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Alex Scott
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MANAGEMENT DISCUSSION SECTION

Alex Scott
Analyst, Goldman Sachs & Co. LLC

All right. So we'll go ahead and get started. First, like to say thank you for joining us today. We have Rob Falzon of Prudential Financial, Vice Chairman. So, thanks for being with us.

QUESTION AND ANSWER SECTION

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

I guess, maybe a high level one to start out with. Over the past year there've been some changes in Prudential in terms of management team. I think some on the growth strategy, investments in the business et cetera. You've been around Prudential for a long time.

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

A

Yeah.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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So I thought it will be interesting to kick it off with just your views around what is changing the Prudential and how you see the company evolving over the next few years?

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

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Yeah. So, yeah, I have been with the company really long time. So, I'm about to say something that you should take in that context, which is, probably it may not be visible from the outside, but from inside of the organization, it's probably more change going on in the organization today than there has been at any point in the past with the possible exception I would say of, when we demutualized and took the company public. So, it's a lot.

So before I jump into that, let me actually emphasize, what isn't or hasn't changed. So first, the commitment that the company has, sort of the strategy that we articulated around, how we're expanding addressable markets with each of our three principal businesses is a constant. We remain very much committed to that. And to execute that in a way which we have operating outcomes, that then merry up with financial outcomes that produce good results for investors is something that we're highly committed.

As we think about that, the things that are changing are around how we execute against that strategy and in particular, some of the cultural aspects of the organization that need to change in order for us to be able to do that. So this is about strategy where you're trying to be responsive to the customer needs, both with regard to experience and with regard to sort of the type of product and the value of the product that we're providing to them.

And as we've in the US increasingly focused, sort of, our growth on penetrating the middle market, that's a very different set of demands that are coming from that marketplace. And so we need to organize ourselves in a way and conduct business in a way that allows us to get to that market in a cost effective basis that gets them the kind of products that they need and does so efficiently enough that we can get them the right value exchange and make a return on that as well.

So, given the example of that in our Life business Alex, as we look at our current levels of sales, what's happening is, in 70% of our sales, we're only generating about 30% of our revenues and that's because as we're pivoting to things both the combination of low interest rate environment and middle market needs, you're pivoting to term products, and term products that are going to have lower notional amounts associated with them. So the premiums on that are lower.

So if that's how the business is shifting, unless we change how we deliver that, we're going to be challenged to either provide that cost effectively to the customer or provide that with the appropriate margin and return to us. And so as we look at our Life business, we've had to look at how do we deliver that type of a product into that marketplace in a completely digital way, right. And so that we take costs out of the equation, but also enhance the experience for the customer.

So if you look at the very front end of that experience of the customer, it's how they buy from us. So today, we have something we call [ph] Fast Track (00:03:33) and we introduced that about a year ago, it allows us to take an application and virtually instantaneous, we say within a couple of hours, but it's really instantaneous for the vast majority of these things. We're 31% now of our applications, we can process on that basis. Its artificial intelligence, it does the underwriting and it approves or disapproves the application right there and then. So, that's a 31%.

We have a capacity to bring that up to about 40% than what we're investing in, then is a capability to actually bring that in the course of 2020 up to 70% of the sales that we're making. So if you sort of think about the implications of that on business system, we need a lot less underwriters. We need more people who are doing data analytics and algorithmic programming and that creates a better experience for the customer because they get immediate response. We deliver a product that's more cost effective to them and we actually earn a good return on that. That's an entire redesign in how we work, both in terms of how we're using talent and how we organize and design around our talent.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And I guess along those lines of the financial wellness, expense initiative which I think is fueling some of what you're talking about, I think when you talked about it earlier in the year there is a range of investment that was going to be made as well as a range of margin expansion benefits...

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

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Yeah.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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....that would accrue to you. Would you just be interested if you could provide an update on sort of where that stands, how you think the range of outcome this is shaping up, whether it's more accelerated, more backloaded and maybe how Assurance IQ plays into that?

