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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 the International Businesses, and PGIM, our global investment manager; Caroline Feeney, Head of US Businesses; Yanela Frias, Chief Financial Officer; and Rob Axel, Controller and Principal Accounting Officer. We will start with prepared comments by Charlie, Rob, and Yanela, and then we will take your questions.

Today's discussion may include forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, our presentation includes references to non-GAAP measures.

For a reconciliation of such measures to the comparable GAAP measures, and a discussion of factors that could cause actual results to differ materially from those in the forward-looking statements, please see the slides titled Forward-Looking Statements and Non-GAAP Measures in the appendix to today's presentation and the quarterly financial supplement, both of which can be found on our website at investor.prudential.com.

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 all of you for joining us today. During the second quarter, we continued to grow our market-leading businesses and become more capital efficient to deliver greater long-term value for our stakeholders. Our momentum was driven by robust sales in our US and International Businesses, as well as strong investment performance and originations across PGIM's private alternatives platform. We maintained our disciplined approach to capital deployment by investing in the growth of our businesses and returning excess capital to shareholders. This progress was supported by our strong financial position.

Turning to slide 3, I will focus my remarks this morning on the strategic actions we are taking to expand access to investing, insurance and retirement security, and how they position us to address the evolving financial challenges of our customers around the world.

One of our most compelling growth opportunities is addressing the increasing global demand for retirement product, solutions and advice. This year, historic levels of Americans will turn 65. At the same time, 55-year-olds will enter the crucial decade before retirement in preparation for life after work. These aging demographics will result in an estimated $137 trillion retirement opportunity in the US and $26 trillion in Japan by 2050.

As a leader in pension risk transfer and individual annuities, Retirement Strategies is delivering products, and solutions that protect the life's work of our customers, and ensure a more financially secure retirement for people around the world. Our market leadership is demonstrated by nearly $22 billion in Retirement Strategies sales in the first half of this year, representing a 67% increase from the prior year. This includes robust sales in pension risk and longevity risk transfer, as well as nearly doubling our individual annuity sales.

Since the launch of our FlexGuard indexed variable annuity product suite in 2020, our sales have exceeded $21 billion. Meanwhile, in Japan, our customers are benefiting from an expanded product suite, demonstrated by a 20% increase in retirement and savings product sale year-over-year.

PGIM, our global asset management business, is well-positioned to address the increasing demand for retirement solutions around the world, while capitalizing on growing institutional demand for private credit and alternative investments. PGIM provides investment solutions that help retirement plan sponsors deliver benefits to millions of beneficiaries.

With nearly $0.5 trillion of assets under management supporting defined benefit and defined contribution plans, PGIM is a market leader, servicing more than half of the world's 300 largest pension funds, including over two-thirds of the largest 100 US pension plans, and is the largest pension fund manager in Japan.

PGIM also continues to grow its private alternatives business with capital deployment of nearly $11 billion in the second quarter, a 35% increase compared to a year ago quarter. This includes the benefit of our recent acquisition of Deerpath Capital.

Moving now to our market-leading insurance businesses, we have expanded our product suite and distribution channels to meet the growing demand for products and solutions that can help bridge the global life insurance gap. In our US insurance businesses, strong sales continue to benefit from expanded distribution and product diversification. This has resulted in a shift to a more capital-efficient product mix. Year-to-date, Group Insurance sales are up 13% and Individual Life sales are up 7% compared to the first half of 2023.

In Brazil, we continue to expand our third-party distribution and benefit from the high quality of our life planners. This has resulted in a 27% increase in year-to-date sales. Across each of our businesses, our strategy is underpinned by the continued investment in capabilities and initiatives that translate into future earnings growth. This includes expanding our products and distribution, and using artificial intelligence, machine learning, and other technology to deliver exceptional sales, service and claims experiences.

Turning to slide 4. Our disciplined approach to capital deployment supported investments in our businesses while returning over $700 million to shareholders during the quarter.

