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Prudential Financial, Inc. (PRU)

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CORPORATE PARTICIPANTS

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

OTHER PARTICIPANTS

Tracy Benguigui

Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Tracy Benguigui

Analyst, Barclays Capital, Inc.

So we're going to get started. Good morning, everyone. I'm Tracy Benguigui, insurance analyst at Barclays and I'm pleased to host this fireside chat with Charlie Lowrey, Chairman and CEO of Prudential. Welcome.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you for having me. Appreciate being here.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Yeah. I thought the best to kick things off is you could just give some opening remarks, what you're seeing in the market and [indiscernible] (00:25) prepared questions. And then if we do have time in the end maybe we could take some questions from the audience.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Sure. Let me start, thank you for having me, by the way. Appreciate it. Thank you all for being here and your interest in Prudential. Let me start by just talking about the second quarter a little bit and what we're trying to do. So for four years, we've had a very specific strategy and that is to become higher growth, less market sensitive, and more nimble company. Every single thing we do can be put into one of the three buckets. And if you look at the second quarter as an example, if you look at becoming less market sensitive, we announced two transactions.

We closed VA transaction for \$10 billion, a reinsurance transaction. We also announced a reinsurance of part of our two well book for \$12.5 billion. And then most recently and I'll talk about this at the end. We just announced another transaction on our structured settlements book for \$10 billion through a reinsurer we created in Bermuda called Prismic.

So on the becoming less market sensitive, we are making significant progress. Then is the growth, how we're becoming a higher growth company. And in the second quarter, you saw that we announced a number of things. One was the acquisition of Deerpath Capital for our alternatives platform within PGIM. It's a private credit business. It's extremely well with Prudential Private Credit.

We talked about Mercado Libre, which is another distribution platform in Brazil, and we are expanding our third-party distribution down there and now have the third largest life insurance company. So we talked about the LRT and PRT transactions that we do and talked about a large LRT transaction which augmented PRT transaction we did in the first quarter.

And then finally, we talked about the retirement business and how in individual retirement we expanded our sales by about 20%. So we're making progress in terms of becoming a higher growth company. The final thing that we announced last week and Tracy will probably talk more about this is Prismic itself, which is a Bermudian reinsurer that we created to reinsure blocks of our own business, potentially reinsure forward CLO and third-party blocks of business. That will give assets to Prismic, excuse me, that will give assets to PGIM to manage along with Warburg, who is our partner, who does the private equity part of the business, and it does a number of other things for us in terms of increasing fees, et cetera. So lots of exciting things that happened in the second quarter, all consistent with becoming a higher growth, less market sensitive and more nimble company.

QUESTION AND ANSWER SECTION

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Great. We're nearing the end of your three-year plan that you shared in February 2021 to reallocate \$5 billion to \$10 billion of capital and return \$10 billion of capital to shareholders. Are you thinking about some type of Phase 2 multi-year strategic plan, maybe beginning in 2024?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. Well, first, let me say that February 2021 seems like about 10 years ago at this point. But we have made significant progress. And if you, again, go through the same three lenses, if you will, on the becoming less market sensitive we have done six derisking transactions, including the three I just mentioned. We have changed our products significantly, so we stopped selling a lot of market sensitive products and we returned over \$9 billion of capital to investors. So we've checked a lot of those boxes.

In terms of higher growth with similar we've done five programmatic acquisitions for PGIM and emerging markets. Again, we have introduced to replace many of the products that we've stopped selling in annuities and life, which were more market sensitive. We have introduced new products like FlexGuard, FlexGuard Income, et cetera, to take their place. And those have been selling very well and those are much less market sensitive.

So we have looked at capabilities. We've looked at distribution in terms of being able to grow. As I said, we have done the Mercado Libre transaction. We did the transaction with LPL with our retail advisory solutions. So there's many, many things we've done. Finally the last part of the strategic plan was to reduce expenses and we set out a goal of \$750 million of expense reduction. We actually came in at \$820 million a year early. And we've looked at processes and procedures and other things to reduce expenses.

