learn about what's going on and to take some of the specific applications and bring them back here. So, there is a lot of work going on behind the scenes in terms of both, as Kurashige-san said, the – what I'll call, the rudimentary back-office stuff of policy admin systems and that kind of thing, but also, a tremendous amount of work going on, on ways to augment the Life Planner and Life Plan Consultant models as we go forward.

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

A

We'll work our way back just behind Ryan there. All right, well...

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Hi, John Barnidge, Sandler O'Neill. You talk about the countries in the medium-term and long-term portion of the slide as not being large contributors to AOI right now. Can you categorize your interest in using M&A to maybe accelerate that exposure to the rising middle class and maybe what countries offer the greatest opportunity for that M&A?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

Sure. So, we think about M&A in two ways. We think about going deeper into the countries in which we're already doing business, and then, we think about gaining access to a limited number of new countries. As my predecessor said and we agree with completely, we're not flag finders, we don't want to be everything to everyone. We want to be everything to a limited number of countries.

And so, as you think about some of the acquisitions we've done over the past few years, we've gone from 24% to 49% in India in our joint venture, and we bought a group business in Brazil. Those are two examples of going deeper into the countries we already are in. Three examples of going into new markets would be our acquisition of 40% of Habitat, starting a joint venture last year with CT Corp in Indonesia, and then through our separate account with LeapFrog acquiring an interest in the oldest Ghanaian life insurance company, Enterprise, which is in business for – which has been in business for almost 100 years and has a 26% market share.

So, those are three examples of going specifically into new markets. But we're in most of the markets we already – we want to be in. So, if you look at the top 10 most populous – most populated countries in the world, we're in the top five already. So, we're in China, India, United States, Brazil and Indonesia. Those are the top five. We're also in Mexico. If you look at the other four, they're Pakistan, Bangladesh, Russia and Nigeria.

So, eventually we may want to go into Nigeria, we probably won't want to go into the other three. So, we're in most of the most populous countries in the world. And so, what we want to do over time through superior execution is to go deeper into those countries. So, you may see M&A in terms of going deeper into those countries as we have in India and Brazil as we go forward.

John Bakewell Barnidge Q
Analyst, Sandler O'Neill & Partners LP

And then my second question, you talk about your digital mobile capabilities. What percent of policies in Japan are digitally submitted today without a human touch, and then just digitally submitted in general? Thank you.

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Kurashige-san, just the percent of policies submitted digitally.

Mitsuo Kurashige A
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

As for the POJ, the policy that submitted from the e-process, as for the process, around 40% to 50% are already digitized. However, that's the process of getting application. So, we try to omit the customer writing into the application. But as for the discussion of the insured amount, and that is supported by the Life Planner, which cannot be replaced by the digitization, but the process itself is done 50% by the e-application.

Charlie F. Lowrey A
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

...words, one of the real hallmarks of Prudential in Japan is the face-to-face distribution, the fact finding and what we call the unlocking of the latent needs. In other words, what is the amount of death protection that someone needs. The hallmark of what we do is face-to-face distribution, the caring, and then lifetime concern for the customer. That is one of the absolutely critical and competitive advantages we have. That is not going to be replaced through the electronics or the digital application. So, we view the digitization of the process as an augmentation to this process, but not in any way, shape or form a replacement for that process.

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Stay in this row. Sorry, I can't see in the back.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, Darin. Suneet Kamath from Citi. Charlie, in your introductory comment you talked about an expectation for low to mid-single-digit growth. Was that in in-force business or AOI and is adding distribution sort of the swing factor in terms of what gets you from low to mid, is it still sensitive to that variable?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

So, that was for AOI, and the swing factor has to do with a variety of things, the things you just mentioned, but also product type. So, as we think about product type, for instance, in Japan, selling more U.S. dollar product, that could help as well. So, it's a combination of things.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

And then, on the death protection side, I mean, we hear from a lot of companies just about how penetrated the life insurance market is here in Japan. So, where is that – and you'd said at one point that you expect to see a significant opportunity for future growth in death protection. So, where is that incremental growth coming from?

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

A

[audio gap] (47:33) situation in Japan, where is the opportunity for growth on death protection?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

A

Right. So, Prudential Japan, when we started the business 30 years ago in Japan, life insurance market was already 90% complete cover. So, it was saturated market already 30 years ago. Maybe the situation is same even today. But what type of protection customer needs? What is the needs of actual protection the customer needs? So latent needs, are they fully served or underserved?

If you look at whether they're served or underserved, the situation is quite different. So, it's not actual participation rate. So, if a customer understand what kind of protection they need and we sell to satisfy the needs, so the market might look saturated if you look at just participation rate. But POJ has grown 30 years. That's because we are serving underserved customer. So, protection, how much customer needs and we'll look at individual customer situations, we capture that and unlock latent needs, that is so-called the basis of need-based sales. So, as long as we do that, then we'll continue to be able to sell our life insurance products and customer put a lot of confidence on us.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

And if I may just add to that on a – let's go through each channel on a tactical basis and show you how we're thinking about it. So, with POJ, POJ is concentrated in some of the major urban areas, but they're expanding through the addition of sales managers into smaller cities where they haven't been before. In addition, there has been a concerted effort to hire women Life Planners to really focus on the needs of women in Japanese society. So, there's a lot of room for growth there.

If you look at Gibraltar, we are in the process of increasing the quality of life consultants, and Yamauchi-san will talk about that, but that will bottom out probably in the first half of 2019, and then we'll be able to see growth there, and there may be some room for growth as you will see in productivity as well.

If you look at the IA channel, when we first started and acquired Star/Edison, we had about 5,000 Independent Agencies. We reduced that to half that number that really wanted our service model, a high touch, high service model, which is the hallmark of our business here. And there's plenty of room to expand in Independent Agencies going forward, through deeper penetration into the number of agencies, deeper penetration into the number of agents in each agency, and then finally, for the agents that are selling our product, have them sell more product. So, there are lots of ways to continue to expand there.

And finally, in the Bank channel, we have relationships with 62 banks. We do business with most of those banks, but at varying degrees. And so, given our seconded Life Planner model and our emphasis on service, and hopefully penetration into those banks, there is room for continued penetration into the banks in which we do some business, but not a lot of business.

So, very – if you get down to the tactical levels in each of the companies, there's significant room for continued growth.

Suneet Kamath Q
Analyst, Citigroup Global Markets, Inc.

Okay. Thanks.

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Back to this side. Is that Tom?

Thomas Gallagher Q
Analyst, Evercore ISI

Tom Gallagher, Evercore. Just had a few questions on the broad shift to foreign currency denominated products and the impact on your business. I know historically PRU had talked about how riders have been a significant contributor to margins. These – are you still selling the same amount of riders, medical riders that is, on as you've shifted to the foreign currency-denominated products, or is that more just being sold with the yen products?

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Maybe for Kurashige-san.

Mitsuo Kurashige A
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.

As to medical insurance, we don't have foreign currency medical insurance product. Not so much rider, but medical-based policy standalone products is the one we offer, so we're maintaining certain size of sales.

Thomas Gallagher Q
Analyst, Evercore ISI

I know that – and this goes back probably three to five years ago when there was a much bigger emphasis on rider sales, is that no longer a big portion of what you're doing in Japan?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc. A

Well, back then, our sales volume and today I don't see that much difference, it's about same.

Thomas Gallagher
Analyst, Evercore ISI Q

And just curious, have you – is there a difference in foreign currency persistency versus yen-denominated product persistency?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc. A

No significant difference. But foreign currency annuity, and once it hits annuity, I mean, maturity, we held that as a closed block. In such case, because of the ForEx, customer decided to keep or sometime they lapse because of the effect of foreign currency rate. But the regular recurring premium products or retirement products, both yen and foreign currency, there's no difference in persistency rate.

Thomas Gallagher
Analyst, Evercore ISI Q

And then, my final question is more sources of profits, because I think the case I've heard for several years now has been the mortality margins are a real driver of the profitability. But the fact that you now have 70% of your sales shifting to FX dollar-denominated products, doesn't that show us that interest rates are a key component of the margin here overall, if, I mean, that big of a portion of your overall sales are shifting and it's purely driven by interest rates and spread?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc. A

Well, business hasn't changed, but the interest spread, U.S. dollar Whole Life or yen Whole Life, if face amount is same and their mortality gain is same. On the other hand, interest gain in Japan, it's very difficult to find any gain, but investment spread in U.S. is easier, especially, we have a collaboration with parent company in the U.S., so it's easier for us to access spread in U.S., so we can enjoy bigger spreads. That's something we're expecting and that is a reality.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc. A

Come up here, Erik.

Erik James Bass
Analyst, Autonomous Research US LP Q

Hi, Erik Bass with Autonomous Research. I guess, should we look at from the demographic shifts that you showed that over time you would expect your product mix to shift more from basic protection products to retirement? And then, if that's the case, can you just talk about the financial profile of those products versus basic protection? And maybe to Tom's question, is there more of an interest rate component to those versus mortality?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.
A

As for the aged customer, when we sell, usually, we sell Whole Life through the insurance, then they can get the tax benefit as well and they can also get the minimum guarantee. On the other hand, through the insurance product in the future, if the customer wants to get – receive the pension, we do have that type of product as well, but whether or not that the investment impact is large, as for the saving type, relatively speaking, it may be big. However, it's not extremely big.

Erik James Bass
Analyst, Autonomous Research US LP
Q

All right. Just a follow-up. Would you expect there to be a shift in mix, I guess, first more towards Whole Life, and then to the savings-type retirement products? Is that the right kind of directional way to think of where you would expect sales to go over time?

Mitsuo Kurashige
Chairman and Chief Executive Officer, Prudential Holdings of Japan, Inc., Prudential Financial, Inc.
A

Well, the Whole Life is our core products and that is not going to change. So, no change to that. Now retirement income, this is the recurring pay products and customer get annuity benefit. We sold this in yen over – about 20 years ago, we launched this product. Even though we had that product, not everybody bought the product. Some people stay in Whole Life, so I don't think there will be significant change in product mix of our sales portfolio.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

Okay. I know there might be more questions out there, but we're at our break now. So, we'll just take a short 15-minute break and we'll come back and there'll be more time for questions at the end too.

[Break] (00:57:46-01:12:19)

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

All right. Welcome back. We'll get things started again. Our next presenter is the President and CEO of Prudential of Japan, which is our Life Planner Business. And he's been in that role only since April, so please go easy on him. But he has been with the company for more than 26 years and his favorite music group to sing is Billie Joe. Please join me in welcoming Hamada-san.

