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Prudential Financial, Inc. (PRU)

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CORPORATE PARTICIPANTS

Bob McLaughlin
Head-Investor Relations, Prudential Financial, Inc.

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

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

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

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

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

OTHER PARTICIPANTS

Erik Bass
Analyst, Autonomous Research

Thomas Gallagher
Analyst, Evercore ISI

Suneet Kamath
Analyst, Jefferies LLC

John Barnidge
Analyst, Piper Sandler & Co.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Alex Scott
Analyst, Goldman Sachs

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

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MANAGEMENT DISCUSSION SECTION

Bob McLaughlin

Head-Investor Relations, Prudential Financial, Inc.

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

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

Now 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 this morning. We delivered solid operating earnings for the first quarter, including strong variable investment income that more than offset the impact of elevated mortality from COVID-19. We've also recently achieved multiple significant milestones in our transformation process to become a higher growth, less market-sensitive and more nimble company. These milestones included continued execution on our plans to reposition our businesses.

We completed two key divestitures and announced another programmatic acquisition. We continue to invest in our businesses to further enhance the customer experience and expand solutions to support sustainable long-term growth. And we also further advanced the progress on our $750 million cost savings program. We are pleased with the pace of these initiatives, which are well supported by our rock-solid balance sheet and help us expand access to investing, insurance and retirement security for our customers and clients around the world. I'll provide an update on each of these areas before turning it over to Rob and Ken.

Moving to slide 3. At the beginning of April, we successfully completed the divestiture of our full service retirement business and the sale of a significant portion of our legacy variable annuities block. Together, these dispositions

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reduced the overall market sensitivity of our businesses by approximately 20%, while enabling us to further sharpen our focus on higher growth opportunities, including programmatic M&A in asset management and emerging markets.

To that end, we agreed during the quarter to acquire a minority stake in Alexander Forbes, a leading provider of financial advice, retirement, investment and wealth management in South Africa. This deal provides access to essential financial tools and further expands our footprint in a strategically important market. We also continue to focus on enhancing customer experiences and creating solutions to drive sustainable growth across our businesses and to address the evolving needs of our customers.

For example, FlexGuard continued to build momentum, and we are excited about its future and our broader suite of complementary annuity products, including FlexGuard Income. In Individual Life, we continued to expand our reach to a broader range of customers and further addressed the $12 trillion life insurance coverage gap with the introduction of a final expense product. And we are also making similar growth investments to further enhance customer experience and expand solutions across our international businesses.

In Japan, we are focusing on evolving our product suite to meet the increasing retirement and inheritance needs of the aging Japan population. In Brazil, we are diversifying our customer offerings with the introduction of a new stand-alone accident and health product. And in China, we introduced [ph] Grow Partners, (00:05:22) a digital sales platform that we are extending to distribution partners and directly to consumers, beginning with a medical cash benefit plan.

Turning to slide 4. We continue to make steady progress towards achieving our cost savings target of $750 million at the end of 2023, while improving customer experience. During the first quarter, we realized $170 million in cost savings for a total of $680 million of run rate savings to date since 2019.

Turning now to slide 5. Prudential's rock solid balance sheet provides significant financial flexibility to execute on our transformation strategy, while returning substantial capital to shareholders. Our robust financial position includes: a high-quality, well-diversified investment portfolio; a capital position that supports a AA financial strength rating; and $3.6 billion in highly liquid assets at the end of the first quarter, as well as over $4 billion of additional proceeds from divestitures that we have already received in the second quarter.

In addition to supporting our strategy for sustainable, profitable growth, we remain committed to returning $11 billion of capital to shareholders between 2021 and the end of 2023. As part of this program, we have increased our dividend by 4% in the first quarter of 2022, our 14th consecutive annual dividend increase.

Before turning it over to Rob, I'd like to update you on a few of our recent ESG initiatives, which we consider integral to our purpose of solving the financial challenges of our changing world. First, relating to the war in Ukraine. In addition to providing financial assistance to humanitarian and nonprofit organizations supporting people impacted by the war, we divested our modest level of Russian financial assets in our investment portfolio.

Closer to home, we've adopted a hybrid working model that combines the benefits of in-person collaboration and remote work flexibility to support our employees and help us attract and retain talent. Our hybrid work model will

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enable us to reduce our total home office properties in the US by approximately 50% over time as we invest in the redesign of 600,000 square feet of office space that will be optimized for collaborative and hybrid work, most of which was completed during the past two years.