Turning to slide 5. Our financial strength, diversified business mix, and risk and capital management framework supports our growth strategy. Our AA rating reflects our healthy capital position, including more than $4 billion in highly liquid assets at the end of the second quarter, a high-quality, well-diversified investment portfolio, and a disciplined approach to asset liability management.

We are confident that our financial strength, our business strategy and the evolving opportunities to support our customers around the world put us in a strong position to deliver long-term value to our shareholders.

With that, I will turn it over to Rob for a closer look at our individual 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 2024. Our pre-tax adjusted operating income was $1.6 billion or $3.39 per share on an after-tax basis, up 10% from the year ago quarter and 12.5% on a year-to-date basis. These results reflect the execution of our strategy to grow our market-leading businesses. Higher spread in fee income was the result of continued strong sales and the benefit of higher interest rates in equity markets. Additionally, expenses were lower and include a reduction in legal reserves. Results for the current quarter also include a modest net favorable impact from our annual assumptions update and other refinements, reflecting the benefit of our diversified business mix.

Year-to-date, adjusted operating return on equity was 13.5% and has improved nearly 1.5 percentage points from the prior year. This reflects the strength of our businesses, the benefits from the deliberate actions we've taken to pivot to more capital-efficient products, and operating efficiencies we've achieved that support growth.

Turning to the operating results from our businesses compared to the year-ago quarter. PGIM, our global investment manager, had higher asset management fees, driven by favorable investment performance, contributions from the Deerpath Capital acquisition, and equity market appreciation. Additionally, higher incentive and transaction fees resulted in an increase in other related revenues. This was partially offset by higher expenses to support business growth.

Earnings growth in our US Businesses reflected higher spread income driven by business growth and the benefit of higher interest rates, more favorable underwriting results and lower expenses. In addition, a more favorable relative impact from our annual assumptions update and other refinements was driven by a more favorable Retirement Strategies update, partially offset by a less favorable update in Individual Life. This was partially offset by lower legacy traditional variable annuity fee income as we intentionally pivot to less market-sensitive products.

Results of our International Businesses included an unfavorable relative impact from our annual assumptions update and other refinements, less favorable underwriting results primarily reflecting policyholder behavior, and lower spread income due to less favorable variable investment income. Results in the quarter also included higher joint venture earnings.

Turning to slide 7, PGIM, our global investment manager, has diversified capabilities in both public and private asset classes across fixed income, equities and alternatives. PGIM's strong investment performance continues to improve with 83% of assets under management exceeding their benchmarks over the past year. This has contributed favorably to strong long-term performance, with 80% and over 90% of assets under management outperforming their benchmarks over the last 5- and 10-year periods, respectively.

PGIM's assets under management increased by 5% to $1.3 trillion for the year-ago quarter driven by market appreciation, investment performance and affiliated net flows. Third-party net outflows in the quarter totaled $9.5 billion. Institutional outflows of $8.9 billion were primarily in fixed income, driven by two large clients. Retail outflows of $600 million were driven by sub-advised equity strategies and mutual funds, and were partially offset by positive momentum in public fixed income.

PGIM third-party flows are episodic due to large single-client transactions. On a year-to-date basis, we generated $17.1 billion of inflows, reflecting the net benefit from large institutional pension clients. As the investment engine of Prudential, PGIM's capabilities support the success and growth of our US and International Businesses in retirement, asset management and insurance. PGIM's asset origination capabilities, investment management expertise and access to institutional and other sources of private capital, including through the recently launched reinsurer Prismic, 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, our diversified PGIM private alternatives platform, which has assets under management of approximately $240 billion, experienced strong private credit origination activity, driven by our direct lending businesses, including from our recent acquisition of Deerpath Capital.

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 focus on growing our market-leading businesses by transforming our capabilities to improve customer experiences, and expanding our addressable market with new financial solutions leveraging the capabilities across Prudential.

