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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to Prudential's Quarterly Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Later we will conduct a question-and-answer session. Instructions will be given at that time. [Operator Instructions] As a reminder, today's call is being recorded.

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

Bob McLaughlin

Head of Investor Relations, Prudential Financial, Inc.

Good morning and thank you for joining our call. Representing Prudential on today's call are; Charlie Lowrey, Chairman and CEO; Rob Falzon, Vice Chairman; Andy Sullivan, Head of US Businesses; Scott Sleyster, Head of International Businesses; Ken Tanji, Chief Financial Officer; and Rob Axel, Controller and Principal Accounting Officer. We will start with prepared comments by Charlie, Rob and Ken, and then we will take your questions.

Today's presentation may include forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, this presentation may include references to non-GAAP measures. For a reconciliation of such measures to comparable GAAP measures and a discussion of factors that could cause actual results to differ materially from those in the forward-looking statements. Please see the slide titled Forward-Looking Statements and Non-GAAP Measures in the appendix to today's presentation and the quarterly financial supplement, both of which can be found on our website at investor.prudential.com.

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

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Bob, and thanks to everyone for joining us today. As always, we hope you and your families remain safe and healthy. Prudential delivered solid financial results for the third quarter, reflecting our strong investment performance and high demand for the products we've introduced to support our customers as they solve their financial challenges in a changing world.

We also made significant progress executing on our transformation strategy to become a higher-growth, less market-sensitive and more nimble company. First, we reached agreements to divest our full-service recordkeeping business and to sell a portion of our traditional variable annuities, advancing our pivot toward less market-sensitive and higher-growth businesses.

Second, we continue to advance our cost-savings program and remain on track to achieve $750 million of savings by the end of 2023. And third, with the support of our rock-solid balance sheet, we are maintaining a disciplined and balanced approach to redeploying capital. I'll provide an update on each of these transformation initiatives before turning it over to Rob and Ken.

Turning to Slide 3. In September, we reached an agreement to sell a block of our traditional variable annuities to Fortitude Re. This divestiture, which is expected to close in the first half of 2022, represents approximately 20% of our traditional individual annuities account values and significantly advances our goal of cutting in half the earnings contribution of legacy variable annuities products through a mix of strategic transactions and natural runoff. This transaction expands upon our prior divestiture activity, including the agreement we announced in July to sell our full-service recordkeeping business and the successful completion of the sales of our Taiwan and Korea insurance businesses.

As a result of these divestitures to date, we expect to generate net proceeds of approximately $6 billion by the first half of 2022. And we continue to explore additional opportunities to derisk in-force blocks of business. With the pending sale of our full-service recordkeeping business and our annuities block transaction, we have combined our individual annuities and retirement businesses to better serve the retirement needs of both individuals and institutions and support our growth strategy.

Turning next to our cost-savings program on slide 4. We are progressing well and remain on track to achieve our $750 million cost-savings target by the end of 2023 as we look to reduce expenses while improving both the customer and employee experience. To date, we have achieved $590 million in run rate cost savings, exceeding our $500 million target for the full year. These savings include $145 million achieved in the third quarter for a total of $385 million this year.

Turning to slide 5. We continue to demonstrate a disciplined and balanced approach to capital deployment by enhancing returns to shareholders, reducing leverage and investing in the growth of our businesses, all supported by our rock-solid balance sheet. Year-to-date, we returned $3.5 billion to shareholders, including $2.1 billion of share buybacks and $1.4 billion in dividend payments, reflecting a 5% increase in our quarterly dividend, compared to last year. And we're targeting to return $11 billion of capital to shareholders by the end of 2023.

During the third quarter, we also took steps to enhance our financial flexibility by redeeming $900 million of outstanding debt. This reduced financial leverage and generated $30 million in annual interest savings going forward. We also continued to deploy capital in our businesses to drive long-term growth.

For example, this quarter, we completed a $5 billion funded pension risk transfer transaction, which is the fourth largest transaction in the history of the PRT market and demonstrates our expertise, ability to execute at scale and commitment to this market. We also deployed capital to support our ongoing pivot to less interest rate sensitive and higher growth products, including our FlexGuard and variable life products. Our capital deployment is supported by our balance sheet strength, including highly liquid assets of $3.8 billion at the end of the third quarter and a capital position that continues to support AA financial strength rating.

Turning to slide 6. I'm pleased to report a meaningful expansion of our environmental, social and governance commitments. Earlier this week, we announced our commitment to achieve a net-zero emissions across our primary global home office operations by 2050, with an interim goal of becoming carbon neutral by 2040. We're also carefully assessing the emissions impact of our investment portfolio.