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

A

Sure. So first is just to emphasize that – the point that the connection to the first part of what I was just talking about, those initiatives are around customer experience and around product delivery. So how do we get the right products into the hands of our customers as we're looking to penetrate the middle market. We need to look at doing that very differently than we've historically done it.

And so as we talked about that, on Investor Day, what we said is that's a program that will incur expenses over the next three and a half years, the point at which we talked about it. So through 2022, that would aggregate to around $600 million to $700 million. That would then produce a margin improvement of about $0.5 billion. And they would be along the kinds of niches very similar to one that I just gave an example to earlier, but a number of other things as well. So around improving the customer experience by virtue of doing that, creating operating efficiencies, which lower costs and improve margins for our businesses as well.

I think in terms of your question of how we feel about that, I think our level of visibility and confidence that has only been going up. So in the course of the third quarter, we announced that we had put into place a voluntary separation program and that program wasn't distinct and won't to be separate from anything that we've talked about before. In fact, it was directly linked to that financial wellness initiative, that initiative of a set of initiatives around redesigning business and creating efficiencies.

And with the idea that being that we could accelerate the identification of areas where we could create operating efficiencies, and therefore get more of the expenses behind us more rapidly. And there have better visibility into the profits that are emerging to that earlier than what we had originally anticipated. Not changing the composition, so we still think that it's $600 million to $700 million of expenses, it's a $0.5 billion worth of margin improvement, but we'll create more visibility on that and the trend line to getting that margin improvement would be a little bit more rapid.

Our expectation is that in the next couple of weeks, we'll file an 8-K as we promised that we provide more information that will give people visibility into sort of how is that plan intersecting with what we talked about on Investor Day in a way that will create sort of more specificity and visibility on what we talked about back in the first half of the year and how that's being affected. But I'd say it's sort of without previewing the numbers that are associated with that, we're feeling as if we have better line of sight. We'll have an opportunity to accelerate and create more visibility around the payoffs that are associated with that.

With Assurance IQ, that's quite distinct from that initiative. Assurance IQ is our retail now platform, direct-to-consumer platform. We talked about cost synergies that maybe what you're alluding to there, Alex ...

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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Yeah.

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

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...associated with that. That's on top of the $0.5 billion. We talked about it as a part of that acquisition. There were probably $25 million to $50 million worth of investments we would have had to make in our Financial Wellness platform that will now be avoided. So that's in addition to the $0.5 billion margin improvement that we had already identified.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Okay. And maybe one more around Assurance IQ. I just wanted to get a feel for – how you'd expect this business to improve your Retail sales platform, sales over time? Is there any update you can provide around how the integration is going, the timeline, over which we would expect to see financial results that are leading to better sales and progress there?

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

A

Yeah. So again to emphasize, when we looked at that platform, we looked at it as a direct-to-consumer way to get it at the middle market in the way that we were getting at the middle market through our Workplace platform. So strategy hasn't changed, both with respect Assurance and with respect to what we call Financial Wellness. Well, Financial Wellness being Workplace, Assurance being direct-to-consumer, both targeted at being able to get to the middle market Assurance frankly, given the cost effectiveness of that platform. We can get not only to the middle market. We can get to the mass market with that platform as well.

As we think about that platform, it's sort of the, do no harm. I'm sort of adding just one that we put out there. It's doing extraordinarily well on its own. And as we're managing, the last thing we want to do is actually get in the way of the execution against what they've been doing very well to begin with. And so, what we want them to do is fully earn their earn out, because if they do that that's going to be a good experience for us and a good experience for our shareholders. And so, we're being very conscious of not actually interrupting the growth of the business and the manager of the business.

Now having said that, when they first approached us before we actually begin discussions about acquiring the platform, they approached us about getting our products onto their platform. They felt as if there are a life component of their platform was not as robust as they would like it to be and they thought someone like us with the brand that we had and some of the capabilities we've had – we have would enhance that. And so, we want to fulfill that sort of original sort of desire from both their standpoint and our standpoint, so our expectation would be that in the first half of next year, we'll have a life product – life term product on their platform and that will accomplish I think something very significant for them in terms of having that capability and then the other part of that is what we have, that fast track capability that I alluded to before that instantaneous underwriting, we're going to be able to put that onto their platform.