Retirement Strategies generated strong sales of $7.5 billion in the second quarter across its institutional and individual lines of business. Institutional Retirement sales of $4 billion included US-funded pension risk transfer transactions of $1.4 billion and longevity risk transfer sales of $1.2 billion. Year-to-date, institutional retirement has generated sales of $15 billion.

Individual retirement posted $3.5 billion in sales, its best quarter of sales in over a decade. Our product pivots have resulted in continued strong sales of FlexGuard, and FlexGuard Income, and fixed annuity sales have doubled from the prior year. Additionally, we continue to reduce market sensitivity by running off our legacy variable annuities.

Group Insurance sales primarily occur in the first quarter of the year based on annual enrollments. On a year-to-date basis, sales increased 13% compared to the prior year, driven by growth in life, disability and supplemental health. We are executing our strategy of both product and client segmentation diversification, while leveraging technology to increase operating efficiency and enhance customer experience. These actions to improve profitability and performance resulted in a favorable benefit ratio of 81.1%.

In Individual Life, sales increased 3% from the year-ago quarter and 7% year-to-date. These increases include the benefit from our FlexGuard Life product, which reached its highest sales quarter since its launch in 2022, and from our pivot towards more capital-efficient products.

Turning to slide 9. Our International Businesses include our Japanese life insurance companies, where we have a differentiated multichannel distribution model, as well as other businesses aimed at expanding our presence in targeted high-growth 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 and retirement 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 and regions where customers' needs are growing, where there are compelling opportunities to build market-leading businesses and where the Prudential Enterprise can add value.

Sales in our International Businesses were up 11% compared to the year-ago quarter. Higher sales in Japan are benefiting from recent product launches as we expand our retirement and savings offerings. These new products are gaining traction with customers and represented 20% of the current quarter sales. In addition, emerging market sales were higher, driven by growth in Brazil, as we continue to expand third-party distribution and benefit from the strong performance of our world-class life planners.

As we look ahead, we are well-positioned across our businesses to be a global leader in expanding access to investing, insurance and retirement security. We continue to focus on investing in growth businesses and markets, delivering industry-leading customer experiences, and creating the next generation of financial solutions to serve the diverse needs of a broad range of customers.

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

Yanela del Carmen Frias

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

Thank you, Rob. I will begin on slide 10, which provides insight into earnings for the third quarter of 2024 relative to our second quarter results. Pre-tax adjusted operating income for the second quarter was $1.6 billion and resulted in earnings per share of $3.39 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 $6 million in the second quarter. Second, variable investment income was below expectations by $90 million in the second quarter, driven by lower real estate returns. Next, underwriting experience was below expectations by $10 million in the second quarter, and we expect $30 million of favorable seasonality in the third quarter. And last, we include an adjustment of $95 million for expenses and other items.

Expenses in the second quarter were lower than expected, reflecting a reduction in legal reserves and the timing of expenses. As a result, we have lowered the full-year 2024 expected loss in Corporate & Other to $1.8 billion. In the third quarter, we expect higher investments in our initiatives to support growth, as originally planned. These adjustments combined get us to a baseline of $3.48 per share for third quarter.

I will note that if you exclude items specific to the third quarter, earnings per share would be $3.56. The key takeaway is that our underlying earnings power increased and reflects our continued investment in the growth of our market-leading businesses and our pivot away from more capital-intensive and lower-growth businesses. 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 regulatory capital ratios are in excess of our AA objectives. Our cash and liquid assets were $4.4 billion, within our liquidity target range of $3 billion to $5 billion, and we have substantial off-balance sheet resources. We remain thoughtful in our capital deployment, preserving financial strength and flexibility, investing in our businesses for long-term growth, and returning capital to shareholders.

Turning to slide 12, and in summary, we are growing our market-leading businesses. We are maintaining a disciplined approach to capital deployment and our growth is supported by the strength of our balance sheet.

And with that, we will be happy to take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now be conducting a question-and-answer session. [Operator Instructions] In the interest of time, we ask that you please ask one question, one follow-up, then return to the queue. Our first question is coming from Ryan Krueger from KBW. Your line is now live.

