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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.

Robert McLaughlin

Vice President-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 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 measure 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.

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. Our second quarter results reflect continued momentum across our businesses, including the fourth consecutive quarter of underlying earnings growth and record operating earnings for Group Insurance. We continue to execute on our strategy by reducing market sensitivity and increasing our capital flexibility, enhancing our capabilities and optimizing operating efficiency to support long-term growth. Our strategic progress and financial strength position us well to navigate the current macroeconomic environment and maintain our disciplined approach to capital deployment.

Turning to slide 3. I'll start this morning by noting two significant milestones demonstrating how we are reducing market sensitivity, and increasing our capital flexibility. During the second quarter, we completed a reinsurance transaction for a $10 billion block of traditional variable annuities and received proceeds of $650 million. With this transaction, I'm pleased that we have achieved our objective of lowering the proportion of traditional variable annuities, while continuing our progress in pivoting to less market-sensitive and higher-growth products.

Additionally, last week, we announced another transaction to reinsure a $12.5 billion block of guaranteed universal life policies, which will be accretive to earnings. We expect to receive approximately $450 million of proceeds when the transaction closes, which is expected to be in the fourth quarter of this year. We also continue to deliver on our vision to increase access to investing insurance and retirement security by enhancing our capabilities and customer experiences and by expanding our distribution channels and products to more people around the world.

In Latin America, we continued to expand our distribution through the Mercado Libre platform and added 150,000 new customers last quarter. Also, Prudential of Brazil achieved a record sales quarter, driven by strong performance by Life Planners, and continued expansion of the third-party distribution channel. Prudential of Brazil is now the third largest life insurance company in the country, growing at twice the market average and reaching more than 3.5 million customers.

In addition, we see continued opportunity, and feel we are well positioned in the international longevity risk transfer market as we completed more than $3.5 billion of transactions in the second quarter.

In the US, our Individual Retirement Strategies business achieved annuity sales of $1.9 billion in the second quarter, a 20% increase year-over-year and the highest since the fourth quarter of 2020. Our FlexGuard suite has reached $15 billion of sales over the past three years, and our fixed annuity sales in the quarter represented over one-third of new business as we innovate our portfolio of annuity solutions to meet customer needs.

As we look ahead, we are well positioned as a global leader at the intersection of asset management and insurance. We are confident that our strategy and mutually reinforcing business mix, which leverages the combined strength of our brand, global asset and liability origination capabilities and multi-channel distribution will enable us to drive future growth and continue to expand access to investing insurance and retirement security.

At the same time, we continued to enhance the ways we leverage technology to improve customer experiences and optimize operating efficiency. One recent example is Model My Retirement, a new digital tool designed to help institutional pension customers gain a better understanding of their retirement benefits and adjust their financial planning accordingly. Customers can now quickly and seamlessly get an estimate of their available annuity benefits through our self-service website.

We also announced a strategic partnership with Nayya, a leading benefits experience platform. The new partnership will allow Group Insurance clients to harness AI and data science capabilities to make more informed workplace benefit decisions. And we are also using chatbot technology and robotic process automation to reduce transaction processing time across our US businesses.

As part of our continuous improvement framework, we are focusing on creating a leaner, faster and more agile company so that we can better meet the needs of our customers, while driving growth and efficiency. We've made good progress in this area, having exceeded the target we established two years ago, but we think there's more work we can do. We are evaluating additional opportunities, including further evolving our operating model, simplifying our organizational structure and streamlining decision-making.

Turning now to slide 4. Prudential's rock-solid balance sheet and robust risk and capital management frameworks have allowed us to confidently navigate the current macro environment. Our AA financial strength is supported by our strong capital position, including approximately $50 billion of unrealized insurance margins, $4.5 billion in highly liquid assets at the end of the second quarter, which does not include the $650 million of proceeds from the traditional variable annuities reinsurance transaction that was completed this quarter and a high-quality, well-diversified investment portfolio and disciplined approach to asset liability management.

Moving to slide 5. Our disciplined approach to capital deployment coupled with the added capital flexibility achieved through our de-risking transactions enables us to effectively balance investing in the long-term growth of our businesses with returning capital to shareholders. In the second quarter, we returned approximately $700 million in capital to shareholders.