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

Thank you, and good morning. I'd like to go to karaoke with Kurashige-san, if we can successfully finish this conference. I'm Motofusa Hamada, President and CEO of Prudential of Japan. I will discuss our Life Planner Business, which is one of the underlying business model of Prudential International Insurance. The three key messages I'd like to deliver today are: we have a growing Life Planner model, driven mainly by our high quality field management that reinforce our sustainable competitive advantage; our lifetime client relationship are driven by recognized quality service; and we are adapting products to the market changes and the customer needs to support growth.

Let me start with the recruitment and training of our Life Planners. We hire college graduates who in principle have proven track records in sales in other organizations. However, we only recruit those from industries other than our own. This is because the goal of Prudential of Japan has always been to transform the Japanese life insurance industry. As such, we provide the training that is completely different from those of competitors.

Out of all capable sales people in the market, we carefully screen and recruit only those who we believe demonstrate high potential to succeed as Life Planners. Indeed, our screening process is so selective that only two, out of every 100 candidates we meet are recruited. Those who are carefully hand-picked will then go through our unique and practical training programs, which have been developed through our broad experiences to-date. Prudential of Japan only sells tailor-made insurance solutions to our customers, to whom Life Planners remain as lifetime partners.

To this end, it is not sufficient for Life Planners to just acquire technical knowledge and sales skills, it is equally important for them to receive training to run basic mindset, such as having the right attitude and building good habits necessary for trusted advisors. To give you some ideas, Life Planners go through an intensive training program at their agency office in first month, followed by a basic training program, which is complemented by on-the-job training for 55 weeks, or up to their 15th month from the day of employment.

Naturally, Life Planners will keep on learning on their own through on-the-job training, even after the official training period is over, to continue to satisfy their customers' changing needs. This way, highly skilled and qualified Life Planners never stop learning. They will keep on pursuing further enhancement of their quality services as professional Life Planner.

There are three areas of focus in our efforts to increase the number of such quality Life Planners. First, we are working harder to attract and recruit more capable female Life Planners. Second, we are putting more energy into the recruitment activities in regional big cities in addition to such metropolitan areas as Tokyo and Osaka. Third, we plan to appoint and steadily increase the field managers, whose jobs are to recruit and develop Life Planners.

This shows the Life Planner model cycle. Highly qualified and skilled Life Planners can offer appropriate product solutions and quality services to their customers, based on their broad knowledge and expertise. This generates Life Planners' high productivity and income level, which in turn results in high Life Planner retention. The higher the Life Planner retention rate, the happier and more comfortable their customers become, which then allows us to enjoy higher customer satisfaction level, and higher policy persistency rates.

To make things even better satisfied customers are more willing and likely to provide Life Planners with referrals, which again drives yet higher Life Planner productivity and so on. This is how the beneficial cycle of our Life Planner model works. The outcome of all this is superior returns and the steady growth.

Next, let us look at some numbers regarding the Life Planner model. Life Planner count has been increasing consistently at a moderate pace, reflecting the high Life Planner retention. Female Life Planner count in particular has shown steady growth in recent years. Productivity measured in terms of number of policies sold by Life Planner per month exceeds far beyond what we consider the industry average, showing the superior quality of our Life Planners.

Next, let me talk about the field management, namely agency managers and sales managers, who are the backbone for the growth of the Life Planner model. For one to become a sales manager, they must achieve high performance criteria as Life Planner, and pass legal or sales manager assessments. Only then, can they be appointed as sales manager and engage in hiring and training of Life Planners.

Agency managers oversee and manage sales managers and they are responsible for the entire agency operations. Again, for one to become a agency manager, they must meet high performance criteria as sales manager and pass rigorous agency manager assessments. Agency managers work closely with sales managers in the recruitment and training of Life Planners.

Agency managers and sales manager are the ones who hold the key to driving further recruitment and play critical roles for all of our growth. Field management has been steadily growing in recent years, which I believe will contribute significantly to our future recruitment and POJ's growth in general.

Our high customer satisfaction level has been externally validated by the survey results announced by J.D. Power. Prudential of Japan became the first company in J.D. Power's history to achieve the Triple Crown ranking at the top of the customer satisfaction survey in all three categories this year, policy issues, claim payment and policy service, also referred to as conservation.

I am very proud to say that our satisfied customer drive the high policy persistency rate we enjoy today. This slide shows most changing needs in our customers' life cycle and the key markets we serve. As you can see needs for financial protection grow as customer age and types of product solution to meet their needs change over time. Our Life Planner leverage all the knowledge and expertise they have to offer every customer the best solution tailored to meet their individual needs.

Our comprehensive product portfolio enables Life Planners to respond to such broad spectrum of customers' needs. In addition, thanks to Life Planners' strong relationship with their customers, we have also been realizing a high level of second sales.

As demand for U.S. dollar recurring premium product has been rising in recent low interest rate environment, our Life Planners have been able to adopt. The amount of annualized new business premium from U.S. dollar recurring premium product has been increasing at an annual rate of nearly 20% over the past five years. This has helped to grow the total annualized new business premiums. The increase in the sales of U.S. dollar product shows how our skilled Life Planners are swiftly adapting to the changing market, and how they are leveraging their experiences and expertise in offering solutions that best match customers' needs.

This slide shows the sensitivity of in force face amount growth at various level of sales. With the current high quality persistency rate, if 2017 sales levels were maintained over next five years, we project that, our in force face amount would increase by 20% by the end of 2022, offsetting any runoffs from lapse, surrender and mortality. Likewise, we predict that in force face amount would remain flat over the next five years even if the annual sales over that period decreased by 40% below the level of 2017.

Finally, let me highlight a couple of recent technological improvement that Kurashige-san referred to early earlier. We have already developed or implemented a new digital – policy application system that removes paper from the process. We also created a smartphone-friendly cyber center site to improve customer service. We will continue to study more use of these technologies to further enhance customer experience.

In summary, let me repeat our three key messages. We have a growing Life Planner model, driven mainly by high quality field management, that reinforce our sustainable competitive advantage. Our lifetime client relationships are driven by recognized quality service. And we are adapting the products to market changes and customer needs to support growth. We remain confident in our prospects for continued superior returns and steady growth. Thank you.

Darin Arita

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

Thank you, Hamada-san. Our next speaker is President and CEO of Gibraltar Life, and that includes our Life Consultant and Independent Agency channels. He's been with Prudential for more than 11 years and his favorite music group to sing are The Eagles.

Please join me in welcoming, Yamauchi-san.

Kazuhiro Yamauchi

President and Chief Executive Officer-Gibraltar Life, Prudential Financial, Inc.

Good morning. I'm Yamauchi, President and CEO of Gibraltar Life. My favorite group is Eagles. And then in Q&A session, please do ask Eagles favorite songs, Take It Easy.

[indiscernible] (01:25:56) last two years, Gibraltar Life has met various challenges, while successfully growing the business. I'd like to share some of it with you and discuss our business model and strategies for further growth.

The highlights of my presentation can be summarized by three points. First, Gibraltar Life consist of two distribution channels; LC Channel, nearly 8,000 highly productive captive agents called Life Consultants, we call LCs, deliver steady growth and leverage our strong relationship with affinity groups.

IA channel. the growing Independent Agency channel, we call it IA has a differentiated strategy. Our high quality market and sales representatives foster a good relationship with Independent Agencies and their producers. Today, I will explain how these two channels help generate growth for our business.

Second, the Teachers' Association or Kyoko is the most important customer base for the LC channel. I will explain how large and stable Kyoko market is for us. And third, we are adopting products to market changes and customer needs to support growth. We achieved growth in foreign currency denominated products, namely U.S. dollar driven by relatively attractive returns for both the customers and the company. I will focus on these three points, after I provide an overview of Gibraltar Life structure on the next slide.

Gibraltar Life & Other is an operating segment of Prudential Financial. This segment consists primarily of two entities; Gibraltar Life and Prudential Gibraltar Financial Life or PGFL. There are two distribution channels within the Gibraltar Life entity. As I mentioned, the LC channel and IA channel. And separately our wholly-owned subsidiary PGFL is dedicated to the bancassurance channel. Consolidated Gibraltar delivers products and services to their customers through these three channels.

In 2017, the LC channel produced 46% of total annualized new business premiums. The IA channel accounted for 15% and the Bank channel represented 39%. I will refer the PGFL presentation to Mr. Soeda and keep my remarks to the other two channels.

We have diversified distribution channels, the two distribution channels have some similarities and some differences. Both channels focus on death protection and our face-to-face sales approach, providing tailored solutions to satisfy customers' need. They also have increased opportunities in providing longevity risk protection for customers preparing for retirement, because of the recent extension of life expectancy in Japan.

The difference between these now is, they're targeted customer segment. The LC channel mainly covers the middle income market and affinity groups and LCs cover the entire country. The IA channel targets the mass affluent and business and professionals market in urban area. The pie chart on this page shows the sales mix of these two channels, the left chart shows the sales of IA channel accounting for 24% of new business. Since the LC channel has a much longer history, it accounts for 93% of total in force policies of Gibraltar.

I will further explain each distribution channel on the following slides. Our LCs have access to nearly all of the Japanese population, to sub teachers, self-defense force members and other general customers, who are located all over Japan, we have our distribution network consisting of 82 branches and 707 sales offices. Through this network, we [ph] service (01:31:03) nearly 5.5 million in force policies, and provide tailored solutions of products and services to customers.

The productivity of our LCs has been trending higher. The quality of an LC matter a lot in order to meet the needs of our customers with products and services through face-to-face distribution. Occasionally, we revisit and update our hiring standards and processes. When we hire an LC, we carefully screen candidates to determine, if the person is capable of maintaining a partnership with the customer and will continue to provide quality service over a long period of time.

In addition to our proprietary training program, which Prudential has cultivated over many years, we have introduced online training and provided basic management training to field managers. Even though upgrading our hiring standard and processes might cause the total LC count to decrease, we believe this results in a strong organization as demonstrated by the steady growth in Policy Count Productivity.

Let me provide further details about the Teachers market, which is our largest affinity group. The partnership between Gibraltar Life and the Japanese Educational Mutual Aid Association of Welfare Foundation goes back a long way. This partnership was started in 1952 by Kyoei Life, which we later acquired and we have continued to build a strong relationship with trust over 65 years.

To give you some perspective of the market size, there are nearly 35,000 public schools across the nation with 950,000 school teachers and support employees. To sub 950,000 teachers, we assign nearly 5,200 LCs to different schools in each region and provide products and services. This is a very important market for us, not only because of its sheer size, but it present numerous business opportunities through their cycle of hiring and compulsory retirement of teachers.