Part of what they've suffered from in their life sales is the way it works now is they'll get a customer who buys, but the execution of that purchase doesn't occur for months later because it then goes to one of their insurance providers. They have to do their underwriting, they have to get the approval and then it comes back and they have a large dropout rate between the when the customer first says yes and then by the time, they actually get the issuing the policy, the customer sort of changed their mind or walked away by being able to put that in their platform as an execution capability right upfront; that's going to – we think they believe substantially enhanced their ability to sell more term product on their platform.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And maybe if I could pivot over to capital deployment on sort of a go forward basis, investors are increasingly dependent on cash flow based analysis rather than a lot of the GAAP metrics. Can you discuss the way PRU looks at its capital generation, its cash flow, how much capacity it has to bring cash up to the holding company and what your strategic priorities are for deploying it going forward?

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

A

Yeah. As I think about cash flow and capital deployment, what I would say is past is very much prologue here. Then if you look at our history, it's one we're about, where we articulate about two-thirds of our earnings translates into free cash flow, as we look at that free cash flow, we've distributed that out in the form of dividends, stock buybacks and then – to the extent we've had interesting things to do like acquisitions or growth opportunities within our business, we've done that.

And so I think that going forward, we have a pretty well, I hope, understood by our investors philosophy with regard to that and we'll continue to execute against that. With respect to dividends, expect to see our dividends continue to grow in line with how our earnings are growing. We increased it 11% last year. If you look at the last five years, it's been a 16% compound annual growth on our dividends.

It represents about half of our free cash flow. So we have an ability to protect that dividend should things turn down. We don't have to cut it, if earnings turned down because we – it's only a fraction of our total available free cash flow and we have 11 years in a row now increased our dividend, right. Ultimately, we'd like to get to 20 years so you qualify for that dividends, Aristocrat Index thing or something, it would be sort of a nice, nice. I don't know that I'll be around that long.

From a stock buyback standpoint, I think what we've always expressed is that with the remainder of our free cash flow, we look for opportunities to create shareholder value and sometimes there are opportunities to invest in our businesses to do that. Sometimes there are opportunities to acquire something in order to be able to do that like Assurance and many times, it's by returning that free cash flow back to our investors in the form of stock buybacks.

So, if you look at the last five years ending 2018, because I haven't updated my numbers for this year yet obviously, but we've redeployed about $15 billion worth of capital. $13 billion of that would have been a return to shareholders over that period of time between dividends and stock buybacks, and that $13 billion, $15 billion is that's a big portion of our roughly $40 billion of book value. And it would have been around two-thirds of our earnings over that period of time as well. So as I said, past very much being prologue with ours, what you should expect us to be doing.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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Okay. And shifting over to PGIM, flows there have been pretty strong pretty stable over a period. Can you discuss the outlook for this business, some of the initiatives that are in place to further this distribution whether more of that is going to occur domestically versus international?

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

A

Yeah. So first, understand PGIM, you have to understand we have as a – and then talking to this audience in particular, we have as an investment management platform sort of a unique approach to the business. We tried to be thoughtful about in each of our businesses about strategy and business design and then hopefully execute well against that.

And in the case of PGIM, it's a multi-manager platform, but it's a multi-manager platform where we own 100% of the multi-manager. So you get the benefit of being a multi-manager in that performance execution well in line with compensation in reward and interface with the investors combined with having it all wholly owned and therefore we get the operating efficiencies associated with from a distribution standpoint and from an operation standpoint of having a $1.3 trillion asset under management platform, one of the 10 largest.