And with that, Rob will now provide an overview of our second quarter financial results and 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 6 with our financial results for the second quarter of 2023. Our pre-tax adjusted operating income was $1.4 billion or $2.94 per share on an after-tax basis. These results reflect underlying business growth, including the benefits from a higher interest rate environment and favorable underwriting experience, partially offset by elevated expenses and lower variable investment and fee income.

Our GAAP net income was $576 million lower than our after-tax adjusted operating income, primarily driven by mark-to-market losses on currency and interest rate derivatives, and losses on fixed maturity sales, driven by higher rates.

Turning to the operating results from our businesses compared to the year ago quarter. PGIM, our global investment manager, had lower asset management fees driven by rising rates and net outflows and higher expenses to support growth initiatives, while other related revenues increased primarily from higher seed and co-investment earnings.

Results of our US businesses primarily reflected a more favorable, comparable impact from our annual assumption update, higher spread income and more favorable underwriting, partially offset by the absence of a onetime gain from the sale of PALAC in the prior-year quarter and lower fee income. The increase in earnings in our international businesses primarily reflected higher emerging markets earnings and a favorable impact from our annual assumption update and other refinements.

Turning to slide 7. PGIM, our global active investment manager, has diversified capabilities in both public and private asset classes across fixed income, equities and alternatives. PGIM's long-term investment performance remains attractive with 80% or more of assets under management outperforming their benchmarks over the last 5- and 10-year periods. In addition, our short-term performance has improved since the last quarter with 80% of assets exceeding their benchmarks over a one-year period. PGIM experienced third-party net outflows of $5.2 billion in the quarter, primarily from public equity strategies. Institutional outflows were primarily driven by client redemptions for liquidity needs, and retail outflows were driven by sub-advised equity mandates.

As the investment engine of Prudential, the 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 net flows, as well as unique access to insurance liabilities.

In addition, we continued to grow both organically and through acquisitions. Our private alternatives and credit business, which has assets of approximately $234 billion across private corporate and infrastructure credit, real estate equity and debt and secondary private equity. Capital deployment across PGIM's private assets platform increased from the prior quarter to $8 billion, benefiting from strong private placement and direct lending originations.

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 drive towards a higher value, higher growth and less market-sensitive mix of earnings, as evidenced by the derisking transactions that Charlie mentioned, invest in our businesses to deliver best-in-class customer experiences and expand our addressable market with new financial solutions, leveraging the capabilities across Prudential.

Retirement Strategies generated strong sales of $7.6 billion in the second quarter across its institutional and individual lines of business. Our Institutional Retirement business has leading market capabilities, which helped to produce second quarter sales of $5.7 billion, including $3.6 billion of international reinsurance transactions, as well as strong stable value sales. Retirement account values were a record high at the end of the second quarter.

In Individual Retirement, our product pivots have resulted in continued strong sales of more simplified solutions like FlexGuard and FlexGuard Income, representing approximately 65% of sales and increased fixed annuity sales that accounted for approximately one-third of sales this quarter.

Our Individual Life sales increased 27% from the year-ago quarter, reflecting our earlier product pivot strategy with variable life products, representing approximately 74% of sales in the quarter. And Group Insurance sales were up 33% compared to the year-ago quarter, driven by growth in disability and supplemental health. We've been very pleased with the momentum we are seeing in our Group Insurance business, as we execute our strategy of product and segment diversification, while leveraging technology to increase operating efficiency, and enhance the customer experience. Our record results this quarter include favorable group life and disability underwriting experience, which resulted in a benefits ratio of 81%.

Turning to slide 9. Our international businesses include our Japanese life insurance companies, where we have differentiated multichannel distribution model, as well as other businesses aimed at expanding our presence in targeted growth in emerging markets. In Japan, we are focused on providing high-quality service and expanding our distribution 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 selective portfolio of businesses in regions where customer needs are growing, where there are compelling opportunities to build market-leading businesses and where the financial enterprise can add value. Our international business sales up 9% compared to the year-ago quarter.

Life Planner sales were up 12%, driven by record sales in Brazil, as well as higher single premium US dollar sales in Japan. Gibraltar sales were up 6%, primarily driven by growth in the bank channel. As we look ahead, we are well posited across our business 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 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 third quarter of 2023 relative to our second quarter results. As noted, pre-tax adjusted operating income in the second quarter was $1.4 billion and resulted in earnings per share of $2.94 on an after-tax basis. To get a sense of how our third quarter results might develop, we suggest adjustments for the following items. First, our annual assumption update and other refinements resulted in a net benefit of $16 million in the second quarter.