This page illustrates sales opportunities in the Teachers market. Aside from some year-to-year variability, the school market hires roughly the same number of new teachers as the number who are retiring each year to fill the position. In 2017, 25,000 teachers and support employees were hired while 23,000 retired. This provides us with sustained sales opportunities each year. We can offer this protection to new and existing teachers, and offer retirement products to retirees, as they receive a lump sum payment from the local government. The number of active teacher has remained large and stable.

The aging society in Japan coupled with a lower pass rate have caused schools to undergo realignment over the past few decades. Schools have been increasing the number of teachers per student to improve the quality of education. As a result, the number of teachers has remained large and stable. As I noted earlier, the Teachers' Association is a most important customer base for our LC channel. This graph illustrates that the Teachers' market accounts for 30% of sales in the LC channel in terms of annualized new business premium in 2017. The growing percentage – sorry, the growing percentage reflects assigning more LCs to this market.

Now, I will explain the other distribution channel, the Independent Agency channel. As I explained earlier, the IA channel mainly targets mass affluent clientele in the business and professional market in the big cities. We have

52 sales offices with approximately 2,600 distribution partner agencies mainly in urban areas. This is a growing channel, because more people are buying insurance policies from independent agencies that accommodated [indiscernible] (01:36:30) the customer needs and changing customer behavior. A high proportion of customers buying from this channel are married with children in their 30s and 40s and like to compare and study various products before purchase.

As you may know the IA channel is more exposed to product and pricing competition than our LC channel. However, we have managed to grow the IA channel with a differentiated strategy. This strategy includes focusing on quality business that can sustain profitable growth over the long-term. Staying away from endless price competition and building a strong relationship with the agencies that resonate our marketing philosophy and policy. The IA channel is based on establishing relationship with agencies and their producers. We aim to build long-term relationships rather than competing for business thoroughly on commission.

To do so, first, we must identify agencies who are producers, who subscribe to our business approach, then provide strong support to them through well-trained and high quality marketing and sales representatives. That is why we put so much effort in their training and development. The chart shows the number of marketing and sales representatives, who are called MRs and SRs and the number of active producers. While providing robust training will increase MR/SR count, support existing partners and recruit new distributors. This is key for our future growth of the channel.

We also have adapted to market changes and customer needs. In Japan, when the standard interest rate was rolled in April 2017, life insurance companies rewarded the guarantee rates or suspended the sales of single premium Japanese yen products. As a result, Japanese life insurers, including those who never handled foreign currency products started to launch U.S. dollar products, with relatively attractive returns and other non-Japanese yen products, in order to compensate for declining Japanese yen product sales.

Meanwhile, Gibraltar already had over 10 years of history, handling foreign currency denominated product. Since recurring premium foreign currency policies are distributed as protection products through consultant sales, Gibraltar leveraged the strength of proven training programs in both LC and IA channels, which contributed to double-digit growth in this area.

Our in force business can grow even without an increase in sales. This page illustrates the sensitivity of growth of our in force business. Even if sales remains similar to the 2017 level, our in force face amount could increase at a steady pace over the next five years. This would result in stable returns and earnings growth.

Lastly, as Kurashige-san stated, I will touch on what Gibraltar is doing with digital and customer data. Gibraltar actively engaged in digital initiatives to enhance customer experience by [indiscernible] (01:40:49) services and improving efficiencies. For example, we promote paper as new business application and post-issue services by building a common system interface across the distribution channels. This can [indiscernible] (01:41:06) customers from complicated administrative figures, increasing processing speed and support customers' confidence in us.

Another example is the introduction of comprehensive customer record system, which includes customer information, contact history and sales activity records that can provide more customized services to customers. By utilizing digital, we are enhancing customer service and sales efficiencies, or both distribution channels.

In summary, I have provided an overview of Gibraltar Life business and its trajectory of growth. Again, here are the key points. We have nearly 8,000 highly productive captive agents called LC delivering steady growth and leveraging strong relationship with affinity groups. Our growing IA channel has a differentiated strategy with high qualified MR and SR to foster good relationship with Independent Agencies and their producers. The Teachers' Association, Kyoko, remains a very important market for us, not only because of its sheer size and stability, but also because it presents numerous business opportunities, so it's a cycle of hiring and compulsory retirement of teachers.

Finally, while keeping the focus on protection-type products we are adapting products to market changes and customer needs to support growth. Specifically, we have increased the sales of non-Japanese yen products by leveraging our expertise and experience. Gibraltar Life is well positioned to generate attractive returns and sustainably grow in the ever changing business environment. We will continue to make every effort to further solidify the foundation of the business by building on our existing strengths and by adopting new technologies. Thank you for the attention.

Darin Arita

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

Thank you, Yamauchi-san. For our next presenter, yeah, just get your translation device ready there. He is the President and CEO of Prudential Gibraltar Financial Life, which is our bank channel. He's been with the company nearly 30 years and his favorite music artist is also Michael Jackson and he's a Thriller. Please join me in welcoming Soeda-san.

Takeshi Soeda

President & Chief Executive Officer, Prudential Gibraltar Financial Life Insurance Co., Ltd. (IP)

Good morning. I'm Takeshi Soeda, President and CEO of Prudential Gibraltar Financial Life. I will discuss Prudential's highly differentiated strategy in the bancassurance market in Japan. During the 14 years, since Prudential entered bancassurance, we have consistently grown a stable business built on a solid foundation through a changing business environment, including financial crisis and negative interest rate. This achievement was made possible by building on our strength.

Please turn to the next slide. We have established a solid foundation in the bancassurance market in Japan. Because distributors and the market thought highly of our differentiated strength, we're able to build today's solid foundation.

What differentiates our business? There are three main points. First, we provide high quality sales support to our partner banks in the significant bank channel market. We mainly focus on death protection products, which are more difficult to sell than saving type products. We provide high quality sales support from inside a bank through former Life Planners who are seconded to our partner banks as well as from outside a bank through highly knowledgeable and skilled wholesalers.

Second is our expanding relationship with banks. We have a number of partner banks with seconded former Life Planners. Once they produce a good track record of success, the banks will increase confidence in us, which will strengthen our partnership with them.

Third is development and distribution of the products in the bank channel, which capture the market environment and the customer needs. This steadily increased the number of banks selling our recurring premium products year-after-year. Please turn to the next slide.

This page shows the share of 2017 annualized new business premiums by channel at the consolidated Gibraltar level. At a consolidated level, Gibraltar Life has three channels, Life Consultant channel, Independent Agency channel and Bank channel, which is the what I will cover. As I mentioned at the beginning, we entered the bank business only 14 years ago, but the business grew significantly to gain 39% share of the total portfolio.

Please turn to the next slide. I will discuss the Bank channel market in Japan. As indicated in the graph, the household financial assets are nearly $17 trillion in Japan and the senior segment, who are age 50 or over owns 86% of total household financial assets. This is a very distinctive situation in Japan. Because of our aging society, the population of our main customers, the senior segment is expected to grow for a long period of time. It means the volume of financial assets we have access to in the bancassurance market will continue to increase. This senior population represents the main customers of our partner banks for their various financial products and the strength of our sales channel is that we can effectively approach these customers through the bank.

Please turn to the next slide. Our bank relationship provides us with a broad coverage of Japan. We have established partnership with all of the megabanks in Japan, several leading trust banks and the largest securities company, with 75 distribution partners and $8 trillion of deposit, we have built a top class bancassurance company. The branch network of these financial institutions covers a wide area across Japan, giving us access to various customers.

Please turn to the next slide. I will introduce how we provide sales support to banks through our uniquely differentiated secondment model and wholesalers. In this business model, we second experienced and skilled former Life Planners with Prudential's sales expertise as Insurance Consultants or IC to partner with banks to sell recurring premium protection-type products, applying their experience and expertise.

Currently, 270 people are seconded to the bank as ICs, stationed as full-time employees, in addition to selling, the ICs are responsible for training bank employees at branches or helping the bank's head office to develop strategy for insurance sales. In addition to ICs, we also have 165 wholesalers, who've visited the banks to provide additional sales support. The graph shows a number of Insurance Consultants over the last five years and you can see the number of IC has grown because banks are supporting our approach, the number of wholesalers also growing.

We have enhanced this program through ongoing rotation between ICs and wholesalers. This results in many skilled sales professionals in the banks who can both train and sell. This is the source of our strong competitive advantage.

Please turn to the next slide. This slide shows a number of financial institutions that have adopted recurring premium protection products. Our core business strategies emphasizes the sales expansion of recurring premium protection type products. This foundation of the business model supports achievement of stable result that are resilient to changes in the financial environment. Our strategy is different than most of the competition that focuses more on single premium and saving type products.

As indicated on the left graph, 43 distributors sell recurring premium protection products in 2017, which is an increase of nearly 50% from 29 banks in 2013. The graph on the right shows the total number of recurring premium protection products divided by the number of distributor adopting them. It shows nearly 20% increase from 2.3 products per distributor in 2013 to 2.7 products in 2017. This proves partner banks support our business, emphasizing recurring premium protection type products. It also implies our relationship with partner banks has further strengthened.

Please turn to the next slide. This slide shows our sales trend that has pivoted to increased recurring premium products, in particular, U.S. dollar products. The sales of yen products slowed down after revision to the standard interest rate in April 2017, which decreased fiscal year 2017 sales from that of fiscal year 2016. Over the past five years, we achieved a steady 23% average annual compound growth rate in the sales of U.S. dollar recurring premium protection type products.

In 2017, we developed a new product to meet the evolving needs of customer. This was a U.S. dollar whole life products for customers wishing to fix the premium amount in yen.

Lastly, same as Mr. Hamada and Mr. Yamauchi, let me touch base on what our bank channel is doing with respect to digital, mobile and data. First is the development of policyholders' portal site. Once it's ready, the customer can access the site to perform simulation or receive policy services, such as updating personal information. This improves customers' experience and strengthen our presence.

Second is the development of the digital new business application. We're gradually expanding paperless policy issue to reduce cumbersome administration work for both banks and for our customers. Third is automated health underwriting at policy issue. This will shorten the time required to issue a policy and allow us to provide protection sooner to the customer.

Next slide is my last one. Let me summarize the strength of our Bank channel. First, we provide high-quality sales support to partner banks leveraging the strengths of our Life Planner model. Second is a strengthened relationship with partner banks as more banks adopt our products as a result of our high-quality sales support. And third is how we've been able to adapt to changes in the market environment and customer needs.

By building on the strengths of our differentiated strategy in the Bank channel, we have solid prospects for continued growth of highly profitable business focus on U.S. dollar denominated recurring protection products.

That is all from me. Thank you for your attention.

Darin Arita

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

Thank you, Soeda-san. So, we'll start the second Q&A session. Just a reminder, can you please wait for the microphone and then state your name and company affiliation?