Within that multi-manager model, it's particularly focused on fixed income. So we're number four globally from a fixed income standpoint and alternatives. So we're number three globally from an alternative standpoint with a particular focus on real estate both debt and equity and private fixed income. So the result of that model and that particular mix of execution has meant that over the last 16 years, what we've seen is consistent positive third-party cash flows consecutively coming in over that period of time. And if you look over the last five years, the fees that we're earnings off of our AUM have been pretty steady at 21 basis points to 22 basis points.

Now, it's not that we don't see some of the same pressures that everyone else sees in terms of flows or an active manager and so, there's the challenge of active management versus flows going into passive. But what we've been able to do is put into place and continue to put in place a number of initiatives to sort of continue to attract flows into the platform. And I would describe those as one around distribution. So, if you look where we continue to invest in our Institutional distribution, we've added staff in Europe and we've added staff in Asia to complement what we're doing in the US, and then from a Retail standpoint as well, we now have I think 28 UCITS in place and half a dozen ETFs in place. Obviously UCITS can be used for both Retail and Institutional. But that's a big investment in a platform from a distribution standpoint.

The second aspect of that would be we've invested in and continue I think the growth opportunities from the flow standpoint will be in the – becoming an increasingly global platform. So today, 70% of our AUM is from the US, 30% of it is from outside the US. In the US, we're doing business with 80 of the largest sort of pension funds in the country, public and private pension funds.

If you look abroad, if you look globally and you look at that number, if you take the top 300 global plans, we're only doing business with about 160 of them. So, I say only that still a lot, but we have an opportunity to grow that pretty significantly. So, as we're looking at the growth in the business from a distribution standpoint, we're particularly focused on being able to do that abroad in Europe by virtue of what we've invested in both in Retail and Institutional and in Asia. We have a large presence in Japan. One of the leading actually Institutional managers in

Japan and we've got like I think $20 billion or something of assets under management in China now as well. So, we're looking to grow in Asia and grow in Europe.

And I think the last component of that is as we look to marry that, the idea of sort of enhanced distribution and getting a – an increasingly global investor base as a way to grow further, we got to have the right products to do that. And so, we've been introducing funds that are generally tend to be higher returning funds both particularly in the private asset class area, as the alternative asset class areas, but also in fixed income, including hedge funds within fixed income. What we're finding is our appeal to many of those non-US investors is around the higher returning strategies that we can introduce to them. And our success of doing that not only adds to flows, but frankly it also is what's has contributed to being able to maintain that 21 basis point to 22 basis point AUM fee, because where we're getting compression on some of the core things that we've been doing, we've been tracking new flows in that are higher returning and higher fee funds. So I think we feel pretty good about the opportunity for us to continue to be a net attractor of flows into the platform, despite some of the macro things that are happening in the industry.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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Got it. Maybe thinking about the PGIM, I think you've talked about core margins of around 30%...

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

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Yeah.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

...in this business. I think that is at least [indiscernible] (00:19:00) that I calculated, but a couple points to maybe 2 points, 3 points better than you've been running in recent quarters. So I'd just be interested to hear about you know is that still the target? How quickly do you think you can get there?

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

A

Yeah. I think you know as David Hunt has articulated our asset management platform you have to recognize, we're not a passive manager, we're not going to be a 40% margin business, but we can very realistically be a 30% plus kind of margin business and I think it's been pretty public about that aspiration. And if you look over the last several years, we've moved up our margins by 200 basis points over that period of time, while we've been very active and investing in capabilities. And so as we're getting the payoff of those capabilities, many of things that I just talked about from a flow standpoint, they're also adding from a margin standpoint. And so, the combination of scale as we continue to get more AUM and the profitability of the higher returns strategies that we're particularly focused on both in terms of the alternatives we have and the fixed income – the hedge fund fixed income strategies that's a way in which we continue – through both scale and margin, we're able to I think continue to realize some upside on our operating margins.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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Okay. So maybe changing gears here to the variable annuities business or even fixed annuities. There has been transactions that have occurred to free up capital. It seems like there's a pretty robust supply of reinsurance capital on the sidelines still. Is that something that you consider Prudential or is it something opportunistically that you could consider to take advantage of that situation and potentially give yourself more capital to deploy?