As an immediate action, we will restrict new direct investments in companies that derive a material portion of their revenues from thermal coal. Separately, on the social front, the Prudential Foundation achieved an important milestone during the quarter, reaching $1 billion in funding to partners aimed at eliminating barriers to financial and social mobility around the world since making its first grant in 1978. These investments include funding aligned with our racial equity commitments to support organizations, such as those supporting minority-owned small businesses and historically black colleges and universities that foster black economic empowerment and address the racial wealth gap.

This milestone by the foundation follows the $1 billion investment mark achieved in our impact investing portfolio in 2020. We are confident these actions taken alongside of our strategic transformation will help us build a more sustainable company on behalf of all our stakeholders. Thank you for your time this morning.

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

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

Thank you, Charlie. I'll provide an overview of our financial results and business performance for our PGIM, US and International businesses. I'll begin on slide 7 with our financial results for the third quarter. Our pre-tax adjusted operating income was $1.8 billion or $3.78 per share on an after-tax basis and reflected the benefit of strong markets and business growth, which exceeded the net mortality impacts from COVID-19.

PGIM, our global asset manager, had record-high asset management fees, driven by record account values of over $1.5 trillion that were offset by lower other related revenues relative to the elevated level in the year ago quarter as well as higher expenses supporting business growth.

Results of our US businesses increased approximately 29% from the year ago quarter and reflected higher net investment spread, driven by higher variable investment income and higher fee income, primarily driven by equity market appreciation, partially offset by less favorable underwriting experience driven by COVID-19-related mortality.

Earnings in our International businesses increased 14%, reflecting continued business growth, higher net investment spread, lower expenses and higher earnings from joint venture investments. This increase was partially offset by less favorable underwriting results, primarily driven by higher COVID-19 claims.

Turning to Slide 8. PGIM continues to demonstrate the strength of its diversified capabilities in both public and private asset classes across fixed income, alternatives, real estate and equities as a top 10 global active investment manager. PGIM's investment performance remains attractive with more than 94% of assets under management outperforming their benchmarks over the last 3, 5 and 10-year periods.

Third-party net flows were $300 million in the quarter, including institutional net flows of $700 million, primarily driven by public fixed income flows. Modest retail net outflows of $400 million were due to equity outflows from sub-advised mandates and client reallocations due to rising rates and inflation concerns.

As the investment engine of Prudential, PGIM benefits from a mutually beneficial relationship with our US and International Insurance businesses. PGIM's asset origination capabilities and investment management expertise provide a competitive advantage by helping our businesses to bring enhanced solutions and more value to our customers. And our businesses, in turn, provide a source of growth for PGIM through affiliated flows that complement its successful third-party track record of growth.

PGIM's asset management fees reached another record, up 13% compared to the year ago quarter as a result of strong flows driven by investment performance and market appreciation. PGIM's alternatives business, which has assets in excess of $250 billion, continues to demonstrate momentum across private credit and real estate equity and debt, benefiting by our global scale and market-leading positions.

As an example, PGIM's private businesses deployed almost $12 billion of capital this quarter, 28% more than the year ago quarter. This strategic focus on expanding higher-yielding products has resulted in stable fee rates over time despite industry-wide fee pressures.

Now turning to slide 9. Our US businesses produced diversified earnings from fees, net investment spread and underwriting income and benefit from our complementary mix of longevity and mortality businesses. We continue to shift our business mix away from low-growth, capital-intensive and interest rate-sensitive products and businesses, transform our capabilities and cost structure and expand our addressable markets. In addition to the agreement that we announced in July to sell our full-service retirement business, this quarter, we also announced the sale of a portion of our legacy in-force annuities block to reduce the overall contribution of traditional variable annuities. These transactions are significant steps forward in shifting our business mix and product portfolio to reduce market sensitivity and accelerate long-term growth.

In addition, our product pivots have worked well, demonstrated by continued strong sales of our buffered annuity products, which were $1.3 billion in the third quarter, representing 88% of total individual annuity sales.

Since the launch of FlexGuard in 2020, sales have exceeded $6 billion. These sales reflect customer demand for investment solutions that offer the potential for appreciation from equity markets combined with downside protection. We have also exercised discipline through frequent pricing actions, and our sales continue to benefit from having a strong and trusted brand and highly effective distribution team.

Also, our Individual Life sales continue to be strong and reflect our product pivot strategy, with higher variable life sales compared to the year ago quarter. Our retirement business reflected strong sales in the quarter, including a $5.2 billion funded pension risk transfer transaction and $1.6 billion of international reinsurance transactions, demonstrating our market-leading capabilities.

