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# Prudential Financial, Inc. (PRU)

Investor Day

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# MANAGEMENT DISCUSSION SECTION

## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

All right. I think we're going to get started. I'd like to thank or like to welcome you to Prudential's 2016 Tokyo Investor Day. We thank you for your participation and the opportunity to share our Japan story. I'm Mark Finkelstein, Head of Investor Relations. If you look in your materials, you'll find an agenda. We have seven presentations today. We will start with overview presentations by Charlie Lowrey, Head of International; and Kurashige-san, CEO of our Japan Operations. This will be followed by presentations by the three Presidents of the business units and then we will conclude with a review of our investment operations in Japan and a financial overview of our international operations.

There will be three Q&A sessions; the first two will be followed by a break. After conclusion of the formal program, we will host the lunch for those of you that don't have to run off to an airplane. So, we hope that you'll have an opportunity to join us for that. We do have one [ph] curveball (01:01).

In the process of getting to Japan, Rob Falzon, our CFO; and Scott Sleyster, our Chief Investment Officer encountered some transportation issues. To make a long story short, their plane was diverted to Alaska. So, as a consequence, they are not able to be here in person, but they will be presenting their materials by phone and there's a lot of good content in their materials and I'm sure you'll find their presentations very useful, but did want to highlight this variants from normal practice.

Couple of logistical items, Wi-Fi, if you want to get on Wi-Fi, there is an open network, it's Roppongi Hills. So, you should be able to access that without trouble, you will also see a headset in front of you. Japanese is in channel one and English is in channel two and also – if you can also mute your phones, if you have your phone on that would be helpful to avoid any distractions.

So, before getting started, please review our forward-looking statements and non-GAAP measure and reconciliations of earnings measures. And with that, I will hand it over our Head of International Operations, Charlie Lowrey.

## Charles F. Lowrey

*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

Good morning. We were thinking about all doing the presentation from afar, because as we were testing the sound system this morning. Rob and Scott's voice booming from the ceiling and it gives them a certain gravy task, that's actually quite, quite wonderful. So, you'll experience that as we go through.

I will provide some comments briefly and some introductory comments about our international business and then turn my program in the form over to my Japanese colleagues. We describe our international strategy as having four legs. The first is to make sure that we are executing our business well in each of the countries in which we're currently located. How we operate will have the greatest effect on our near-term performance.

The second leg relates to the types of products that we offer and there are two aspects to this, innovation to meet customer needs and product profitability to ensure the products meet our hurdle rates. You will hear about both sides of this coin, namely innovation and product profitability from my colleagues.

The third leg relates to the distribution expansion, of which Japan is probably our best example, but which is actually happening in all the different countries. And finally, there is M&A, either to expand in existing countries, or to expand in select new countries, as we did in Chile earlier this year.

As you can see on the following page, we have been able to grow this business consistently over time through a variety of interest rate markets as well as the stock market. Growth has flattened in the past two years as we've been burdened by unfavorable foreign exchange rates, less favorable alternative investments and lower interest rates. However, as you will hear, our underlying fundamentals of our businesses, especially in Japan, remain very strong.

So, let me talk briefly about our businesses outside of Japan. We take a very discerning view with regard to other markets, looking for growth markets that fit with our business model. And we don't think the word strategic is a synonym for unprofitable. We will only enter into markets that we believe we will be able to achieve our hurdle rates over an acceptable period of time, such as our acquisition of Habitat recently in Chile.

Brazil would be another country to highlight, which while still relatively small to Japan, has been growing nicely and now has about 14% of all our Life Planners and about 11% of all Life Planner sales.

Now, I mentioned product profitability as a real focus of ours, and you can see that the discipline we have with regard to hurdle rates results in high margins and high ROEs. Obviously, this environment has affected ROEs, but because of the product mix, the majority of which is recurring premium death protection and the quick actions we take that you'll hear about, we continue to produce high, and what we believe will be sustainable ROEs over time.

Now, despite everything you may hear to the contrary, we believe Japan remains a very attractive market. In large part, this is because of our business model, 60% of our business is through captive distribution and about two-thirds of our existing and new business is death protection.

As a result, we derive the majority of our returns through mortality and expense margins, which were not dependent upon spread. We've had a history of growth in Japan as you will see on the next page and hear from my colleagues, we believe there are numerous avenues for future growth. The business models provided stable cash flow that enables the business to return cash to its parent, and has returned more than 60% of after-tax AOI for more than five years.

Finally, we're in position – we're positioned well for the future. By virtue of the significant actions we have and we'll continue to take the response to the economic environment, the high quality and type of products in our existing book of business and that we continue to sell. And the way in which we considerably manage our portfolio, which Scott Sleyster will talk about later on today.

Now many people say that Japan is shrinking and therefore asked a question, how can you continue to grow and why do you continue to do business there? And it's true that the population is decreasing, but if you look at our target market, which is the top two parts of the bar, this market will grow by 12 million people from 1980 when we started the business to 2040, over a 60-year time period. Now, it obviously peaked in the middle in 2010, but the point is, there is still a very large market with significant needs going forward.

In the part of the market that is growing most quickly, represented by the dark blue part of the bar at the top, has significant needs for income, tremendous intergenerational transfer of wealth and healthcare, all of which require greater sophistication from the sales force, which is exactly our business model and what we have to offer.

So there are obviously challenges including the macro environment leading to regulatory changes to discount rates and mortality payables and the like. But these are issues that this management team has dealt with in the past and continues to ably navigate.

On the other hand, we do believe there are reasons to be optimistic based upon our unique distribution model, the opportunities presented by an ageing demographic, and our product expertise. And we hope that you come away from today with both the confidence and the optimism that we have in Kurashige-san and his team.

And so let me now turn the podium over to Kurashige-san. Kurashige-san has been with Prudential for 25 years and is only the third leader of our Japan businesses in over 30 years. So, Kurashige-san over to you.

## Mitsuo Kurashige

*CEO-Japan Life Insurance Operations, Prudential Financial, Inc. (Japan)*

Good morning. I will present an overview of Prudential's Life Insurance business in Japan. Prudential has established a strong presence in the Japanese market. To start, let me explain why we continue to believe that the Japanese market remains highly attractive to Prudential.

Next page please. As a result of building and management of our business, based on the differentiated strategy, we have been able to produce high yield returns than what you typically see in the Japanese market. And we believe, we can continue to grow our business driven by distribution expansion, our broad product portfolio and ongoing customer need for our product.

Let me elaborate on these points. Prudential Japan with its unique Life Planner model is positioned to continue to increase the number [ph] of core key (10:34) Life Planner as you have seen consistently over time. At Gibraltar, with a less consultant count now stabilized following the integration of Star and Edison. We are positioned to start to show stable growth going forward.

In Gibraltar's Independent Agency channel and Prudential Gibraltar Financial Life's bank channel or third party channels as we say. We seek to selectively expand while demanding solid profitability. At the [ph] product revenue (11:14), we've been hit from a broad collection of multi-currency product. In the second quarter, we had higher sales of foreign currency denominated product than yen denominated product.

Further, in connection with the ageing population in Japan, we see opportunities to use Life Insurance product to [ph] average (11:41) post retirement and its expanding need. And more broadly, satisfy the production need of our customers through our need-based sales process.

Key challenges are, this is on the right hand side of the table, to be specific, they include the impact of declining interest rates on investment returns, which has contributed to the need to the best product pricing to response the changing economic environment, which impacts the attractiveness of our services or product to customers.

The effect of divisions or [ph] expect of divisions (12:33), the standard discount rate and expect changes to mortality tables and the objective to continue to invest in system and infrastructure. In addition, there is a potential for increasing competition in third party channels, such as the Independent Agency and bank channel.

Next page please. As you can see on page 3, we have taken a number of actions on our product in 2016. This includes dividing the guaranteed interest rate, reducing commissions, and suspending sales of single pay yen denominated product. For product denominate in U.S. dollar on the other hand, we have expand product. We have introduced new whole life product in Gibraltar and expect to introduce more data this year and in 2017, at both Gibraltar and Prudential of Japan.

Next slide please. The chart shows the ROE of our Japanese business standalone since 2012. As you see, we have produced high returns historically, and expect to continue to produce strong ROE in the future, even with macro change [ph] facet (14:10). The next two slides show a profile of our overall broker business in Japan, as there was business we have sold more recently.

Page 5 shows our breakdown by product category. Death protection product made up nearly 60% of our annualized new business premium in 2015, while sales of retirement; saving and A&H product were well-balanced for the remainder. Our in force policies have a similar composition with the maturity of our in force broker business focused on death protection.

Page 6 shows the annualized new business composition by currency in 2011 and the first half of 2016. As you can see, we have experienced [ph] a ceased (15:17) from yen denominated product to U.S. dollar denominated product, with U.S. dollar product representing a higher percentage of sales than yen denominated product through June 30, 2016.

Next slide please. The chart shows the total value of the in force face amount of our Japanese businesses on a constant currency basis over the past five years. We have generated a stable growth over this time period led by our Life Planner – Life Consultant on [indiscernible] (15:56) Bancassurance and Independent Agency channel. Next slide please.

This slide shows the strong market position Prudential holds in the Japanese market. Based on 2014 data, Prudential ranks in the top five in new business face amount, new business premiums as well as total in force face amount. Notably Prudential was top 2 in new business face amount. Also premium income and total asset, we're just outside of top five at top six.