Right in the middle of there, Alex?

QUESTION AND ANSWER SECTION

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Hi. It's Alex Scott, Goldman Sachs. I guess the first question I had was on the Life Planners and you highlighted that there is changes that are being made to products to meet the consumer demands. I mean, are there any structural changes to products that you can provide color on, or is it truly just kind of the focus on U.S. dollar denomination?

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

A

So, maybe for Hamada-san, just the changes to the products in the Life Planner channel.

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

A

Yes. As I mentioned earlier, we are driving our business primarily on the protection business. It's been 30 years since the founding of the business, so Life Planners and our customers are becoming older, and there is the need for aging. So, at the beginning when we first start the business, we didn't have the nursing care products. So, we also sell that kind of product as well, or we have developed such products.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Follow-up question on the Life Planners that become the sales managers. I mean, it looked like the number of sales managers had increased pretty significantly. Is that transition occurs, do you have maybe aging of Life Planners and they want to become sales managers. Is that a headwind for productivity that we should be thinking about, or you need to bring on more Life Planners to sort of replace sales, does that make sense?

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

A

So Hamada-san, the Life Planners becoming Sales Managers, does that affect the productivity?

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

A

Thank you for your question. Those Life Planners that become Sales Managers, they are not necessarily older Life Planners. After three to five years – after three to five years after they join the company, they become the Sales Managers.

Of course competent Life Planners will become the Sales Managers. So, temporarily, the productivity may drop, but they can recruit further or more Life Planners. And by doing so, we can improve the productivity. So, overall, they will contribute to growth.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

Adding to that a little bit, not all Life Planners strive to be Sales Managers. Many, many, in fact most Life Planners love being Life Planners. That's what they do. But some want to become Sales Managers. And in the second quarter and the fourth quarter each year is when Sales Managers are appointed.

So in the second quarter, last quarter of this year, there were 63 Life Planners that became Sales Managers, that doesn't affect individual productivity at all. The productivity of Life Planners overall of the entire Life Planner population has been plus or minus six, for a long period of time, which far exceeds the marketplace.

What happens is when you appoint a Life Planner, there's probably about a year before you see the – their product – excuse me.

When you appoint a Sales Manager there's probably about a year before you see their productivity increase, their productivity being defined as the recruitment of other Life Planners. So, while the Life Planner count may dip a little bit in the second and fourth quarter, because of the appointment of Sales Managers, that bodes really well for the growth of overall Life Planners in the future. But your other question about productivity, that you won't see the productivity level change much at all as, as Life Planners are appointed to Sales Managers.

Alex Scott Q
Analyst, Goldman Sachs & Co. LLC

Thank you.

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Josh?

Josh D. Shanker Q
Analyst, Deutsche Bank Securities, Inc.

Thank you. Josh Shanker from Deutsche Bank. I guess this question probably is more directed towards Life Planners, but there may be resonance with the other channels as well.

A little bit of what Alex had to say. Of the new Life Planners, is there evidence the education is creating a set of Life Planners who are more productive more quickly than the Life Planners in the past and that is a way that you're measuring that so you know. And similarly on the customers are you tracking at what age your first engagement or first sale with the customer, and is that first relationship you have with customer going down over times that Prudential is in their sort of stream of relationships at a younger age you can capture them as they get older?

Darin Arita A
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.

Maybe we'll start with Hamada-san there. I think two questions on that in the Life Planner. Are we, you know are the new Life Planners more productive than past Life Planners. It's the first question and then we'll get to the second question.

Motofusa Hamada A
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

So Life Planner rehired and to measure their quality. What we focus on the most is retention rate of Life Planners. Once they join the company first year and second year, how many of them still stay with us. That is the retention rate. Last few years, we maintained very high levels of retention rate, so we believe the quality of Life Planner rehire is very high, especially last few years. Should I...

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

the question. We can do it. I think that was on are we tracking the – when we're engaging for the first time with customers their age and is that trending lower?

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.
A

Depend on the channel, it's different. For Life Planner Business, when they join the company, first they will sell their acquaintance and friends market. That's where they start the business and they will do the robust sales and receive the confidence and touch their heart, then they will give us referral. That is our business model. So, they will start from the similar age generation customers with Life Planners, that's the general approach. Last few years, that's how it is. It's been that way. So we hire Life Planners, who is about 30 years old or so. So our customers are around that age. That's where we start business with.

Josh D. Shanker
Analyst, Deutsche Bank Securities, Inc.
Q

Age engagement isn't important and are we tracking it?

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.
A

As to the productivity, well, we have made a little bit stricter for recruiting standard. We only focus on high quality Life Plan Consultants and those are the ones we are hiring. So if you look at the policy account, monthly productivity and annualized premium per policy, it's increasing. That is our trend.

And [ph] first contact (02:04:18) customer age segment, exactly same as Prudential of Japan, our LC will start to sell their family member and relatives and friends and acquaintance that's how they expand their market. So naturally they will approach the customer who are about same age with who they are. So approach is the same as Prudential of Japan.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.
A

Other quick sort of details about the dynamics. So when you hire a Life Planner or Life Plan Consultant as Yamauchi-san said, their first year they sell to friends and family. So productivity is going to be far higher. So with a Life Planner, it can be anywhere between 10 and 12 policies, 8 and 12 policies the first year.

The reason for the 80% retention rate after 13 months is the transition and this can – this is for a Life Planner or Life Plan Consultant from selling to friends and family to then going out and selling to prospects. That's a big transition and not everyone makes it. But those that do that go through that come back to either roughly 6 policies for POJ or four policies for Gibraltar. So, there is higher productivity to your point in the first year, but that's typical. That's kind of friends and family. After that, they're off to the races, if you make it past that that downturn.

In terms of who they sell to and whether it's getting younger, you're not really getting younger, because remember we don't hire people who've – either aren't already employed or haven't been in the sales, sales practices before of some sort, not in the insurance industry. But these are seasoned sales professionals, so they've worked for a while, so we hire them when they are 28, 30, 32 somewhere in that range. So that they have experience. And so when they sell to their peers, it's in that range. So it hasn't beginning younger, but that's been consistent I think with what POJ has done all along, and frankly Gibraltar has done.

Josh D. Shanker
Analyst, Deutsche Bank Securities, Inc.

Q

Thank you very much.

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

A

We'll go to Humphrey next. Humphrey, keep your hand up.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Humphrey Lee with Dowling & Partners. Just to follow-up on the Life Consultants' productivity, obviously the trend has been pretty good over the past several years. As you continue to improve the productivity, where can you see the kind of – [indiscernible] (02:06:57) average policy count per month or the annualized premiums would trend over time. Obviously, it's probably not going to be as good as Life Planners, because it's in different markets, but can you get to like high 4s or 5? Like what where do you see is the end game?

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

A

So for Yamauchi San, question for the – the Life Consultants and the productivity trend, where can that go over time?

Kazuhiro Yamauchi
President and Chief Executive Officer-Gibraltar Life, Prudential Financial, Inc.

A

If I see numbers like four or five I will be very happy. But it takes time to grow people on top of that to the customers, we have to offer a certain level of services as the company. So that will also take time to train and develop LCs. So we are not expecting any huge jump in the productivity, but we will maintain the current level of productivity and that's what we have in mind.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

What we think about is Life Planners are [ph] 6 (02:08:03) plus or minus, and Life Plan Consultants are you know if we can get to [ph] 4 (02:08:10) plus or minus. Those are really good numbers and both those far exceed the industry average. So as you think about it, those are the kind of numbers that we think.

Humphrey Hung Fai Lee
Analyst, Dowling & Partners Securities LLC

Q

Just a follow-up question on I guess the broader distribution channels, we've heard many times at the Asia market, especially for the Japanese market, mutual funds is not really particularly a preference of to the consumers, they prefer the insurance and death protection products. But I think in part of it is because of the equity market during the 1990s and maybe early 2000s have been pretty flat. But then, you definitely see a boom in terms of equity market performance over the past several years in part due to economics. Do you see – like what is your plan in terms of kind of maybe selling mutual fund product, manufactured by PGM kind of through your channels?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

So let me take that one in a broad basis. At this point, we have no plans to do that. Our focus has been and remains on death protection. We have a limited number of savings products as well, but that is our competitive advantage. That's what we do really, really well. And for the foreseeable future, that's what we'll stick with.

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

A

Go over to John.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

John Barnidge, Sandler O'Neill. I have a question you know the demographic trends the aging Japanese population isn't something new. You have a slide about that. The Teachers Association it's 1.07 million teachers, obviously, there was some shifting between active and retired teachers on an annual basis. But the given the aging of the population, I would have naturally thought that there will be less demand for teachers and that there would actually be a shrinking association. Could you talk about that as well as your outlook for that association? Thank you.

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

A

It's a question for [ph] Hamada (02:10:10), the Teachers Association, why is that not a shrinking number of teachers and what's the outlook?

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

A

Right. So teachers demographic is proportionate to Japanese population's demographic, but the number of retiring teachers increased, but also the higher equivalent amount of new teachers every year, because like the government is trying to enhance the quality of education, which means in one class or one student versus number of teachers, the ratio has increased. So that's why the total population of teacher is not going to decrease, I will be maintained. That's what we think.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, Darin. Suneet Kamath from Citi. You showed two charts, one for Life Planner and one for Gibraltar, that showed what the in force would be if sales were flat or what the growth would be and there was a pretty stark difference between the two. I think Life Planner was like 20% and Gibraltar might have been 4%. So, does that ultimately come down to the differences in persistency and I don't think you gave persistency statistics for the channels outside of Life Planner. If you could give those that would be helpful.

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

A

So maybe start with Hamada-san on that and you know that in force sensitivity, the difference between Life Planner and Gibraltar.

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

A

At Prudential, it's been only 30 years since we started business, on the other hand was Gibraltar. They have a very long history if you think of how they started the business actually. So, the percentage of cash outflow is larger for Gibraltar of the in-force amount, so that accounts for that difference that you alluded to.

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

and therefore the policies that are coming due. So it's not – it's not persistency per se, but it's a age of the book. If you think about how Gibraltar was started with QA and then Star and Edison and all the other firms that were purchased over time.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

And so are the persistency statistics for that non-Life Planner channels, similar to what we see in Life Planner?

Charlie F. Lowrey
Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

A

For new business, yes, they are.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then my follow-up was just on the Life Consultants and the Independent Agency Channels, how do you avoid conflict between those channels? Are they calling on the same people? Is there any risk that you made sort of they may be bumping into each other as they try to write new business?

Motofusa Hamada
President and Chief Executive Officer, Prudential of Japan, Prudential Financial, Inc.