We will continue to look at that as an ongoing continuous improvement. So what I would say, Tracy, is that all the things that we have done in past is prologue. We will continue to do as we go forward, including expense reduction, looking at organizational structure, looking at other ways of becoming even more efficient as we go forward. But we'll also focus on becoming higher growth and potentially doing more programmatic M&A and looking at additional derisking transactions if appropriate.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Great. You discussed a little bit on the second quarter call your open architecture platform, which is essentially the intersection of asset management and insurance. Could you elaborate on the framework of this platform and what you're thinking it could do for Prudential?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. So we're really excited and we think that Prismic is another arrow in the quiver of what we're trying to do in terms of creating a mutually reinforcing business over time. And Prismic and the open architecture platform is a very much a significant part of that. So if you think about what Prismic can do for us in terms of reinsurance, it can reinsure back books, it can reinsure forward flow, which would continue to allow us to grow and feed assets to PGIM. And it allows us to reinsure third-party books, which again would transfer significant assets to PGIM.

Warburg doing the private equity piece. PGIM doing the majority of the other part. It also enables us to think about augmenting and expanding PGIM's third-party assets, as well as its alternative platform. And so most of the acquisitions we have made up until this point have been for PGIM [audio gap] (07:28) expanding capabilities in the alternatives platform, which could be used for part of the open architecture.

The final thing I'll say is just on the advisor to Prismic. So we have set up an advisor called PGIM portfolio advisors that manages the asset allocation of PGIM. That sits on top of PGIM or excuse me, manages the asset allocation of Prismic that sits on top of PGIM, but what it enables us to do for the first time is actually take multi-sector institutional mandates to be able to then go within PGIM and select the assets to be in that multi-sector mandate.

We haven't had that before. Investors came in bound into fixed income, equities, alternatives, and this allows us to say to them, okay, we will do the asset allocation and that could be important going forward. So there are lot of ways in which this can benefit us.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

That sounds exciting. So with Prismic, what message are you looking to ramp up growth in which vehicle specifically what type of liabilities do you track with?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So longer term liabilities. But we can – we had a number of different reinsurers in Bermuda, Prismic being one of them. But Prismic would – I think what would fits very well with investor demand in sort of longer term liabilities at this point, which is why we looked at structured settlements, we look at other things as well as we go forward.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

So why do you think you may have a competitive advantage in scaling Prismic versus others who may try to replicate the strategy?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

As certain others have Bermudian reinsurers, but if you think about what we have, we operate at the intersection. We're only in three businesses, right. We're in asset management where we have one of the largest asset managers in the world. We're in insurance, we are one of the top players globally in insurance, and we're in retirement. Those are our three businesses.

And Prismic is at the nexus of that, where it can take the liabilities that we generate through our different businesses or through what we may generate with third parties. But it can take both our back books, which we have plenty of. It can take forward flow, which we generate significant amounts of forward flow that gives us, I think a competitive advantage. And it feeds into the fact that we have one of the largest and best asset managers in the world, I would argue.

And so it is a way of expanding that as well. So if you think about the mutually reinforcing business system, we have all the pieces necessary to make it work. We don't have to just rely on back book or other things that the other people may have to buy.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Got it. So the definition of open architecture from the press release, seems to be checking a lot of the boxes. How do you stay focused on delivering?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So again, we have three goals and only three goals. And so I keep it very simple, which is become higher growth, less market sensitive and more nimble. And everything we do needs to tick one of those boxes and Prismic fits into two of those boxes. So becoming less market sensitive, becoming higher growth. So it is squarely in the center of what we want to do as we go forward in terms of expanding on each of these boxes.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Great. So Prismic's in Bermuda, so let's talk about that a little bit. You are increasing your use of both affiliated, you have Lotus Re [indiscernible] (11:10) unaffiliated Bermuda reinsurance. What is the strategic rationale for this types of transaction?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

For the reinsurance transaction?

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Yeah.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. So we think there are a couple of reasons. One is becoming less market sensitive. The other is to induce higher growth. And so our view on reinsurers is that we want a number of reinsurers, because by definition, reinsurers want to spread the risk around. And then we want very high quality reinsurance as well. And to the extent that Prismic is one of those reinsurers and has the benefit that we own part of it, we understand that we can monitor, we can manage it and that's an important component.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

[audio gap] (11:54) regulatory process in Bermuda, how do you feel about closing your transaction, your process to review the counterparty credit risk? Are you taking into account the BMA proposed new rules for scenario-based analysis like the matching adjustment? And do you have minimum Bermuda capital requirements for external reinsurer?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. So lots of questions there.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Yeah.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

I will try to remember them and if I don't...