Next slide please. Now, let me explain how our businesses and distribution are organized to sell product to a broad cross-section of Japanese customers with different income and asset levels and varying life insurance needs. We benefit from a multichannel approach including our captive agent channel with Life Planners and Life Consultant as well as our third party Bancassurance and Independent Agency channels.

In our Life Planner channels, we – our life insurance – Life Planners, also [ph] diversed (17:26) an expand [ph] via (17:27) market through their all networking effort and [indiscernible] (17:31) including those that they get from their customers. Their primary target is the high net worth market, as well as business insurance and professional market segments. The Life Consultant channels targets a wider mid-market clientele and, notably, it has a strong presence in affinity market, particularly with the teachers market.

In our Independent Agency channel, we seek to grow through the active engagement of our marketing representatives, who teach sales skills and provide the training to agencies. In this channel, we have seen an increase in business insurance sales, as well as individual insurance in the professional market.

And finally, Prudential Gibraltar Financial Life insurance specialized in the bank channel. Through the bank, we are able to efficiently access high net worth customers and tap further into the – this protection need of customers. We have a differentiated strategies in the bank, as you will hear more later this morning from Soeda-san.

Next slide, please. This slide showed the productivity of our Life Planners and Life Consultant, as measured by the average policy sold per agent per month. As you can see, our proprietary distribution channels are very productive and this is one of the key of our success. We believe the productivity of our captive agent will exceed industry average.

Next slide, please. This slide shows the number of our Life Planners and Life Consultants that's a member of Million Dollar Round Table, a special prestigious group that represents the top agent in the Japanese market as measured by sales revenue. This data is as of April 1, 2016. Prudential of Japan again achieved first place of MDRT membership and has now achieved distinction for 19 consecutive years. Prudential of Japan employee [ph] more (20:20) 40% of MDRT members than the next project competitors, Sony Financial.

Gibraltar has also shown an increase in number of MDRT members, remaining third place in the ranking. Of [ph] significance (20:38), total number of MDRT members in Prudential of Japan and Gibraltar account for about one third of total membership in Japan.

Next please. I'd like to touch on the advantage and the challenges we see in our third party channels, namely bank channel and Independent Agency channel. Through these channels, we are able to access new customers that our captive agent have not been able to access. This enable us to leverage Prudential's brand and financial strengths to the benefit of greater cross-section of Japanese customers.

Further, by [indiscernible] (21:28) the sales experience of Prudential to bank and the Independent Agencies through training and the [ph] seconded (21:37) Prudential of Japan employees, we have been able to differentiate our service, and build longstanding relationship with our third party distribution partners. There are, of course, some challenges in the bank and the Independent Agency channels. Notably, sales volume can be more volatile. This is particularly true for the bank channel, where the amount of sales can fluctuate more widely as a result of adjustment in premium rates and other changes. It can also be more affected by contributive factors, such as the launching of new product.

Obviously we cannot control the factors in those channels to the same extent, we are able to – we are able with our captive agent channels which contribute to this greater sales priority. We accept a level of fluctuation in our sales table as [ph] a result (22:51). However, our main focus is on product mix and making sure we are remaining appropriate level of profitability. As a consequence, we have seen us take numerous pricing and product action, as the environment has [ph] evolved (23:15).

Next slide please. In closing, I'd like to leave you with the following three points; we are adapting proactively to current market environment. We have adjusted product and pricing aggressively as interest rates have declined and we have seen [ph] a shift (23:39) in our sales mix to more foreign-denominated product.

We generate strong margin and we believe that our strong margins are sustainable based on our differentiated business model and focus on sound risk management and asset liability management. And we continue to see growth opportunities through expanding distribution, leveraging product capabilities and benefiting from our lifetime customers relationship. Thank you very much.

## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Okay. We're going to start our – we're going to start our first Q&A session with Charlie and Kurashige-san. Just to remind everybody of the ground rules, please wait for the mic to ask your question, this is webcast. Please, and I beg you, keep your questions short and speak slowly, and one at a time with a follow-up. We are going to try to not repeat all the questions. So, that would be very helpful in that process.

You also may want to have your headset on for our Japanese speakers; their responses will likely be in Japanese and translated. So, with that, we can start the Q&A and the first hand I saw up was Tom Gallagher.

# QUESTION AND ANSWER SECTION

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Thank you. Tom Gallagher, Evercore ISI. The yen-based products that you are either repricing or suspending, which I assume are most of the whole life or retirement oriented yen policies. Can you comment on what percent of sales were in force premium this represents and is this a bigger challenge for Gibraltar or POJ?

A

So, yen products, in terms of the sales suspension of yen products, as to single yen, single pay yen products. We already suspended some of the sales. But the recurring pay whole life or other products, we don't intend to suspend the sales.

In terms of the share, I don't have the number at my hand right now to be able to answer, but that's the current situation.

**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

If I can just add a couple of quick things. I think over 80% of our products are recurring premium. So, that will give you at least some ballpark of some of the amount that we may have eliminated, because it's not all of the rest. Because most of the rest of the product is single premium fixed annuities, but we reprice those every two weeks.

So, of the – I'm just thinking off the top of my head, of the amount it's probably 2% or 3%, it's not a lot, but it was the stuff that was unprofitable and wasn't meeting our hurdle rate, so, we eliminated it. But that gives you sort of [ph] breath of justice (27:18), I think where we are.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

And that's the product that was suspended to only 2% or 3%?

**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

Yes.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

And...

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.* A

Well, we'll try and confirm that [ph] over that (27:31).

**Thomas Gallagher**
*Analyst, Evercore Group LLC* Q

And the product, can you provide a little color on the repricing of the other products and as – are you repricing both recurring premium, yen products and single pay?

A

2017 April standard reserve rate is likely to be [ph] upstated (28:04) and because of that – right now, standard reserve rate is 1%, but it's going to be lower to 0.25%. So, we have to take action against that, and we have to optimize our pricing for yen products, so we plan to do so.

Having said that, do we really need to change pricing for all yen products or not, we're still in progress of planning. So, we haven't decided the detail yet. But the reserve we have to accumulate based on the new rate, so which means we have to optimize our pricing. So, we have to take a necessary action.

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.* A

We'll now move to Ryan Krueger, who is...

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

Thanks. Ryan Krueger with KBW. Charlie, you mentioned mortality table changes as a potential risk. Can you comment on when the changes are expected to be implemented, and if you would be required to reduce your prices, and then lastly, if there's other offsets that you could take to offset those – that risk?

A

Yes. So, mortality table change is currently under discussion with an actuary association. It has still being discussed, but when and how much, those details have not been decided. Just like reserving rate, the mortality table, if that is changed, we would appropriately price our product; we like to take certain actions accordingly.

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

As a follow-up, I guess when new mortality tables have come out in the past, does the FSA actually require companies to adjust their pricing to reflect the new mortality tables or are there other things you can do to maintain the same level of mortality margins on new business?

A

So, basically FSA's policy is that reserving rate, the standard mortality table are established, and based on that reserve has to be accumulated. That is the rules by FSA. But, regarding pricing that is up to discretion of each company. But in many cases, regarding the changes, we are – many companies I think are responding to the changes accordingly.

In the past, historically, so, when reserving rates changed, we sometimes didn't change our pricing for one year or so. But, basically afterwards, we basically try to accommodate the pricing to the changing of the reserving rate.

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**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

The other -with the mortality tables is that there are a lot of factors that go into it. So, it's not as simple as to say that, the changing in the reserve rate. So, there can be offsets. So, the good news is we have time to think about it, we have time to see what the new mortality tables are, and we'll have time to react to it in a different way.

The other thing, let me just go back to, Tom, your question a little bit more, and that is the kind of changes that are being made. And I think what you'll see in the other presentations from our Japan colleagues is that they have not been shy about making changes and making changes quickly to react to certain changes that have taken place in discount rates and other things. So, you'll see not only the elimination of products, but you will see reduction in commissions or crediting rates, increasing in premiums.

So, they – there are a lot of tools in the toolbox or levers that they can use in order to protect the profitability and this – I think this team, frankly, is a role model for all our organizations here, around the world, and in the U.S. for being extraordinarily anticipatory about the changes they make in order to protect the margins, and you'll see that as in some of the presentations, the kinds of actions that have been taken.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Erik Bass.

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**Erik J. Bass**
*Analyst, Autonomous Research*

Q

Thank you. Erik Bass of Autonomous Research. You mentioned as one of the potential challenges, increased competition in third party channels. I'm just hoping you could expand a little bit more on what you're seeing or what you think you may see there? Thank you.

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A

Right. So, third party channel competition. Product need to be very attractive, so, product competition and also commission whether higher or low, the commission, competition are two things drawing attention a lot. However, when it comes to competition of commission, including Bancassurance, we are asked to disclose the commission, considering fiduciary duty, we have to maintain a commission at appropriate level. Just because commission is high, distributors should not recommend a product to the customer not considering customer's needs. That's the discussion here in Japan. So, I think commission competition will be a little bit alleviated because of this.

Our strategy is basically totally different from those competition. We focus on the producer at third party distributor, and make sure they sell death protection products, life insurance products appropriately to the customer considering the customer's benefit. We sell this if the benefit to the customer, and make sure customer is satisfied with the products and purchase the products. That is the process we take. So, I know there's a fierce competition out there, but we are not go in there. That is our strategy.

