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Prudential Financial, Inc. (PRU)

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to Prudential's Quarterly Earnings Conference Call. At this time, all participants have been placed in a listen-only mode. Later, we'll 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-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 International Businesses and PGIM, our Global Investment Manager; Caroline Feeney, Head of US 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 those predictions that 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 the 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 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 today. As we look back on 2022, I am proud of the progress we've made executing against our strategic priorities. During the year, we continued to transform our business to be less market sensitive and better positioned to deliver sustainable long-term growth.

We exceeded our $750 million cost savings target one year ahead of schedule. And our rock solid balance sheet provided the financial strength to navigate the evolving macro economic environment. I'll provide an update on each of these areas, beginning with our business transformation.

Turning to slide three. During 2022, we reduced the overall market sensitivity of our business by completing the sales of the full-service retirement business and the PALAC block as well as the run off of traditional variable annuities.

We simultaneously continue to invest in the long-term sustainable growth of our business through programmatic acquisitions and partnerships in emerging markets. In Africa, we acquired a minority interest in Alexforbes, a leading provider of financial advice, retirement, investment and wealth management in South Africa.

We also continue to grow our third-party distribution network in Latin America, particularly in Brazil, where third-party distribution now accounts for about 50% of sales and complements our strong Life Planner channel.

Additionally, we advanced our vision to be a global leader in expanding access to investing, insurance and retirement security. For example, we completed the second largest pension risk transfer transaction in US market history with IBM and closed several major longevity risk transactions, including the $8 billion transaction we completed in the fourth quarter with the Barclays Bank UK Retirement Fund. These transactions underscore our leadership in these markets as well as the strength of our interconnected business model.

Our IBM PRT transaction provided PGIM with more than $8 billion in additional assets under management and is a good example of how we leverage synergies across our businesses. We see a strong pipeline of opportunities in these markets in the year ahead.

We continue to expand our product offerings to meet the increasing customer needs for financial solutions. For example, building on the success of our FlexGuard annuity products, we introduced during the fourth quarter FlexGuard Life, an indexed variable universal life product.

In PGIM, we expanded our private loan capabilities through PGIM Private Capital, including our direct lending capabilities. This broad proprietary origination platform provides our insurance businesses and our institutional clients with unique investment opportunities and is another example of our self-reinforcing business model.

We also invested in enhanced customer experiences that blend human touch with advanced technology. In Brazil, for example, we expanded our digital sales application to expedite same-day policy delivery and processing with greater automation.

In addition, as the administrator for the IBM PRT transaction, we introduced new technology capabilities to expedite the onboarding experience for 100,000 IBM pensioners. And as part of our continued efforts to refine customer experience, we implemented a company-wide initiative to better understand the evolving needs of all our customers around the globe, and in turn, deliver the most effective products and solutions to meet their needs.

Moving to slide 4, we achieved $820 million of annual run rate cost savings, exceeding our target of $750 million one year ahead of schedule. We reached this milestone by streamlining and automating the way in which we operate, while improving the customer and employee experience. We leverage new systems and technologies to enhance our digital underwriting, claims and fund processing capabilities, improving efficiency while reducing customer wait times.

For example, for many of our Individual Life customers, we reduced the underwriting time from 22 days to 22 seconds. Our Group Insurance claims processing is now 3 times faster, and fund verification to process new annuity sales now takes 2 to 3 days, down from 2 to 3 weeks.

We also implemented a hybrid work model for our employees that reduced our US real estate footprint by 50%, equating to approximately $50 million in annual run rate savings.

And finally, we adopted a continuous improvement mindset that helps us proactively identify and execute on cost savings opportunities that enhance customer and employee experiences and continue to improve our competitiveness going forward.

Turning now to slide 5, our rock solid balance sheet and disciplined approach to capital deployment have helped Prudential navigate financial and macroeconomic challenges for nearly 150 years, and 2022 was no exception. Our financial strength, including our AA ratings, is supported by $4.5 billion in highly liquid assets at the end of the fourth quarter as well as a high-quality, well-diversified investment portfolio.

We continue to balance investments in the growth of our businesses with returning capital to our shareholders. During the fourth quarter, we returned more than $800 million to shareholders through dividends and share repurchases for a total of over $7.5 billion since the beginning of 2021. For 2023, our board has authorized up to $1 billion in share repurchases as well as a 4% dividend increase beginning in the first quarter. This represents our 15th consecutive annual dividend increase.

Looking ahead, our strategic progress, financial strength and self-reinforcing business system, coupled with the higher interest rate environment, position us well to be a leader in expanding access to investing, insurance and retirement for our customers across the globe.