With respect to Assurance, our digitally enabled distribution platform, total revenues, our primary financial metric as we concentrate on scaling the business, were up 47% over the prior year quarter.

During the third quarter, we increased the number of agents to prepare for the seasonally higher expected demand of the Medicare annual enrollment period that occurs in the fourth quarter.

Turning to slide 10, our International businesses include our Japanese life insurance operation, where we have a differentiated multichannel distribution model as well as other operations focused on high-growth emerging markets. Sales across both Life Planner and Gibraltar operations were higher than last quarter amidst the state of emergency in Japan that ended on September 30.

However, sales were lower than the prior year quarter, which were elevated ahead of the US dollar-denominated product repricing in Japan that we implemented in the third quarter of last year. We also continue to see sales momentum in Brazil, particularly within the third-party distribution channel. We remain encouraged by the resiliency of our unique distribution capabilities, which have supported the continued growth of our in-force business.

And with that, I'll hand it over to Ken.

Kenneth Yutaka Tanji

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

Thanks, Rob. I'll begin on slide 11, which provides insight into earnings for the fourth quarter of 2021 relative to our third quarter results. Pre-tax adjusted operating income in the third quarter was $1.8 billion and resulted in earnings per share of $3.78 on an after-tax basis.

To get a sense for how our fourth quarter results might develop, we suggest adjustments for the following items. First, variable investment income outperformed expectations in the third quarter by $570 million. Next, we included a placeholder for COVID-19 claims experience in the fourth quarter that is a similar level to our experience in the third quarter.

While we have provided this placeholder for COVID-19-related claims experience, the actual impact will depend on a variety of factors, such as infection and fatality rates, geographic, and demographic mix and the continued acceptance and effectiveness of vaccines.

Third, we expect seasonal expenses and other items will be higher in the fourth quarter by $140 million. Fourth, we anticipate net investment income will be reduced by about $10 million, reflecting the difference between new money rates and disposition yields of our investment portfolio.

And last, we expect the fourth quarter effective tax rate to normalize. These items combined get us to a baseline of $2.27 per share in the fourth quarter. I'll note that if you exclude items specific to the fourth quarter, earnings per share would be $3.05. The key takeaway is that our underlying earnings power has increased from last quarter, driven by the benefits of business growth, our cost-savings program and market appreciation. While we have provided these items to consider, please note that there may be other factors that affect earnings per share in the fourth quarter.

Turning to slide 12. We continue to maintain a robust capital position and adequate sources of funding. Our capital position continues to support a AA financial strength rating and have substantial sources of funding. Our cash and liquid assets were $3.8 billion, which is greater than three times annual fixed charges, and other sources of funds include free cash flow from our businesses and contingent capital facilities.

Turning to slide 13 and in summary, we are executing on divestitures. We are on track to achieve our targeted cost-saving initiatives. And with the support of our rock-solid balance sheet, we are thoughtfully redeploying capital.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] Our first question today is coming from Erik Bass from Autonomous Research. Your line is now live.

Erik Bass
Analyst, Autonomous Research

Q

Hi. Thank you. So, we've recently seen asset managers, such as T. Rowe and Franklin, announce sizable deals to acquire private and alternative asset capabilities in transactions that were generally well-received by investors. Wondering if you see more properties like these available in the market? And would this be the type of programmatic M&A that you might consider for PGIM?

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

A

So, thanks, Erik. It's Andy, and good morning, I'll take your question. So, let me start by reiterating that PGIM is a business that has demonstrated incredibly strong ability to grow organically year-after-year. And that's really due to the success of our multi-manager model and the team's very strong execution. We've seen $55 billion in net flows over the last five years, and we've seen $11 billion in year-to-date flows.

As we've talked about in the past, though, we do want to build upon that track record with programmatic bolt-on M&A. And we've been very assertive in making sure that we're both in the know and in the flow, and we are aware of these transactions in the marketplace.

We're leaned into areas that are higher-growth and higher-fee-oriented areas. Three I would mention; we're looking to continue to globalize the business, specifically in Europe and Asia. We're looking to continue to build on our already strong alternatives business, where we have $250 billion in assets under management. And our acquisition of Montana Capital Partners is a great example of that. And we're looking in the area of real assets. As always, we're going to be disciplined in what we do and in how we deploy capital.

To your question about sizable deals, we very much feel, if you look across our managers in PGIM, we are at scale. So, it's unlikely that you would see us do what I would call a big pure-play scale deal. But to the degree that we would look and potentially do something larger, it would come with a key capability or strengthen us in a material way in a key geography and also bring along with it synergies.