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**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

The other thing I might add is that we compete, if you look at our distribution model, we compete based on service. And, you well may roll your eyes and say how can you do that, but, it actually is the fundamental basis of this distribution model. So, we're very different than others, and let's say we have, 60% are captive agents and the Life Planners and Life Consultants, and you can see how many MDRT members we have. You can see the quality of the distribution of those people and the way in which they interact with their clients. Their lifetime clients, you'll hear this from [ph] Yuji Tonnison (34:55) and you'll hear it from others. It's a very different distribution model than many other companies here.

In terms of the third party, the other 40%, we also compete on surface. You'll hear about the seconded LPs in the bank channel, you'll hear about how we have reduced the number of independent agents that we do business with by half in order to compete or in order to do business with the companies that appreciate the level of service that we provide. And that level of service is a real differentiator, and as a differentiator and a source of competitive advantage, enables us to sell product, especially as Kurashige-san recurring premium death protection, in a way that others don't. And that's a real point of differentiation for us.

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**Erik J. Bass**
*Analyst, Autonomous Research*

Q

Thank you. And I'd like to follow-up specifically for competition on dollar denominated products, as you've seen more that the domestic competitors pivot towards offering those products. Have you seen an increase in competition?

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A

All right. Domestic players, I mean I'm not sure if I should represent them and say something, but the other products are newly launched. I heard the rumors, some companies are planning to do that, I think you know more than I do actually. So, that maybe the case, but the dollar products, to sell dollar products in reality in the market, customers are going to take forex risk.

So, you need to be able to explain that, disclose the fact, make sure a customer understand that and buy it. And we in Prudential program, we have a suitability program over the phone call. We confirm the customer, make sure there is no misunderstanding and customer will agree to take the forex risk. So that procedure takes a lots of effort, it's not easy thing to do. But we already have experienced over many years, over few years, so we accumulated [ph] know how's (36:55).

So, to make sure a customer, to understand the risk – disclosed risk, otherwise it's very inappropriate to sell products with the risk. So, new companies, if it's going to enter the market have to take – go through the sales process. To be more – but I don't really know which company will introduce what products to the market.

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**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

The other point I would make is their dollar products in their dollar products, right? You can have much more simple dollar savings products, and then you can have more complex dollar death protection products. We focus, and this is a recurring theme you'll hear on death protection. That is not easy to sell, you overlay on top of that multi-currency death protection. That's a really difficult sale. And therefore, you need very sophisticated people, who have real knowledge and can provide the level of service in order to sell those products. And we – again, we think that, that's a sustainable source of competitive advantage for us.

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**Alan Mark Finkelstein** A
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Eric Berg, the green shirt, yup. Thanks.

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**Eric Berg** Q
*Analyst, RBC Capital Markets LLC*

Thank you. Eric Berg from RBC. I'm actually going to ask a different question from the one that I was going to ask because of something you just said. So, thank you. I just find it – and I'm hoping you'll go beyond saying it's a cultural thing. I just find it really surprising that Japanese nationals – the wealthy Japanese nationals would be willing to take a chance on the value of the death benefit that their family is going to receive upon the policyholder's death based on foreign exchange risk. I mean, I could understand – that's just what I want to say, and maybe you could response to that. Why would a person who presumably is buying the coverage to know that his or her family will be okay after that person's death take a chance on the foreign exchange risk?

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**Mitsuo Kurashige** A
*CEO-Japan Life Insurance Operations, Prudential Financial, Inc. (Japan)*

Right. So, first, our approach on need-based sales is that we try to find out how much customers need of this protection. We first think about it and maybe ¥30 million is necessary for one particular customer and how then – how it can be covered. For example, it can be a whole life product, then with this current pricing, yen whole life and the dollar whole life, if you compare them, yen whole life tend to be more expensive for customer, then for customers payment capability may not be strong enough, so that customer may prefer a dollar product or maybe variable insurance maybe chosen possibly. Then, why even taking FX risk the customer would like to purchase dollar insurance, it's because dollar whole life interest rate – the guaranteed interest rate is higher, so premium tend to be lower.

So, the customer can purchase a lower pricing death protection, but this protection maybe fluctuate, likewise premium may fluctuate. So, that range of a fluctuation should be acceptable range for the customer. That is what we focused on. So, I don't know if I answered your question sufficiently, but the FX risk perspective, Japanese people accept that relatively. That is what we think. And customers, even there is a FX risk, customer accept it, because they understand it. That's how they purchase the product. And we further confirm their understanding on suitability program.

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**Eric Berg** Q
*Analyst, RBC Capital Markets LLC*

My one follow-up question relates to the...

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**Charles F. Lowrey** A
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

One sec.

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Eric Berg
*Analyst, RBC Capital Markets LLC*

Q

Oh, sure, sure.

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Charles F. Lowrey
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

Just two other quick comments. So, what Kurashige-san is saying is you can buy more death protection for the same amount of premium. And so, you look at the variability of that in the FX, and if the downside is still acceptable ,then they have upside. So, that's the first point. The second is the Japan consumers don't take a lot of investment risk, right? Most of their investments are either in fixed income or cash. You won't see them a lot in equities or other things. So, if you have a bucket of risk, if you will, and they want to spend that bucket here, they're not spending it anywhere else. So, it's not like they have half their portfolio in equities, which could go up and down and other things. So, this to them would be the one area, where they might take a risk. And then if you look at all of their assets, this would be an acceptable level of risk.

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Eric Berg
*Analyst, RBC Capital Markets LLC*

Q

My second question relates to your intended focus on the estate planning market, your interest in the estate planning market prospectively. My question is, in the United States, of course, the estate planning business is tied up closely with taxes, in particular, the estate tax or the inheritance tax. Briefly, is it similar here? Do you expect increases in the estate tax? My question in other words is what is the role – what is the connection here between life insurance and estate taxes, and what is the outlook for the estate tax?

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Mitsuo Kurashige
*CEO-Japan Life Insurance Operations, Prudential Financial, Inc. (Japan)*

A

So, inheritance tax rate increased about two years ago. So, the inheritance tax measures are based for the – make lots of financial institutions product, new product released. In Japan, the concept is how to use life insurance products. So, inheritance is when the person dies, which happens only one time in life. But the asset to transfer every year, while you still live, you can give the estate by gifting to your children, then you can reduce the inheritance tax.

For example, if you have $200 million of estate every year, if you want to give the estate to two children by ¥3 million, then that could be converted to the premium – of recurring premium of life insurance. Then, of course, he or she has to pay like 10% of tax. But every year, like ¥6 million in decrease, and that would be ¥60 million, and eventually ¥120 million in 20 years. Then because ¥18 million, that would be at 30% of the tax. So, that's how the inheritance tax and gifting tax structure is structured.

So, that's why we can apply recurring premium life insurance. That's how their needs can be satisfied. So, what to be left to which child, if you have a lot of children? You might have a real estate property, then maybe you can give the real estate property to your son, and this claim can be given to the second son, for example. So, life insurance – through life insurance products, you can directly give your financial assets to your child. Otherwise, your house, your land has to be split. Then that is another way to use the life insurance.

So, there are lot of consultations around use of life insurance, then that's how we try to plan based on the customer needs. So, with the use of life insurance, that is very important. Of course, life insurance – with the life insurance, there is a tax advantage as well. But including that, there are lot of different cases that we can apply life insurance to – for the major of inheritance tax. That is what currently we're doing.

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

[ph] Jimmy? (45:18)

Q

Thank you. Thank you. So, you've grown your Japanese business partly through acquisitions and hugely during times of distress. Obviously, low interest rates are creating some challenges, but not extremely severe yet either. But, what's your view of the environment for the type of deals that you tend to do here? And what's your appetite for additional deals in Japan, given that the business is becoming a bigger and bigger portion of the overall earnings?

**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

So, the current situation is that it is creating some stress in obviously the Japanese market with Japanese companies, but not undue stress at this point. So, we don't see any obvious acquisition opportunities.

To speak about opportunities, I think, we're in a really good position that they're nice to do, than they'll have to do. If something came up, we would look at it. But, our view is that we have an extraordinary business here. And, the last thing we'd want to do is to challenge that business in any meaningful way. So, if something came up that was a potential bolt-on, would we look at it? Sure. But, the proof of concept would be extraordinarily high. We really like the business we have here. We think it's extraordinarily well run. And we'd be very cautious about doing something.

Q

And then, just since you're already here. You're not discussing your Chilean business, obviously, but there's been a lot of talk about pension reform in Chile and different proposals being thrown around. What's your view of, if and what form, pension reform in that country will take? And how does that effect Habitat?

**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

A couple of comments. The first, let me comment on Habitat itself. We really like the company. We like the management there, it's the second largest pension fund manager. It has the lowest fees of any company, which we think is a very good fact. It also has extraordinarily good investment performance. So, in terms of the kind of dynamics and metrics of the company itself, we feel very good about it and where it stacks up in relation to all the pension managers.

The situation, as you say, I'll use a word euphemistically, is fluid at this point. We are monitoring it very carefully to see what the government response will be. I think the government inherently is very supportive of the existing structure, but there's obviously a populous movement to make some changes to it. The thoughts that have been [indiscernible] (48:18) by the government this time are kind of, at this point, are at the margin, but it's something we are actively looking at trying to help manage, et cetera, and we'll see what happens. Way too early to make any predictions at this point. But we do think relative to the field, we're in a very good position in terms of having the lowest fees and some of the best performance, but more to come.

Q

Thank you.

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Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Okay. I think we're going to take our first break. So, we will break for 15 minutes. If we can be back then, that would be appreciated. Thank you.

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# MANAGEMENT DISCUSSION SECTION

## Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Let me just go back to Tom Gallagher's question. And the answer that Charlie provided was correct. So, if you look at the single premium whole life yen product in 2015. It represented about 3% of total sales.