Now before turning it over to Rob, I'd like to extend a special thank you to all our employees for their dedication to our customers and our communities. Together, we have made significant progress on our transformation and are fulfilling our purpose of making lives better by solving the financial challenges of our changing world.

And now, over to Rob to talk about the fourth quarter financial results and to provide an update 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 six.

Pre-tax adjusted operating income was $4.7 billion or $9.46 per share for 2022 and $1.2 billion or $2.42 per share in the fourth quarter. These results reflect lower variable investment and fee income, partially offset by improved mortality as COVID has transitioned to an endemic phase, an increase in spread income due to rising interest rates and underlying business growth.

In addition, full year results include the strengthening of reserves from our annual assumption update and the gain on the sale of the PALAC legacy variable annuity block. Our GAAP net loss for the quarter was $1.53 per share and included net realized investment losses and related charges and adjustments of $800 million, largely reflecting the impacts of rising interest rates. This loss also included a $700 million goodwill impairment due to the reduction in the estimated fair value of Assurance.

While Assurance is making good progress in many areas and had a profitable fourth quarter, the impairment reflects lower growth expectations, a higher discount rate applied to future cash flows, reflecting macroeconomic conditions and lower publicly-traded peer valuations.

Turning to the operating results from our businesses compared to the year ago quarter. PGIM, our global investment manager, reported lower fees primarily due to lower assets under management resulting from higher rates and equity market declines.

Results of our US businesses primarily reflected less favorable variable investment income, partially offset by the impact of higher rates on spread income and more favorable underwriting. The decrease in earnings in our International Businesses primarily reflected lower spread income, largely due to less favorable variable investment income and less favorable underwriting, including elevated surrenders in Japan due to the depreciation of the yen.

Turning to slide seven. PGIM, our global investment manager, has diversified capabilities in both public and private asset classes across fixed income, equities and alternatives, including real estate and private credit. PGIM's investment performance remains attractive with more than 79% of assets under management outperforming their benchmarks over the last 3-, 5- and 10-year periods.

For 2022, PGIM experienced positive institutional net flows that were more than offset by retail outflows, primarily in fixed income, consistent with industry trends due to the rising rate environment. In the fourth quarter, PGIM experienced third-party net outflows of $11.7 billion, driven by public fixed income strategies across institutional and retail clients. Institutional net outflows were driven by a few large client redemptions, while retail net outflows reflected the impact of the rising interest rate environment on retail flows across the industry.

As the investment engine of Prudential, success and growth of PGIM and of our US and international insurance and retirement businesses are mutually reinforcing. 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 and create more value for our customers.

Our insurance and retirement businesses, in turn, provide a source of growth for PGIM through affiliated flows that totaled $13 billion during 2022 as well as unique access to insurance liabilities.

In addition, we continue to grow our alternatives business, which has assets in excess of $230 billion across private credit and real estate equity and debt, and benefits from our global scale and market leading positions. Notably, PGIM's private businesses deployed nearly $43 billion of gross capital in 2022.

Turning to slide 8. Our US businesses produced diversified earnings from fees, net investments spread and underwriting income and benefit from our complementary mix of longevity and mortality businesses. We continue to shift towards higher growth and less market-sensitive products and markets, enhance our customer experience, while reducing costs by amplifying the use of e-capabilities and self-service tools, and further expand our addressable markets.

Retirement Strategies achieved robust sales in fourth quarter and full year 2022 across its institutional and individual lines of business. Our Institutional Retirement business has market-leading capabilities, with full year sales of almost $32 billion, driving record account values at the end of the year. This includes being selected for a 50% participation in a $16 billion pension risk transfer transaction and our fourth largest international reinsurance transaction of $8 billion in the fourth quarter.

In Individual Retirement, product pivots have resulted in continued strong sales of more simplified solutions like FlexGuard and FlexGuard Income, representing over $12 billion of sales since inception as well as increased fixed annuity sales.

Our Individual Life sales were consistent through the year and reflect our earlier product pivot strategy, with Variable Life products representing approximately 70% of sales for the year. And our Group Insurance benefits ratio has improved during the year from lower COVID mortality.

Turning to slide 9. Our International Businesses include our Japanese life insurance companies, where we have a differentiated multi-channel distribution model as well as other businesses aimed at expanding our presence 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 protection product focus continue to provide important value to our customers as we expand our product offerings to meet their evolving needs.

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

Our International Businesses experienced their highest sales since the third quarter of 2020, including record sales in Brazil. Compared to the prior year quarter, Gibraltar sales were up 20%, mainly driven by the Life Consultant channel, primarily from higher US dollar sales. Life Planner sales were also up 17%, driven by continued momentum in Brazil's third-party distribution channel as well as higher sales in Japan.

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 continue to focus on investing in growth businesses and markets, delivering industry-leading customer experiences and creating the next-generation of financial solutions to better serve the diverse needs of a broad range of customers.