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

A

Yeah. I guess two headline thoughts on that. The first is as we look at that annuities book that we have, it's an extraordinarily attractive economic book for us. So it's producing higher-teens returns. The question I get sometimes in these one-on-one meetings is, yeah, but is it real? And my response is look at the free cash flow that we're throwing off of it. So yes, it's very real, you can see it in the cash flow that's coming off. So it's a higher return, high free cash flow and a very stable business for us. So you don't see a lot of volatility and capital and earnings as markets move because of the way in which it's constructed and hedged. So we feel really good about that business. So that's sort of point one.

Point two would be that having said that that in every business that we have are ones where we constantly look at how can we optimize our use of capital in a way that can be more accretive to shareholders. And so would we be open to a transaction either with any part of our annuities blocks or for frankly, our life blocks or our long term care blocks? We get questions along any of those. The answer is, yes. We would be absolutely open to those kind of transactions, but we're not driven by things like accounting. Those are things that are sort of we've already advanced – pretty much advanced adopted the accounting. We already has the accounting that look substantially like what's coming...

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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Yeah.

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

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...at the market from an annuity standpoint. So it's – we don't have a particular urgency around either a burning platform or an accounting concern that would cause us to want to accelerate something like that. But it is something that we think is we have a responsibility to look at all the time and part of our BAU as we evaluate how do we optimize ROE.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

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And then when I think about the growth of the annuities and just the flows, could you talk about some of the things you're doing to whether it's on the distribution side. I know a lot of companies have been focused on the wholesaling different channels. Are there things you're doing that make you believe you can get back to positive flows here for variable annuities or just annuities overall?

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

A

Well, there are a number of things that we're doing. I'm not sure I'm at the point we're in this interest rate environment. I'd put a stake in the ground and say that we can get the positive net flows. So let me break those into two pieces. We have as we think about our VA platform, we have introduced more diversity in the products that we have there. So in addition to the variable annuities and the HDI product that we've been known for, we have a significant now component of our sales that are sort of not equity linked in the same way or the returns on that don't have equity risk associated with it. And that's been a growing part of our platform.

If you look at our overall sales, I think the market from – in 2018, grew by 12% or something like that. We grew by 40%. So we had a very significant growth in ourselves and that is in fact the benefit associated with having been able to introduce a more diversified product line up and expanding our distribution, so big into RIAs and IMOs a way to expand warehouse and our captive distribution. So I think that those investments have paid off well for us.

Now having said that, from a flow standpoint what you would see is, we have a legacy block of business, a cohort of business which is very profitable business for us. But we sold it after the crisis, and through that period of time where it's coming off its surrender charge period. And so what you're finding is that, as that surrender charge goes away, we have the combination of higher withdrawals and lapses that are causing headwinds from the standpoint of net flows.

And so in 2018, if you look at our quarterly net flows or our sales net of that dynamic, what you would see is that we had net outflows of about despite the growth in sales, we had net outflows of about a $1.5 billion a quarter throughout the course of the year, and this year through the first three quarters of the year, we've managed to shrink that, but it's still about $1 billion a quarter in net outflows.

That dynamic in terms of the cohort, that's coming off the – the higher level of sales cohort, that's coming off the lapse period or the lapse guarantee period is that, that goes through the end of 2020. So we still have had some headwinds in front of us in terms of one more year of that cohort that has to, that's coming off of it. It's a lapse protection period that we'll probably see some level of – elevated level of lapses that will be mitigated by sales. But I'm not sure we're at the point where we would say we can totally offset that during 2020.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

And I guess along the same lines in Retirement, how are interest rates affecting the environment for pension risk transfers and how do you see the pipeline for the Full Service business?