So, okay. The next section is going to cover the three business units. And we will start with a presentation on Prudential of Japan by Ichitani-san.

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## Shoichiro Ichitani
*President and Chief Executive Officer, Prudential of Japan*

Hi. Thank you and good morning. I am Shoichiro Ichitani, President and CEO, Prudential of Japan. I'd like to discuss our Life Planner model, which is a foundation for the overall business of Prudential International Insurance. The sustained track record of performance, we have achieved at POJ and our continuing growth opportunities.

This graph shows a steady growth of our in force business, since POJ commenced the sales in 1987 after its formation as a separate company, following Prudential's initial entry to into the Japanese Life Insurance market through a joint venture with Sony.

Our core principle of providing life insurance solutions through needs-based selling by full-time professional Life Planners, is a differentiated superior approach in the Japanese market. And it's appeal to customers, together with our execution, have supported steady growth of our in force business over 28 years, since we begun business.

Our 20-year compound gross rates of 9% reflects our rapid growth from start-up driven by the success of our model. The sustained mid-single-digit growth over the past 10 years, including through the financial crisis and the many challenges in the business environment reflects the resilience of our model, As we continue to adhere to the principles, that drove easily our success.

This is our sales trend by product category. Our sales in 2012 reflected increased purchases of certain products due to tax role and pricing changes. While events such as these can have an impact on our sales attempt in the short term, our trend is largely driven over time by growth of our Life Planner force.

Over the past five years, we achieved an 18% average annual compound growth rate in death protection products, including term life and whole life. The contribution of these products to our overall sales has increased, while the share of retirement business has declined, reflecting our adaptation as declining interest rates made it more challenging to provide attractive value propositions for customers and products with greater cash accumulation features.

We have the key drivers you'll see here as measures of the underlying success of our distribution model. Our Life Planner count has consistently increased at a moderate pace, affecting our high-safety recruiting and superior agent retention. Productivity measured in times on both annualized premiums by policies sold. And number of policies sold by Life Planner per month has been sustained at levels that are well above what we would consider typical in the market, reflecting the quality of our agents.

And this graph shows growth of our insurance revenues, including premiums, policy charges and fees on a constant dollar basis. Revenues have increased consistently along with the growth of our in force business, affecting both our sold sales results and superior persistency, driven by customer satisfaction, achieved through our needs-based selling approach and the ongoing side support of our Life Planners.

This is an illustration of what we call the beneficial cycle of our Life Planner model, which drives the strong key indicators of success that I discussed. The high-quality service our customers receive from our Life Planners, which start with a comprehensive evaluation of life insurance needs, leading to an appropriate product solution and support by highly skilled professional advisor, through this is a high level of customer satisfaction. This drives strong policy persistency and quality referrals to our Life Planners, reinforcing their high productivity and income levels. This, in turn, drives a high level of agent retention, and agents who stay with our company for long careers can support the financial security needs of their customers over a lifetime. With our diverse portfolio of quality products, the outcome is our sustained track record of superior returns and steady growth.

Our high level of customer satisfaction has been externally validated by superior rankings in surveys by J.D. Power. In these surveys, the customer satisfaction level was assessed by categories, covering, acquiring policy claims handling and policy service. And Prudential of Japan has consistently ranked at or near the top in each of these categories.

Here are some key drivers of our ongoing growth opportunities. These include continued growth in our Life Planner count, the prospect of Second Sales to the customers over a lifetime. Retirement and estate planning needs of an increasing older population and the experience and the skills of our Life Planners in offering in U.S. dollar products, emphasizing recurring premiums for which demand has increased in the current Japanese interest rate environment.

This is an illustration of the changing needs we serve over a customer's lifecycle. And in the market that are the main focuses of POJ. As you can see, need for financial products grow over time and the key types old product that fit these needs change. Our Life Planners draw on their training and experience to propose solutions tailored to the different needs of each client and a comprehensive product portfolio can meet a broad spectrum of these needs.

This slide shows how we have benefited from the Second Sale opportunities that arises as a result of long tenured Life Planners maintaining relationships with their clients as trusted advisors over a lifetime. Nearly, 800 of our Life Planners have more than 15 years of experience with us, and their client relationships average more than 10 years. These relationships bolster our future growth prospect. The experience the Life Planners serves increasingly sophisticated needs of their clients, especially our core customers, who are in their 30s to 50s. They move toward retirement and begin to consider estate planning needs.

This just shows sensitivity of the growth of our in force business at various levels of sales. With our high policy persistency, we would project that continuation of our 2015 sales level over five years, would produce an 18% total increase in our force business – in force business by year-end 2012 – I'm sorry 2020. With that level of sales more than offsetting expected runoff from lapse, surrender and mortality.

Assuming continuation of the strong persistency we have enjoyed for many years, we project a flat in force, looking five years forward in a stress scenario with annual sales over the period 36% below the level of 2015. We're well positioned to meet the challenges of the current environment and actively managing product portfolio to maintain appropriate return expectations with low and negative yen interest rate.

As I discussed, the core focus of our business model is on recurring premium death protection products with returns mainly driven by solid mortality and expense margins. We've increased our emphasis on U.S dollar products, while taking actions on yen products, where returns would be compromised, but declines interest rate. In addition, our strong asset liability management reduces our exposure to reinvestment, deinvesting at lower years. Scott Sleyster will cover this in detail later today.

In summary, our proven Life Planner model has driven an industry-leading level of customer satisfaction. Superior sales productivity benefiting from the [indiscernible] (01:01:42) by satisfied customers and strong agent retention, as our Life Planners are rewarding for their high quality performance. We will continue to pursue steady growth of our Life Planner force over time through the selective recruiting, that is a key element of our model. And we are actively managing to the current market environment, as we have a variety of financial market developments over our history, with effective product and asset liability management strategies, mitigating our exposure to grow interest rate. And we remain confident in our prospect for continue superior returns and steady growth.

Thank you very much.

## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Okay. Our next speaker will be Yamauchi-san to talk about our Gibraltar Life business, which includes our Life Consultant and Independent Agency channels. Okay.

## Kazuhiro Yamauchi

*President and Chief Executive Officwer, Gibraltar Life Insurance Co., Ltd.*

Good morning, and thank you for participating in our – to the Investor Day. I am Kazuhiro Yamauchi, President and CEO of Gibraltar Life. I joined Gibraltar Life in 2007 and became its President in April of this year. During my nine years with the company, I have seen it meet many challenges and achieve substantial growth. Today, I would like to share some key aspects of our business model and strategies, that we believe Prudential Life will continue growth and solid returns.

Today, Gibraltar Life is a product of series of successful business acquisitions and integrations, with the common theme of consolidating under Prudential's proven business principles to build a stable foundation for solid returns and growth prospects. Following the integration of the Star and Edison businesses, after our acquisition in 2011, we have stabilized the agent count and achieved a more cost-effective capital distribution system. And the Life Consultant force is now positioned for organic, growth.

We benefit from a longstanding distribution relationship with the Japanese Teachers' Association which is called [indiscernible] (01:04:25). We have complemented our Life Consultant distribution, with an Independent Agency channel commencing in 2009, focusing on protection products consistent with our business model. We have achieved solid returns results through challenging financial market conditions. Our focus on death protection products, strengthening U.S. dollar and other non-yen products and strong asset liability management have mitigate our exposure to low and negative interest rate in Japan. In addition, we are actively managing our product portfolio to maintain appropriate expected returns.

This is a view of the acquired companies that integrated to comprise today's Gibraltar Life, which began with Prudential's acquisition of Kyoei Life in 2001, following its bankruptcy. The restructuring of Kyoei left us with a large broker in force business with very attractive returns. And we built upon this business by leveraging many of the principles of our successful Life Planner business at Prudential of Japan. With this solid foundation, we acquired and integrated Star and Edison and another company called Yamato.

Leading to a structure with broad coverage of the Japanese market through our Life Consultant captive agents, independent agents and the bank channel through our PGFL subsidiary. So, Soeda-san who had PGFL will discuss the bank channel.

The Life Consultant and Independent Agency channels each follows our basic strategy focused on death protection products with face-to-face selling based on customer needs. In both channels, choosing the right people is the key to success. For Life Consultant, we focus on selection and training of quality agent. And for agency channel, it is vital to form relationships with quality partners and cultivate marketing and sales representatives to work effectively with the producers. These channels complement each other by focusing on different customer segments. The Life Consultant focus on middle class client and teachers across the nation, giving us a broad geographic reach across Japan's prefectures, while the agency channel mainly focus on upper middle class customers in urban market as well as the business and professional market.

This slide show the relative contribution of the Life Consultants and agency channel to Gibraltar Life sales and policies in force, excluding the bank channel. The agency channel contribute 27% of 2015 sales, a meaningful complement to the sales of our Life Consultants. The Life Consultant channel accounts for 94% of policies in force, reflecting the vast majority of business that came to us through acquisitions as well as the channel sales contribution.

I will discuss each of the channels in the subsequent slides. Starting with the Life Consultant channel, you can see a large increase in the count for 2011 when we acquired Star and Edison followed by a decline which we expected as we integrated the businesses adopting Prudential's productivity and quality standards by our compensation and emphasis on death protection products.

After the integration, you can see the stabilization and the modest increase in the count in 2015. And we have returned productivity to pre-acquisition levels. This was the same pattern we experienced in the early 2000s when we transitioned the former Kyoei agents to Prudential's model. We will pursue further growth at a measured pace as we appoint additional experienced Life Consultants to field management positions to support our selective recruiting with an emphasis on quality.