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Yeah. I'll come back to you.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

...come back. We – in general, let me take a step back, I think we have incredibly constructive relationships with all our regulators, whether it's the BMA, whether it's NJDOBI in New Jersey, whether it's JFSA in Japan, we believe in regulation, we just want it to be good regulation. And so we work extremely constructively with each regulator to make sure they understand our needs and that we understand their requirements.

So we've been working hand in glove with the BMA for a number of years now in terms of setting up Prismic in a way that's consistent with what we need, but also with their standards. And if their standards change, we will adapt accordingly. And we've been discussing that with them over time. So they are a really good regulator in terms of articulating what they need, but also working with us to make sure that their standards are implemented, that are – that we understand what they are and we're acting accordingly.

As a result of that, we don't anticipate any delays in the closing of the transaction, right. It's effective September 1, dependent upon or contingent upon regulatory approval, and we would hope to get that in the near-term. So – but the regulation – the regulator, again, in Bermuda is extremely effective and very good.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Can you also provide an update on the Somerset transaction and those discussions?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. So the Somerset transaction I think is seem to be going very well in addition, and with Somerset and with any reinsurer, what we look at is both the quality of the reinsurer, but as importantly, and I think it's important for everybody to understand there are structural considerations with any transaction that are really, really important as well. So is there over collateralization? Do you have control over the asset mix and the asset allocation?

So there are a lot of structural considerations that make and can strengthen a transaction relative to any particular reinsurer. We focus both on the quality of the reinsurer and very much on those structural conditions as well, because that is extremely important in thinking about the solidity of the reinsurance and that particular transaction.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Outside the structural constraints, do you have minimum Bermuda capital requirements to acquire those internal reinsurance?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. These are all regulated by the BMA and there are capital requirements associated with that.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Okay. Talk a little bit about capital management. I mean, it's great to see that PRU's [audio gap] (15:15) in Prismic. I mean it all kind of adds up to \$1.5 billion over time. And then if I add the piece of the recent NAIC IMR adoption, I think it's up to 10% [indiscernible] (15:26) should add some RBC [audio gap] (15:29) not to mention ex-deal and IMR update your holdco cash was \$4.5 billion in the second quarter, which really is the high end of your \$3 billion to \$5 billion range. So if I put all that together, how has [indiscernible] (15:43) capital reshaped your desired capital deployment measures, when you think about all your menu of places like M&A, programmatic, large scale, buybacks and reinvestment into the business.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. I thought you might mention buybacks. What I would say is, first of all, on the IMR, on the IMR part of it, I think we announced in the second quarter that it could be worth sort of \$1.3 billion the IMR [audio gap] (16:12), but we'd let our RBC ratio go down a little bit and with the expectation of it coming back up. So we don't really – you can kind of put that off to the side, because we don't really consider that's kind of bound capital if you will.

In terms of the rest, we have a very consistent view about capital redeployment, and there's kind of a sequencing. So the first thing we do is make sure we have a rock solid balance sheet that amount to us fulfilling our promises. It is extremely important to keep AA rating, rating agencies obviously have their own requirements, as do we. And so you will always see that we will have adequate capital and capital flexibility going forward. So that's job one. Job two is to invest in our businesses. So we talked about wanting to be a higher growth company. We need to invest in our businesses. We need to invest in products, capabilities, technology, et cetera. We want to remain extremely competitive in the marketplace and to do that, you have to invest in businesses and continue to do that.

The third is then returning capital to shareholders and we've always said we wanted to a prudent capital deployment. First would be dividends, obviously and we have 15 years of increasing dividend. We're proud of that track record and that's something that we would – that we focus on.

And then finally, fourth is stock buybacks as a way of returning excess capital to shareholders. So that is the order that we think about things. It has been a consistent process for us. And that's way it will remain. We will continue to think about capital deployment in that – in those [indiscernible] (17:54).

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Right. Given you are augmenting your capital light business in your mix, how does that position through on the cash flow perspective, could we see some upside to your 65% free cash flow conversion.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

No. No, let me expand. So I think our businesses need capital to grow. And so we will continue to invest in the businesses regardless of whether [indiscernible] (18:26). That is what we've done. That's what we'll continue to do. Some years you see that we have less free cash flow. Some years you would see more free cash flow. But we think that 65% is about the right number as we go forward. So you won't see us increase that in the near-term.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Okay. Let's talk about PRC, can you discuss your appetite for pension risk transfer on [indiscernible] (18:53) reinsurance in the current economic environment? Do you feel like there'll be more split transactions like we saw for IBM last year?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah, I think you'll see more. The market is tending toward that, especially on bigger transactions like the IBM transaction, which was a \$15 billion transaction. The good news about those transactions is usually even if we put [indiscernible] (19:17) administration of the entire block, which has been consistent, given our track record performance and expertise.