Next, variable investment income was below expectations in the second quarter by $50 million. While we have not included an adjustment for the third quarter, the potential exists for continued revaluation of real estate investments and lower prepayment activity due to the current market and economic conditions. Variable investment income will vary from period to period. However, over time, it has exceeded our expectations.

Third, underwriting experience was below expectations by $5 million in the second quarter, and we expect $20 million of favorable seasonality in the third quarter. And last, we included an adjustment of $90 million for other items, primarily due to elevated expenses in the second quarter. These adjustments combined get us to a baseline of $3.26 per share for the third quarter. I'll note, if you exclude items specific to the third quarter, earnings per share would be $3.35.

The key takeaways that our underlying earnings power continued to improve due to business growth, including the benefit of higher interest rates, partially offset by higher investments in our capabilities and growth initiatives. I would also note that due to continued opportunities to build capabilities, pursue growth initiatives and gain efficiency, we expect an increased level of investments in these areas that will be reflected in corporate and other. While we have provided these items to consider, please note that there may be other factors that affect earnings per share in the third quarter.

Turning to slide 11. 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. Our regulatory capital ratios were well above our targets, and we have substantial off-balance sheet resources, including $9 billion of contingent capital and liquidity facilities. We remain thoughtful in our capital deployment, balancing preservation of financial strength and flexibility, investment in our businesses and shareholder distributions.

Turning to slide 12 and in summary, we are transforming our business for sustainable growth. We continue to navigate the current macro environment with the financial strength of our rock-solid balance sheet, and we maintain a balanced and disciplined approach to capital deployment.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question today is coming from Tom Gallagher from Evercore ISI. Your line is now live.

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. First question is, can you talk a little bit about the dividend flows, the dividends that were paid up in the quarter from the subs? It seemed like a pretty strong capital generation quarter. So, a little bit behind what drove that? And relatedly, the capital that you're going to be – that you received for the VA transaction or the freed up capital and the [ph] SGUL (00:18:41) deals later this year, would you expect to be able to dividend those up and use the proceeds?

And then, finally, the IMR rule change, can you comment on whether that affected your RBC this quarter? Do you expect that to affect it later in the year? Thanks.

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

A

Yeah, hey, Tom, it's Ken. Yeah, we executed planned distributions from our businesses in the second quarter. That cash flow reflected dividends from PICA and Japan and other affiliated cash flows from subsidiaries as well. And again, it was all part of our plans for the year. Our capital position as a result is very healthy. Our regulatory capital ratios are above our AA objectives. That would include the benefit of the recent VA reinsurance transaction, but does not yet reflect the GUL transaction, which will be subject to close later.

And again, our holdco assets were $4.5 billion, relatively flat from the prior quarter and at the high end of our target range. So, again, we'll benefit from the GUL transaction when it closes, and the NAIC IMR proposal when that is adopted. So, that's not yet in our RBC ratios. And these will all be key considerations for dividends from PICA to PFI in the second half of the year. Again, with the close of GUL and the NAIC's decision on negative IMR. So, overall, we feel very good about our capital position and the outlook for our flexibility looking ahead.

Thomas Gallagher
Analyst, Evercore ISI

Q

Okay. Thanks, Ken. And then, just a follow-up. On the potential IMR changes, I think the limitation is now looking like 10% of surplus. Can you give a little bit of color for – I think you had had something like $1.8 billion negative impact from that in 2022. Would you expect to be able to reverse most of that, some of that? And would we still be looking at potential limitations or future losses, if rates keep going up here? I guess is the other follow-up on that. Thanks.

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

A

Yes. So, you're right, Tom. The proposal is subject to a limitation of 10% of statutory surplus with adjusted for some exclusions. And for us, that's about $1.3 billion or you can think of that as about 26 RBC points. So, that's what it would represent for us where we sit and where interest rate sits right now.

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

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey. Good morning. So, first, just a question on your Japan business and how are you thinking about potential changes in your new sales mix, given changes in the capital regime and also just fluctuations recently we've seen in terms of interest rates and currencies in Japan?

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

A

Hey, Jimmy, it's Andy. I'll take your question. Our Japan operation, as you know, is competitively advantaged with outstanding distribution, great product and a strong brand. And we've been quite pleased with the sales results this quarter as we experienced year-over-year growth in our LP, our LC and our bank channels. That growth was aided by higher US dollar product sales. But we've also been investing into the business. Clearly, our work on innovating our product designs and enhancing our customer experience is paying off.