This slide show the broad geographical coverage of the Life Consultants channel, providing access to our major customer segments across the nations including teachers, members of self-defense force, and general customers in both urban and less densely populated area.

We cover all of Japan's prefectures with 83 branches and nearly 740 sales offices, enable us not only to enjoy broad sales reach but also to provide high-quality service for our policyholders. The teachers market accounted for 27% of our Life Consultant sales in 2015. We offer the exclusive products for this high, attractive market, [ph] appealing (01:10:29) to new teachers entering their careers, experienced teachers with changing insurance needs, and [ph] retiring (01:10:39) teachers with products appropriate for each career phase.

Let me provide some additional detail on the teachers market. Our relationship with the Teachers Association in Japan dates back to 1952 when it was established by the former Kyoei Life. We gained direct access to public school teachers and support employees through this organization under a relationship of trust built over more than 60 years.

This is a large-scale market, providing access to about 35,000 schools with roughly 950,000 teachers, which we serve through approximately 5,000 Life Consultants. This market is important to us not just for its size but also for the perennial sales opportunities that arise from new teachers entering their career each year and [ph] annual mandatory teachers' (01:11:46) retirement.

Moving to our independent agency channel. Independent agency distribution is highly competitive with many companies seeking sales through agencies based on products and commissions. Gibraltar Life, however, has approached this channel with a clearly differentiated strategy. This strategy includes pursuing quality long-term relationship rather than just augmenting policy sales, avoiding price competition as a key to winning sales, and building strong partnership with agencies who [ph] resonate (01:12:33) with Prudential's approach.

Agency distribution is based on partnership, and we cultivate high quality business-to-business relationships rather than attracting and retaining the agencies through the commission levels. We provide solid support through highly skilled, trained marketing representatives. As you can see in the chart, we have grown the number of these representatives and now support our monthly average of about 1,500 active producers. We see the agency channel as a growth opportunity. And we expect to continue to increase [ph] our complement (01:13:20) of marketing and sales representatives while cultivating additional agency partners.

This slide presents sales trends for our Life Consultant and independent agency channel. For the Life Consultants, you can see the jump in sales when we acquired Star and Edison in 2011 and the decline as we integrated the businesses, including implementation of Prudential's distribution model. As we expected, attrition of mainly newer producers had a negative impact on sales. With the count now stabilized and productivity return to pre-acquisition level, we are back on the path to sales growth for the channel.

Sales for the agency channel first became significant with the relationship that came to us in 2011 through the Star and Edison acquisition. And both in that year and 2012 reflected elevated demand for certain products by business customers in advance of tax law change. After those years, you can see modest growth, reflecting our development of the channel. As you see here, each of the channels emphasize this protection product. The fixed annuities are mainly U.S. dollar products with market value adjustments in the event of premature surrender.

This chart shows the sensitivity of our in force business at various level of sales. Since Gibraltar Life was built on the foundation of large acquired blocks of business, there is substantial expected annual business runoff. If sales were to continue to over five years at the same level as 2015 and all else held constant, we would project that this would more than offset expected attrition and produce a 4% total increase in our business in force. With a similar assumption of unchanged lapse rates and other factors, we would project a flat in force looking five years [ph] forward (01:15:55) in a stressed scenario with annual sales 7% below the 2015 level.

Here is some key productivity data. For Life Consultant, we have stabilized the count and as I mentioned productivity in terms of both annualized [ph] premium per sale (01:16:20) and policies sold per agent per month has increased since our successful completion of the integration of Star and Edison. For the agency channel, [ph] an initial (01:16:34) decrease in agency count as we focus on relationships with partners who we identify as best fit for our strategy as part of the business integration followed by modest growth.

To summarize, Gibraltar Life has built a solid earnings base through successful acquisition and business integrations. We have applied key principles of Prudential's business model to grow a strong sales and marketing organization, emphasizing death protection products. Our Life Consultant and agency channels provide broad national coverage over the Japanese life insurance market to meet protection needs. And with our diversified product portfolio, emphasis on products driven by mortality margins and solid asset/liability management, we are well positioned to generate strong earnings even under the challenging current environment.

In the 15 years since Gibraltar started operation as a Prudential company and almost five years since the merger that [ph] forms our fine (01:17:59) structure, we have built a strong foundation to generate stable earnings and growth. And I will continue to make every effort to make the foundation stronger and bigger. Thank you for listening.

## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Okay. The next presentation will be on the bank channel. Soeda-san will give his presentation in Japanese so if you could please put your headset on if it's not on already.

## Takeshi Soeda

*President & Chief Executive Officer, Prudential Gibraltar Financial Life*

Thank you and good morning. I am Takeshi Soeda, President and CEO of Prudential Gibraltar Financial Life or PGFL. I will discuss Prudential's highly differentiated strategy in the bancassurance market in Japan. During the 12 years since we entered bancassurance, we have consistently grown a stable business on solid foundation, focused on death protection products through a changing business environment including the financial crisis and declining interest rates.

Next slide please. The bancassurance market in Japan, similar to Europe and other parts of the world, is mainly focused on saving type product. In contrast, [ph] we conduct (01:19:45) a business model that is differentiated from other companies in this market by pursuing high-quality business with emphasis on death protection products that provide solid mortality-driven margins.

What differentiates our business? There are four main points. First is our core business strategy, emphasizing death protection products and recurring premium policies in particular. This foundation of our business model supports achievement of stable results that are resilient to changes in the financial environment. Second, we provide high-quality sales support through former Life Planners who are seconded to certain of our partner banks and through highly skilled wholesalers. This support is key to our focus on death protection products which are more difficult to sell than saving type product.

The third point is that our insurance product portfolio features non-yen products mainly U.S. dollar denominated which are highly attractive to bank customers with substantial deposit funds. The fourth point is our active product management. We seek to maintain appropriate expected returns by responding to changes in the financial environment by adapting our product portfolio, including ongoing review of pricing and commissions and suspensions of sales where necessary.

Next please. Here is a view of the customer pool that can be accessed through bancassurance in Japan. With our aging society, those who are aged 50 or over comprise 46% of the population, and this senior population owns 85% of total household financial assets. And this is very distinctive to Japan. This senior population represents the main customers of our partner banks for their financial deposit products. And our sales channel can effectively approach these customers through the banks. Currently, a large volume of variable annuities and similar products sold several years ago are reaching maturity. And at the same time, the banks hold trillions of dollars of term deposit, together creating a substantial opportunity for sales of insurance products. Direct access to this opportunity is one of the trends of our bank channel.

Next please. This slide shows a number of our partner financial institutions. We have established partnerships with all of the mega banks in Japan, several leading trust banks, many regional banks, and the largest securities company. With 75 distribution partners, we have a leading foundation in bancassurance. The broad network of these financial institutions covers a wide area across Japan, giving us broader national access to a highly attractive customer pool.

Next please. We offer a comprehensive product lineup through our 75 partner financial institutions mainly consisting of protection products, such as whole life insurance with a broader product portfolio than other companies engaged in bancassurance in Japan.

Next please. This slide shows the relative contributions to our sales by product type for the year 2015 and the first half of 2016. In 2015, non-yen product contributed 69% of our sales. The percentage contribution of these products, which are mainly U.S. dollar denominated, grew to 78% for the first half of 2016. With emerging negative interest rates on Japanese government bonds, we suspended sales for single premium yen-denominated products, leading to the decline in the overall contribution of yen-based products to our sales. However, at the same time, we grew our sales of non-yen products, primarily U.S. dollar denominated business, and achieved a 12% increase in sales for the first half of 2016 on a constant currency basis.

Reform of the inheritance tax system effective in January 2015 enhanced our bancassurance opportunity. Life insurance can serve as an effective solution for inheritance planning and lifetime gifting. The confidence customers place in banks for consultation in these areas enhances the value of the banks to us as distribution partners.

Sales support to our partner banks is one of our key strengths, so that's something I would like to cover now. Since regulatory changes made sales of all insurance products through banks possible commencing in 2007, we have actively developed sales of protection life insurance products by leveraging Prudential's product and marketing expertise.

With our focused development of skilled sales resource over the past eight years, we now have about 130 wholesalers providing sales support to banks. We also have 240 of what we call insurance consultants or so-called IC who are former Life Planners that we have seconded to banks to directly sell life insurance products at bank branches and also to train bank employees so that they are able to sell our products on their own. We have enhanced this program through rotation between IC and wholesalers, and we now have many skilled professionals in the banks who can both train and sell. This is a strong competitive advantage for us.

Please go to next slide. Let me expand on the insurance consultant, IC secondment model. Under this model, former Life Planners apply their experience and expertise in selling life insurance products directly within the banks, resulting in two major benefits for our bank distribution partners. First, the banks can realize significant life insurance sales at early stage of the relationship with us as the insurance consultants sell directly to the customers. And second, the banks can leverage skills of these professionals through their training of employees at the branches to sell protection products on their own. The growth in the numbers of insurance consultants shown in the chart [ph] we expect (01:28:35) to support [ph] for this approach (01:28:37) in leading banks re-enforced by its success.

Next slide please. This slide shows our sales trend. Over the past five years, we achieved a 14% average annual compound growth rate in sales of the death protection products. We emphasize sales of other products are more opportunistic and therefore, vary over the time.