We think that there will be a robust market for PRT and LRT, we've seen it to-date we think it's a \$40 billion to \$50 billion annual market that's out there, partly because of the funding of the pension funds being now overfunded. And so many of them are saying, gosh, given the potential of a recession, given other things, we should hit the bit now rather than later. So I think you see a lot happening in the marketplace.

And you see differences that are occurring in terms of plan sponsors and gosh, I'd like to split it because we think that's a good thing to do from a risk perspective. You also see others reinsuring part of the deals and that's beginning to happen in some, we've done some of that and others have. So I think this is all good, because there is a lot of demand in the marketplace. And to the extent that we can bring in more capital of share on some of these bigger transactions, I think that's a positive development in the market. But PRT and LRT are here to stay and the markets, both of the markets are very robust as you saw from what we were able to do in the first and second quarters.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Sticking with spread business like also ramping up [indiscernible] (20:43), what balance you're trying to strike on taking up the [indiscernible] (20:46) of higher interest rates, which are near a 15-year high, and reducing market sensitivity business the key objective you've had for quite some time?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. I think our goal – it's an interesting question. What we think about is creating a sustainable profitable growth over time. And what that means is emphasizing or deemphasizing the products depending upon the market. And what we see in terms of growth in the economy, in terms of inflation, in terms of other things.

So you will see us again as we introduce the product to toggle up and down those products based upon the demand of our customers and interest rates and the returns we get. And you've seen us begin to do that more than we have in the past. So FIA is – the fixed annuities is just an example of what we may do. It's also an example of how we may be able to use Prismic in the future to reinsure some of the forward flow that we're creating.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Okay. Looking at PGIM, how is PGIM influence your total return on your general account?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

PGIM influences in positive way. So if you think about PGIM roughly, and this isn't exactly but 20% of the assets are manage or we manage for third-party retail, 40% for third-party institutional and 40% for general account. So we're competing every day in the marketplace to create alpha for our institutional investors. And the general account is a beneficiary of the kind of talent we have in PGIM. So we manage, we look at the alpha that's generated every quarter for the general account by each product and make sure that PGIM is delivering significant value to the general account.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

We've been seeing retail outflows with PGIM. What can you do to contain that outflow and what will it take for this trend to reverse?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So I'm not sure you can do a lot to contain the overall outflows that happen in retail. Retail is notoriously fickle when it comes to different market conditions, whether it's equity markets going up or down, whether it's fixed income and you go from a 500 basis point increase that will happen to retail flows. What you can do is mitigate it in a couple of ways.

One is to what we call all weatherized portfolio. So in the Great Recession, when I was managing PGIM, one of the things we tried to do was to create a series of products so that if a retail investor wanted to move out of fixed income into a more stable product, we had that for them to move in. So that's the first thing. So is to create product and capabilities, we've also created a lot of alternative capabilities because as you well know, retail investors, especially in the lower interest rate environment were more attracted to alternatives. And so we've been able to, for high net worth, create alternative platforms.

The other thing we've done is to make sure that we have vehicles through which retail investors can invest in a way they want. So if they want to invest in a product in mutual funds, they can do that. If they want to do that through an ETF, they can do that. In Europe, if you want to use it, we can do that. So we try and be agnostic in terms of the way they invest and then provide the products which – or into which they can invest and in that way at least mitigate, Tracy, to a certain extent, the outflows that inevitably take place when there are big disruptions in the marketplace.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Looking at Morningstar data about half of US retail investors are using passive MF or ETF over time as the passive bucket could be even more prominent, would you consider cutting your fees remain competitive?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

We have cut our fees. So in fixed income, as you look at that, these fee levels have been coming down somewhat. Obviously, passive is kind of a race to zero, active is not, but active fees have come down somewhat. The way we've mitigated that and kept PGIM fees essentially flat is through the growth in our alternatives portfolio where with these obviously are higher people are willing to pay higher fees for performance and performance based fees. And so as we've expanded our alternatives platform in credit and real estate and mortgages, et cetera, and made some of the acquisitions we've had, we've been able to keep the overall fee at the same level. But let's be clear, some of the acquisitions have been coming down over time.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

[audio gap] (25:41) lumpier than retail. What product and solutions you are seeing greater pressure [indiscernible] (25:47) opportunity?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. Luckily the decrease in flows have been decreasing. So in the second quarter, I think we had \$3 billion of outflows that was less in the first quarter, which was less than the fourth quarter. So institutional flows have been changing and have been coming down. That's a good news. Where we see institutional interest is in a number of areas. We've seen it in higher yielding credit, we've seen it in mortgages, we've seen it certainly in private placements, we've seen it in secondary private equities.