As we look at the interest rate changes, as we always say, overall higher interest rates are good for Prudential and are good for our Japanese businesses. We do believe that those higher interest rates will obviously give us greater flexibility in our product design, and then delivering value back to our customers. So, while we may see a shift of the mix between US dollar and yen denominated, we think we'll still see strong demand. And as we look forward, we're optimistic about our ability to continue to grow the Japan business and deliver shareholder value.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Does the change in capital affect your, sort of, economics of your products between US dollar and yen denominated?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Hey, Jimmy, it's Rob. So, a couple of thoughts. As you're referring to the eventual adoption of ESR, first point, ESR is still a work in process, and is not scheduled for adoption until like 2025. And so, we continue to work with the JFSA and with the industry to fine-tune the ESR regime, which is, to-date largely mirrored the regime that's been established on the international side. As currently constructed, it would cause us to look creatively at how we manage our book of business and ourselves.

So, I don't think it would necessarily change our distribution and our sales, but where we hold the assets against those sales could be in Japan, or it could be reinsured into other jurisdictions in order to be able to make sure that we're matching economics of the products that we're selling into the economics of the statutory regimes in which they reside. So, we're comfortable that either through a combination of advocacy and getting sort of the right economic outcomes and/or the other levers that we have available to us, that we'll be able to sort of continue the balance of sales that we have and sort of manage the way in which we capitalize and reserve those sales.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. And then, just shifting on to PGIM, the negative flows this quarter, how much of that is something that's maybe Prudential related that might continue into the second half versus maybe just overall industry-wide issues that a lot of your peers have had in asset management recently as well?

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

A

Sure. Jimmy, it's Andy. I'll take your question. And I'll just hit it broadly to talk about flows for the quarter. As we've talked about, flows are an outcome of having great distribution broadly diversified products and strong investment results and we've been a net flow winner over a multi-year period in PGIM. And we're quite confident in the strength of our capabilities. And as always, we're going to continue to manage this for the long-term.

That said, this quarter, we did see a material reduction in our outflows versus the previous quarters. On the retail end, outflows were $2.2 billion and were predominantly an equity story. We've seen retail clients rebalancing their portfolios based on the heels of strong equity market appreciation.

On the institutional side, the outflows were $3 billion for the quarter. Again, that's a material improvement over the previous quarters. These outflows included both equity and fixed income. The equity story for institutional is the same as that for retail. It's a client rebalancing. For fixed income, we saw some of our clients make asset allocation changes and other shift to passive.

As far as an outlook, near-term, we expect that this current investor behavior is going to continue. And to your question, our trend is consistent with what we're seeing across the rest of the industry. Over the longer term, we have a lot of confidence in our PGIM platform, and we know that we're going to return to strong positive flows and gain market share.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. Thank you.

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

Good morning. Thanks for the opportunity. Question on PGIM, another investment manager on some of these risk transferred assets. How long does that those agreements last? Can you talk about how the wind-down of those assets would work? Thank you.

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

A

So, John, it's Andy. I'll take it. Maybe I'll bring it up a level just talk about in general, as we do de-risking transactions. And in particular, the recent de-risking transactions we did in Individual Retirement Strategies and Individual Life, it is true, we'll lose some assets under management from the general account. But we – as you've noted, we worked hard and got an IMA. That is deal-specific, how long those IMAs go depending deal to deal. But it does give us the ability to continue to manage majority of the assets. And at the end of the day, if you look across the risk transactions that we've done recently, it's not really going to have a material impact on PGIM earnings.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Hey, John, it's Rob. Maybe just a little further elaboration. In the reinsurance of the PDI transaction, recall that those are individual sort of client separate accounts. And so, those – the separate account business there is something that PGIM will continue to manage. With regard to the GUL business, the agreement that we have there is actually a seven-year initial IMA. And obviously, with good performance, we would expect to continue to be able to manage that even over a longer period of time.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you for that. And then my follow-up question, sticking with asset management business, do industry-wide headwinds lead to inorganic opportunities? And are there products or geographies you'd want to get greater scale in?