In addition to helping us achieve our cost savings targets, our real estate and hybrid work strategies are one of the several factors that will contribute to a 2050 net zero emissions target. Alongside these efforts, we are also finding new opportunities to support our home city in Newark, New Jersey, including new investments in local commerce, live workspaces for residents, small business owners, and additional opportunities to foster local home ownership. We look forward to continuing to support the city's revitalization.

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

Robert Michael Falzon

Vice Chairman, Prudential Financial, Inc.

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 6 with our financial results for the first quarter of 2022. Our pre-tax adjusted operating income was $1.6 billion or $3.17 per share on an after-tax basis and reflected a benefit from variable investment income, which exceeded the net mortality impact from COVID-19. PGIM, our global investment manager, had higher asset management fees than the year ago quarter.

However, these were more than offset by lower other related revenues as well as investments made to support business growth. Results of our US businesses increased 12% from the year ago quarter and reflected higher net investment spread, including benefits from variable investment income and rising interest rates, more favorable underwriting, primarily due to declining COVID-19-related mortality experience and lower expenses, primarily driven by our cost savings initiatives, partially offset by lower fee income resulting from the runoff of our legacy variable annuities. Earnings in our International businesses decreased by 8%, reflecting lower net investment results, less favorable underwriting results and lower earnings from joint venture investments, partially offset by continued business growth.

Turning to slide 7. PGIM, our top 10 global investment manager, has diversified capabilities in both public and private asset classes across fixed income, alternatives, real estate and equities. PGIM's long-term investment performance remains attractive with more than 84% of assets under management outperforming their benchmarks over the last 3, 5 and 10-year periods.

PGIM experienced third-party net outflows of $4.3 billion in the quarter as institutional net inflows, driven by fixed income and real estate, were more than offset by retail outflows, driven by mutual fund investors rebalancing out of fixed income due to rising rates and inflation expectations. As the investment engine of Prudential, the success and growth of PGIM and of our US and International insurance and retirement businesses, are mutually enhancing. PGIM's asset origination capabilities, investment management expertise and access to institutional and other sources of private capital are a competitive advantage, helping our businesses bring enhanced solutions, innovation and more value to our customers.

And our insurance and retirement businesses, in turn, provide a source of growth for PGIM through affiliated flows and unique access to insurance liabilities that complement its successful third-party track record of growth. PGIM's asset management fees increased by 2% compared to the year ago quarter, reflecting positive third-party flows and a continued shift towards higher fee-yielding strategies, including the benefits from recent acquisitions over the past year, partially offset by the impact of rising rates.

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As rates rise in the near term, investor demand for some fixed income strategies could continue to moderate. However, over the longer term, a stabilized higher rate environment would be a positive for fixed income demand and PGIM's business.

We continue to grow our alternatives and private credit business, which has assets under management of approximately $240 billion, across private credit, real estate equity and debt, and private equity secondaries, and benefits from our global scale and market-leading capabilities.

Notably, across PGIM's private platform, we deployed nearly $10 billion of capital, up 20% from the year ago quarter, reflecting the continued strong environment for both real estate and private credit.

Now, turning to slide 8. Our US businesses produced diversified earnings from fees, net investment spread, and underwriting income and benefit from our complementary mix of longevity and mortality businesses. We continue to shift our business mix towards higher growth and less market-sensitive products and businesses to transform our capabilities and cost structure and to further expand our addressable markets.

Our product pivots have worked well, as demonstrated by strong sales of recently launched simplified solutions. Our FlexGuard and FlexGuard Income products represented $1.4 billion or over 90% of total individual annuity sales in the first quarter. We continue to exercise pricing discipline informed by changing market conditions and our sales benefit from having a strong and trusted brand and a highly effective distribution team.

Our Individual Life sales also reflect our earlier product pivot strategy with variable life products representing approximately 70% of sales for the quarter. We also successfully completed the national rollout of our Individual Life Express Term Plus product with a large national distributor and recently launched a final expense product continuing to expand our middle market presence.

And we are focused on enhancing customer experience through digital tools, including automated underwriting, resulting in more than 90% utilization for eligible policies in the first quarter of 2022.