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

Kenneth Yutaka Tanji

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

Thanks, Rob. I'll begin on slide 10, which provides insight into earnings for the first quarter of 2023 relative to our fourth quarter results. As noted, pre-tax adjusted operating income in the fourth quarter was $1.2 billion and resulted in earnings per share of $2.42 on an after-tax basis.

To get a sense of how our first quarter results might develop, we suggest adjustments for the following items. First, variable investment income was below expectations in the fourth quarter by $125 million. Next, we adjust underwriting experience by a net $60 million, as we normalize for fourth quarter experience and expect seasonality in the first quarter. And last, we expect other items to increase adjusted operating income by $91 million, primarily due to seasonally elevated expenses in the fourth quarter. If these items combined, get us to a baseline of $3.01 per share for the first quarter.

I'll note that if you exclude items specific to the first quarter, earnings per share would be $3.07. The key takeaway is that our underlying earnings power has improved due to business growth and the benefit of higher interest rates. While we have provided these items to consider, please note that there may be other factors that affect earnings per share in the first quarter. As we look forward, we have included other considerations for 2023 in the appendix.

Turning to slide 11, I'll now provide an update on the adoption of the new accounting standard for long-duration insurance contracts, which went into effect on January 1. The new standard applies to our GAAP financial statements and will have no direct effect on our statutory financial statements, cash flows or dividend capacity.

We estimate that as of September 30, 2022, GAAP equity will increase by approximately $15 billion comprised of two components. Accumulated other comprehensive income, or AOCI, will increase by approximately $17 billion, primarily due to the remeasurement of long-duration liabilities with higher discount rates in our Japan business. Retained earnings will be reduced by approximately $2 billion, reflecting the reclassification of non-performance risk gains from retained earnings to AOCI and other changes in reserves.

Also of note, GAAP equity will continue to exclude certain unrealized insurance margins from products subject to LDTI. As of September 30, 2022, the estimated after-tax unrealized insurance margins related to those products are approximately $50 billion, primarily in our Japan business. These margins are an important factor in determining financial strength and assessing profitability.

And finally, we do not expect significant impacts from LDTI on our total underlying earnings power, as impacts across our businesses will largely offset.

Turning to slide 12. Our capital position continues to support our AA financial strength rating. Our cash and liquid assets were $4.5 billion, at the high end of our liquidity target range. We have substantial off-balance sheet resources, including contingent capital and liquidity facilities. We remain thoughtful in our capital deployment, balancing the preservation of financial strength, investment in our businesses and shareholder distributions.

Turning to slide 13 and in summary, we are transforming our businesses for sustainable growth. We exceeded our targeted cost savings one year ahead of plan and will maintain our disciplined and continuous improvement mindset going forward. We continue to navigate the current macro environment with the financial strength of our rock solid balance sheet.

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 US LP

Q

Hi. Thank you. Just hoping you could talk a bit more about how you're viewing excess capital. If we look at the pieces you provided, the PICA RBC ratio is below the 400% level where it's run historically, I think the SMR ratio looks in line and holdco liquidity is within your target range, but at the low end, if we adjust for the planned debt call that you talked about on the last call. So if this suggests a little excess capital, but are there other pieces or sources that we should be considering?

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

A

Yeah. Hey, Erik, it's Ken. Overall, we do feel good about our overall capital picture in multiple parts as you suggest, but I thought it might be helpful to give a little bit of an overall context for our capital management.

We've had a very well-established and consistent approach. And it served us very well particularly last year, as we look to shift our business to be less market-sensitive and grow, while also maintaining financial strength and the flexibility.

We closed the sales of our full-service business and the PALAC variable annuity block last year. That released capital at attractive terms. And we also deployed capital to the second largest PRT transaction with IBM.

We also, as we mentioned and discussed on our last call, absorbed the capital impact of the assumption update in our life insurance business and the non-economic impact of higher rates on stat capital.

Again, that was expected. It's manageable. And we've appropriately addressed those capital implications.

When you put that all together, we ended 2022 in a solid capital position. Our RBC ratios were above our AA objectives and our target there is to be above 375%. Our Japan solvency margin ratios are above their AA objectives. We have an HLA balance of $4.5 billion at the holdco. And as you mentioned, that's at the high end of our target range. And we have a healthy outlook for our businesses with sustained profitability and free cash flow.

So that led our board to authorize $1 billion of share repurchases for next year – or this year, actually, 2023, and that's reflective of our capital position as we end 2022. That also considers the free cash flow outlook for our businesses and our opportunities to deploy capital, and also the macro environment, whether that's a potential for another recession or other stress event.