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

John, it's Andy again. I'll take that. So – and I'll start where I always start when we talk about this. We've demonstrated a strong ability over a couple of decades to grow PGIM organically. So, we – certainly, as we look at the programmatic M&A, we don't need it to grow. That being said, we do remain interested in augmenting the organic growth plans with programmatic M&A. If you look at what we've done recently, Montana Capital Partners, PGIM Custom Harvest and now Deerpath, those are really good examples of the areas that we said we are going to lean into higher fee, higher growth.

As we look forward, we're going to continue to work to globalize the business and lean into areas like private alternatives and real assets. Clearly, any disruptive environment can lead to opportunities. So, we make sure that we stay in the know and in the flow of what's going on in the industry. But as always, we will remain very patient and be disciplined in our approach.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you.

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

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

Hi. Thanks. Good morning. I was hoping you could discuss the new open architecture platform that was referenced in the June press release and give some more specifics on really what you're looking to do there?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.
A

Ryan, it's Rob. I'll take that. As we've talked about in the past, we see really interesting opportunities that exist in the intersection of asset management and insurance, you see evolving in the industry. And we're quite excited about what that implies for our ability to create avenues of growth, both in our insurance and our asset management businesses.

So, we're being thoughtful about how we execute against that opportunity. And that includes organizing ourselves in a way, so as to institutionalize our ongoing balance sheet optimization capability. So, think about that on the liability side as we're looking at reinsurance solutions, to balance the use of captives, affiliates and third-party reinsurance, to continue to actively evaluate additional blocks – existing blocks of business for reinsurance, and then also looking at flow or new sales solutions.

On the asset side, it's about expanding our lens on the available assets or investments that can generate greater outflow for us, while also expanding our capabilities to source those investments either directly or in partnership with others, including things like acquiring capabilities as we did with Deerpath. This is an important component of our broader strategy, which is around enhancing valuation by becoming higher growth, less market-sensitive and more nimble.

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

Thanks. And just one follow-up there. I mean, should we think of this as also including a potential to bring in more third-party capital in a sidecar-like structure to back some of your new business in the future?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc. A

I think we're looking at the full range of opportunities that would exist there. And so, going from captive to third-party and hybrid solutions that would exist in between that.

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

Got it. Thank you.

Operator: Thank you. [Operator Instructions] Our next question is coming from Wes Carmichael from Wells Fargo. Your line is now live.

Wes Carmichael
Analyst, Wells Fargo Securities LLC Q

Hey. Good morning. I just had a follow-up on Tom's question on the Holdco liquidity. So, I think in the first quarter, that was roughly around $4.5 billion, it ended this quarter at $4.5 billion. But if I kind of add up all the uses of capital in the quarter, from buybacks, dividends, I think there was $1.5 billion of callable debt. I think there were around $2.5 billion of uses in the period. So, I'm just curious, like were dividends accelerated? I know you said that they were planned, but was there any other affiliated borrowings? I'm just trying to square that because it's a pretty sizable use of capital. I'm just trying to figure out where that came from.

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

Yeah. Hey, Wes, it's Ken. No, it was all planned. So, the distributions we received were all planned, and we didn't issue any debt in the quarter either. In fact, as you recognize, we called some debt, which again was all planned. So, -- and we didn't pull forward anything. So, it was all part of what our plans were for the year. So, I hope that helps.

Wes Carmichael
Analyst, Wells Fargo Securities LLC Q

Okay. And just maybe any thoughts around your kind of PRT pipeline? And just maybe how you think about that versus balancing that with like the longevity business and deploying capital to those two in the Institutional Retirement business?

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

A

Yeah. Hi, Wes, it's Caroline, and I'll take your question. So, first of all, I'd say, overall, we're very pleased with the strong results we saw across our entire Retirement Strategies business, with just over $7.5 billion in total sales and record institutional account values of $259 billion. This included $5.7 billion in our Institutional Retirement Strategies business, highlighted by a strong quarter in international reinsurance transactions.

In terms of the pipeline overall, Wes, we continue to see strong opportunity in both the US and global risk transfer markets with strong funding positions, both above 100%, and also high intent to transact. And I would be remiss not to mention what was just announced yesterday that we were selected to secure the pension benefits for about 2,000 of [indiscernible] (00:33:51) retirees and their beneficiaries. And so far, we've seen a record first half of the year in PRT. And while we expect to see a strong second half, we don't expect to surpass last year's record pipeline. We also see an extremely strong pipeline in the UK with funded positions that were 110%.