Our Retirement business has market-leading capabilities, which drove funded pension risk transfer sales of $700 million in the quarter. And our Group Insurance business reflected sales growth of 5% compared to the prior year quarter, driven by an increase in supplemental health sales.

Turning to slide 9. Our International businesses include our Japanese life insurance companies, where we have a differentiated multichannel distribution model as well as other businesses aimed at expanding in high-growth emerging markets.

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

We continue to enhance customer experience and agent support, including through digital tools. The value we provide customers was recently recognized by the 2022 J.D. Power Life Insurance Customer Satisfaction Survey. Prudential of Japan was ranked number one in all three categories; contract; servicing; and claims.

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

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In the first quarter, we continued to focus on expanding product and business capabilities in emerging markets to meet the evolving needs of our customers. We launched a new accident and health product in the large and growing Brazil market, and continue to expand our wellness platform across Latin America.

In addition, as Charlie discussed earlier, we are pleased to expand our presence in Africa with the announcement to acquire a minority interest in Alexander Forbes through our existing partnership with LeapFrog Investments.

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

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

Kenneth Yutaka Tanji

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

Thanks, Rob. I'll begin on slide 10, which provides insight into earnings for the second quarter of 2022 relative to our first quarter results. Pre-tax adjusted operating income in the first quarter was $1.6 billion and resulted in earnings per share of $3.17 on an after-tax basis.

To get a sense of how our second quarter results might develop, we suggest adjustments for the following items: first, variable investment income outperformed expectations in the first quarter by $275 million; next, we adjust underwriting experience by a net $165 million. This adjustment includes a placeholder for COVID-19 claims experienced in the second quarter of $40 million for our US businesses based on 25,000 COVID-19-related fatalities in the US and a placeholder of $25 million for our international businesses. 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 effectiveness of vaccines.

And last, we expect other items to be $95 million lower in the second quarter, primarily as a result of completing the sales of both our full service retirement business and a block of legacy variable annuities. These items combined get us to a baseline of $2.75 per share for the second quarter.

I'll note that if you exclude items specific to the second quarter, earnings per share would be $2.91. A modest decline from recent quarters, primarily from the completed sales of businesses. And the proceeds from these sales will provide flexibility for future capital deployment.

I would also note a few other items: first, due to the rise in interest rates, we no longer anticipate a reduction in net investment income from portfolio reinvestment. The benefit from a rising rate environment on our investment income compounds over time as we reinvest our portfolio. However, the reductions in assets under management and related income in our fee-based businesses occurs more immediately.

In addition, as a result of our derisking actions, the sensitivity of our adjusted operating income to markets will be reduced by approximately 20% on an annual basis. We also expect to report a gain on the sale of the legacy variable annuity block and adjusted operating income in the second quarter.

Impacts from the annual review of actuarial and economic assumptions will also be reported in the second quarter. In accordance with our established practice, we have a comprehensive process that will include, among

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other things, the review of long-term interest rates, inflation, COVID mortality experience and updated industry data that may impact our assumptions.

And finally, as a result of new foreign tax credit regulations, we are expecting an effective tax rate in the range of 21% to 23% for 2022. While we have provided these items to consider, please note there may be other factors that affect earnings per share in the second quarter.

Turning to slide 11. We continue to maintain a robust capital position and adequate sources of funding. Our capital position continues to support a AA financial strength rating, and we have substantial sources of funding. Our cash and liquid assets were $3.6 billion and within our $3 billion to $5 billion liquidity target range. And other sources of funds include free cash flow from our businesses, proceeds from divested businesses and contingent capital facilities.

Turning to slide 12 and in summary. We are executing on our plans to reposition our businesses. We are on track to achieve our targeted cost savings and our rock solid balance sheet provides financial flexibility to execute on our transformation and thoughtfully deploy capital.

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

QUESTION AND ANSWER SECTION

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

Erik Bass
Analyst, Autonomous Research

Q

Hi. Thank you. Can you provide some more color on the net flow drivers for PGIM in the quarter? And with interest rates continuing to move higher, can you talk about how this is affecting fixed income demand from both retail and institutional clients?