So, again, when we put that all together, we feel good that we're consistent with our AA objectives. We have a level of flexibility. And that's what our board considered when they issued – where they authorized $1 billion in share repurchases for this year and increased our dividend 4%, which, again, is the 15th straight year of dividend increases.

So, hopefully, I gave you a much broader answer there, but I hope that's helpful context.

Erik Bass
Analyst, Autonomous Research US LP

Q

Yes. Thank you. And then my second question was just hoping you could provide a bit more color on the company's sensitivity to short-term interest rates, which [ph] it seems like has been (00:23:26) a big uplift, particularly in the Individual Retirement business. Hoping to get a little bit of the sensitivity there. And then just wondering, if it were to reverse and the Fed were to cut interest rates, would then you see kind of the earnings pattern for Individual Retirement move back lower?

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

A

Yeah. Hey, Erik, I'll start and then turn it over to Caroline to give a broader business context, but just from a sheer sensitivity to short-term rates. Yes, we are benefiting from short-term rates. And generally, overall, our variable annuity business is sensitive to rates, both long-term and short-term. So a rise in both is actually helping us.

In terms of short-term rates, we did see a pickup in earnings because we're earning a higher return from collateral that's posted on our hedging positions, and that's driven by the uptick in short-term rates. But there's more dynamics going on broadly for the business, so maybe, Caroline, I'll turn it over to you for that.

Caroline A. Feeney
Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

Yeah. Of course, Ken. So, Erik, first, I should point out that the individual annuities market had a record year last year, with over $300 billion of sales and our own Individual Retirement Strategies business delivered strong sales and earnings. And our sales success continues to be driven by our FlexGuard suite of indexed variable annuities, where we now have over $12 billion in sales clearly reinforcing our leadership position as a top five player in this market.

We also saw, Erik, some strong growth in our fixed indexed and fixed annuity solutions with fourth quarter results twice that of what we saw in the third quarter. Actually, in fact, more than 25% of our sales for the quarter came from these products. So ultimately, we're pleased with the progress we've made in this space. And we like the diversification these products bring to our overall business mix and the role they can play is a strong complement to our FlexGuard suite of solutions.

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

Thomas Gallagher
Analyst, Evercore ISI

Q

Morning. Ken, should we think about debt reduction being a planned use of the $4.5 billion of holdco cash in 2023? I think you have a callable instrument in the middle part of the year of $1.5 billion. Should we assume you're planning on calling that or you still expect – should we expect that to remain outstanding?

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

A

Yeah. Generally, our – and again, I think I mentioned this on the last call, our overall level of debt has been pretty consistent over the last few years. And we do have the ability to call about $1.5 billion of debt this year in June, but that's up to us. We're not obligated to do so. It is our practice to pre-fund upcoming maturities and calls, and we've factored that into our debt issuance plans last year.

Having said that, we're going to continue to evaluate the market conditions and our liquidity position and factor that into the decision to – and the timing to call the debt or not. And we're also going to look at our overall funding needs going forward. And again, our discipline is to pre-fund upcoming plan. So it's really an ongoing cycle is the best way you should think of it.

Thomas Gallagher
Analyst, Evercore ISI

Q

Okay. Thanks. And then, can you – just for my follow-up, can you talk about how big of a GUL charge you took at – for the – at PICA for year-end? And any other, well, call it, adjustments that we should consider that occurred on a statutory basis at year-end between – I assume there might have been AAT reserve releases or any other ins and outs that you can provide on the statutory impacts? Thanks.

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

A

Sure, Tom. As we described, when we updated our assumptions for GAAP, we would be making those same assumption updates for stat and that – for statutory purposes occurs in the fourth quarter. So that was – our GAAP impact was about $1.4 billion. It is larger on a stat basis. Stat tends to be more conservative. And that's what occurred in the fourth quarter.

That was generally what led to the – our RBC ratio in the fourth quarter going from above 400% to below it, but still, again, above our AA objective of 375%. And we didn't make a capital contribution into PICA to achieve that, again, as we expected. So just a reminder of the moving parts there.

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

Suneet Kamath
Analyst, Jefferies LLC

Q

Thanks. I guess for Ken. Just curious, have you used Lotus Re yet, and if and when you use it, should we expect sort of the freed resources to be somewhere in that neighborhood of the $800 million capital contribution that you originally made?

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

A

Yeah. Thanks for bringing that up. We do have a company in Bermuda called Lotus Re, which is a reinsurer, and it does give us the capability to reinsure business to that entity, and we did so in 2022.

As you mentioned, we initially capitalized it and then we reinsured a block of Variable Life business to that business – to that entity in 2022, and that was a source of capital release. And all of that was factored into our PICA outcomes for the year, which, again, we continue to be above 375%.