A

The LCs that target the individual customers, and IA Channel, where they mainly target business and professionals. We are not in a situation, where we see competition among those two channels. However, with individual customers, there may be some impact on a very localized basis. But in that case, it's the same companies, customers, so that's how you recognize them.

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

Okay. Great. I think we are at the break now. So, we'll take a 15-minute break and come back. Thank you.

[Break] (02:14:18-02:29:23)

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

All right. Welcome back, everyone. So our next presenter is the President and CEO of PGIM Japan, which is part of our investment management business. He has been with the company for more than 11 years and his musician of choice is Stevie Wonder. Please join me in welcoming Nitta-san.

Yasuhisa Nitta

President & Chief Executive Officer, PGIM Japan Co., Ltd.

Thank you, Darin. Darin didn't share the other one favorite name before the meeting. My biggest surprise today was Kurashige-san loves One Direction. So, [ph] head up (02:30:06), my name is Yasuhisa Nitta, Chief Executive Officer, PGIM Japan. Firstly, thanks for attending today. This is the first opportunity for PGIM Japan to join Tokyo Investor Day as [ph] one Prudentials (02:30:18). I'm very happy to have such a great opportunity.

Before starting my presentation, I would like to talk about our relationship with affiliate insurance companies. As we're the asset management unit of Prudential Group, we have two big business categories, affiliate and other one is the third-party.

In very early stage of our history, our business were mostly for affiliate insurance company. Even now affiliate are the biggest portion in our total asset under management and the management for affiliate assets will be continued to be very important mission for us.

On the other hand, we also have made big effort to expand the third-party business over the past 10 years and have grown very successfully. In recent years, third-party business has been our main growth driver. Today I'm focusing on our third-party business and hope it will be meaningful to understand about our business.

Let's go to page 2. Today, I have three message. The first one is that we're positioned in an attractive market. Secondly, generating significant growth. Thirdly, long-term focus to fuel a sustainable growth, I would explain each point with several slides from the next page.

Go to next page, please. At first, I will talk about the first point of the key message, we are positioned in an attractive market, I would talk about this about over the next four pages – sorry, pages 3. Before discussing about the PGIM Japan, I would like to introduce total PGIM strength first, because this PGIM strengths and the reputation in the industry has been so important for our growth so far, and also will be very important for our future success here.

PGIM is the top 10 global asset manager, with a $1.2 trillion in asset under management, with diversified active strategy across the public and private asset classes. Indeed, we are the top player in the alternatives real estate and the public fixed income space as well as in Japan. You can see tops three box of the right-hand-side.

PGIM is a global in the truest sense with 36 offices in 15 countries and with a robust third-party client base, where we drive more than 80% of our fee revenues. PGIM has a unique multi-manager model, the autonomy and independence that each business has within this model had relate to the exceptional investment performance as you can see that in left-hand-bottom chart. And this performance has led to 15 consecutive years of positive institutional inflow. That is a data point that very few of our competitors could point to. You can see that in the right-hand-bottom chart.

Please go to page 4, this page shows PGIM Japan's positioning in PGIM, how important we are for PGIM. As for assets under management, PGIM Japan manages $194 billion as of June 30 of this year. This is 17% of total PGIM's AUM.

Another important aspect of PGIM, PGIM is marketing all product line of PGIM multi-managers structure in Japanese marketplace. Actually in our existing third-party client, most of assets are overseas assets, which are managed by sub-advisory scheme under PGIM's multi-manager structure.

Right-hand-box, you can see each specialized manager of multi-manager model, firstly, PGIM Fixed Income, fixed income manager, including the structured product. PGIM Real Estate is real estate manager; PGIM Real Estate Finance is real estate debt manager.

Jennison QMA is both equity manager, Jennison Associate is fundamental equity, QMA is Quantitative Equity. Lastly, Prudential Capital Group is private debt manager.

Please turn to page 5. Page 5 shows how attractive Japan market is for asset management business, and our successful development here. The left-hand chart shows Japan's institutional market size. You can see the market has grown with double-digit pace over the past five years. [ph] While (02:35:10) institutional market is growing and business opportunity for professional asset manager expanding, the middle chart explains one background there.

Since Government Pension Investment Fund, we usually call it GPIF, GPIF changed their policy asset mix in 2014, they have reduced the exposure of the Japanese bond and increased other asset classes. Though they're foreign bond, both Japanese foreign equity and alternative, those asset classes which they need to outsource it to external managers. As a result, the share of external manager has increased. Generally speaking, other large public pension followed this way.

Another aspect – although not specific slide here, the demand from financial institution had increased as they increased the credit investment in overseas market because of ultra-low yield in the domestic market and the stagnant loan business.

Another – under these environment, we are successfully competing with other managers and that have increased our presence in the industry. Primarily, we're focusing on foreign asset managers as our competitors, because our business model is different from large Japanese trust banks and asset managers. Previously, the industry ranking over the right-hand-side, our ranking had been rising in both, pensions and privately placed investment trust.

Please turn to page 6. This is our investment performance. Investment performance is the most accurate [indiscernible] (02:37:01) factor for us as active manager and determining our positioning in the industry. Please see the left-hand chart, the driver of our growth and [ph] the fact really (02:37:12) distinguishes PGIM is our strong investment performance.

Indeed very few competitors can state more than 95% of AUM outperformance the benchmark in this [ph] three (02:37:26) time period. The right-hand chart is Japanese bond performance, which is managed by PGIM Japan. This is a data from GPIF's annual disclosure. Our performance is the first place in both, three years and five years. This shows how competitive our investment capability is.

Please go to next page. In next two page, page 7 and page 8, I will talk about the second point of my key message, generating significant growth. In page 7, you can see how PGIM Japan has grown over the past 10 years, how we expanded product breadth and client coverage.

In terms of product capabilities, we provided only Japan [ph] end (02:38:14) portfolio and the [ph] simply (02:38:17) U.S. Investment Grade Corporate. That's the beginning. We have been expanding our business. We have been expanding our product breadth here. Primarily in fixed income space to various type fixed income credit strategy that, including [ph] emerging high yield assets (02:38:33), also we started to grow our aggregate grade-type product, especially for pension client.

We enhanced [indiscernible] (02:38:43) sales activity over the past few years, not only equity as a traditional asset class, but also alternative asset class, including Real Estate fund like PRISA / PREDS, also real estate debt product and private debt product. In terms of client coverage in our stage, we primarily focused on financial institution, which have a big investment demand into 14 credit markets and we successfully established the relationships with the right institution there.

Next stage, our client coverage expanded to public pension space, where we have now recognized one of main players. In recent years, we are working on private pensions and retail space, both are still early stage, but we are successfully building business momentum there.

Please go to page 8. Page 8 shows the history of our third-party business. This is significant growth history. As you can see in the left handed chart, our third-party business was very small 10 years ago, actual growth started around 2009, 2010, and had kept very strong growth so far. In the first half of this year, we continued to grow and enjoy the strong inflow.

As I mentioned in page 7, we have so far grown in institutional space, and you can see the chart, our rapid growth had been driven by both, financial institutions and pensions. Since 2013, we have secured over $40 billion inflow and we assume – we have been very successful among the industry competitors.

I would like to emphasize again our strong investment performance has significantly contributed to our business growth and that was most important background of our successful history.

Please turn to page 9, and the rest part of my presentation, I would like to discuss about the third point of my key message, long-term focus to fuel sustainable growth. Page 9, I describe three key strategy of PGIM Japan. Firstly, diversify client base. Second, we leverage our multi-asset capabilities. Thirdly, invest to drive future growth.

Please turn to page 10. This page describes first point how we will develop and expand our client base going forward. In terms of financial institutions, we already established strong relationships with many of the largest institutions. Therefore, we are keeping this relationship and pursuing further growth. As for public pensions, we already have relationships with five out of the top-seven public pensions. Primarily, we are working on generating alpha and producing a good performance for existing mandate and also pursuing cross-selling opportunities.

As for private pensions, this is still early stage, primarily we are focusing on top-100 private pensions. We are also working on consultant relationship, because the rating from consultant is very important for this area.

Lastly, retail distributors. This is also still early stage. We are primarily pursuing fund wrap opportunities with mega distributors.

Please turn to page 11. This page, I describe next point, how we leverage our multi-asset capabilities. For that, it is very important to think about investment environment. Actually, investors' needs are shifting under recent difficult investment environment. There are four-point aspect to think about. Firstly, domestic yield environment. As you know, domestic yield is staying at ultra-low level and we cannot expect a significant change for foreseeable future.

Secondly, expensive currency hedging cost, especially financial institutions usually hedging most of their currency exposure, increasing the hedging cost to make their investment more difficult.

Third one is credit spread. Although the markets trend are bit reversed this year, credit spread has tightened since 2009 and approaching historical low level. Lastly, rate hike in the U.S. market, this makes investors more conservative in investing to foreign fixed income market and the investors could have more interest in floating rate-type product.

Although I don't mention the detail in each client segment here, generally speaking under this difficult environment, investors are seeing more opportunity in higher yielding of floater and alternative strategies, including real estate, private debt and hedge fund.

This is a bigger opportunity for PGIM to leverage our multi-asset capabilities and expand our business. PGIM's strengths are well suited to Japanese client's needs. PGIM has a very strong capability in alternative space as you can see the bottom part of this page.

Please go to page 12, lastly I will talk about how we invest into the resource of our future growth. Firstly, branding for establishing strong PGIM brand in Japanese marketplace, we are increasing the advertisement in domestic media and also increasing seminar and conference for investors.

Secondly, investment capabilities, we are increasing derivative and credit capabilities in Japan, including CDS and developing a new investment strategy.

Thirdly, client servicing capabilities, we are increasing human resource, primarily in sales, marketing and client service function, but also enhance other support function.

Page 13 as a wrap-up, as I mentioned in the beginning, I covered our three key message today and talked about overview of PGIM Japan, including our growth history and view for the future. I hope this was some help for you to understand about PGIM and Prudential. Thanks, again.

Darin Arita

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

Thank you, Nitta-san. Our final presenter is CFO of Prudential. He is also our next Vice Chairman. He has been with the company for more than 35 years and his artist of choice is Michael Bublé. I had no idea he is such a romantic. Please join me in welcoming Rob Falzon.

Robert Michael Falzon

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

Thank you. Yeah. You don't want to hear me sing. I'll clear the room pretty quickly. I'm very glad to be here this year, and I actually say that with more sincerity than most, because those of you who may remember from two years ago in our Investor Day here, Scott Sleyster, our Chief Investment Officer and I were on a flight that had some mechanical issues and we never made it past Anchorage, Alaska. And so we got piped in here through the speaker system, which may have had certain advantages. I understand, we came across [indiscernible] (02:46:35) voice of God, and see me in person may be significantly less compelling persuasive.