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

A

Yeah. So if you look at our Retirement business, we've got a very robust Full Service business that's doing quite well. So we have record levels of flows to that business in 2018, had the largest single case we've ever won in the history of the business in the second quarter of this year and we continue to see good momentum from a flow standpoint. So I think we have a very robust franchise there. That only gets better competitively as I think the stakes around scale and commitment go up in that sector. And then we continue to be a market leader on the pension risk and longevity risks transfers and we're early innovator in that market. We have a distinctive track record around execution and that helps us both win business particularly in the segment that we focus which is the larger transaction and to the market.

So with regard to each of those, on pension risk transfer, what we're seeing is that the immediate pipeline there actually still looks pretty robust. Most companies that are planning to do something like this plan well in advance. So it's a yearlong type of a process that they undertake. And as they go into that process, at some point early enough in the process as they get committed to it, they one way or another hedge out the liability. And so the fact that rates have dropped down fairly significantly has – had less of an impact on them and therefore it is not causing them to sort of revisit whether they should proceed forward with the transaction. So we see a pretty robust pipeline in the near term associated with those companies that have been in the market and continue to have an interest in executing.

If rates stay where they are, it's less clear what will happen and think about it as in the second half of next year in terms of whether that pipeline will continue to recharge because funding for pension plans went down pretty significantly as a result of the drop in interest rates. And that could then cause some hesitation to go into the market when that gap is still that wide until we – kind of wait it out to see whether the gap would close or decide that it's not going to close, it could get worse and so proceed forward. We don't know how that's going to play itself out. So we're a little cautious about the longer term pipeline, but feel pretty good about what's out there near-term.

On the longevity risk transfer business, that's being driven for us primarily out of the UK surge of activity in advance of Brexit. The only thing I can say is everyone is trying to reduce whatever risk of variability they can from outcomes from Brexit. So they've – we've seen a heightened level of activity associated with that, but pension schemes in the UK or actually quite well funded, and so we expect that that pipeline will continue to be quite robust and while we're seeing some elevation as result of Brexit, we don't that it suddenly drops off post-Brexit, because there's continued demand and they're well-funded, so they don't have some of the hurdles of lower interest rates that we have here in the US.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Maybe if I shift over to International, I guess, Japan specifically. Yeah, I think some of the spend that occurred this last quarter I was referenced that there were some infrastructures that was built out and maybe some of it had to do with regulatory oversight et cetera.

So I'll just be interested to hear general regulatory update, if anything there was kind of fueling that spend will flow through to what we'll see in terms of sales. And then if there's any kind of update around capital and what drives your cash flow and FSA?

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

A

Yeah. So I would say that, if you think about the JFSAs activities, they have been going across the industry. And I think doing a more in-depth review of sales, both products and practices. We have always maintained an extraordinary good relationship with the JFSA. We've been role model in many areas and we want to continue to enjoy that kind of relationship.

And so we're making investments in order to stay in front of the curve on that and to continue to be sort of representative of best-in-class in that from a sales standpoint. So I think from that standpoint, we wouldn't expect that to have any material impact on how we think about actual sales. It's more about the investments we're making and controls around infrastructure and controls around our sales.

On the capital side, what you've seen is, the JFSA is looking very closely at what's happening on the international landscape with the IAIS, International Association of Insurance Supervisors and something called the ICS, everyone maybe aware of that, so the International Capital Standard. And what we're seeing is that, Japan has an interest in putting in a more economically sensitive capital construct in lieu of the current solvency regime that they have. They're going to do that very slowly and very carefully. So they're taking guidance from the ICS. We expect that they will adopt some version of the ICS as a group capital construct. And we also expect that that will have some not insignificant influence on what they do from a local solvency regime as well.

The timing of that is likely to trail the IAIS as opposed to get out in front of it, one. And two, it's likely to also have adjustments that reflect the way in which insurance is written and managed in Japan as well. They have different mortality and morbidity risks. They have a different capital markets than we like we have here in the US. And all that needs to get reflected in that regime. The JFSA has been very vocal about pointing these things out in the international community. Many of the things they have been pointed out have actually been adjusted in the latest version of the ICS that was exposed in Abu Dhabi, just in this last month but not all of it.