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

Q

Hey, thanks. Good morning. My first question was on Prismic. Can you give an update on your progress towards additional transactions? And would you anticipate getting another one done before the end of the year?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Good morning, Ryan. It's Rob. Yeah, we and our Prismic investors share aspirations to grow well beyond the initial $10 billion transaction that we completed relatively recently. We continue to work on a very active pipeline of multiple insurance transactions. That pipeline includes ongoing balance sheet optimization, flow or new sales solutions across our businesses, as well as third-party blocks where we have a particular focus on Japan. I would be – we would be disappointed if we've not entered into an additional transaction before year-end.

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

Q

Thank you. And the second one was on just hoping you could revisit your earnings sensitivity to short-term rates. And I think in addition to the total sensitivity, can you give some perspective on the different moving parts between some of the businesses?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Hi, Ryan. It's Yanela. Yes. With regards to rates, short-term rates, we do not expect much of an impact due to changes in short-term rates. We have cash at the holding company and collateral in Individual Retirement Strategies that earn short-term yields. And this is generally offset by interest rate derivatives where we pay short-term rates and receive fixed, and we use these to manage duration across our businesses. So, generally, these are offsetting.

Let me also address long-term rates since we've seen some recent movement. With respect to long-term rates, we have benefited from the rise in rates over the past few years, which have been at levels that are significantly higher than over the past decade. And this has increased our portfolio yields in both domestic and international. So, higher rates are good for us, and it has been a tailwind. If rates were to decline, it would reduce our new money rates. But we do have a healthy spread between our new money rates and portfolio yields. And lastly, I would point out that we have a very disciplined ALM approach, which significantly reduces future spread volatility of the in-force.

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

Great. Thanks a lot.

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

Suneet Kamath
Analyst, Jefferies LLC
Q

Good morning. Thank you. I guess, last quarter, you guys were pretty optimistic about the industry annuity sales. I think you said over $400 billion, and year-to-date, that's tracking pretty closely, so that's good. I guess my question is, given the move in rates that we've seen, with the 10-year now somewhere in the 3.8% neighborhood, do you think that'll dampen demand for annuity growth? And how are you thinking about pricing in this, if this becomes the new kind of rate environment? Thanks.

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

Yeah. So, Suneet, it's Caroline, and I'll take your question. So, right now, the annuity market continues to be extremely strong, as you referenced, with the market on pace to deliver a third straight record year, outpacing last year's run rate by over 20%. It's certainly possible that in a decreasing interest rate environment, we could see some pullback from the record sales levels, particularly in fixed annuities.

From a Prudential perspective, while we've been very pleased with the growth in our fixed annuity sales, for us, it's really just a piece of the overall portfolio. We have the broadest product portfolio we've ever had, with no overconcentration in any single product. In fact, this past quarter, we had record sales in three distinct products, and two of those are in our RILA suite of solutions, which are actually less sensitive to interest rates. And Suneet, this really reflects our very deliberate strategy, which enables us to serve the broadest set of customers across all market conditions.

Frankly, we're also very excited about the broader retirement opportunity. We do see strengthening tailwinds from rapid growth in the population of Americans over age 65 and as well as increased demand for solutions that protect retirement savings and provide lifetime income. So, we believe customer demand for protected income will continue to be the driving force behind growth over the long-term and we're well-positioned to meet that demand with our diverse portfolio of solutions and the strength of our brand and distribution.

And finally, Suneet, you asked a question about pricing. We are also very well positioned to continue with our pricing discipline, which we have the ability to adapt pricing and enter the market with revised pricing in very short order, which enables us to be very nimble with changing markets.