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

A

Sure. Good morning, Erik, it's Andy. As we've discussed in the past, PGIM flows are going to vary from quarter-to-quarter, and we're very focused and stay focused on our long-term track record. We're very proud of the fact that 18 of the last 19 years, we've had positive third-party flows. In the first quarter, we did experience $4.3 billion in net outflows. It was a challenging quarter for the fixed income US mutual fund industry in general, and we were similarly affected. We saw $4.6 billion of retail outflows, almost entirely driven by retail investor repositioning out of fixed income.

On the institutional side, we saw a positive $300 million driven by flows into public fixed income and real estate. We continue to think this is good proof of our diversification. And on the institutional side, we see algorithms actually positioning into fixed income given the rising rate environment. As we step back, our long-term track record remains very strong. We saw $55 billion in flows between 2017 and 2021, with $27 billion of that being on the retail side.

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That being said, we do think it's fair to expect continued pressure on the retail fixed income industry as the rates and spreads continue to rise, but that's a near-term effect. As Rob said upfront, higher rates are good after the transitory period for the fixed income business. We're very confident in the fact that we have the right products, the right strategies, exceptional long-term investment performance and great distribution and we'll be a net winner over time.

One thing I wanted to add today, when we talk about flows is more around the privates business that Rob talked about given that those are higher fee rate businesses. We continue to benefit from a very strong market for real estate and private credit. We were able to put $9.6 billion to work in the first quarter across real estate at PGIM Private Capital and raise another $1.8 billion. So, we are confident in PGIM and confident in the long-term track record.

Erik Bass
Analyst, Autonomous Research

Q

Thank you. I appreciate all the color there. And then I was hoping that you could talk about the implications of the weaker yen for your Japan business in terms of earnings, capital and then demand for foreign currency-denominated products. And I realize that you're hedged for 2022, but can you just remind us what percentage of your earnings are in yen?

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

A

Yeah. Hey, Erik, it's Ken. I'll start off on sort of the financial implications. And you're right, we do have a pretty established and, we think, a very effective hedging program. But first, it's important to know that of our – because of the success of us in the Japan market with US dollar products, a substantial portion of our reserves and our assets backing those reserves are US dollar-denominated.

And that, in combination with the fact that, as a Japanese company, our expenses are almost exclusively denominated in yen. The combination of that results in our income from our Japan business being mostly – nearly all of our US – our income in Japan is US dollar denominated.

What income we have denominated in yen, we hedged over three years. And we have a net equity capital hedge position as well. So, it's a long-established hedging approach, and we think it performs well, both from an accounting and economic standpoint.

Erik Bass
Analyst, Autonomous Research

Q

Got it. And for the product demand with just – you sell a lot of foreign currency denominated products, [ph] is there an impact there? (00:24:57)

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

A

Yeah, maybe I'll hand that over to Scott.

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

A

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Hi, Erik, this is Scott. Yeah, in the – it's a little bit of a mixed bag or a dislocation, if you will. But for the most part, higher US interest rates, which I think are related to the currency, is good for demand, as Rob said, and I think, it's good for Prudential overall. But as investors in Japan are looking for more attractive yielding products, that's good.

In the short run though, and when the currency moves, it does make the price tag of the purchase a little more expensive. And we have found in the bank channel, where there's an intermediary in there, you may see slightly higher surrenders because of the run-up in the dollar. But net-net, we think it's generally a positive for us. Thanks.

Erik Bass
Analyst, Autonomous Research

Q

Got it. Thank you.

Operator: Thank you. [Operator Instructions] And we ask, you please ask one question, one follow-up, then return to the queue. Our next question is coming from Tom Gallagher from Evercore. Your line is now live.

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. Ken, a question on the HoldCo cash and just overall capital generation in the quarter. If I look at the – it looks like you issued $1 billion of junior debt in the quarter, so that would be an inflow, and you got $300 million of cash from the dispositions, and I guess, $4 billion-plus is still closed after the quarter, but that's $1.3 billion.

And then I look at your HoldCo cash balance, it didn't change versus 4Q. So just curious, how I should think about that. It doesn't – looking at it that way, it doesn't look like there were much in the way of dividends that came up during the quarter.

Were there capital needs that came up in the subs? Or is it a timing issue? Can you help us think through, like, the capital generation in the quarter and what that should look like going forward? Thanks.

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

A

Yeah. Thanks, Tom. Yeah, we did issue $1 billion of hybrid debt – actually, it was actually early in the quarter and before the rise in rates and before the spreads widened out. So, we're happy with that execution.