Erik Bass
Analyst, Autonomous Research

Q

Got it. That's helpful. Thank you. And then was hoping you could talk a little bit or provide some more color on your group claims experience this quarter, and particularly, the trends you're seeing in both group life and disability.

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

A

Sure, Eric. It's Andy. I'll take that one again. And let me start on the group life side. So, as I'm sure you know and you've seen in the press, Delta has had a large impact on the country. The deaths in 3Q were 3 times what were expected. We were expecting 30,000 deaths, and we saw 95,000.

We are a top three life and disability carrier, so – and because of that, we have a very big and broad book of business. And there's really three effects that I would point to that we saw in the quarter.

First, US deaths in the age group between 35 and 54 tripled from a percentage perspective. And we cover a lot of younger workers. The average age of our group block is in the neighborhood of 46 years old.

Second, as you probably know and expect, we have a large national account book of business and have a very strong share in healthcare, in retail and in manufacturing. These are areas where frontline workers are out and about by the definition and nature of their job, and therefore, more exposed.

And then, the third thing I would mention is, about 50% of the pandemic impact we saw on the life side came from claims in the southern United States. So, clearly, this is very unfortunate that we keep experiencing this, but we're proud that we're able to deliver on our promises and help these families.

As I flip to the group disability side, I would frame it as, we're seeing what we expected to see, and we're seeing what we prepared for as an organization. And as I frame this, this impact on the disability side was not the predominant impact on group insurance. It was the life side. But having said that, the disability benefit ratio was somewhat elevated at 85.9%.

There were really two effects that were at play. In our fee-based STD and absence business, we are continuing to see a higher level of absence and STD claims. That really leads to more expense in the business, and you see that show up in the admin ratio.

On the LTD side, as we talked about in previous quarters, we had both put up IBNR, but also we had built claims staffing to be able to – be ready to handle what we expected to come, which we thought we would see enhanced incidents due to both the morbidity impacts of the pandemic, but also the impacts from the unemployment – the subsequent unemployment. And we are seeing that.

Our incidents on LTD was up about 10% in the quarter, and our severity was up as well, about 10% in the quarter. But again, this is what we expected to see, and this is what we prepared for. So, we're handling it well. And we would expect, obviously, for this to improve and subside over time.

Erik Bass
Analyst, Autonomous Research

Q

Great. Thank you.

Operator: Thank you. Our next question today is coming from Ryan Krueger from KBW. Your line is now live.

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

Q

Hey, good morning. First question was, what areas are you focused on additional derisking? Does that include more potential variable annuity transactions? And then, is individual life also part of the consideration?

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

A

Yeah. Hi, Ryan, it's Charlie Lowrey. I'll take that. As we stated in our opening remarks, we're making significant progress on executing to become a higher-growth, less market-sensitive and more nimble business. And this includes, as you rightly point out, the sales of our full-service recordkeeping business and our block of traditional variable annuities, as well as the completed sales of what we've talked about in Korea, Taiwan, Italy and Poland. We have also noted, to your point, that in the past, we're looking at other blocks of business that may include the areas that you spoke about. So, we're accomplishing a significant amount, but we still have a lot of work to do.

I would note that in terms of our overall goals, we have – which we stated is between $5 billion and $10 billion of capital that we wanted to free up to reposition, we're already $6 billion into that, right? So, we don't need to do other deals at this point. We are very happy with the economics of the deals we've done as we think it reflects the high quality of the businesses we have, but we'll only transact other deals if they make sense for all our stakeholders as we go forward.

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

Q

Thanks. And then a bit of a follow-up on M&A. So, you've done a few deals, but they've been on the pretty small side, I think, in terms of capital, and you have a fair amount of capital coming in next year from the transactions you've announced. Do you still anticipate ultimately redeploying that additional capital freed up into M&A transactions over time? Or if not, would you consider upping the buybacks again?

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

A

Yeah. I think, what we've always said in the past, Ryan, is that if we can't find good uses for that capital, we will return that capital to stakeholders. But what I would also say is that we are looking both organically and inorganically at ways of redeploying that capital, and organic investment is another way of doing that. So, we'll be very disciplined as we go forward in looking at potential acquisitions.

The M&A is going to focus on, again, asset management and emerging markets as we increase the percentage of earnings from growth areas and reduce the percentage of our legacy traditional variable annuities, but we'll continue to focus in a very disciplined way on those two areas. Andy mentioned in his previous comment the acquisition of Montana as a capital partner as an example of that, but we'll look at the pipeline that's out there and see if there are good deals to do. If they're not, we'll return capital to shareholders as we have in the past.