Suneet Kamath
Analyst, Jefferies LLC

Q

And can you size that capital release?

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

A

I don't think we want to put a precise number on it. It's an internal reinsurance transaction, but it does improve our flexibility.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. And then, I guess, my follow-up for Charlie. I guess, overnight, we saw some headlines that came out about – I don't know if they were quoting you or referring to some comments that you made about Prudential's M&A strategy and perhaps a change post, I'm assuming, the goodwill write-downs for Assurance IQ.

So, just wanted to give you a chance to comment on that and kind of how you're thinking about M&A, especially as you think about that strategy of around improving the earnings contribution from growth businesses that you talked about, I guess, two years ago?

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

A

Sure, Suneet. Thanks for the question and our ability to clarify. Yeah. We saw the headlines too and we're slightly surprised. Our strategy remains consistent with exactly what we have been doing. So what we've said is that we won't be investing in early-stage companies with less proven track records. What we're focusing on is developing a portfolio of programmatic acquisitions, concentrating on more established businesses where we can expand the capabilities and scale of our existing businesses. And this approach supports what you said, which is our strategy of growing PGIM in emerging markets and really focusing on asset management and high-growth international markets that will help increase our fee earnings and growth profile.

And if you look at our recent – most recent four transactions, which include ICEA LION, Montana Capital Partners, Custom Harvest Asset Management, and most recently, Alexforbes, these are all examples of this approach of acquiring more established companies and are consistent with what we have done and what we will do going forward.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. Thank you.

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

Alex Scott
Analyst, Goldman Sachs & Co. LLC

Q

Hi. First one I had is on just sort of sources of cash flow as we think about 2023. You've talked about $1 billion of share repurchases, potentially some debt reduction. Could you talk about how that'll be funded between PGIM cash flows, PICA in the US businesses versus Japan? And specifically, I'm interested in particular in PICA, if you plan to take dividends out this year?

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

A

Yeah. Hey, Alex, it's Ken. Yeah. Our businesses are generating free cash flow to maintain our shareholder distributions, and also to support the growth of the business. And we do have diverse sources of cash flow to the parent company. That's provided by our business mix across our US insurance and retirement PGIM and Japan businesses. And they're all expected to contribute, over time, I think the way to think about our free cash flow ratio is it's been about 65%, given our – of our after-tax AOI, given our mix of business and growth. And we think that's about right. And we would expect, again, to receive capital from all of our businesses, including the PICA legal entity.

Alex Scott
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Second question I had is on Japan. Sales have picked up recently and looked pretty good. I guess, the premium growth is still a bit weaker on year-over-year comps and so forth. So I was just interested in what you expect from that? What kind of top line growth can we expect from that business?

Andrew F. Sullivan
Executive Vice President, Head of International Businesses and Global Investment Management, Prudential Financial, Inc.
A

So, Alex, it's Andy. I'll take your question. Yeah, you sort of mentioned some of the effects as we look back from the COVID pandemic that obviously resulted in some headwinds from a sales perspective, but, thankfully, as we sit here, those pandemic challenges have subsided quite a bit.

We're exceptionally proud of our Japanese businesses. We've steadily increased our market share over time and we've consistently ranked in the top three for new business [ph] face amounts (00:33:52) every year of the last decade. That's generated significant earnings and cash flows for Prudential.

Our strategy to grow the business is threefold. First, we're very focused on continuing to strengthen and expand both our captive and our third-party distribution. Second, we're going to continue to innovate and expand on the solutions that we deliver to our customers. And finally, and importantly, we remain laser-focused on delivering an outstanding customer experience with a particular emphasis on our digital capabilities.

We're very, very proud and good at that. In fact, we're consistently ranked by J.D. Power's in the top three and often number one in policy issuance, policy service and claims. The market remains highly attractive to us and we intend to grow our position in the low single digits over time.

Alex Scott
Analyst, Goldman Sachs & Co. LLC
Q

Got it. Thank you.

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

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

Hey, good morning. I had a follow-up on Japan. Have you seen any change in policyholder behavior [ph] in term that may – (00:35:00) driven by the weaker and volatile yen that we've seen over the last year regarding the FX products? Thanks.

Andrew F. Sullivan
Executive Vice President, Head of International Businesses and Global Investment Management, Prudential Financial, Inc.

A

Yes, Ryan, it's Andy again. I'll take the question. So given the rise in the US dollar and the weakening of the yen, we have seen an elevated level of surrenders in the business. The effect there is really some customers are looking to monetize their gains out of their non-yen products in yen terms.

That being said, we saw this effect begin to decelerate in the month of December, and that deceleration has continued here in the month of January, as the yen appreciated. So we would expect as the yen starts to stabilize, this effect will stabilize in the business.