Okay. So as you heard this morning from our International business leaders, we have a differentiated business model and it's enabled by superior execution. To wrap up today, I'm going to demonstrate how that business model and how that execution translates into strong financial performance for us from our businesses here.

The three key points that I want you to take away from my presentation today, first, the attractive fundamentals of our International businesses produce solid predictable earnings growth and a high ROE, while maintaining a balanced and conservative risk profile.

Second, we've actively managed the challenges associated with currency and interests rates and we believe that the headwinds from these on our earnings growth are subsiding.

And third, finally, our businesses continue to generate significant capital that can be redeployed either into International growth opportunities or distributed back to the U.S. in line with our overall expected enterprise free cash ratio of 65%.

So let's start by taking a high level look at our results over the past five years. During this timeframe, we experienced substantial headwinds in the form of currency depreciation and low interest rates. Excluding these market impacts, our International earnings from a core standpoint grew at a compound annual growth rate of about 5% from 2013 to 2017.

Our strong business performance is reflective of solid business fundamentals in Japan, which accounts for about 90% of our International earnings. Growing momentum in Brazil and other select markets and a continued focus on a differentiated business model, coupled with superior execution across multiple distribution channels.

Over this period, the yen depreciated by 40%. Although it reduced earnings only by a fraction of this about 50% or so, this is largely because only about 25% of Japan's earnings are yen-based.

We expect the earnings impact from foreign currency movement to lessen in the future. Our yen plan rate for 2018 is modestly stronger than 2017, reflecting the more recent moderation in the depreciation of the yen. For 2019, we've already locked in our yen hedge rate at a more favorable plan rate, which will benefit earnings going forward.

And we expect the earnings contribution from yen-based products to continue to decline. Also recall, that we have our yen equity hedge, which protects our ROE at the enterprise level from a depreciation in the yen, I'm going to come back to this in a few minutes later in the presentation.

Sustained low interest rates have also been a headwind to growth, but to a lesser extent. We've been living in a low rate environment in Japan for a prolonged period of time and our business model reflects this. Our sources of GAAP earnings in Japan are largely underwriting margins as you heard this morning. So persistent low interest rates have not been as impactful to earnings.

Going forward, we expect even less of a headwind as the year-over-year drag from interest rates subsides due to new money rates approaching our current book yield, and I'm going to come back to this in a few moments as well.

As the impacts from market headwinds, yen depreciation and low interest rates subside, our future growth should be more in line with the historical 5% core rate shown on this slide. I want to pause a moment and just revisit some of the questions that came up in the earlier Q&A with regard to growth and source of earnings.

So, first, the U.S. dollar products that we sell do have higher margins than our yen-based products. The more competitive or higher interest rates in the U.S. produce that higher margin, but we're still getting very substantial margins from our underwriting in those. Those higher rates allow us to present to customers a better value proposition in the products that we're selling to them.

Secondly, if you think about our existing book, we have about 11 million policies in Japan. The net in force on that about $700 billion. Compare that to, in the second quarter, our new business annualized premiums were about $600 million, so our growth and our source of earnings will continue to be primarily driven by that installed book of business.

So when this – you saw the slides in the two presentations on POJ and Gibraltar, on a blended basis, what those slides told you was that sales from 2017 could decline by about 25% and remain at that reduced level for several years, and our in force would still remain stable over that period of time.

Additionally, as you saw in Charlie's presentation, we're making strategic investments in high-growth markets like Brazil, Chile, Indonesia and India, as well as seed investments in emerging markets like Africa. These investments we expect to benefit growth over time.

Our International business continues to generate a relatively high unleveraged ROE. You'll notice that there was a decline in our ROE during the first half of this year. This is largely due to an increase in our GAAP equity arising from tax and accounting changes that went into effect at the beginning of the year. It's comprised primarily of two components. First, the benefits of U.S. tax reform, including the lower corporate tax rate and the adoption of a modified territorial international tax system in the U.S. lowered our deferred tax liability and increased our equity.

Second, the adoption of a new accounting standard required us to increase our equity for the unrealized gains that we had in our equity securities. We anticipate being able to sustain our current level of ROE, which is well in excess of our cost of capital and hurdle rates.

Financial strength and active risk management underpin everything we do in our core to both our customer and shareholder value propositions. As discussed in the past, we have a carefully selected business mix and risk profile at the enterprise level. The risk profile of our International businesses is complementary to the overall enterprise risk profile. Within International, our primary risk is insurance.

The mortality component of this provides a natural balance to the longevity risks we assume through things like our pension risk transfer business and other of our business lines. We actively manage the risks of our International business. I'll touch on each of these briefly, product, interest rate, credit and foreign currency risks, in the next couple of slides.

So, as discussed in the earlier presentations today, we actively manage our product portfolio to meet the changing market conditions and evolving customer needs. For example, in Japan, it has been challenging to meet our return objectives on yen-denominated products. This is largely the result of the standard interest rate reduction in Japan early last year, which increased the amount of reserves we need to hold on sales of yen-denominated products.

In response, we suspended the sales of the low-return yen products and pivoted to further – further pivoted over to U.S. dollar products, which we've already been selling, as you heard this morning, for many, many years in

Japan. As a result, yen single pay products represent less than 1% of our sales today. In contrast, U.S. dollar products now account for about 80% of our sales in Japan.

We also actively introduced new products and re-price existing products to reflect market conditions, protecting our return objectives, while serving the needs and preferences of our customers. And we benefit from our product mix, which continues to be protection versus savings. In fact, upwards of two-thirds of our U.S. GAAP earnings are based on underwriting as opposed to spread margins. This puts significantly less pressure on ALM as a source of earnings, and it is why we're able to back our liabilities with such a high quality asset portfolio, which I'm going to come to in a moment.

We've been successfully managing through a low interest rate environment in Japan for decades, as I mentioned earlier. In addition, through active product management as just discussed, interest rate risk has been effectively mitigated through strong asset liability management. This is at the heart of what we do.

We have a deep understanding of the liabilities that we underwrite and invest in assets to match our estimates of the duration of those liabilities. Within the investable universe, practically speaking, that's between 30 and 40 years, depending on currency, we closely match the key rate durations of our liabilities. Beyond the investible universe, we monitor the tail risk of our long-dated liabilities as a part of our interest rate management program using derivatives and alternative investments to complement our fixed income investments.

As a result of our active product management and disciplined ALM, the impact on growth from the sustained low rates that we've experienced has been mitigated, though not entirely eliminated as shown in my earlier slide. And while interest rates remain low by historical standards, both in the U.S. and in Japan, we believe that the residual drag on year-over-year earnings growth is moderating and should entirely dissipate in the next few years.

As shown on this graphic, over the past several years, our yield on new investments has been below the overall portfolio yield for both U.S. dollar and yen-denominated sales. This gap is a proxy for the drag on earnings caused by investing in new assets at low rates. As the gap closes, as projected in the chart using the forward curves for the U.S. Treasury and for JGBs, the headwind to growth moderates and eventually becomes a tailwind to growth. While the convergence in the yen portfolio is more extended, this is somewhat offset by the very long duration of those liabilities and assets, and the very low turnover that we have in that asset portfolio.

And to reiterate what I mentioned at the outset of this presentation, based on our current projections, we anticipate our International business will continue to be able to sustain our current ROE level and grow at a rate consistent with our core historical rate even in the current interest rate environment.

We have a highly profitable business model. And as mentioned earlier, upwards of two-thirds of our earnings are derived from underwriting margins. Because of this, we do not need to take excess risk in our investment portfolio in order to meet our targeted pricing returns, which in turn means that we have a very high quality investment portfolio.

Drilling into the portfolio a little bit, about 90% of our International business investment portfolio is related to our Japan business. I'm going to focus on Japan for a moment. About 98% of the portfolio is in fixed income assets, of which 95% is investment grade rated.

As mentioned in Nitta-san's presentation on PGIM just before me, PGIM has a top-three worldwide ranking for assets and investment grade strategies. We fully leverage PGIM's deep expertise and credit knowledge, which provides a competitive advantage in our portfolio construction. And as sales continue to shift to U.S. dollar products, we continue to take advantage of PGIM's deep expertise in U.S. credit markets and our origination capability in private placements and mortgage loans to enhance the overall portfolio yield.

Over half of the portfolio is invested in Japanese governments and agencies and almost 90% of the portfolio is rated single A or above. While not shown in the split between currencies, there's about 57% yen, 37% USD and 6% other currencies dominated by Aussie dollar. The U.S. dollar assets backed liabilities originated in dollars and are used for our yen equity hedge, which I'm going to come to next.

Currently, risk assets comprise about 5% of the portfolio and are primarily made up of high yield investments and non-couponed investments. As mentioned earlier, risk assets can be used in portfolio construction due to the long duration of our liabilities as we do not have significant short-term liquidity needs to satisfy policyholder obligations.

About half of the non-coupon investments are comprised of dividend paying Japanese equities and JREITs with a strong dividend paying history. These investments have benefited us over the years from both their higher income profile and the level of market appreciation. The remaining non-coupon investments are comprised of hedge funds, a little bit of private equity and real estate.

Turning now from interest rate risk to foreign currency exchange rate risk. We have a robust FX hedging program in place, primarily to protect against the economic impacts from fluctuations in the Japanese yen vis-à-vis the U.S. dollar. The program is designed to reduce volatility in our reported earnings, due to changes in exchange rates within the year, protect enterprise earnings and return on equity, mitigate the exchange rate impact on our capital levels, including our reported SMR ratios and protect the long-term value of our investment in our Japan business.

Currently, the size of our program is about $16 billion, and it's comprised of two components. Income hedges, which are about $2 billion, and our equity hedge which is about $14 billion.

Starting with the income hedges, you'll recall I mentioned earlier that only 25% of Japan's earnings are yen-based. This is because about 20% of our in force, 40% of our investments and 80% of our new product sales in Japan are U.S. dollar denominated, providing U.S. dollar revenues while all of our operating expenses are yen-based or yen-denominated.

We hedge this portion of earnings through forwards that smooth the impact of the change in yen by layering in swaps over a 36-month, three-year period of time. This provides greater predictability in earnings and cash flows over that 36-month period.

As mentioned earlier, based on the forward FX rates locked in to-date, we anticipate foreign currency to provide a benefit to earnings in the future as contrasted to the headwinds that we've faced in the recent past.

Our equity hedge is designed to supplement our income hedges in order to preserve ROE, and protect the long-term economic value of our investment in our Japan business. It is primarily executed by holding U.S. dollar assets against yen liabilities and using an internal hedge to move the economics between Japan and the U.S., while protecting our local solvency margin ratios. I went through the mechanics of this at the last Tokyo Investor Day, so I'm going to spare you that in this presentation.