Suneet Kamath
Analyst, Jefferies LLC
Q

Okay. That makes sense. Thanks for that. And then I guess for Rob on Prismic again, you said that you'd be disappointed if you didn't do something this year. Should we think about the sort of first deal that you do, should that be on the smaller side as sort of a proof-of-concept deal or is that not the way that you're thinking about it? Thanks.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

So, Suneet, so it would actually be the second deal. So, the first transaction we closed was about $10 billion in reserves and so relatively significant in size. For the next transaction, what I would say is that the nature of underlying liabilities is what impacts the sizing of the transaction. And that's going to be dependent upon sort of market sensitivity, hedging, and collateral needs. So, we're not constraining it simply because of appetite or access to capital or other capabilities. It would really just be a function of making sure that as we're constructing the Prismic portfolio, it all fits together well.

Suneet Kamath
Analyst, Jefferies LLC

Q

And are you leaning one way or the other in terms of the different uses? Like, you've talked about flow, you've talked about your own in-force, you've talked about third-party. Is there one way that you're leaning in particular on that?

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Well, I would say we can – the continued balance sheet optimization is probably our highest priority, Suneet, and incidentally, the most controllable of the things that we're working on. But both flow and third-party are high priorities for us, and they are being actively worked as well.

Suneet Kamath
Analyst, Jefferies LLC

Q

Okay. Thanks, Rob.

Robert Michael Falzon
Vice Chairman, Prudential Financial, Inc.

A

Okay.

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

Elyse Greenspan
Analyst, Wells Fargo Securities LLC

Q

Hi. Thanks. Good morning. My first question is on PGIM. I know you guys had called out two large pension outflows in the quarter, but I was hoping to just get more color on trends in flows, both on the institutional and retail side, and how you think about the outlook for the balance of the year.

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

A

Sure. Good morning, Elyse. It's Andy. I'll take that. So, our flows in PGIM have become more variable. This is mostly driven on the institutional side of the business, so let me start there. We're the sixth largest manager of defined benefit assets globally, and we have very large strategic pension clients.

If you look at many of these defined benefit portfolios, as we sit here today, are overfunded, and those clients are either de-risking or they're exploring PRT. So as a result, we're seeing more than normal institutional money in motion, leading to a variability in our institutional flows. Overall, we expect that in PGIM, we'll be a beneficiary of that environment, given our world-class fixed income solutions and our leading PRT business.

If you take a step back though and look across the year, last quarter, you saw us benefit with noteworthy PRT wins and a large pension mandate inflow. This quarter, we saw fixed income outflows as a few of our clients de-risked and moved. But the important part is when you look across the year, our institutional flows are positive year-to-date at $17 billion.

On the retail side of the business, we've experienced large improvement versus last year. Year-to-date, our flows are flat, and that is a market improvement. We're starting to see flows back into our fixed income retail products with $1.1 billion in positive inflow this quarter. We believe this is poised to accelerate once clients start to move to $6 trillion that's sitting in money market assets over into longer-term active products. And we expect that declining rates are going to be the trigger to that action.

So, the punchline overall from a flows perspective is we expect that we will remain a net winner over the long-term, but you should expect near-term variability. It will continue in this environment.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thanks. And then my second question was on the group side. Results there were pretty strong. Just anything you're calling one-off there? And then how should we think about the benefits ratio trending in that business over the balance of the year?

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

Sure. Elyse, it's Caroline, and I'll take your question. There's really nothing that's one-off, Elyse. It was really very much core strength in the business, which was driven by a few different factors. First of all, we continue to see strong life and group disability results, driven by favorable mortality and by our focus on effective claims management, which is an area we continue to invest in. We also continue to see strong double-digit growth in our supplemental health business, which is a core component of our diversification strategy. And we've also seen growth in our under 5,000 lives in our association market segments, helping us further broaden our portfolio. So, overall, Elyse, the business is growing, and it's doing so at attractive margins.

In terms of your question on the benefit ratio, we delivered a very strong result coming in at 81%, in line with the year-ago quarter and below our target range of 83% to 87%. Given that we have been below our target range for the first half of the year, you can expect for the year we would be towards the lower end of that target range.

Elyse Greenspan
Analyst, Wells Fargo Securities LLC
Q

Thank you.