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

Q

Got it. And then on the [indiscernible] (00:35:45) charge, is there a chance that some of that could reverse from the AAT subtest from higher interest rates when you do the look back in 2023?

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

A

Ryan, it's Ken. I think you're referring to our asset adequacy testing. We're not expecting any significant change in our AAT reserves in light of the higher rate environment.

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

Q

Okay. Got it. Thanks.

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

Thank you. A follow-up on your statutory reserve charge for your assumption update. Last quarter, Ken, you mentioned it would be absorbed within PICA's excess capital position. Has that changed in the quarter where the ultimate size ended up being higher than your expectations? And also on like GAAP reserve charges, I understand that funding for a statutory reserve charge does not have to come in all at once in 4Q. So can you share if you booked a portion of it before 4Q?

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

A

Hey, Tracy, no, in terms of the assumption update, that is recorded in – that was recorded in the fourth quarter, again, consistent with established practice for statutory reporting and nothing new there to report, came in as expected. And we did not need to fund PICA with capital from the holdco as – also as expected. So, nothing really new there.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. And your latest buyback authorization levels suggest you're not meeting your objective over three years of $11 billion of capital returns. So I'm just – if you could walk us through what has changed since you set that objective? Was it just the reserve charge or is it something else like [ph] PRT? (00:37:52) I guess, my broader question is, from this experience, are you rethinking the idea of coming up with a multiyear plan versus a singular year plan?

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

A

Yeah. Tracy, it's Ken. Just looking back here and as a reminder, we set that a three-year objective in 2021 and the target was initially $10 billion over the three-year period. Later in 2021, we increased that objective, as cash flow for 2021 was very strong.

And as I kind of highlighted earlier in the call, in 2022, last year, we managed through a number of significant items, which was our assumption update in our life insurance business, the jumping rates, and the non-economic impact on stat accounting and then we had the major PRT transactions.

And again, when we put that all together, we think we end up, at the end of 2022, in a very competitive position from a capital standpoint and a healthy outlook for our businesses with sustained cash flow going forward.

So, yeah, that's what got factored into the decision along with the outlook of the economy with the recession uncertainty. So the $1 billion will put us a little shy of the $11 billion, but it'll only take about another quarter to achieve that.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you.

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

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey, thanks. First, just could you talk about your sales pipeline in PGIM in both the retail and the institutional side and how that's looking?

Andrew F. Sullivan
Executive Vice President, Head of International Businesses and Global Investment Management, Prudential Financial, Inc.

A

Sure, Jimmy. It's Andy. We have a high degree of confidence in our approach in PGIM. As you've heard me say before, flows are an outcome of really three things: having a broad and diversified product portfolio, great long-term investment results and great distribution. The bottom line is we've stayed very focused on those elements because we know they work. It has resulted in our strong track record over – with positive flows in 18 of the last 20 years.

So we're continuing to expand our product range and vehicles. Just as an example, our Ultra Short Bond ETF ranked number two in terms of net flow rate in its category. Second, we're continuing to invest in distribution on both the retail and institutional side. In retail, we're maintaining our high-activity, high-visibility approach with advisers. And in institutional, we added a significant number of new clients this year.

And then, obviously, finally, our long-term investment track record speaks for itself over 3, 5 and 10 years. The predominant impact that we've seen has been a fixed income impact. And in particular, we believe that sustained higher rates are really good for the fixed income business.

So we're going to keep doing what we know works, and we're confident that we're going to be a net grower over time.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Do you have enough visibility to sort of assume that you'll have positive flows on an overall basis at PGIM for 2023 or too early to say?

Andrew F. Sullivan
Executive Vice President, Head of International Businesses and Global Investment Management, Prudential Financial, Inc.

A

So as I've said in the past, flows vary a good bit quarter-to-quarter. Especially on the institutional side, they're chunky. So we wouldn't provide a forecast on that. Over the long run, we know that we're going to grow.

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

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you very much. My question's around agents. As I look at the agent counts, they've declined overall in international. Is there anything being done to drive greater agent recruitment? Or with productivity improved, are you taking Assurance lessons on the tax side to the agent force more generally?

Andrew F. Sullivan
Executive Vice President, Head of International Businesses and Global Investment Management, Prudential Financial, Inc.

A

So, John, it's Andy. I'll take your question. So really, the impact you saw near-term, COVID kept pressure on our recruiting efforts and retention efforts. Fact is, throughout the last couple of years, it was a harder environment to recruit and establish culture with new agents. That impacted our Life Consultant counts more so than our Life Planner counts, but it did affect both.