And Wes, finally, I'd say that given our expertise and our ability to manage large complex transactions along with our financial strength, we are well positioned to remain a leader in both markets.

Wes Carmichael
Analyst, Wells Fargo Securities LLC

Q

Thank you.

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

Hi. Thanks. I wanted to go back to the risk transfer deal just for a second. I think, Charlie, in your comments that you talked about achieving your goal on the VA side. And obviously, you've done an [ph] SGUL (00:34:52) transaction of late. Should we think about this as still ongoing activity for you? Or are you sort of declaring victory here and kind of moving on to some of the more growth-oriented areas of your strategy?

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

A

So, I would say, yes, to both of those. So, let me go through – yes and, Suneet. So, first, I'll go through each one sort of GUL and then the VA business. But, first, we are very pleased with the valuation we received for reinsuring the $12.5 billion block of guaranteed universal life policies that we announced last week. And as we said, we expect to receive approximately $450 million of proceeds when the transaction closes. The transaction will be accretive to earnings and will also reduce our market sensitivity and increase our capital flexibility.

But would we consider an additional de-risking opportunity for life sub-block? Absolutely, as long as it met the strategic financial objectives and made sense to all our stakeholders. However, we're going to be disciplined in our approach as the Individual Life business continues to be core to our purpose. There's still significant potential for growth in the industry with a $12 trillion life insurance gap. And I think our strong Individual Life sales in the second quarter reflects our product pivot to less market-sensitive products. And from an enterprise perspective, our Life business helps balance our longevity with our mortality, so it remains important to us.

On the VA side, it's a little bit of a different story, but there are some similarities. So, we've made considerable progress in reducing the market sensitivity and increasing our capital flexibility through the two transactions we've done, and we're pleased with the valuations, again, that we received for reinsuring the $10 billion block of traditional variable annuities in the second quarter as well as the valuation for the $30 billion block we sold last year.

But as a result of these transactions, as we've said, and the natural runoff of this business, we have achieved the original objective that we established two years ago of blowing the proportion of traditional variable annuities. So, we're not in a position of having to do another transaction. Having said that, I want to be very clear that we'll continue to explore additional opportunities. But again, to state the obvious, but I'll state it, we'll only do something, if it's in the best interest of all our stakeholders.

But these transactions aren't only about de-risking. As you said, they're also about growth. So, while we've been quite successful in our de-risking efforts as part of our strategy, we've also been equally focused on growing with less market-sensitive products in our businesses, which you've seen over the past few quarters.

So, let me turn it over to Caroline for a minute, because – Caroline, would you want to talk about some of the progress we've made with that part of our strategy?

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

A

Yeah. Sure, Charlie. I'd be happy to talk about how we're growing both these businesses. So, first of all, on our Life business, as you said, we have a $12 trillion insurance gap. So, we have a strong growth path forward, particularly when you think about the 15 million Americans who are currently underinsured. And as you mentioned, Charlie, we've been very successful in pivoting our businesses to products that have a more favorable risk profile. Our new solutions have less embedded guarantees, they're less capital intensive, and we're writing new business at attractive returns. And as part of that, we saw strong sales in the quarter, up more than 25% over the prior year.

And then, on the Individual Retirement Strategies side, we also continued to deliver strong sales and earnings. And in fact, we had our strongest sales quarter since the fourth quarter of 2020, and roughly a 20% increase over the prior year. And that's anchored by our FlexGuard suite of index variable annuities, where we now have over $15 billion in cumulative sales, reinforcing our leadership position as a top five player. And we also saw strong growth in our fixed annuity solutions, which were roughly one-third of our sales in the quarter and a significant increase over the prior year.

So, I'd say that our de-risking transactions along with our product pivots, have put us in a position to be more nimble with less market sensitivity, and we see a meaningful opportunity for strong growth in both businesses going forward.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. That makes sense. And then, I just want to follow up. I think, Ken, in your prepared remarks, towards the end of your commentary, you talked about an increased level of investment, I think, in the corporate segment. I was just wondering if you could maybe size that and then some thoughts around for how long should we expect this incremental investment to be impacting that line. Thanks.

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

A

Sure. What I mentioned there was we have found new opportunities to invest in our capabilities and including growth opportunities and to gain efficiency. It's building on the programs that we've executed in the past, and we have increased our investment level there. We've put a placeholder in there in terms of our run rate of about – an increase of about $25 million a quarter. And so, that's – given our plans now, we think that's appropriate planned increase in the pace of that.