And that's part of our process to prefund upcoming debt that we would like to either – that's either maturing or we're going to call. And we do have about $1 billion of hybrid debt that's going to be callable in September. So, we've sort of earmarked that $1 billion for that purpose. Liquid assets at the holding company will fluctuate due to timing. Typically, that's within our $3 billion to $5 billion target.

But in the first quarter, as is in typical with most first quarters for us, subsidiary dividends and cash flow were low and then they tend to be greater in the second part of the year. And so, part of that is just timing. But we also did make a capital contribution to a new reinsurance subsidiary that we have – that we've established in Bermuda in the first quarter. And that will give us the ability to reinsure policies from PICA, our US insurance company through that new subsidiary to give us more economic reserving and greater capital efficiency over time.

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So over time, it was – it did require some capital to initially fund, but over time we feel good about that in terms of giving us much more balance sheet efficiency going forward. And then also, just keep in mind, we did receive $4 billion from the sale of full service and PALAC in April.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got you. And just a follow-up there, Ken. Can you comment on the size of the new reinsurance vehicle that's, I guess, range on the captive that you referenced?

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

A

Yeah. We initially capitalized it with $800 million. So, that was the amount of initial capital that we put in. And although, it's a requirement now, it's actually going to provide capital efficiency in the future. So, you can think about that as a net positive to our capital efficiency over time.

Thomas Gallagher
Analyst, Evercore ISI

Q

Thanks. That's helpful.

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

Suneet Kamath
Analyst, Jefferies LLC

Q

Great. First question just on strategy. I guess, Charlie, we've been talking about this objective of improving the earnings contribution from growth businesses to, I guess, over 30%. And we're a year into the strategy and haven't really seen that move all that much, at least based on way we're calculating it. So, my question is, is the plan to still sort of get there over the next couple of years? And is it going to take something more than programmatic M&A in order to accomplish that?

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

A

Sure. Thanks for the question. So, we can't control the markets, but this is – we look at it as both a numerator and a denominator issue. And we're continuing to make progress on both – through both the acquisitions we've made – the four acquisitions we've made over the past year and the dispositions that we just completed. And so, you've seen that we've made progress with the four acquisitions and the two major dispositions. And we'll continue to execute on the strategy. We have a sense of urgency. We're going to make progress as we go forward, and we'll make progress in both ways.

Suneet Kamath
Analyst, Jefferies LLC

Q

And can you give us a sense on the timing of the use of the $4 billion of proceeds? Obviously, we could think about a couple different buckets, right, M&A and/or capital return to shareholders. But now that these deals have closed, sort of over what timeframe would you like to use that capital?

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

Yeah. Sure. So, as I hope you've seen, we are operating with a sense of urgency, right? Speed is important, but we don't have a specific time band per se. So, we're going to remain prudent stewards of capital, as we've said and continue to evaluate programmatic acquisitions. But as we've also said and as we've done in the past, we'll return capital to shareholders, if we can't find the appropriate opportunities over time. So, we're going to continue on our process. But as you've seen, we have returned capital to shareholders, and we'll continue to operate in that fashion.

Suneet Kamath
Analyst, Jefferies LLC
Q

Got it. If I could just sneak one more in for Ken or Rob. When we think about the individual annuity business, I think in the past, specifically thinking about the highest daily value product, I think, the commentary you guys gave in the past is a rising interest rate environment, coupled with a falling equity market environment is generally not great for that business, which is the environment, obviously, we're sitting in today. So, can you just talk about from a risk management perspective, how that business is holding up in this environment?

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

Yeah. Suneet, this is Ken. We've very well-capitalized and reserved our business, and we have a highly effective hedging program. And that has been very effective of mitigating market impacts, both from equity markets and interest rates. And so – and it continues – it continued to be very effective in the quarter. So, no change there.

Suneet Kamath
Analyst, Jefferies LLC
Q

Okay. Thanks, Ken.

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 very much for the opportunity. Expense ratios in both Group Disability and Group Life Insurance declined. I know that some of the source of the expense saves programs, but you're also building to service COVID claims. Can you maybe dimension some of the improvement in admin expenses there between those two? Thank you.

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

Sure, John. Good morning. It's Andy. So our admin expense ratio for the quarter was 15.6%. That was almost a 4% improvement from Q4, but was basically flat from Q1 of last year. I would just, keep in mind, fourth quarter was elevated by some one-time compensation expenses, so there's some seasonality effects going on.