The next topic that I wanted to spend a few minutes on is capital. We have always maintained that financial strength is critical to our business model and value proposition to customers, investors and employees. And our capital ratios along with our demonstrated capital flexibility are important measures of that financial strength.

We view capital through multiple lenses. These include regulatory solvency measures, the solvency margin ratio in each of our international entities is strong and consistent with our targeted levels for AA.

This slide shows the ratios of our largest international entities, all of which are in Japan, and all of which are very well capitalized. And we have internal economic solvency view that we apply to each of our international entities. We also look at our regulatory and economic solvency measures under a range of stress scenarios and we have an Enterprise Capital Protection Framework in place to ensure that we have the resources available to withstand cyclical, severe and extreme market stresses while still maintaining competitive, regulatory and economic levels of solvency appropriate to each of those scenarios.

We hold capital to the most constraining of these multiple lenses. As most of you know, international regulatory frameworks are evolving. This includes the international capital standards being developed by the IAIS and local regimes in place like Japan, Korea and Taiwan.

We remain highly engaged with regulators and the industry in development of these regimes. And as we stated in the past, we believe our strong capital levels will be evidenced in any reasonable regime as they are through the multiple lenses that we already apply to our financial strength. While maintaining strong capital levels, our international operations have also been able to generate a high level of free cash flow and redeploy a significant amount of capital.

Over the past four years, as Charlie indicated in his presentation, we've redeployed over $5 billion, representing in excess of 60% of the after tax AOI over that period. Our Japan operations have been the primary contributor to that capital redeployment. While distributing over 60% of our earnings, we've also been retaining capital to grow our international operations as these businesses mature, they should then begin to contribute to our increased free cash flow.

We deploy International earnings through various mechanisms that are available to us, including dividends, derivatives, affiliate lending and reinsurance. And we are confident that we have the tools needed to continue distributions consistent with our historical levels and with our targeted enterprise free cash flow ratio.

We believe International business has the attributes of a highly valued protection-focused company. We have a sustainable differentiated business model with unique distribution. We have highly predictable stable earnings that have generated historical mid-single digit core growth. We believe that due to the moderation of capital markets headwinds, our historical core growth rate is a reasonable indicator of our near-term growth potential in earnings. And we feel good about our longer term growth prospects as strategic investments we're making in high growth markets will begin to pay off.

We produce attractive mid-teen un-levered returns and expect to maintain this level in the future. Our capital position is strong looked at under a multiple of lenses. And, finally, we generate and redeploy significant and stable cash to the Enterprise, while also investing for future growth.

Additionally, the risk profile of our International business is complimentary to the overall enterprise risk profile and provides opportunities to grow our businesses while benefiting from risk diversification across those businesses. We believe that these attributes are important to consider as investors and analysts assess our enterprise value and the contribution to that value that comes from international operations. I'll leave you with these messages. Thank you, and I think Darin, we're now turning it over to questions.

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

That's right. Thank you, Rob. Before we start the Q&A session, I just wanted to put a shout out of thanks. Putting this event together, it does take a lot of work and energy across the organization. And first of all, there is a number of young Japanese volunteers that joined us, many of them are in the back of the room or holding the mics are on this side. So thank you to them. And then also thank you to all the teams within Prudential that helped make this happen.

With that, we can begin the Q&A. Just remember to wait for the microphone, and then state your name and your company affiliation. Jimmy, there?

QUESTION AND ANSWER SECTION

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

Hi. Jimmy Bhullar, JPMorgan. I had a couple of questions. First on PGIM, if we think about, I think 17% of assets you mentioned are – or PGIM Japan accounts were 17% of overall PGIM assets. The proportion of overall PGIM revenues, EBITDA margins or profits is that commensurate or is that higher or lower in Japan? Just trying to get a sense of sort of the profitability of those assets versus the rest of the business?

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

A

For Nitta-san, just the profitability of the assets in PGIM?

Yasuhisa Nitta
President & Chief Executive Officer, PGIM Japan Co., Ltd.

A

Hi. As for the key in the investment business as you probably know, it varies greatly depending on the asset class. Also even within the same asset class, depending on investment strategy, the target returns can be different and therefore the fees can vary. Also depending on the structure of the account, it can vary as well.

As I mentioned earlier, in Japan, we have various types of asset classes. And recently, we are handling alternative asset classes as well. So, in that context for PGIM as a whole, the revenue yield for the group for PGIM as a whole is 22 basis points. So, against that overall fee level, we made contribution with various asset classes.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

[ph] Tony II (03:09:21) is the Japanese, Japanese portion.

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

A

That's the overall.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

That's the overall.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

And just like if you assume same clients, same asset strategy, are the fee yields better here than they are in the U.S. or the rest of the business?

Yasuhisa Nitta
President & Chief Executive Officer, PGIM Japan Co., Ltd.

A

We cannot compare between Japan and overseas. Depending on the size of the transaction, with the customer and the total relationship, the fee is determined, so we cannot just compare between Japan and overseas.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

And then another one, Rob, do you have any sort of initial views on just changes in accounting for a long duration contracts and how that affects the International business, but then maybe Prudential as a whole?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Yeah. I had a sense this question was coming, Jimmy. So, let me start with some constructive observations. The – where FASB went in targeted improvements, there are a number of good things that came out of that.

One, you know greatly simplified the accounting for DAC. Two, created more consistency and how VAs will be accounted for sort of company-to-company on a prospective basis. Three, the concept of creating symmetry and valuation between assets and liabilities is something that we think has actually has merit and would be quite helpful.

When we went through the crisis, what we saw is that one side of our balance sheet, namely assets were being marked to market, and the liability side was not, and it caused noise in communication of our financial strengths during that as a result of that asymmetry in valuation. So, the concept of value in both sides we actually think is a good construct. And then the last think I'd mention is, the increased transparency into the assumptions that are driving best estimate valuations, we also think has a lot of merit.

Now having said that, as many of you know, we're not big fans of the way in which FASB has chosen to implement this. And the impact of that is something that's sort of still to be determined, there are lot of methodology choices that we'll have to make and we're working our way through and making the appropriate investments in models and systems to be able to do that.

Having said that, there are some generalizations that I think I can make about what will happen once we adopt this and as you sort of look at our financials on a go forward basis. First, good ALM should be reflected in movement of our assets and our liabilities going forward in directions that will offsetting in roughly equal orders of magnitude, and so expect to see going forward that AOCI will be sort of proportionally impacted on both, the asset and the liability side as a result of the mark on both those reflecting how we match up their assets against our liabilities.

Two, I guess specifically with respect to Japan, Jimmy, maybe to answer that piece of it. In Japan, we have significant pads and cushions in our reserves and we would expect that post adoption as a result of this pivot date concept that FASB has introduced that those pads and margins be recognized on a prospective basis in our earnings. The pattern of that recognition yet to be determined based on some of the methodology choices that we have to make, but we think there'll be high visibility and release of those earnings as they amortize in under the new accounting standard.

From a big picture standpoint, I would note that as, again as many of you know, we have spent the last few years, very focused on creating a greater alignment between what we think are our very attractive business fundamentals and our operating results with how they manifest themselves in our reported operated earnings.

And trying to eliminate noise in that, both from the standpoint of volatility in those results and the matching of those results between our operating earnings in the way in which we report GAAP. The FASB rules in which they've currently been articulated will present increased challenges to us in our efforts to express to you that continued matching between fundamentals operating performance and reported earnings.

The good news is, we have a number of years in front of us to figure this out. And just as we've over the last several years figured ways in order to be able to make that connection, we'll be working in order to try to, through the methodology choices that we make and through working with FASB and with others in the industry, to ensure that we do get that connection between performance cash flow and earnings on a go-forward basis. So, I think it's still very early days, Jimmy.

We've got a lot of work that's in front of us, and we intend to come up with a result that's consistent with the efforts that we've undertaken historically, which is making it easier for you, not more difficult for you to see through to the underlying driving economics of our business.

Jamminder Singh Bhullar
Analyst, JPMorgan Securities LLC

Q

Thank you.

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

A

Go to you see Ryan there, right.

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

Q

Thanks, Ryan Krueger, KBW. I had a question on earnings growth you talked about more mid-single-digit earnings growth going forward. How would that dimension between Japan, specifically? And then a gradual increase in contribution from the non-Japanese businesses?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

It's going to be Japan-dominated. As Charlie mentioned in his presentation, given the size of our Japan book, it's 90% of our earnings today. So, a 1% increase in Japan...

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

Q

Yeah.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

...everything else just to keep pace has to grow at 10%, you sort of do the math. So, while our other businesses are growing, and particularly what you have is number of our startup businesses, you're investing in those businesses in the early years, they're not generating earnings. As you flip from investing to actually generating earnings, they will contribute to our growth.

I think the way that Charlie articulated that is probably the best way to think about it. Think about our three developed business Japan, Korea, Taiwan as being the drivers of growth over the next three years to five years. And then think about those other businesses as being drivers to growth beyond that period of time, probably the earliest contribution they're coming from our Brazil operations and obviously Chile is already contributing in. But, again, given the current size of those businesses relative to Japan, that growth is being primarily generated by our Japan business.

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

Q

Thanks. That's the reason for my question it seems like Japan in force is maybe growing more in the 3% range or so. And you talked about more 5% earnings growth, so is there some expectation for earnings growth above in force growth and what's the driver of that?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Yeah. I would just differentiate in force from earnings. We have operating leverage and you have the way in which you account for – where you can have an in force that's stable and still have growing earnings coming out of that in force as a result of the recognition of profits from the in force. So, there is a rough correlation between the two, but generally our earnings growth is going to exceed our in force growth.

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

Q

Thanks. And again, can you just tell us what the hedged FX rate is for 2019?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

I cannot.

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

Q

Okay.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

But I will in December.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

That's a good try though.

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

Thank you.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

But I will in December.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

That's a good try though.

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

Thank you.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

Come around back to this side. Go to Tom there.

Thomas Gallagher
Analyst, Evercore ISI
Q

Thanks. Just for the record, favorite artist, Lady Gaga. My children would be embarrassed if I had said to them. Rob, just on the comment on the solvency. You'd mentioned through multiple lenses PRU look solid or strong, can you talk about economic solvency? How you look through that lens? Can you give us a number, or at least some relative positioning?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yes. We have our own proprietary economic solvency ratio, it's not one that's necessarily comparable to other companies, Tom, because it's not calculated the same way. In that economic solvency ratio, we are multiples of what we will consider to be a minimum level of solvency that we would want to maintain through stress, so it's a very strong picture for us, which is reflected in the statutory ratios that we have. And so, while there are shortcomings to statutory ratios, directionally I think they actually have good information in them and are consistent with what we see in our economic solvency.