I just want to mention that the way we look at these opportunities is they're often company-wide, and that's why you see the expenses occurring in corporate, but the benefits then are reflected in our business segments. And then, overall, from an expense level standpoint, we've maintained basically a flat level of expenses, while we've increased the level of capacity to invest in growth and capabilities and efficiencies, the efficiencies that we've gained there have given us that capacity. And so, overall, we've seen a flat level of expenses, improved level of capabilities, gained efficiencies and improved margins.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. So, you're not signaling that we need to reflect this $25 million in our corporate forecast going forward? It's more – you're going to have this, but it's going to be offset by efficiencies and other things?

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

A

Well, yes. But if you think about corporate, you should think about that as being an ongoing level of spend in corporate.

Suneet Kamath
Analyst, Jefferies LLC

Q

Got it. Just offset at the segments.

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

A

Yes.

Suneet Kamath
Analyst, Jefferies LLC

Q

Thanks.

Operator: Thank you. Your next question is coming from Erik Bass from Autonomous Research. Your line is now live.

Erik Bass
Analyst, Autonomous Research US LP

Q

Hi. Thank you. Can you provide an update on share of emerging markets businesses and what they're currently contributing to earnings and how they're growing from a bottom line perspective?

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

A

So, Erik, it's Andy. I'll take the question. Let me just start by kind of reminding everyone of the strategy. Our focus on emerging markets is part of shifting our overall business mix to be higher growth. And we're quite pleased with the performance of our EM portfolio, which is, obviously, and as you could see, steadily growing and positively contributing to our earnings profile.

I would highlight a couple areas. We're very pleased with our results in Brazil and quite optimistic about our prospects. Brazil posted strong double-digit year-over-year sales growth with success across basically every channel, Life Planner, Third-party and Group, and we had another record quarter.

Second, I would highlight our Habitat joint venture has contributed steady growth since the acquisition in 2016. As of the end of the second quarter, total Habitat assets under management is $67 billion. That makes us number one in Chile and number two overall in Latin America. Third, we're continuing to invest in emerging Asia and Africa.

And then, finally, and Charlie mentioned this sort of at the top of the call was, this really exciting partnership we have with Mercado Pago, which is for financial subsidiary of Mercado Libre. Mercado Libre is the largest e-commerce system in Latin America and has given us access to the mass market in Latin America, and we're seeing really nice growth there. So, we don't necessarily break out the specific growth rates, but this is a portfolio that's becoming quite meaningful with our particular emphasis being on how Brazil and Latin America are growing. And as we look forward, we really do believe we're in the right spots at the right time, and that growth will continue.

Erik Bass
Analyst, Autonomous Research US LP

Q

Thank you. And then, on PGIM, I was just hoping you could talk about the drivers of the other related revenues and your outlook for the second half of the year? I think the baseline outlook assumes that these normalize. So, is that an expectation or just a modeling assumption?

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

A

So, thanks, Erik, it's Andy again. I'll talk about the quarter, and then I'll talk about the outlook. In the second quarter, ORR came in at $31 million, which was about $20 million below our average expectation. The bottom line there is the slowdown in the real estate market is playing through as we predict it, and we've seen lower agency earnings, lower real estate transactions, fees and lower incentive fees. As far as looking forward, we would expect near-term to see pressure remain on the ORR line really until the market experiences a rebound in the real estate transaction volumes.

Erik Bass
Analyst, Autonomous Research US LP

Q

Thank you.

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

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Thank you. Let's talk about RBC improvements. I appreciate that you quantify a IMR relief. How many RBC points are you expecting from your VA deal and [ph] ULSG (00:44:56) deal?

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

Hey, Tracy, it's Ken. The VA deal, it's – the $650 million is about 13 RBC points, and the $450 million from the GUL deal is about 9 RBC points. So, that's the quantum expressed in RBC.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

Okay. Awesome. When I'm thinking about these transactions and the counterparty credit risk, do you look at the size of capital by reinsurer? Let's just put the ratings aside like the Somerset Re capital base feels a little bit light. You did say there was over-collateralization, but I don't think there's a comfort trust. What mechanisms do you put in place to reduce recapture risk? And if you could also share any assumptions that Somerset liked with that deal?