We are starting to see the beginnings of our core expense improvement of impacting our businesses. When I think about that, I would say the expense saves are more attributable to the overall expense work. The incidents and severity in the business remain elevated, even though they have started to come back towards normal, they

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remain elevated, and we maintain the higher level of staffing in both our claim and our call centers. So, we would expect that the admin ratio will stay elevated for the remainder of the year.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Great. Thank you. And then my follow-up question. Can you talk about maybe how higher rates have changed the conversation around pension risk transfer activity with potential counterparties? Thank you.

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

A

So, John, it's Andy. Thanks again for the question. So, we – maybe let me talk about the current quarter and then I'll go into looking forward. So, as you're aware, this is a very transaction-oriented business. And first quarter tends to be light, and that's kind of what we saw with the industry. We think the first quarter was somewhere around $5.3 billion. We were very pleased, as Rob said, that we did two deals for $700 million.

Overall, as we look forward for the rest of the year, we believe it's going to be a strong year, and think the overall industry level should clock in around $40 billion. The fact is, funded status hit a record high in February of 102%.

And if you add on top of that, the rise in rates and then the volatile environment that we're in, all of that bolsters sponsors' desire and proclivity to transact. So, this is a big market that it has become more competitive, but we know that we could pick our spots and be disciplined and net-net, will grow over time.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you.

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

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Good morning. I'm wondering if your intolerance of interest rate sensitive business changed at all considering [indiscernible] (00:35:44) is nearly 3%, may go up from here? Like are you thinking at all about increasing the portion of spread-based business going forward?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Hey, Tracy, it's Rob. Let me take a stab at that. First, to your point, yeah, rising interest rates are a good thing. They're a good thing for the industry and they're a good thing for us as a company, both because it allows us to be more competitive in providing a value proposition to our customers and our products and also because it has a positive impact on our portfolio yield. Having said that, it is our desire to have a mix of businesses and products that are less market-sensitive and less market-sensitive across market cycles.

So, our focus is on trying to operate at the intersection of both shareholder and customer value propositions that are sustainable throughout cycles. If you're asking about how we think about the impact of higher interest rates on the long-term reversion rate that we have in our assumptions, obviously, that drives pricing and valuation. We do

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our assumption updates in the second quarter, probably not something – anything specific we can say about that. But maybe I'll turn it over to Ken and he can comment more generally.

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

Yeah. Thanks, Rob. Yeah. The long-term interest rates and our assumptions are something that we do look at in our assumption updates annually. We do that by looking at multiple perspectives sort of from an array of economists and banks and asset managers. We also look at the forward curve, which as you know, has increased recently. And we set our assumption kind of close to the median of that. And also with our assumption update, inflation has risen. We factor near-term inflation into our reserve setting as well as for long-term inflation as well.

And then part of our assumption update will obviously cover mortality and other policyholder behavior as well, including not just our own experience, but anything we get in terms of new data from other sources in the industry. We did recently receive a new industry study that indicates experience is more adverse in some of our assumptions of our US life insurance business. We're evaluating this information and its applicability to our business. And to the extent that it would cause an increase in reserves or a decline in earnings. So that – all that work is underway. It will conclude later in the quarter, and that will be part of what we report in the second quarter.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Okay. Great. I'm also wondering has unfavorable FX impacts changed your view right now on increasing international business through M&A.

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

Hi, Tracy, this is Scott. I'll go ahead and take that one. I guess in the short answer, I'd say, not really. We're seeking to build out a well-diversified emerging markets portfolio of businesses. And we see local currency weakness as an opportunity to improve our US dollar purchase economics, if you will. But that being said, we do factor in the potential for currency risk over time by using risk-adjusted discount rates in our valuation estimates, when we think about these businesses. So, I would say, if you take a step back, we'd actually say, it's a net positive.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Okay. Sorry, if I could just sneak one quick one, that mention of that reinsurance entity established in Bermuda for the PICA business. I'm just wondering, is that reinsurance flow or a back book? Is that being reinsured?

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

Initially, we're going to use it for reinsuring some of our in-force business, but we are gaining experience in Bermuda and our ability to use it – we will be considering strategies, potentially, for flow in the future.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Thank you.