Next slide please. Even in the challenging current environment, we can achieve stable result and appropriate expected returns through active product management. For example, in response to declining and negative yen interest rates, we suspended sales of yen-denominated single premium products early this year as I mentioned earlier.

In addition, in June 2016, we reduced the discount rate for advance payments on yen-denominated recurring premium products and suspended acceptance of full-year advance premiums on our yen-based increasing whole life products. We'll continue to actively manage our product portfolio considering interesting rate trends and to emphasize sales of U.S. dollar-denominated products.

And next one is my last slide. In closing, let me summarize the strength of our bank channel. First, in Japan, the majority of household financial assets rests with the senior population, which we can effectively address through our partner banks. Second, we've leveraged Prudential's sales expertise for protection products to develop a solid competitive advantage for the bank's channel over the past eight years.

Third, we focus on sales of recurring premium protection products with earnings driven by solid mortality margin emphasizing U.S. dollar products as a core element of our strategy. Fourth, the growth of intergenerational wealth transfer in Japan coupled with the reform of inheritance tax system has enhanced our opportunity in the bank channel.

Finally, our ongoing active product management supports our achievement of stable results and maintenance of appropriate expected returns through the challenges of a changing financial environment including today's low interest rate. By building on the strength on our differentiation strategy in the bank channel, we have solid prospects for continued growth of high-quality business, focused on death protection products.

Thank you for your attention.

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## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

[indiscernible] (01:32:00).

# QUESTION AND ANSWER SECTION

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Okay. We're going to start our second Q&A session. Before we open the mics to the audience, I did receive a question at the break related to the prior session. So, let's tackle that one first. And the question related to specifically what our margins on yen and non-yen products and how do they compare. We don't give product-by-product margins, of course, but I thought, maybe Kurashige-san and potentially Charlie will want to have some comments on this before we get started with the second Q&A.

**Mitsuo Kurashige**
*CEO-Japan Life Insurance Operations, Prudential Financial, Inc. (Japan)*

A

So, yen and non-yen product margin. So, yen products include whole life or term insurance [ph] varies (01:32:58). So, as a [ph] growth wise (01:33:00), it's difficult to express about margin. Investment spread, about investment spread, it would be better or higher with a non-yen, but yen, so we can get mortality margin with yen. So, overall, the margin perspective, we are comfortable with our current margin level.

**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

If I may add a couple of comments to what Kurashige-san said, I think it would sort of stretch the realm of credibility to say that our margins on our yen products haven't gone down. So, they have a little bit. I think there are a fair number of mitigants in place. One is the speed and severity of the kind of changes that our Japanese colleagues have made to many of the products.

The second is obviously the kind of products we sell, right? So, again, over 80% of what we sell is recurring premium and death protection. So, there is just by nature of the kind of products we sell, there is a certain mitigation to the effect of interest rates because as Kurashige-san said, we're not as dependent upon spread. Having said that, the returns have gone down somewhat, but I think the mitigation of some of these other actions are very powerful and have really limited the damage that could be done.

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Right. Okay. Right. Yaron, in the middle.

**Yaron J. Kinar**
*Analyst, Deutsche Bank Securities, Inc.*

Q

Thank you. Yaron Kinar with Deutsche Bank. My question pertains to the Life Planner business. So, as I understand it, there is aging in the Japanese population. There is an increased demand for more sophisticated products as one ages. So, why aren't we seeing an improvement in productivity as that trend continues?

A

So, aging society and you're talking about our productivity against that sort of aging society. Productivity is not going up. Is that your question? Basically, POJ is focused on death protection products, so-called need-based sales of death protection products. It's a recent growth. We hire a lot of young Life Planners especially those in 20s and 30s. So, there are lots of unserved demand of death protection. So, we are mainly focused on those young family to meet their death protection needs, and we're so doing that. But gradually, those Life Planners also accumulate their experience. Then they will shift to more aged customers. So, in the future, we have lots of room to grow in those senior segment of the market.

POJ, since the commencement of business, it's about 30 years or so. So, captive agent recruiting, we hire around 30 years old people. So, we started 30 years ago, around 30 years old people. And now, they are hitting 60 years old after 30 years. So, people in 30s serve their own generation customers at the beginning. They're called their so-called x-market, y-market, which is their acquaintance market or family market. They are about the same age with the Life Planner. Now, their customer also grow together with Life Planners, and they are hitting around 60 years old, which is a little bit different from Japanese demographic society as a whole.

So, we'll see more senior customers going forward. But right now, we don't have that [ph] many senior (01:37:05) customers. That's because our demographic of Life Planner is different from Japan's demographic.

Charles F. Lowrey
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

If I can add one other comment and that is six policies per month is an extraordinary number. If you look at the average policies I think for all of Japan agents, it's about 1.8 to 2. So, you have 1.8 o 2. You have Gibraltar at 3 to 4. You have POJ at six plus. They red line at some point. You can't do more than that.

So, the fact that there is a tremendous opportunity, they're producing at six-plus policies per month. They're kind of maxing out there. So, you might be able to do a few more in certain months, but in general, that's extraordinarily productive.

So, that's why I think Ichitani-san has focused on adding to the Life Planner count because there is more opportunity there, but just human beings can only do so much. They have to actually sleep. And so, it's pretty impressive that they are able to continue at that level of productivity for that long, which is why you see how many MDRT members there are.

Yaron J. Kinar
*Analyst, Deutsche Bank Securities, Inc.*

Q

So, my follow-up would be assuming that the six product sales per month continue, should one over time expect the premium level for that average sale grow?

A

Well, the youth customer is addressed by young Life Planner versus older Life Planners with older customer relationship and the product nature also change. So, one Life Planner, amount of the premium they sell become bigger according to the different customer they sell. We don't really plan by the company but customer environment change and age change, then volume of premium is likely to increase. We can imagine that.

Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Okay. Two rows behind Yaron.

**Humphrey Hung Fai Lee**
*Analyst, Dowling & Partners Securities LLC*

Q

Humphrey Lee from Dowling & Partners. I think from the POJ comments earlier, you talked about second sales, I guess. Maybe can you give us some statistics in terms of customer penetration, maybe like number of policies per customer, and how does that compare to the industry?

A

So, the second sales volume-wise, as Kurashige explained earlier, the young LPs are getting older little by little. They are just about – have started to address that in particular. So, one protection per household but after that, their children. When the children gets older, maybe you can sell additional products to the household. That story is ongoing. So, I don't have a specific number compared to other companies. So, the expansion of count should be realized by our need-based sales. We are observing that trend currently.

**Humphrey Hung Fai Lee**
*Analyst, Dowling & Partners Securities LLC*

Q

And then shifting gear a little bit, I think two years ago, you guys talked about the change in inheritance tax and how that creates potential opportunities for more life-related sales. So, looking at kind of the past two years in terms of death protection sales, do you have a mix in terms of pure death protection-driven sales versus inheritance tax or tax planning type of sales in your sales mix?

A

Right. So, people in 20s or 30s need death protection for their life. They purchase death protection in that segment of customers. But after that, 10 years later, 20 years later, the customers become 40s or 50s in age. Then as a second opportunity [ph] than in (01:41:25) past two years. In particular, Life Planners started to talk about inheritance needs. So, additional sales, in terms of that, customers in 40s or 50s are buying more insurance for the inheritance needs. So, the initial pure death protection sales compared to the pure death protection volume is not that significant yet, but we are trying to enhance that direction.

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Soeda-san, do you want to address that as well?

**Takeshi Soeda**
*President & Chief Executive Officer, Prudential Gibraltar Financial Life*

A

Right. So, life insurance, in case of death protection, there is the protection of death or also retirement saving or nursing care needs or estate planning. There are many ways to use – there's multiple purpose you can serve with the policy. It's really hard to draw a line [ph] this product goes (01:42:25) with this purpose. But just before break of the first session, we talked a little bit about estate planning and we can do the gift. So, you shrink. You do the gift so that then you can shrink the inheritance assets itself. And that sort of solution seems to be active in our product if you look at the policy, customers using our policy to do that sort of solution.

**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Tom Gallagher?

Thomas Gallagher
*Analyst, Evercore Group LLC*

Q

Thanks. Tom Gallagher. Question on page 12 in the POJ slide. You show the in force sensitivity to sales being down zero to 50%. I get the punch line here is to highlight the benefits of high persistency. But is the other point that we should be taking away from this that you expect the sales environment to be challenged? Can you comment at all about what we should be reading into this slide?

Charles F. Lowrey
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

I will just start off and say you shouldn't read anything into this to address your question specifically. It is purely a sensitivity to show some numbers. And if you wanted some additional numbers, if you increase sales 10%, the in force increase would be roughly 23% at that same timeframe. If you increase sales 20%, it would be 28%. So, you shouldn't read anything into it, but I'll let others comment.

A

Right. POJ over many years, we have grown our in force. You mentioned it's a very challenging environment. Even in a challenging environment, just like how I used to be, we are still generating the same numbers, and we can grow in force. So, if we continue to sell at the same level, then we can increase our in force. So, this data just to explain that.

Charles F. Lowrey
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.*

A

I think your initial impression was right. The point of the slide was to emphasize the power of persistency and our high level of persistency enables the in force to grow even without sales. It's purely a sensitivity.

Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

I think that's [indiscernible] (01:44:51).

Q

It is. Just quickly and maybe you've touched on this a little bit. It seems like all the domestic companies are focusing on the same non-yen-denominated products that you guys have been doing for quite some time. Does that represent increased competition if the large legacy mutual and non-mutual life insurers in Japan are sort of getting into what historically has been your turf?