So a lot of the areas where we have expertise, we've seen increased interest. What I would also say is that institutional flows on the fixed income side tend to get soft or go negative in a rising interest rate environment, obviously. But as interest rates begin to peak, we think we'll see the interest in fixed income come back again, as people say, okay, we've hit the peak, let's start investing, because we'll start to see outperformance in the fixed income arena.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Maybe turning to individual life and mortality, what is your longer term view of mortality versus pre-2020?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

We think it's about the same as the pandemic turns into an endemic. So you're starting to see some increase in COVID again. But people are now treating and it seems to be more open -- more like a flu symptoms. So we're not seeing any difference. And if you looked at the second quarter and the assumption updates, we didn't see a lot of difference. I think we're hopefully past any of the COVID surge.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Do you think COVID led to mortality pull forward are you assuming less mortality improvements anyone thought?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Less mortality improvements than anyone thought – than we once thought. And again, if you think about second quarter and assumption update, we didn't – as we looked at plan versus actual it was reasonably as expected. So we thought it might be different a couple of quarters ago, but we're not seeing that.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

On the second quarter call, you're being constructive about growing individual life given the diversification benefits [indiscernible] (28:07) mortality risk. At the same time, individual life has been a lesser contributor to overall earnings. So how do you reconcile the need for diversification credit and achieving acceptable individual life returns on undiversified or standalone basis?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. It's a great question. Certainly, LDTI did not help our earnings situation and then it sort of pushed out earnings going forward and that may depressed current level of earnings. But the couple of comments, one – three comments. One, individual life is core to our purpose of who we are and we feel passionately about the \$12 trillion gap that exists in life insurance in the US and being able to expand access to hopefully fill that gap somewhat between existing product and simplify solutions, which we're working on and other things. So that's one comment.

Another comment I make is that we are actually very pleased with the profitability of what we're selling now. And it is we're selling, we think, a good product, less market sensitive product that is significantly above our cost of capital. And so we are to your point, we're quite comfortable with the product we're selling and the profitability of

the product and how it relates to consumers' needs. And so this is an important part of who we are. I think it contributes to our profitability and it will increase over time as the new product we sell becomes a bigger part of the back book essentially.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Maybe [indiscernible] (29:50) in Japan, how do shareholders unlock value from your \$50 billion of unrealized insurance market?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Well, the good news is we have a lot of insurance margin. Now, if you think about what insurance margin is, it's really the present value of future premiums, less the claims that we think will pay. And that really is the definition of sort of earnings and cash flow going forward. So the \$50 billion will translate into free cash flow over time. Now, one way to unlock that might be potentially to do reinsurance transactions. But on the other hand, this is an important component or is the component of free cash flow and consistent cash flow from Japan over time. So we look at it, we say we're glad it's there and it's going to be an important part of our cash flow generation capability as we go forward.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

In Japan, does the proposed ESR framework change your hedging strategy tied to products you would sell and the uses of internal or external reinsurance?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah. Good question. First of all, ESR framework won't come into place until April of 2025, so we still have time. Second of all, we're one of a small working group. I said earlier, we have great relationships with all the regulators. We were at to be – part of a small working group of companies that are working with the JFSA to look at and in purpose, this is [indiscernible] (31:19) but the ISS – the International Capital Standards developed for Europe and translate those into Japan and look at both the intended and unintended consequences sort of things. So the short answer is more to come because we still don't know what those regulations are.

On the other hand, I think the good news is that we have the ability to change products or to reinsure blocks or to do other things, depending upon how the regulations come out. And if you think the industry itself, we're not alone in that. I think the industry itself is looking at all these things. But we're working again very constructively with the regulators to help them think through [indiscernible] (32:05) consequences of the implementation of ESR.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

In corporate and other what were some of the reasons for expenses materializing worse than expectations and what is the rest of the year end look like?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Okay. So in the second quarter, the expenses were higher in corporate and other for a couple of reasons. There were some one timers in there, but there was also increased initiative spending. We pulled some of that up from the businesses. So I think the way to look at expenses is actually just a – what are the overall expenses for Prudential, not just in corporate and other because corporate and other has increased, but the expenses in the business have decreased.