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

Alex Scott
Analyst, Goldman Sachs

Q

Hi. I had a follow-up just on Suneet's question and the answer there. And when you mentioned that the business mix shift, part of it's the denominator. I guess, I think part of that is also being communicated is the runoff of the annuities business over time, or at least the, sort of, more legacy piece of the annuities business.

And now that, that transaction is closed, I was just wondering if you could give us a more firm way to think about how we should expect the earnings power to run off or whether some of the new product growth can offset that?

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

A

Yeah. Hey, Alex, it's Ken. Yeah, our traditional – we've – we're no longer issuing traditional variable annuities. So, it is running off. And after our – the sale of about 20% of our block of business with PALAC, it will continue to run off at about $3 billion a quarter is what you saw in the quarter.

So, you can kind of think about that as kind of $12 billion to $15 billion a year, and that's about an 8% runoff a year. So that, combined with the PALAC business that was 20%, that over time will get us very close to our objective to reducing our income from traditional variable annuities. And having said that, we would think about other ways to do that as well.

Alex Scott
Analyst, Goldman Sachs

Q

Got it. Thank you. And then, I had one more follow-up to the response on the impact of interest rates, particularly your comments on the actuarial review. The inflation impact that you mentioned, I assume that's probably long-term care and the reimbursement style policies.

Could you help us think through the sensitivity to that? I mean, you've provided a lot of sensitivity around long-term care. And so, we have all of that around changes in discount rates and new money yields and so forth.

But the inflation one, I've struggled to put my finger on. So, even if it's just relative to rates, which is the bigger factor, any kind of commentary you can provide to help us think through that would be useful.

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

A

Yeah, Alex. Yeah, the long-term care is probably where that's most relevant in terms of inflation. We have factored in inflation, obviously, into our reserves, including increases in near term, it's – long-term inflation would be where it's more sensitive. We have provided some of those sensitivities. So – and overall, we think, it's very manageable for us.

Alex Scott
Analyst, Goldman Sachs

Q

Thank you.

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

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. My first question is on Assurance IQ. You guys took a goodwill impairment there in the fourth quarter. And I believe at the time, you mentioned that part of the rationale for that was the lower valuation of the public peers. I noticed you didn't take another charge this quarter, and the peers have rerated subsequently lower from a few months ago. Was that contemplated when you took the charge in the fourth quarter? Or any update you can give us there?

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

A

Yeah. The charge that we took in the fourth quarter was relevant to the environment at the end of the fourth quarter. We again did a qualitative review of our – the value of our insurance – goodwill in Assurance, and we did not need any further impairment. So, that's where that stands.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Okay. And then my second question, the group disability loss ratio was pretty strong in the quarter. Can we just get some more color there and just how you expect that to trend over the balance of the year?

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

A

Yeah. Elyse, it's Andy. We very much obviously like the improvement that we saw in the disability business this quarter. It was our best benefit ratio since 2018 at 73.4%. I would frame this as what we've seen in disability, it continues to behave as we would expect and what we have been preparing for. And you always need to split this into the two different impacts. The one impact on the absence and STD side. On that side, we do continue to see a very high level of COVID-related claims. That, in general, turns into the need for the elevated staffing in claim and call. And because those are fee-oriented businesses, it shows up in our more from an elevated admin ratio perspective. We're going to stay the course on that staffing because being there for our customers is critically important in job one.

On the long-term disability side, as I mentioned earlier, we are beginning to see both incidents and severity trend back downward in the business. You'll recall the previous two quarters both of those were up about 10% in Q3 and Q4. But on top of that, our claims teams are also experiencing very good claims resolutions. And what we're hearing from our claims managers is the combination of very low unemployment at 3.8% and wage inflation accelerating, there's a strong desire for claimants to get back to the productive workforce. So in all, we're very pleased with the claims team's performance, and we're obviously happy to see the beginnings of an improvement in the environment.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thanks for the color.

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

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

All right. Thank you very much, and thank you all for joining us today. We continue to make significant progress on repositioning our business mix and advancing our cost savings program to transform Prudential into a higher growth, less market-sensitive and more nimble company. We're confident this strategy will help us deliver an even more meaningful difference in the lives of our customers and sustain value for our shareholders, while enabling us to fulfill our vision of becoming a global leader in expanding access to investing, insurance and retirement security. Thanks again for your time today.

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

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