A

So, as I said earlier, the non-yen product, we don't know whether there will be strong non-yen products. We don't know yet. And regarding the hard work to sell products would be a difficulty. It requires good education to captive agents to be able to sell non-yen products. So, the sales skill, education-wise, we are much more advantageous. We are confident because we – so, some Japanese companies also sold single premium non-yen products before in the past, both single premium and recurring premium products to satisfy protection needs. That perspective, we have already advantages. And that is not something that other companies can easily copy.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.* A

[ph] Right there in the middle. (01:46:31)

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**Mike Kovac**
*Analyst, Goldman Sachs & Co.* Q

Mike Kovac, Goldman Sachs. Can you discuss just sort of across the board some of the steps that you're potentially making to commission structures across the different products and distribution channels to facilitate some of your sales goals?

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.* A

Should we just go down the line? [Inaudible] (01:46:56).

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A

So, I'm not quite sure which pages or which presentation you're referring to. We are planning to change pricing. So, once we change pricing, then we have to change our commission. And it happened in before, too. But when we changed commission, then that's going to affect the compensation of our agent. So, we have to be very prudent.

On the other hand, Bancassurance commission disclosure is required from October in the major banks. If the insurance product is sold from major banks, then that's going to be disclosed from October. So, we – I heard that the way you're paying commission will be changed. So, in October, you will get information from the market, I think, how commission is paid by different insurers.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.* A

[audio gap] (01:47:54-01:47:59) Eric?

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**Eric Berg**
*Analyst, RBC Capital Markets LLC* Q

[audio gap] (01:48:01) Thanks very much, Mark. All over the world, life insurers and asset managers, and others, who manage the public's money, are talking about income solution; lots of people say it's Prudential. So, I guess my question is how does that work in the sense that interest rates are extremely low everywhere? To be sure, they are lower here than in North America. But there's no magic here, everyone's looking at the same fixed income market. How do you give income to people when interest rates are essentially extremely low in everywhere?

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**Charles F. Lowrey**
*Chief Operating Officer-International & EVP, Prudential Financial, Inc.* A

Just what we do here is perhaps retirement income.

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### Takeshi Soeda
*President & Chief Executive Officer, Prudential Gibraltar Financial Life*

A

Retirement income. So, they have to manage – I think how we manage. I think that is your question. So, basically, so regarding assets, so, we match the asset to liability duration, which is ALM strategy. We have our parent company. So, we learn investment know-how from the parent company. I wonder, if I'm answering the correct – to the question.

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### Eric Berg
*Analyst, RBC Capital Markets LLC*

Q

I mean as you said, there's no magic bullet, right? So, you can't promise that which you can't deliver. Scott will go into, I think, more detail about our, as Kurashige-san said, our ALM strategy and what we do with alternative investments in order to boost yield in Japan, because I think we have a distinct competitive advantage with our investment management division and some of the products that they invest in, like mortgages and private placements and whatnot, which can augment the interest rate that one would otherwise get from just investing in either corporate bonds or governments.

So, but that's at the margin. So, we have looked at the crediting rates, we have lowered crediting rates. So, there is no magic bullet and I think we have – again we have the capabilities to augment what people could otherwise get in the market, but that's all. So, there are no – it's a tough environment, and there is no magic bullet.

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### Takeshi Soeda
*President & Chief Executive Officer, Prudential Gibraltar Financial Life*

A

[Foreign Language] (01:50:38) So, it could be a little bit different from what you asked, but as long as you sell death protection and death protection products – it's not mainly focused on interest gain, it's more on selling protection, and we can enjoy mortality gain and expense gain. So, we can enjoy those gains. That's the primary focus.

So, it's not just focus on investment area. Some of the – it's quite a different profit structure. And Prudential Group is enjoying very solid mortality and expense margin. We have a very thick portion of profit coming from them. So our fundamental profits are ensured from selling death protection. Not directly answering your question, maybe, but that's how we are.

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### Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

[audio gap] (01:51:29-01:50:33) Okay. We will take a 15-minute break.

# MANAGEMENT DISCUSSION SECTION

## Alan Mark Finkelstein

*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

All right. We are in the final set of presentations, and we are going to start with a presentation on investments and asset liability management in Japan. The presenter is Scott Sleyster, our Chief Investment Officer. And Scott, you may begin.

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## Scott G. Sleyster

*Chief Investment Officer & Senior Vice President, Prudential Financial, Inc.*

Thanks, Mark. I'm sorry, I could not be with you in person today. Why don't I start on my second slide that are labeled, Meeting Investment Challenges in Japanese Macro Environment. So, let me start with what our experience has been in investing assets to support insurance liabilities in Japan over the past 30 years.

So, in both Charlie's presentation and, again, in Rob's, which will be following mine, we have a chart which shows long-term Japan interest rates for the 10-year GDP. And if you look at Rob's carefully, you'll see that the first time it dipped under 1% was all the way back in 1998.

And I pointed out to simply say that we've been dealing with low rates in Japan for most of our operating history. Thus, low rates have informed our product mix, and therefore, we largely develop products that primarily generate the returns from actuarial and administrative margins, and require [ph] little to no (01:53:12) investment margin to achieve the attractive returns that you saw in Charlie, Kurashige-san and the other business executives' presentations.

That being said, I don't want to imply that negative rates, out to 10 years, are not a headwind; they are. And Rob will be providing some sensitivity analysis based on sustained low rates in his presentation. However, the effects of low rates have been significantly moderated by our strong asset liability management discipline, which has strongly influenced both our product offerings as well as our portfolio construction.

Lastly, I would note that there are limited opportunities to invest in attractively priced, long-dated yen-denominated credit instruments, and this has resulted in leaving us with a very high-quality portfolio, and potentially, some flexibility to take credit risk if the market offers it down the road.

Also, to the extent that sales continue to shift to U.S. dollar products, our opportunities to take advantage of credit market opportunities in the U.S. market and the European credit market will only increase. And, we are very well-positioned to do that through the strong credit management capabilities that exist within PGIM Prudential's asset management business.

So in the pages that follow, I plan to focus on a number of capabilities that position us well to manage through the low rate environment, and should allow us to continue to manufacture attractive and profitable insurance products for our Japanese customers.

Those include a very strong ALM discipline, a modest amount of reinvestment risk from our existing block of business, a very high-quality portfolio with the flexibility to take advantage of future market opportunities, and a product mix shift that favors the strength of our internal asset management businesses. So with that, why don't I switch over to the next slide, please.

So, Prudential has a globally consistent asset liability management approach, and it is very much what I would call a strong form, liability-driven discipline. So the Chief Investment Officer, the ALM organization in Prudential is separate and distinct from our investment department. Prudential's investment – former investment department, if you will, is PGIM, and it's an asset management business. And, the work that my department does in asset liability management views PGIM as a customer. And, therefore my staff spends the majority of their time with the product businesses, with the actuaries, with the product development people and the finance people to make sure that the assumptions that they're using on new products that are being developed can be achieved in the market. And so, that we really understand the liability characteristics of the existing block, so that we manage it very well.

In that process, we basically look at legal entities. Within legal entities, we look at the currency buckets of the products. And then within the currency buckets, we look at the individual product characteristics, and we call those investment segments. And, what our portfolio managers do is look at the characteristics of those individual segments under a series of market paths, if you will, and we come up with what we replicate to be the expected liability characteristics over time.

And then, the job of the portfolio manager then isn't to manage a total return portfolio, but it's to hedge that liability with specific instruments that will manage the risk out of that, and in fact, will protect the margin that we priced into the product.

We have a well-matched portfolio then against those portfolios, so that we'll take each of those replicated portfolios. We'll look at the key rate durations, and then we'll buy assets that line up against those key rate durations. And, we do that in essence, out the entire investable curve, which is, of course, 30 years in the U.S., and at times, goes out to 40 years in Japan.

As it relates to our asset liability management positioning in Japan, particularly for the POJ type, the protection and long-dated products, we have very long-duration liabilities, and therefore we hold very long-duration assets against to them – against them. We have a tight key rate duration targets and tolerances that keep our portfolios in line with those liabilities. We manage our interest rate positions by currency. And while we don't always go out to 40 years because we find the market isn't as liquid, we're very tightly matched, out to 30 years. And, in fact, have a fair amount 40-year positions in Japan.

Can we go to the next page, please. So, on this slide, I would like to direct your attention to the right side or the reserve – the reserve, so $138 billion. 70% of the existing block of reserves, the $96 billion, relates to Japanese yen related products. The balance, $32 billion in U.S., and $10 billion in other, complete the total. The other $10 billion is essentially all Australian dollar reserves.

As Charlie noted earlier in the presentations today, less than 50% of our sales were in yen year-to-date. And so, this portfolio mix or this reserve mix, that's 70% today, will be increasingly dollar and Australian dollar-based, with the passage of time. Shifting over to the other pie chart on the left, you'll see that we have about $167 billion of invested assets against those reserves. First of all, you'll notice that the pie is largely proportional, showing that we are buying assets to hedge those reserves in local currencies.

You will see that we hold some additional U.S. dollar assets, $50 billion versus the $32 billion in reserves, and that's because of an intent on Prudential to want to have some of its surplus in U.S. dollars – excess surplus in U.S. dollars because we're a U.S. dollar denominated company. And Rob Falzon will talk to that in his presentation a bit, but essentially, $14 billion is represented by the bright part of the pie chart, whereas the $36 billion is against the reserves.