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

Q

Thanks, Charlie.

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

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Good morning and thank you for taking my questions. My first question is regarding the fourth quarter outlook for Assurance IQ. Can you talk about the preparation you've done so far in terms of – for the enrolment period? And how confident are you in terms of kind of generating the necessary level of activities to support the breakeven AOI?

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

A

Humphrey, good morning, it's Andy. And thanks for your question. So, as you know and as we've talked about in the past, we do expect our revenue at Assurance IQ to be strongest in the fourth quarter given the annual enrollment season. Medicare Advantage remains a very strong opportunity for us. If you look, last year, we had a little under 1% share in that marketplace, and that marketplace is growing at 10% per year. So, there's a lot of space to operate.

As you saw in the quarter, we continue to invest in the platform, both in the business overall, but specifically in the quarter, we invested in building out our W-2 Prudential agent force. And what we saw is coming into the annual enrollment period season, we came in with more agents than we had last year, and those agents were operating at a higher level of productivity right out of the gate. So, we're encouraged versus last year. As I've said before, we're confident in what the platform can do for us in the long term and its ability to scale.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

I guess, from a model...

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

A

Hey, and Humphrey, it's Ken. Just if I could add, as Andy said, we're well prepared. For the purposes of the baseline for the fourth quarter, we just simply put in a placeholder for Assurance at a breakeven because we wanted to neutralize for the seasonality, but it's not a forecast. It's just a placeholder to neutralize the earnings for the fourth quarter.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Okay. Got it. I see. Yeah, because I was just thinking like what type of revenue level would you need to have in order to get to that breakeven target, but it seems like this is just more of a placeholder as opposed to anything.

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

A

That's right.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Okay. All right. My second question is regarding PGIM, especially on the retail side. The flow seems to be – kind of have softened a bit over the past couple quarters. Can you provide some color in terms of what you're seeing there and what kind of actions that you have taken to improve retail flows?

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

A

Yeah. Humphrey, it's Andy again. Thank you for your question on PGIM. So, as we've discussed in the past, we will see natural variability and variation quarter-to-quarter when it comes to flows. This quarter, in aggregate, we saw modest inflows driven by a positive result on the institutional side, thanks to our work at fixed income and real estate. We did experience modest outflows on the retail side as a result of client reallocation out of equities and in the fixed income space into shorter-duration strategies.

What I would say is, in any given quarter, you could experience client reallocations, and that can go either way. What we think is very important to keep your eye on is the long-term track record. And as I've said, this is a business where we've experienced a lot of flows over the long term and $11 billion year-to-date. That really comes from both outstanding capabilities and strong execution.

We have a broad and diversified product portfolio in PGIM. And we, as you've seen in the release, we continue to have exceptional investment performance with 94%-plus outperforming benchmarks in the 3, 5 and 10-year period. So, we're confident that while there'll be variability quarter-to-quarter, potentially in the near-term, we will be a net winner over time.

Humphrey Lee
Analyst, Dowling & Partners Securities LLC

Q

Got it. Thank you.

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

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you. So, assuming this quarter so far is an early glimpse on LDTI with some company disclosures. There was one that was quantitative, another more qualitative. Your 10-Q is not out yet, but are you planning to add any disclosures there, like either now this quarter or in the near future?

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

A

Hey, Tracy, it's Ken. We continue to evaluate the new standards and refine our methods. And we continue to adjust as we move towards the effective date, and the effective date is still over a year away. And the impact also will be subject to rates at the time of the effective date as well as the actions that we have been taking and will continue to make to shift our business to be less market-sensitive. And that will have an impact obviously at the time of the effective date. So, overall, we're making good progress on implementing the new standards, but it's too early to provide estimates, and that's where we are.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. Maybe just one question on that, on your Japanese business. To the extent that there are dollar-denominated products, does that act like a mitigant at all in your view when those liabilities have to be marked to market?

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

A

We've had a long-standing capability and competitive advantage in US dollar business in Japan. And again, our Japan business is focused on serving the lifetime needs of our customers with a primary focus on death protection, including those that are denominated in US dollars. It does have a long duration profile and it's supported with robust reserves and a high-quality investment portfolio and is very financially resilient.

Again, we're not – it's too early for us to provide estimates. But overall, although the accounting will be modified, we feel very good about the overall profitability of the business, the risk profile, and the financial strength of our Japan business, including the US dollar business.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

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

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, good morning. I guess the first question is a follow-up on your capital management. Charlie, you made a comment – two comments that you would look at the pipeline and that organic investing is a way to deploy the capital. So, could you clarify what you meant by organic investing and the amount of money that might that require?