Operator: Thank you. Next question is coming from Wesley Carmichael from Autonomous Research. Your line is now live.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

Hey. Good morning. Thank you. On Individual Life, I was hoping you could touch on the assumption review impact. What drove that unfavorable in the quarter? And do you think there's an ongoing impact to either earnings or cash flow?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

Hi, Wes. It's Yanela. So let me take your question. I mean, to take it a step up, the annual assumption update this quarter had a modest benefit to adjusted operating income, as you saw. And this is a result of our multi-line business mix that generally creates risk diversification and tends to moderate the annual assumption update impact. So, the net modest benefit was due to favorable mortality updates for the Institutional Retirement Strategies, partially offset by unfavorable policyholder behavior updates for both Individual Life and Japan.

And to your question about what drove the large impact to Individual Life, the negative impact to Individual Life was primarily due to lower guaranteed universal life surrender experience post-COVID as individuals retain their life insurance policies at higher levels than previously assumed. And this was based on our examination of updated emerging experience data of our business and information available from a number of industry studies. So, that is what drove the assumption update. And we do have a small ongoing impact from the assumption update as well.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

Got it. That's helpful, Yanela. And is that ongoing impact? Is that an operating earnings impact, or is there any statutory impact in that?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.
A

So, there's an ongoing operating income perspective. From a statutory perspective, the assumption update there, we have a process. From a process standpoint, that is done at the end of the year. So that will be reflected in our statutory results at the end of the year. Having said that, any impacts are not expected to be meaningful to our assessment of capital availability, cash flows, or our capital deployment plans.

Wes Carmichael
Analyst, Autonomous Research US LP
Q

No, that's great. Thank you. And then maybe my follow-up on variable investment income. I think some of your competitors this quarter have talked about an expectation for real estate equity returns to improve in the back half of the year. So, just curious if you guys have the same outlook or not.

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

It's Rob. I'll take that question. I would say that if we look at the industry from an overall basis, our real estate investment group has a forecast that there will be actually continued valuation declines through the remainder of the year across the industry. Those valuation declines, though, will be in the low-single digits. So while we think we're close to an inflection point where that could begin to turn around, we're not quite sure we're at the trough of that yet.

Wes Carmichael
Analyst, Autonomous Research US LP

Q

That's helpful. Thanks, Rob.

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

Thomas Gallagher
Analyst, Evercore ISI

Q

Good morning. Just a follow-up on that actuarial review. I think most of the $800 million or so net income release from the review came from RILA. Do you mind just sort of – A, is that correct? And, B, can you talk about what drove the change? Was that a utilization assumption changes? And will that be a GAAP-only impact, or will there be a statutory impact as well?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Yes, Tom. It's Yanela. So, yes, the non-AOI impact was mainly due to RILA, and it was really driven by a methodology update to the annuity valuation, and this is really to be consistent with industry standards and also more consistent with how we actually manage the product. So, it's a valuation methodology change. It is GAAP-only, so we will not see a comparable statutory impact, and that is just following the normal variable annuity reserving and capital standards.

Thomas Gallagher
Analyst, Evercore ISI

Q

Got you. Okay. Thanks. And then my follow-up is, can you just comment on what caused some of the weakness in Institutional Retirement this quarter? Was it spreads, underwriting, expenses? And how do you feel about earnings visibility going forward in that business?

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

A

Yeah. So, Tom, it's Caroline. So, we actually don't see much weakness in the earnings, especially given both reported and core earnings are up this quarter compared to the prior-year quarter. If I just take the institutional side of the business for a moment, it does take time to see the impact from our risk transfer transactions materialize in our earnings. So, in essence, Tom, sales leads and then, obviously, earnings will follow.

We had $4 billion in sales this past quarter, and we believe that rapidly growing demand for pension de-risking in the US and our international markets will continue to fuel profitable growth. We did see some less favorable underwriting this quarter, as well as lower VII on the institutional side.