What we're trying to do is to keep expenses flat on an overall basis as we go through. So there'll be puts and takes in corporate and other. But I think it's more constructive to look at the overall expense base of Prudential, which gets back to what we're trying to do in terms of expense management and the program we went through to cut \$750 million of expenses over the time period we did.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

So how do you feel about the credit environment in general, more specifically, what makes you comfortable with your private credit and commercial real estate exposure?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

So I think the credit market in general is a little bit soft. I think our view is that we can take the tail off of the scenarios and then I don't think – we don't think there's going to be a significant deep recession. There'll be a softening – soft landing, yes, absolutely. Would that have some credit implications? Yes. And so we're watching our watch list very carefully.

But what I will say, having managed PGIM through the Great Recession and being front and centered with a while ago, we have an extremely robust risk framework. So both with our private credit and with our real estate groups, we have taken a lot of steps to mitigate this. So as an example, in real estate, we started producing office exposure on the mortgage side in 2017. We are underweight office, we are underweight retail office and only 2% of the portfolio. So it's a de minimis amount and we have very high – very low loan to values, very high debt service coverage. So we think we're in good shape there.

On the private placement front, we are also – we have the unique private placement capability and that we directly originate most of the – the majority of the loans that we do. We have direct relationships with our lenders and we are the only lender. And so if there is a problem, first of all, we know we have strong dialogue with our lenders. We know if there are problems coming up immediately, we may work proactively to mitigate those problems through either the implementation of the covenants that are in place or [audio gap] (35:18). So we have actually a low – relatively low defaults, very high recoveries relative to the industry. So I've seen this moving before, I've seen these groups that work. They know – they are extremely experienced, they know what they do. And I, for one, feel very comfortable about our ability to weather anything that comes at least in these two asset classes.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

[indiscernible] (35:46-35:54).

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

They all have covenants. So – yeah, we – this is – the covenants is not something that we went covenant light on in private placements. We've seen value of covenant in downturns and we'll have yield step ups, we'll have all sorts of things in there which we can use as negotiation. And actually the borrowers really like it because again, they're dealing with a partner, they're dealing with one person, they're not dealing with a group of lenders. And we can go in there early and we can go in there fast or we can constructively work with them to come up with a solution that works for them and us and that has a near to our benefit time and time again.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

Going on the commercial real estate side could take many years to play out. How do you think your portfolio would be impacted?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

I mean, it will be impacted over time. Obviously, we do have office exposure that's our big exposure. It's a small exposure, because as I said, we started to decrease. We're underweight office and started to decrease that in 2017. And we're in the right retail. We're overrated multi-family ag and industrial. So I think we are the – sector is – the portfolio is very defensively positioned and we feel very good about it. Again, high debt service coverage at over 2.4%, low loan to value at under 60%. So will there be issues? Of course, there will always be. But in general, do we feel very good about our exposure? Yes, we do.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Q

We have a couple of minutes left. Maybe I have time for one question. The audience, if anyone has?

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

In the back there.

Q

Hi, good morning, Charles. Maybe just a quick question on the LPL deal that you did. So what was the value proposition for PRU? And especially considering some of your proprietary products like – why is LPL platform chose, any color would be great.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Sure. We think we're actually very excited about this. So we have, I think, 3,000 and don't quote me on this, but we have about 3,000 advisors. It's a very, very important distribution system for us and platform for us. There are biggest distributor of both annuities and life, but if you think about 3,000 advisors and you think about the investments we need to make in technology and other things, we don't have the scale that others do that can be cost effective.

So what we want to do is link up with a world class provider that has the platform, the technology, the investments necessary to provide our advisors with a world class solutions and more importantly, a world class platform. And so we looked around and we decided that LPL was the partner we wanted to go with in order to do that.

So we keep the front-end, we keep all the products we want to sell, et cetera, et cetera. But we now have access to LPL's platform and other things which will be a huge help. They become the broker dealer. They take over all the regulatory requirements, but we keep the front-end in the distribution. So I think it's the best of both worlds and we're very excited about what this can do for our advisors going forward.

Tracy Benguigui

Analyst, Barclays Capital, Inc.

Okay. And with that, thank you so much Charlie. Let's give a round of applause.

Charles F. Lowrey

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Yeah.

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