And then with regard to the pipeline, color on that. Is there – because the two deals you did were rather small, is it possible that there might not be anything that really intrigues you, and you might have other uses for that capital?

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

A

Sure. So, a couple of comments, taking them in order. In terms of organic growth, if you look at FlexGuard as an example, so we have pivoted away from the variable annuities with guaranteed living benefits and then started with new products and are investing in those and supporting those as they grow. And that really ties into becoming a less market-sensitive company, and frankly, a higher growth company. So, that's an example. So, we'll look at the product pivots that we do as an example of organic growth.

In terms of inorganic growth, I think, there are going to be plenty of opportunities as we go forward, especially in the areas that we want to invest in, namely asset management and emerging markets, some of the growth areas.

So, over time, I think, we will find good places to put the capital. And as always, if we don't find places to put that capital to the extent that we don't have attractive opportunities that meet our strategic and financial criteria, we'll return the excess capital to shareholders as we've done in the past.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. That makes sense, Charlie. And then with regard to your international businesses in Japan, Gibraltar and the Life Planners, sales were off pretty sharply in the 30 plus percent range. And in the press release, you cited the dollar-denominated product repricing that went on in the year ago quarter, that people wanted to catch these products. Could you clarify for us whether those products written a year ago were adequately priced and adequate returns? Was there a possibility for anti-selection? And now going forward, with an emergency act and kind of that getting out of the rearview, is there a possibility that as COVID subsides, these sales could really jet upward?

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

A

Thanks, Andrew. This is Scott. I'll go ahead and take that one. As you recall, we took significant crediting rate actions last August on our US dollar products. And that's really just part of our ongoing effort to maintain strong profitability on all of our new business activity. And that's across Japan, but across all of our other operations. And as is typical, that does create a sales surge ahead of the crediting rate, which typically pull sales forward from a quarter or two.

And then additionally, I would say the impact of COVID emergency states, as well as the Olympics in Japan also dampened sales for a period. But we are happy with the recovery that we've had in sales. And if you look at the third quarter – quarter-over-quarter, it looks good.

In Japan, we benefit from having multiple distribution channels. We've got life planners, life consultants, the affinity channel, bank and third-party distribution. And further, I would say that we've made significant progress in using and enhancing technology and new strategies to support both our customers and our distribution channels.

So, I think, all of that put together says we feel pretty good about the sales momentum that we have. And we maintain a strong discipline and a continuous watch on our pricing actions. And where we're priced now, quite frankly, we don't foresee any material repricing actions on the horizon in Japan. And I think, we made the actions that we took a year ago in a timely manner. Ken, were you going to say something?

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

A

I'd just say, our Japan business has consistently written business above its cost of capital. We were happy with the returns last year, and it's these pricing actions that keep us in good position from both a profitability, but a customer value proposition. So, it's been a pretty consistent story.

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

A

And Andrew, it's Charlie, if I could just add one -

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

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

A

Andrew, if I could add one other thing, and that is what Scott alluded to, which is that we have been extraordinarily disciplined in looking at the pricing of all our products around the world, not just in Japan, but as Scott said, in all the other countries, including the US.

And we've been really pleased as we've increased the pricing, as we've had to with the low interest rates, the strength of the sales, and I think that comes from 3 points of view. One is the strength of our brand. Second is the strength of the solutions we provide, such as – with our new introduction of FlexGuard in this example. And third is the quality of our distribution, which is both in-house distribution and through third parties. So, we have plenty of different ways of distributing the product and I think that inures to our benefit.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks, Charlie.

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

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. So, individual mortality held up pretty well this quarter despite the increase in COVID mortality and also by some measures, there was elevated non-COVID mortality also this quarter. In terms of describing why you think your block only had minor sensitivity, can you comment on what that might be? Is it just vaccination levels, older age, demographics and geography? Or anything you could share on that?

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

A

Yeah. Tom, it's Andy. I'll take your question, and thanks for the question. So, when you think about our Individual Life block in the third quarter. I'd go through a series of items here. I think we did see lift. Third quarter, I think, as you're aware, is our highest underwriting gain quarter. So, there's definitely seasonality that's showing in the results.