As we've started to transition to more of an endemic, we are seeing an improvement and expect to see an improvement over time. We'll remain focused on two areas: first, strengthening our existing people's performance and we're exceptionally proud of our talent. We have the highest number of Million Dollar Roundtable members, who really deliver every single day for our customers. And second, we are continuing to lean in to attract land and develop new agents, which as we come out of the COVID pandemic, we believe will be easier for us.

So this is a model that has worked for us very consistently over a long period of time, and we expect to keep seeing steady performance.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you for that. And then my follow-up question. Can you talk about the decline in group new annualized premium in both group life and group disability? Is this from renewals, selective exits or job cuts [ph] at the large and jumbo end of (00:43:27) the market? Thank you.

Caroline A. Feeney
Executive Vice President & Head-US Business, Prudential Financial, Inc.

A

Sure. John, it's Caroline. So I'll take your question. So, first of all, just let me say, we're very pleased with the momentum that we've seen in our Group Insurance business. And as you're aware, the fourth quarter does tend to be a little lighter in terms of sales quarter, with the first quarter being our largest, as the majority of our cases do have January 1 inception date.

So the lower sales that you're noticing on a year-over-year basis is largely due to just a large case buyout last year that drove up sales volumes. And these do occur periodically and certainly can produce some variability in sales volumes, particularly in those lighter sales quarters.

So, John, if you were to normalize for last year's one-time buyout that we saw, sales are actually up about 7%. And obviously, this is on the disability side.

On the life side, it's just a matter of timing of premiums, driven by changes and when some customers do enrollment in the year. So I would just say, overall, we feel very good as well about our existing pipeline as we continue with our strong sales momentum.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you for the answers.

Operator: Thank you. 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. Thanks. Good morning. My first question, can you talk about the impact that you've seen on your RBC ratio from the IMR getting forward at zero. And do you think that that issue is solvable via either NAIC changes or by getting a permitted practice from New Jersey?

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

A

Yes. Hey, Elyse. The impact on our PICA RBC ratio was about 35 basis points, maybe a little bit more. And that occurred with the rise in rates from 2Q through 4Q. And you'll be able to see that in our Blue Book and Green Book combined. So – and we'll be reporting that at the end of the month.

We have been with very active discussions with regulators, and I know many others have – across the industry have been as well. There seems to be a good understanding of the issue and a lot of careful consideration being given on how to best address it, so more to come. But rest assured, we're working with our regulators and many others are as well to see how best to address this issue.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thanks. And then, Rob, I think you had mentioned that the board was looking at capital deployment in the context of a recession and severe credit cycle potential. Can you talk about what kind of credit outlook factored into the board's decision on the 2023 buyback plan? And what is your budget for downgrades and impairments if we enter into a recession?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Thanks, Elyse. As Ken articulated earlier, the decision with regard to the buybacks factored in a number of considerations, including in that the possibility of recession, and obviously, a recession that might be accompanied by a credit cycle, which could affect the portfolio.

A couple of thoughts on that. First, while we do scenarios, which would anticipate the potential for both negative migration and credit losses, we also take some comfort, as our board did, from the strength that we have in portfolio management. We think we're incredibly well positioned in the event of any deterioration in the economy that might lead to a credit cycle.

We're not yet seeing any of that, I'll note, Elyse. If you look at our net credit migration in the fourth quarter and for the full year 2022, it was actually positive. So, we haven't seen any imminent signs of distress sort of percolating within the portfolio that would lead us to be overly concerned about that. But as we established the buyback amount that was authorized, we did anticipate that such a thing could occur and that we would want to be able to both anticipate that level of buyback and have the strength to be able to absorb anything that might happen from a negative migration or default standpoint.

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

A

Maybe I'll just add, just to remind people, we do have contingent sources of funding, in particular, our PCAPs, which is $3 billion is a guaranteed source of funding. So, that's an important source of funding in the event of a variety of reasons, including stress.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Thank you.

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

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Hey. Good morning. I know there's been a number of capital questions and the IMR was impacted this quarter due to derivative losses, given rising interest rates. Now we've got rates coming off a bit in 1Q 2023. So, I'm wondering if you could give us a little sensitivity on rates and how we can think about that impact on capital, particularly with regard to these derivatives?

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

A

Yeah. Again, rising rates is generally a good thing economically, but for this one item called IMR, a decline in rates would help. But it's a pretty complicated and complex item and will also vary depending upon the activity level. So, I can't give you a precise sensitivity as a result. But we factored into our overall capital position in order to make sure we can deal with the volatility.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Okay. And maybe help us on the expenses. So, you've got this terrific $820 million run rate savings. But as I look at the results, I'm unable to [indiscernible] (00:50:05) find those benefits falling to the bottom line. So, maybe like a little color geographically, is all of it hitting the bottom line? Like, just a little color as to how we could think about that $820 million going forward?