And then, on the individual side, Tom, there are two key drivers of our core earnings. First, I would point to the strong sales we're driving through our expanded portfolio, which includes our RILA and our fixed products. And this past quarter, as you heard, was especially strong, our best quarter in over a decade.

The higher sales volumes across these products will also drive future profitability, but over the near term, those profits are tempered by the higher upfront distribution costs associated with those higher sales levels. And then, second, there's the impact from our decision to no longer sell traditional variable annuities with living benefit guarantees.

While this business continues to generate strong fee income, it will run off at roughly $3 billion to $4 billion per quarter, offsetting some of the earnings growth from our new business. But we see this largely as a transition. Ultimately, we like the business we're putting on, and those strong sales are contributing higher quality earnings, but you're still going to see an impact from the intentional runoff of our traditional variable annuity block.

Thomas Gallagher
Analyst, Evercore ISI
Q

Got you. Thanks, Caroline.

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

Thanks, Tom.

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. Appreciate the opportunity. Can you talk about growth in the group channel and how much of that's coming from, at this point, employee growth versus wage and then adding more coverage? Thanks.

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

Sure, John. It's Caroline. I'll take your question. So, the growth in our book continues to be primarily driven by the execution of our diversification strategy, which is focused on growing in the under 5,000 lives market, as well as our focus on further diversifying in disability and supplemental health products.

We're certainly benefiting from strong employment, John, which is driving overall employee and wage growth and will continue to grow organically in the block. However, when you look at what is primarily driving our growth, it is more driven by the strong underlying fundamentals and executing on our strategy. So, hopefully, that helps you.

I would also say one more thing in terms of our strategy. We've also made a lot of progress on diversification in our under 5,000 lives market, which spreads our premiums out more across the year. So, we're continuing to like what we see in our diversification.

John Barnidge
Analyst, Piper Sandler & Co
Q

Thank you. And my follow-up question is, on the comment about building a select portfolio in international markets, I know you're focused on where you want to be. What does the opportunity set look like internationally? And is there an opportunity to accelerate that through M&A? Thank you.

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

So, John, it's Andy. I'll take the question. Yeah. And as you said, our strategy on emerging markets, or in international in general, is to accelerate our growth through a select set of emerging markets by extending our leadership position in Latin America, by strengthening our footprint in emerging Asia, and in particular in India and Indonesia, and by investing in market leaders in Africa.

I mean, I think the important thing here is you're already seeing very, very strong, good growth in Brazil that is leading to healthy earnings growth in that block of business. Many of these other markets offer us very good opportunity, but they will take time to develop. So, this is about the medium and long term as well.

As far as M&A, we are absolutely open to opportunistic, programmatic M&A to help us accelerate our growth in those markets. But as always, organic growth is going to be job one for us. We're confident that over time, emerging markets will become a bigger part of the Prudential pie.

John Barnidge
Analyst, Piper Sandler & Co

Q

Thank you.

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

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Hey. I had a question for Yanela or maybe for Rob just on capital deployment. Your cash flows and capital levels are obviously pretty strong, yet buybacks have been fairly modest relative to most of your peers, even as stock trades at a relatively low multiple. So, I'm just wondering if you could talk about your appetite for buybacks versus other uses of capital.

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

Hey, Jimmy. It's Yanela. So, look, we remain well-capitalized. You saw PICA's RBC ratio in excess of our AA objective of 375%. We are positioned to continue to invest in the growth of our businesses and you've seen that year-to-date where we've closed three large PRT transactions exceeding $10 billion in liabilities and we funded strong growth across all of our businesses. And even with that, we continue to pay dividends out of our insurance subsidiaries and our highly liquid assets increased a bit, as you mentioned.

But we will remain thoughtful in our capital deployment. We will remain focused on preserving financial strength and flexibility, investing in our businesses for long-term growth where we see a lot of opportunities and then returning capital to shareholders.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Okay. Thanks. And if I could just ask about your views on the sales outlook for the Japanese business. Just given the high volatility in the yen, I think that's depressing demand for some forex products there. But how are you thinking about your trends in your business in Japan and just the sales outlook in that market?