We also saw in the quarter fewer large face amount claims. And again, that's the type of thing that will vary quarter-to-quarter. This quarter, we happened to just see fewer of those. I guess the – when it comes to the pandemic effect, in particular, I would say that our block tends to be more oriented towards the Northeast as far as geographic distribution. And I think, it's pretty clear that from a US death perspective, it was heavier in the Southern region of the United States. And then, yeah, you've mentioned this, but the average age of our ILI block tends to be older, and those older-age demographics tend to have higher vaccination rates.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got you. Okay. Thanks. And then for my follow-up, just curious, any updates on economic solvency regime in Japan? Is that still – I think last I heard, it was like 2025. Is that still the timing? And if so, how do you feel that you're positioned to adopt that?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Hey, Tom, it's Rob. I'll take a shot at that. To our knowledge, there's not been any change in the timing of that. The JFSA has been well synchronized with a broader international – ICS, or the International Capital Standard, that's being rolled out. And so, it's – their plan has always been to sort of be slightly behind the implementation of that as their new solvency regime is closely aligned to that.

And with respect to our Japan business, I think as both Ken and Scott have pointed out, the underlying economics to our Japan business are incredibly strong. And so, we would hope that under both accounting and regulatory constructs that, that ultimately is visible.

Having said that, we would – we had articulated some concerns, as others in the industry have, with regard to both the International Capital Standard that's being proposed in terms of some fundamental flaws that continue to persist there. And then to the extent that those carry over into Japan's economic solvency regime, that would be a concern that we would have. But we continue to be in an active dialog both on the international front and in Japan, along with a number of our peers. And we're optimistic that through that continued engagement, we can ensure that the economics of the underlying business get appropriately reflected in the regulatory constructs.

Thomas Gallagher Q
Analyst, Evercore ISI

Okay. Thanks, Rob.

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

Elyse Greenspan Q
Analyst, Wells Fargo Securities LLC

Hi, thanks. Good morning. My first question, on the PRT business, you guys had some pretty good activity in the third quarter. Can you just talk about the pipeline there for the fourth quarter? I know that tends to be heavy towards the end of the year. And any initial outlook for 2022?

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

Yeah. Elyse, hi, it's Andy. I'd be happy to take the question. So, we think the market in 3Q was in and around $17 billion and that's very consistent with what we communicated on the previous couple calls, that we felt the back half of the year would be very healthy.

The average funded status for plans is around 97%, which is the best level in 10 years and they still have a very strong desire to transact. We think the total market size for the year will be in the neighborhood of $40 billion and we think that level of momentum will continue in the near-term.

This is a space that, in many ways, we're a pioneer in and very much a leader in the space. As we've said in the past, we are very committed to it, and we are going to pick our spots. We're very confident that the strength of our brand and our capabilities and our track record. We're going to gain more than our fair share over time. But in the near-term, we do think the market is going to be healthy.

Elyse Greenspan Q
Analyst, Wells Fargo Securities LLC

Okay. Thanks. And then my second question, going on to your Group Life book, you guys gave some good color on what drove the elevated COVID losses there in the third quarter. As we think about the fourth quarter in 2022, do you expect that you would see losses in line with kind of that same elevated severity that you've been seeing? And then how much of your losses that you've set up so far for COVID are IBNR?

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

A

So, Elyse, maybe I'll start and then Ken could follow-up. So, I kind of went through the dynamics of what's causing the elevated mortality, the three predominant things being the average age, the predominance of our book in certain segments, and the distribution of the claims being in places where the vaccination rates are lower. We would expect those underlying drivers to continue near-term into the fourth quarter.

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

A

Yeah. And Elyse, in terms of IBNR, the – it's a – we stayed pretty current on claim activity. So, the lag is measured in weeks and we have a pretty established process to measure that and so that continues.

In terms of an outlook for 2022, we have not provided an outlook beyond the current quarter. And based upon, as Andy described, just sort of the continuation of current trends, we think that's the most reasonable approach.

The situation is very unique and very dynamic, a lot of variables at play, whether it's social distancing or other preventive measures or vaccines and treatments and variants. So, we've – in our baseline, we've extrapolated the current trends and that's what that reflects.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thank you.

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

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. Just sticking with the group business, given the enduring nature of the pandemic, unfortunately, is there a need to build more administrative expenses to support that effort?

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

A

So, John, it's Andy. I think as we've talked about in the past, we actually have a higher level of both call and claims staff across our product lines. We hired out ahead of what we expected to see. So, we were well prepared as it was coming in. But we think that that level is already reflected in the admin ratio that you see.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's great. Thank you. And then maybe my follow-up, just wanted to touch on that comment around LTD incidents increase in frequency and severity. How should we be thinking of this maybe in light of vaccine mandates? There's headlines about Boeing and Raytheon in percentage of workers there. I'm just trying to think through that in light of PRU's focus within the group market. Thank you.