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

A

Yeah. It has been a company-wide objective. So, the impact is across all of our businesses and the contribution that our corporate centers make towards that. And it does hit the bottom-line. Having said that, we are investing to grow certain business lines, particularly PGIM and international and so they just want to add that dynamic in there as well.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Got it. And just a real quick technical question. Are you planning to deploy capital into Assurance IQ going forward or will it – now that its generating a little profit, can it be self-funding?

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

A

Yeah. We've maintained Assurance well-capitalized and funded its losses as they've been incurred. Profitability continues to improve and we'll continue to keep it well-capitalized going forward.

Andrew Kligerman
Analyst, Credit Suisse Securities (USA) LLC

Q

Thanks a lot.

Operator: Thank you. Next question is coming from Michael Ward from Citi. Your line is now live.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, guys. Good morning. Just a high-level question. I was wondering if the capital pressures, reserve charge, maybe earnings pressure in certain lines over the last 12 months or so, I'm wondering if that has changed. Specifically, how you think about your business mix at all? And I know you've taken a few solid steps so far, but it seems like some incremental divestment or derisking could help reduce some of these pressures going forward. So I'm just wondering how you're thinking about that prospect?

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

A

Sure, Mike. It's Charlie. I'll take that. So as you know, we've made significant progress in our transformation so far, but we would also note, we still have more work to do to become a higher-growth and less market sensitive company.

And as we look ahead, we're going to focus on our financial performance. We're going to focus on advancing our transformation, including the customer and employee experience. And we're going to focus on continuing to thoughtfully deploy capital. All of that, with a goal of creating long-term sustainable value for all our stakeholders.

And we think we're well-positioned across our businesses to be a global leader in expanding access to investment – investing, insurance and retirement security, and we'll do that in three ways. We'll continue to invest in our growth businesses and markets as we go forward. We'll deliver industry-leading customer experiencing, leveraging our broad capabilities and scope of diversified businesses, in which we'll continue to invest as well. And we'll create the next-generation of financial solutions to better serve the diverse needs of a broad range of customers.

So what I'd say in summary is that we're definitely committed to becoming a higher growth, less market sensitive company. And our progress will obviously be dependent upon opportunities that arise and the macroeconomic conditions we face, but we're laser focused on what we need to do and we'll accomplish that.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. Thank you. And most of my questions were asked, but I was curious, just sort of nail in the coffin, making sure you're not liable for the earn-out with Assurance IQ?

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

A

Yeah, I'll cover that. Actually, one of the things that we disclosed for GAAP is the fair value of that earn-out, and we've been disclosing that as zero. So I think that would give you a good indication.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Okay, great. Thank you.

Operator: Thank you. Next question is a follow-up from Suneet Kamath from Jefferies. Your line is now live.

Suneet Kamath
Analyst, Jefferies LLC

Q

Great. Thanks for the follow-up. Maybe just two quick ones. Just for Ken, I was curious about your comment about no change to AAT reserves even with the move up in rates. Can you just talk about why that would be the case?

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

A

Yeah, because AAT, I mean, it looks at a number of scenarios and it also looks at not just the level of ending surplus, but also interim periods. And with derivatives, we have some interim periods that kind of offset the impact of the – the impact of higher rates on the ultimate period. So it's a little technical question, but overall little changes there.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. And then just curious on LDTI. I know you said that the AO impacts offset across businesses. But can you just give us a sense of maybe which businesses saw benefits and which businesses saw some pressure?

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

A

Yeah. Sure. So, yeah, again, overall, we don't expect an overall change to the run rate level of the earnings. And actually, some of the businesses will have no or little impact, which would be, as you would expect, PGIM, Assurance and Group Insurance.

The earnings from our International and Institutional Retirement businesses, are expected to increase on a run rate basis. And that's really due to the earlier recognition of the unrealized insurance margins, which are quite sizable.

On the other hand, earnings from Individual Retirement and Life Insurance in the US are expected to be lower, and that's primarily due to the slower recognition of revenue for those businesses. Again, kind of some pluses and minuses that offset, but that's sort of the segment level information.

We, like others, will be providing a lot more information prior to our first quarter earnings when we restate under the new standard. So, you can expect to get a lot more.

Suneet Kamath
Analyst, Jefferies LLC

Q

Okay. Thank you.

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

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

Okay. Thank you, and thank you, everyone, for joining us today. I hope we demonstrated the progress we are making to transform Prudential to deliver sustainable, long-term growth and meet the evolving needs of our customers.

Looking ahead, we remain confident in our strategy and the strength of our company. For nearly 150 years, Prudential is focused on creating value for our customers and other stakeholders, who we will continue to serve as we strive to be the global leader in expanding access to investing, insurance and retirement security.

Thank you again for your time today.

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