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

Sure, Tracy. It's Ken. A number of things there, so let me cover them. If I miss them, make sure I come back to them. But overall, we utilize reinsurance and our counterparties very carefully. We spread our reinsurance across a select group of high-quality third-party reinsurers. And as you would expect, we have standards for that reinsurance that we certainly applied to these transactions.

While they're entering into the business, they do have experience. The management team of these reinsurers have a lot of industry experience and are committed to the business in the long-term. But beyond that, we have contractual provisions, some of which you alluded to.

But I also want to highlight that we'll be doing the administration of the business. So, we have complete control over that. And the reserves for the business in one instance will be in a comfort trust and the other to the structure, to [indiscernible] (00:46:49) account, but they provide similar assurances and protections, and again, will be over-collateralized with the procedures for timely settlement.

We also – I want to highlight that – have investment guidelines for the investment portfolios for the investments that are held in these trusts or accounts. So, overall, when we put that all together, we think the counterparty risk is well-positioned for us. I think I covered your questions there, but hopefully, that helps.

Tracy Benguigui
Analyst, Barclays Capital, Inc.
Q

It definitely does. If I could just slip in if there was any assumptions like mortality or lapse rates that Somerset [ph] non-life (00:47:32) looking at the deal?

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

Yeah. Obviously, those are their assumptions. Again, they have the people there. On the other side with Somerset, they have a lot of experience, but they make their own assumptions. But also, they obviously are going to be subject to their own regulatory standards in the jurisdictions of which they operate. So, this got a lot of regulatory attention on both their side and our side, and we think that's also in good standing.

Tracy Benguigui
Analyst, Barclays Capital, Inc.

Q

Got it. Thank you.

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

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, guys. Really appreciate all the commentary around the de-risking and simplification. I'm just curious, should we think about this as you guys are sort of saying you're open for considering more block deals or internal reinsurance restructuring and whatnot? Or should we think about it as potentially more significant, like a more material split or divestiture within the organization to unlock value?

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

A

Hi, Mike. This is Charlie. I think it's really the former. In other words, if you think about what we're trying to do, if we take a step back and think about strategy of becoming a higher growth, less market-sensitive and more nimble company, this clearly falls, as Caroline and I talked about, in the first and second bucket. So, we are de-risking and have de-risked and would consider further de-risking transactions, if they made sense to stakeholders, but at the same time, using that as a way to pivot to becoming a higher growth company.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. That's very helpful. Maybe on Group Insurance, it hasn't gotten much airtime. Results were pretty favorable as they have been for peers. Just curious, if there's any sort of updated kind of annual go-forward earnings power for Group now?

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

A

Yeah. So Mike, it's Caroline, and I'll take your questions. So, certainly, I'll start by saying it was indeed a great quarter for Group Insurance. And as Charlie mentioned upfront, we saw record earnings and an overall benefit ratio of 81%. That reflects the execution of our strategy of product and segment diversification and our continued focus on profitability.

Total disability new business premiums grew 24% year-to-date, compared to the same period last year. And our supplemental health business, a core component of our product diversification strategy, also saw a strong double-digit growth. And our segment diversification strategy is focused on growing in the under 5,000 lives bucket. We've got great momentum with that segment now comprising about quarter of our block. We're also pleased to be achieving that diversification and growth without sacrificing profitability and pricing discipline. The current quarter also reflects favorable mortality experience in the working age population, driven primarily from lower incidents and the impact from positive rate actions on renewals.

And also disability continued to see strong results as well. That was driven by lower incidents, strong employment numbers and our continued focus on effective claim management. The disability benefits ratio we saw was our second best reported ever, trailing only last quarter. So, moving forward, Mike, we are confident in our Group business. We believe we're in a great position to continue executing on our strategy, while continuing to grow in a disciplined and profitable manner. Because of this, you'll note that we've already increased our expectations for core earnings going forward.

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

A

Mike, one other thing. It's Charlie. We talk a lot about the investments we're making in technology, processes, infrastructure and other things. And this is – what's pleasing about this is that this is a tangible – you can see a tangible outcome of some of the investments we're making, specifically in Group this time, but there are tangible outcomes we're beginning to see.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thank you, guys. Appreciate it.

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.

All right. Thank you again for joining us today. We are making progress transforming Prudential to deliver sustainable long-term growth and to meet the evolving needs of our customers. We are confident that our strategy and mutually reinforcing business mix will enable Prudential to become a leader in expanding access to investing insurance and retirement security. Thank you again, and have a great day.

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 today.