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

A

Yeah. Jimmy, it's Andy. I'll take the question. Maybe let me just start by saying we're very, very pleased with the sales results that we saw. We experienced strong year-over-year growth in our life planner, independent agent, and bank channels. And sales in Japan were up 10% year-over-year. That is really flowing from our work to continue to broaden and innovate our product portfolio and to enhance the customer experience in our business.

The fact is, in that 10% year-over-year up, 20% of our sales this quarter flowed from more recent product introductions, including both life and annuity products. And we've been expanding our yen offerings in addition to our US dollar offerings. Obviously, we see effects from the yen strengthening and weakening. Lately here, with the strength we've seen, we think that will be a benefit to our US dollar products as it'll make them more affordable for the consumer. Japanese consumers are still absolutely interested in taking advantage of the US interest rates.

So, we're pleased with the yen movement this week. We are pleased with the work that we've done and the results we've shown, and we expect to continue the good sales trend.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

And is competition in that market fairly rational? Because we've heard from some of your peers that it's a much more competitive market than it used to be a few years ago.

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

A

Yeah. Jimmy, I'd start by saying all the businesses we compete in are competitive, but I would say, yes, the marketplace is rational. At times, you may see a competitor get aggressive, but overall we see it as a rational market with a good ability for us to derive and drive profitability. And we're competitively advantaged with broad product portfolio, differentiated distribution and a good brand. So, the last thing I always reinforce is we'll be disciplined no matter what the competition does and make sure that we deliver for the customer and the shareholder.

Jimmy S. Bhullar
Analyst, JPMorgan Securities LLC

Q

Thank you.

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

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, guys. Good morning. I was wondering if you have any sense of – on the Individual Life charge, I was wondering if you have any sense of, like, how that would have looked had you not done the GUL deal. And I guess I'm curious, like, if these types of reserve actions or assumption updates, does that keep you in the market for further risk transfer opportunities?

Yanela del Carmen Frias
Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.

A

So, Mike, it's Yanela. Let me take your question. So, obviously, we executed on the transaction earlier this year. We don't have a sense of what the impact would have been. So that said, in terms of further de-risking transactions, we always are looking at options and opportunities to the extent they are available.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then I noticed the disclosure for PGIM. I think part of the outflow or the reduction in AUM was that you moved quant funds to runoff. I was wondering if you could expand on that and if that contributed to the investment performance in the quarter pressure.

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

A

So, it's Andy. I'll take the question. I'll take that in two parts. First, the quant manager you're referring to is not a material part of our business. It had less than a $1 billion in assets under management. And it's a subcomponent on the quantitative equity side that we're exploring strategically what we want to do with the capability.

But as far as – you referenced investment performance, we're actually quite pleased with our investment performance in the business. Obviously, that is job one. It's the most critical ingredient. And if you look at our short-term and long-term results, they have been very, very strong and we remain confident in our ability to continue that track. But as far as that block of business, it's small, not material to the overall business.

Michael Augustus Ward
Analyst, Citigroup Global Markets, Inc.

Q

Okay. Thanks so much.

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

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

Sure. This is Charlie. Let me make an observation, if I may, before the closing comments and that we are experiencing very turbulent times right now obviously. And this is exactly when clients need us the most. And we've seen that in the past when clients turn to us during these kind of volatile times, such as the great financial crisis and others that we've all been through. And what we've observed is that we've been a net beneficiary in these turbulent times as there is a real flight to quality, which we define as having the financial strength, the strength of brand and the strength of distribution, so that clients can meet us when, where, and how they want.

Now obviously past isn't prologue, but I'll make the following observation. And that is that we have exactly the capabilities that clients need in terms of investing, insurance, and retirement security and that we will be laser-focused during these times in helping them as they map through this volatility. So, we'll continue to focus on our clients and we'll continue to deliver sustainable value to all our stakeholders as we go forward.

So, thanks and have an enjoyable weekend.

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