And so, it's hard to say exactly what's going to happen there other than I think they will move to something that's more economically motivated. I think the takeaway for us is simply that we've always managed our business from a capital standpoint with an economic model in mind and that we would expect that whatever they come up with so long as it takes some sort of regional regime would reflect sort of the robust way in which we're already managing to an economic model. So we don't feel threatened in the JFSA shifting to a more economic model. We think actually the strength of our reserving and capital would be as transparent under that regime as it is under the existing regime.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Got it. Well, maybe we'll stop there and see are there any questions from anybody in the audience?

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Can I ask a couple of follow up questions on pension risk transfer? One is, what are the most important skills to be able to do this business? Is it on the investing side or is it more about analyzing the particular characteristics of the pool of pensioners in terms of the longevity or whatever?

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

A

Yeah.

Q

And then the second question is, has competition in this business changed and is the expected return depended on the size of the deal? I mean, could you maybe – as the deal size gets bigger, there are a few people you're competing against? So that's the sort of second question.

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

A

Yeah. So in terms of the sort of the skills and analysis, that sort of differentiating there, what I would say is, in a segment in which we compete, which are the larger transactions, the ability to underwrite is critical because what we do is, we don't – small transactions are going to use tables to approximate what the experience is going to be for that and you see that happening all the time in the smaller transactions.

For the larger transactions, the benefit is that you actually get real data and the equivalent of hundreds of years' worth of data in many instances and that allows you to build your own actuarial models around that experience in order to be able to price it appropriately. So the underwriting for larger transactions becomes significant and can be a competitive advantage, the extent that you have insights under that underwriting, that others do not depending on sort of what the nature of the employee population looks like.

Equally important is the ability to invest and to match it up with a class of assets that can then fund that in a competitive way and we think that it needs to be high quality, we continue to maintain the portfolio there. If you look at the portfolio that backs our pension risk transfer, it looks much like the portfolio that backs the full general account to [ph] A (00:33:20) on average. But the ability to put things like, private placements and mortgages that might be – that same credit quality, but get higher yielding make you more competitive in the marketplace.

The third piece of that that I think is important is also the ALM discipline outside of just the construction of the portfolio from a credit composition standpoint, but it's being able to be very disciplined about how you match up the earlier cash flows and then the key reiterations of the liability against the asset portfolio. It's a business in which you can remove a lot of interest rate risk, if you're smart about how you manage it. It's also a business in which you can assume a lot of interest rate risk, if that's the way in which you're going to try to get competitive in the marketplace and to take that risk. We've always taken the approach of a fully immunizing to the extent possible, the rate risk that's indebted in that block of business. There's a second part to your question that I have now forgotten.

Q

[indiscernible] (00:34:09)?

A

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

Yeah. So we believe that our ability to differentiate on the larger deals [indiscernible] (00:34:20) what Phil Waldeck, the former leader of that business, now he's heading over US businesses, as I said before is that 80% of the business that he was referring I think to give this quote, he was referring to 2018. But I think it has to – it still pertains today. 80% of the business that we looked at, we got last look. We didn't win all of that business, but we got last look and we got last look because we reviewed the highest quality provider counterparty on it. 50% of the business we won, we did not win because we were the lowest cost provider.

So we know that in half the business we booked, we were actually – our competitor out there, one or more competitors that were out there with more aggressive pricing that we provided. So I think the answer is that yeah, there's still, it's competitive. We've seen – the returns we earned on our earlier deals versus the returns we're earning today all still above our target rates and above our cost of capital. But we are indexed as returns obviously as a first mover in the market than what we're earning today. So it has become more competitive.

We're able to continue to differentiate ourselves and get attractive returns based on the quality of the platforms that we have, so that hasn't entirely gone away, although I think as you go down the spectrum of deal sizes, it gets increasingly commodity like and some of that differentiation is less compelling to the counterparties.

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Okay. We'll stop it there. Thank you everybody. Thanks for joining us.

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

Thank you.