And in fact, in certain regimes, we would argue that while they are less market sensitive, they are more conservative in many aspects than an economic view of solvency, which is sort of an interesting outcome.

With regard to the types of solvency ratios that you may be referring to, Tom, there are really two things that are going on. One, in the international level, there is the ICS that's being developed and we've participated – this is the fifth year we've participated in that field test. That hasn't a one single number incidentally, they continue to test multiple variations of it within the field test. And so, it's not a single number that we would necessarily compare to.

I would say with respect to that, that we and most other global players in the industry are highly critical of that ratio. It is fundamentally flawed in a number of ways. We're encouraged by the fact that not only we find out to be the case and [indiscernible] (03:18:55) they have made some progress over the course of that five years, there have been some improvements in that calculation, but nonetheless it remains flawed.

But not only industry, there are a number of significant regulators, international regulators, which have also expressed concerns with that construct. And that includes the United States; it includes OSFI in Canada; it includes the JSFA, here in Japan; it includes Taiwan; and even in Korea, as they have experimented with an early adoption of ICS, they've come out this year with something called KICS, which makes some fundamental changes to the ICS to address some of the shortcomings of that construct.

So, lots of work yet to be done there, it's going into sort of a four or five year sort of test period and our expectation is, it's going to need to continue to be refined over that period of time and we're working to make sure that that's an outcome from it. The other area where there's been an economic solvency ratio tested this year in Japan, that to-date has been primarily leveraging the ICS.

Although, in our discussions with the JFSA, they're using that as a base for information not necessarily as a base for what they expect to adopt here. Our expectation is in our conversations the FSA is being incredibly thoughtful about this, they're being very deliberate about it and whatever they adopt here in the way of an economic solvency ratio will be reflective of the business model that exists here in Japan, which has very long duration and has an asset composition from a portfolio construct that looks very different than other places in the world and JFSA is aware of that and we believe we'll make the appropriate adjustments to a economic solvency ratio to reflect that. Sorry for the long answer, but that hopefully covers your question.

Thomas Gallagher
Analyst, Evercore ISI

Q

No, that's helpful. So – but what's the way we should think about ESR. I mean, I think I assume you're disclosing that to the FSA, because every other domestic company – every Japanese company I've met with so far has given that out. So, is that – do you feel like it just not comparable, or is that – and is that something that you will disclose it at some point, maybe making some adjustments to make it more comparable.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

No, Tom, we don't intend to disclose it. Yes, the solvency ratio to-date has really been the ICS calculations. And again, up until this last field test with the JFSA has had multiple iterations of it. So, there hasn't been a single ratio. So, when people quote the ratios, I'm not sure what they're quoting.

Thomas Gallagher
Analyst, Evercore ISI

Q

Okay.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Our intent is actually not to get ahead of the refinement, but that it's, as I said, for businesses, who's – where there are underlying businesses, heavily weighted toward long duration liabilities, which then need to be backed with long duration assets. Those calculations are deeply flawed. And you see that both in the volatility ratios and in the outputs from those ratios as a result of that business design. So, when you're dealing with short duration products, many of the flaws of the design don't – are less apparent.

But in the construct of our business and some of the other large Japanese players, both public and non-public, you can see that the flaws become more obvious. So, it's something we don't use. It's something that is not instructive and in fact it can be misleading and so, we don't intend to be disclosing this until we're much further long in the process and some of the keys that we've worked out of it.

Thomas Gallagher
Analyst, Evercore ISI
Q

Got you. And my other question is, just I see that you've pivoted – you and I think pretty much everyone else has pivoted away from the yen denominated products, particularly single pay. But, is there way that we should think about you of the recurring pay yen products – recurring premium yen products, I presume that's a meaningful portion of your recurring revenues. And also a lot of these would have been sold in a similar rate environment that we're in today. Should we be thinking about some large proportion of your recurring revenues being – facing that same issue that then calls you to exit on new policies today? Like, I don't know can you dimension that a bit.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yeah. Let me make two observations that might be helpful on that, Tom. First, important to note upfront, when we price new products, we price under a variety of interest rate scenarios, including a flat for forever scenario. And so – and we want to ensure that the returns to us are attractive in that scenario, in light of that kind of scenario, in which our hurdle rates might look like in that scenario. So, we do not price solely with our actuarial assumptions about what will happen with regard to this sort of a long-term reversion rate and interest rates. We want to understand what the returns look like in the current interest environment as well, and it has to pass certain hurdle rates with respect to that.

Two, that's been factored into the analysis, when we've looked forward about our – with respect to our growth rate. And so, when we showed you that convergence between portfolio yield and market yields and we reflected on our historical growth rate and thinking that that's probably what's likely to manifest on a go-forward basis, incorporated into that would be any decline in – any reinvestment that yields lower than might have would have originally anticipated, when we underwrote the business. So, our growth rate reflects that low rate environment, as applied to both new sales and the turnover, or the reinvestment in the existing book.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

Go to Erik.

Erik James Bass
Analyst, Autonomous Research US LP
Q

Thank you. Erik Bass with Autonomous. Question for PGIM, what percentage of the Japan assets are in currency hedged mandates today? And have you seen any outflows, or is that a concern given the increased cost of hedging?

Yasuhisa Nitta
President & Chief Executive Officer, PGIM Japan Co., Ltd.

A

Specifically speaking, it's about the customer's mandate, so I cannot talk about the percentage number to the total. But as far the hedge cost impact to the business, what I can say is, as I mentioned in my presentation, the increase of the hedge cost is making the changes to the customers investment target that is very important for us.

The investment needs of the customer is changing and how we can actually address to that is very important in the asset management industry. In this sense, the higher yield area that includes alternative asset class, whether we can actually incorporate this is very important in determining the winner and loser in the asset management space. So, in this sense, we have the best of the investment capabilities and are confident that we can address this hedge cost changes, and also the investment need changes and that is the investment capability that we have.

Erik James Bass
Analyst, Autonomous Research US LP

Q

Thank you. So, is that right to summarize that you may see some pressure on kind of core fixed income type products, but you think there is an opportunity to shift to higher yielding products that can maybe offset the increased cost of hedging?

Yasuhisa Nitta
President & Chief Executive Officer, PGIM Japan Co., Ltd.

A

As an overall trend, that is correct. But whether the weighting of fixed income, whether that will go down or not, we need to look at the shift that's happening within the sub-segment of fixed income. So, it doesn't necessarily mean that the fixed income as a asset class will go down by sub-segment. What I mean is, whether it's investment grade or high yielding.

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

A

A question right there. Right.

Peter Alexander Deutsch
Analyst, Fidelity Management & Research Co.

Q

Peter Deutsch, Fidelity Investments. Could you give us an update on the subsidiary lending capacity and how we should think about how much of – what governs that? Do you view it as get extracting some of the embedded value, given the very strong reserving in Japan or how do we think about the level of subsidiary loans you can get out of Japan?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

We are trying to understand the question about our capacity under the, sort of the caps for affiliate lending?

Peter Alexander Deutsch
Analyst, Fidelity Management & Research Co.
Q

Exactly.

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Yeah, okay. The regulatory cap there would give us capacity of around a little over $4 billion. We would probably not take it to that level, we sort of think about an operating level that's probably around half of that or so. There is – in addition to that, we have loans between Japan and the parent company that are about $0.5 billion that still remain outstanding. So, you can kind of look at that as – that's one of the levers that we have available to us to bring capital out of Japan and back to the U.S.

Now, having said that, Peter, what I sort of add to that is, we have multiple levers for redeploying capital out of Japan. And we've used many of those and some we've used in different orders of magnitude, depending on sort of what's most efficient for us at any one point in time. But the ability through reinsurance, derivatives, the affiliate lending that you just asked about and through dividends coming from our J-GAAP income, we are highly confident we have all the flexibility we need to meet the targets that we've established with regard to redeploying capital out of Japan and back to the parent company.

Darin Arita
Senior Vice President, Head of Investor Relations, Prudential Financial, Inc.
A

And maybe we'll just do one more there. Yeah, Alex.

Alex Scott
Analyst, Goldman Sachs & Co. LLC
Q

I just had a quick one. This is Alex Scott, Goldman Sachs. I just had a quick one along the same lines. I mean, for FSA earnings, could you gives us any color on sort of the trend you're seeing there. And if any of the changes you're making to the products and I guess specifically the shift to USD products, is the reserve strain, the capital strain a bit less there? And is that a trend that will allow you to have more dividend flexibility over time?

Robert Michael Falzon
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

So, Alex, the way I think about it is, on average – and it varies in any given period, but on average think about JFSA – J-GAAP, excuse me being around half of U.S. GAAP. And so when you think about our earnings and our earnings growth, think about our J-GAAP earnings would sort of maintain that kind of a ratio vis-à-vis our U.S. GAAP. And that then provides a dividend capacity that we could take out. That's the way in which we chose to take earnings out of the country, which is one of the levers that we have.

We – and – so that's a significant amount of earnings that we would be able to dividend out. It is one of the levers we have and we'll continue to use, but is just one of our levers and that's where I'd like to emphasize that we have lots of capacity for bringing – an alternative means for bringing earnings out of Japan.

And so we don't – while the J-GAAP earnings are useful reference point to us and the trend in that over long periods of time, J-GAAP should approach closer and closer to U.S. GAAP for many of the reasons that you cited. That's not a primary driver of our capital redeployment flexibility. The other levers that we have available to us are drivers of that.

Alex Scott

Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Darin Arita

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

All right. Let me turn it back over to Charlie for some closing comments.

Charlie F. Lowrey

Chief Operating Officer & Executive Vice President, International Businesses, Prudential Financial, Inc.

So, hopefully today, what you come away with us is a consistency in the presentations that deliver a number of key points that we've tried to make, which are, one, we believe we have a well-executed and sustainable business model that really does have a significant competitive advantage and through its differentiation of distribution, so that's the first point.

The second is, what does that yield? That will yield consistent and profitable growth over time with our ability to redeploy capital.

And the third point is, in these presentations you heard a lot about digital, data and mobile. And in the background what you see or what you heard is that we're investing significantly in augmenting, not replacing, but augmenting the distribution model we have, by going closer to the customer and allowing them to really access us when, how and where they want. But with an underlying emphasis still on phase-to-phase distribution, which I come back to, is really our differentiation.

So, I'd just like to end by saying thank you for coming. Thank you for your interest and we look forward to continuing to answer questions over lunch.

Darin Arita

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

Thank you.