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

A

So, it's Andy, again. I guess I'd say two things. Our expectation for the number of deaths in the quarter take into account what we think the current approach is in the employer marketplace and the current landscape of mandates. To the degree, our book tends to be more of a national account book of business, and there are more mandates in that segment, I think that would be a help to us and a tailwind.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Great. Thank you for your answers, and best of luck.

Operator: Thank you. Our next question today is a follow-up from Tracy Benguigui from Barclays. Your line is now live.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thanks for taking another question. I just want to touch on your upcoming combination of individual and institutional retirement business. Is this just to simplify your operational model after the pending full-service sale, or should we expect anything strategic coming out of that either on the expense or revenue side?

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

A

So, Tracy, it's Andy. Let me take your question of – about the drivers. So, first and foremost, this is really a statement about our commitment as a firm to helping solve the retirement needs in America. And we continue to see a real need in the pension derisking area. We continue to see the need to lean in and help individuals in their retirement accumulation and deccumulation journeys.

This was really about taking two businesses that had great momentum, that were market leaders in their space and combining together the market leading talent in the market and market leading capabilities. The benefits we expect to see is it will accelerate our decision making as we continue to go after the retirement need and sharpen our focus on the retirement space. So that was really the driver, and it's an important step in how we're transforming our business mix and system.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Thank you.

Operator: Thank you. Our next question is coming from Jimmy Bhullar from JPMorgan. Your line is now live.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey. So just a follow-up question on, Charlie, your comments around dispositions and/or derisking reinsurance type transactions. I think you mentioned annuities potentially and Individual Life as well. But how do you think about long-term care in that context? And is that a business where you're seeing counterparties emerge? Or is it still like the bid-ask is too wide to expect a transaction in the near future?

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

A

Yeah. I'll start and then maybe Ken can add to that, Jimmy. I think, what you observed is exactly correct. So, it is something that we would, obviously, look at if the market was there, but I think, the market is extraordinarily thin at this point for bidders on blocks like that.

I would also observe that we have a very – a relatively small block of business and a relatively young block of business. And as a result – and one, frankly, that we feel reasonably good about, in fact, quite good about. So if we are, as we've said, going to be very disciplined about the divestitures we make and with an eye toward creating shareholder value, we need to get – make sure that the – if we did transact something that it would be a transaction that was in the economic interest of our shareholders. And given the young block that it is, the bid-ask spread, if you will, can be quite large. So, we'll continue to evaluate options if they come up. But at this point, we are continuing to run the book, and the book is going quite well. Ken, anything to add?

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

A

No. I think that covers it well, Charlie. Nothing to add from me.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

And then, just on the – can you talk about the operating environment in your two largest international markets, in Japan and in Brazil? Obviously, different stages in terms of COVID in both the markets. But how are those businesses faring? And what your outlook is for sales, given the pandemic and economic conditions in Latin America?

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

A

Well, why don't I start, Jimmy, with Japan, which I think I covered a little bit before. But I would say that just the combined impact of the state of emergency and then the Olympics really did slow things down, and the effect of that really ran through September 29, with the state of emergency.

We've come out of that nicely. And we really feel that our channels have benefited from our use of technology, as have our customers during this period. So, we really feel like our sales organizations have adapted well to the new environment. And now that we see things out of a state of emergency and returning to a more normal state, you've seen a good sequential quarter.

I would also say that, recruiting has been somewhat challenged during a COVID environment. We've also learned how to recruit and bring people on board in a more remote environment. But I think, as we come out of COVID, both the actual sales activity and the ability to recruit will continue to improve, and we see that as a positive sign.

In Brazil, our sales have been improving from the combination of having a strong Life Planner model. But more importantly, we've been building out third-party distribution. And most recently, that's now exceeded a-third of our sales. And just a few years ago, that was closer to 10%. So, we've seen positive momentum from the channels that we sell in.

COVID hit harder – quite frankly, a bit harder in Brazil than it did in Japan. And again, we're really happy with the resiliency that our sales force has shown there. So, overall, we feel good about the trends in both markets. And I think, the most recent quarter is indicative of why we maintain that confidence.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

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

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

Thank you. And thank you all for joining us today. Our performance this year and the progress we're making on repositioning our business mix and advancing the cost-savings program, along with disciplined capital deployment, reinforces our confidence in our strategy to transform Prudential and generate substantial growth. We remain optimistic about the opportunity to continue to deliver strong financial outcomes to all our stakeholders. Thank you again for joining us today and for your time.

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