Let's go to the next slide, please. So, on this slide, we're actually taking a drill down looking at the assets or the investments supporting the yen liability portfolio. So, why don't I start with the topline, which is Prudential of Japan and our LP model. There, you see we have $33.2 billion in assets and if you go over to the middle column there, you'll see that we only have $500 million running off against that in any given year.

And not only that, if you look at the line below that, where we have $28.1 billion in assets, you see we literally are only going to have about $100 million of run-off against that portfolio per year over the next three years. That's a runoff rate for POJ, that's about 1.5%, and that really is the benefit of our ALM discipline. We have long-duration products, therefore we've constructed a very long duration portfolio.

The fact that we're getting a 2.5% yield on that block of business in the Japanese market lets you know that we bought those assets along the way when we were selling products and yields were higher. And that's a very long-duration portfolio, and it greatly mitigates the runoff and the reinvestment risk against the existing block of business.

If you look at Gibraltar Life below that, I think you'll find that it's similar, but that is a much larger block of business at almost $64 billion. In a similar manner, it has about a 2.4% weighted-average book yield, and the runoff is a little greater because some of those products are in fact shorter in Gibraltar, and the runoff rate there is about 3%.

Next slide, please. I thought I would do the same thing for the U.S. dollar liability portfolio, just over $32 billion. I think the first thing I'd like to do is direct you over to the weighted average yield column on the right. You would note that in POJ, that portfolio is yielding 5.3%, and in Gibraltar Life, it's yielding 4.2%. And what that really highlights is the fact that by investing in U.S. dollar and Australian dollar products, we can take advantage of our investment capabilities in PGIM.

We can put in higher yielding assets simply from being in higher yielding markets, but we can also benefit from PGIM's capabilities in commercial mortgages and private corporate loans, where we pick up additional spread. And that then allows us to offer much more attractive yields within those products, which I think that kind of goes back to one of the comments earlier about the value of the insurance being greater in these dollar products.

The runoff, of course, is a little bit faster in the U.S. dollar portfolio, since many of these products are a little bit shorter. But, again, because of our strong ALM discipline and the duration that we have, it's only 4.4% for the POJ products, and 6.1% for the Gibraltar Life products.

Next slide, please. I wanted to speak to how we invest the $50 billion of assets, U.S. dollar assets in some additional detail. So, let me talk about the light blue segments, if you will, that relate to the $32.5 billion that are directly supporting U.S. dollar liabilities. The first point I would like to make is that, about $10.4 billion of that total, or a third of that total, relates to single premium products in which we're not going to have additional deposits, and so that takes away reinvestment type issues. For the other $22 billion, we do have some recurring premium risk.

And then that takes me to the gray and the very dark blue segments of the pie, which is the additional assets that total $17.2 billion. $12.7 billion of that relates to our Yen Equity Hedge Program that I spoke to earlier. But that does leave $4.5 billion, in which we're buying U.S. dollar assets that we have hedged into yen through the forward markets.

 

That's not a particularly large program for us. We are still getting attractive returns on those assets, but that's getting to be a crowded trade. We're seeing a lot of flows, quite frankly on our asset management business from yen and the dollar assets with hedges. And just given that we think it's such a crowded trade, we don't really have any intent to increase that by any significance in the near-term.

Next slide, please. So, what I was speaking to before was really the stability and the long-duration nature of the existing block. We are continuing to sell new business and on this slide, I highlight that our annual net insurance cash flows are expected to be $9. – or actually were $9.6 billion in 2015. You'll notice that 45% of those flows were U.S. dollars and Australian dollars. So, you're starting to see that sales effect.

But we are underwriting some additional yen business. And as you heard from the business executives, we work closely with them to make sure that the investment assumptions, combined with the actuarial and administrative expense assumptions allow us to manufacture attractively priced products.

Next slide, please. On this slide, I simply lifted PGIM, our internal asset manager. And I wanted to talk about some of their capabilities because I really do believe having an organization like PGIM is a competitive advantage to Prudential, and particularly, in terms of the kind of returns that we can deliver on U.S. dollar products in Japan. And I think that's something that exist for us, and not necessarily for many other competitors.

So, first and foremost, our asset management business grew out of the investing that we do for the insurance company, so it's very strong in fixed income. The largest component is public fixed income, and we have a very – a very strong team in the public fixed income market. Most of the third-party money they manage is total return, whereas our insurance portfolio is buy and hold, but we really do benefit from the quality of the research in the strengths of the team that exist there.

However, I think our biggest competitive advantage relates to the Prudential Capital Group and the Prudential Mortgage Capital Company Group, which are listed on the right side of the page. For these, for Prudential Capital, over 50% of their origination in some years, over two-thirds is direct. They have regional offices across the United States, several in Europe and one in Australia, where they directly work with borrowers.

In the case of Prudential Mortgage Capital Company, they have even more offices in the U.S. than through cap. They have one – maybe two offices in Europe now, and they do actually have a Tokyo office for originating mortgages.

The benefit of this is that, these help diversify us away from public credits. All of these loans have covenants, which is not common in public instruments or 144As. We do also collect an illiquidity premium, and we have superior recoveries when these credits do fall behind, and in fact, have features that allow us to bump interest rates. So, we think those are very attractive asset classes. And to the extent the Japanese businesses are doing more U.S. dollar business, they will get their proportionate share of those assets.

Next slide please. I just wanted to point out the quality of the Japan portfolios. 97% of this portfolio is in fixed income, and 95% of the portfolio is in investment grade assets. That's a really high-quality portfolio by U.S., European or Japanese standards. As a matter of fact, 69% of the credit portfolio is rated A – A and above. When we think about our portfolio, we actually refer to risk assets, including high-yield bonds. But, in this case, that's only 5% of the portfolio, and when you back out the below-investment grade bonds that simply highlights that our non-coupon investments are only 2% of this portfolio, and that's mostly in Japanese equities and J-REITS.

If you look at the pie charts below, the pie chart on the left highlights that fully 48% of the portfolio is in JGBs today. If you carve out the 5% high-yield, then you're left with the 47%, which is in mortgages, privates and public fixed income. And we break that out or break that down on the pie chart on the right, and you'll see that fully 29% of that is in AA and above securities, another 40% is in A, and that leaves us with less than a third of the credit portfolio in BBB instruments. So, it's a very high-quality portfolio.

Next slide, please. I thought – I get a lot of questions these days about in these low-rate environments, are you guys reaching for yield or you stuffing the portfolio with a lot more risky assets. It's a natural concern for investors and rating agencies, and it's certainly a natural concern for regulators. So, I thought this slide would be helpful to respond to that. So, first of all, year-to-date, you can see that 23% of the portfolio went into JGBs. And another 9% went into U.S. treasuries in the dollar portfolio. So, again, almost a third of the portfolio is going into government securities, another 37% went into investment grade public fixed income. But the trend you see here, that I think is important, is that the 10% and the 13%, the 23% of the portfolio, went into private placement mortgages and private corporate investments, and that is the back, the U.S. dollar block of business. We don't have to – we're not rolling that in or hedging that on a forward basis that's pure U.S. dollar assets against U.S. dollar liabilities.

And then lastly, I would highlight that our below-investment grade purchases, the portfolio is at 3%. Our purchases, year-to-date, are at 4%, so certainly no dramatic increase. And I would tell you that actually, the reason you're closer to 4% today is that as we get more U.S. dollar assets, we can actually put in some privately underwritten, below-investment grade bonds. So I think the – I think this page really just highlights that with the U.S. dollar product shift, we're really able to take greater advantage of the PGIM capabilities.

My last slide that I'll speak to relates to really just a snapshot of the credit profile of the U.S. businesses, excluding Japan – the total company excluding Japan, and excluding our closed block. And you can see that for that business, which is largely the U.S. businesses, 88% of the portfolio is invested in credit instruments. We're doing this inside of a AA-rated U.S. business, and it's a really high-quality portfolio.

And yeah, when you look over on the right side of the page, you can see that we only have 50% of the portfolio – 50% of the portfolio is in JGBs, leading half the portfolio in credit. So, I'm not positing that you should expect to see any significant change in this portfolio in the short run, but it simply points out that as we sell more U.S. dollar business, we've really got the ability to take advantage of those PGIM capabilities and put some more credit-risky assets in the portfolio. We've got a lot of room to go if we want to do that over time.

Why don't I stop there, and turn things over to Rob.

## Robert M. Falzon

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

Thank you, Scott. So, let's take this down to the home stretch. From a – and actually, if we could just advance to the slide that's got the Venn diagram, why don't we start there. From a finance perspective, we think of that operating metrics for Japan business in much the same way as we think about the metrics for the overall enterprise. And we think about that in the context of it being a balancing act.

We seek to have strong fundamental performance in execution that generate growth, and our ROE in excess of our cost of capital for the businesses that we operate here. That performance should manifest in high-quality, predictable reported results, consistent with the relatively low risk of the businesses. And we want earnings to translate into free cash flow that could be redeployed, either into inorganic growth opportunities or distributions back to the U.S. holding company.

All the above needs to be underpinned by financial strength and stability. Any component of this then can be enhanced at the expense of having some other component of it suboptimized; for instance, free cash flow could be increased by reducing our organic growth and not taking advantage of the attractive ROEs that we earn by reinvesting in our existing businesses.

Alternatively, earnings growth could be accelerated by pursuing the lower quality, higher risk business mix or by compromising on our financial strength. We see the balanced growth in ROE risk and cash generation in a way that optimizes the value of our Japan operations to us and in turn, to our shareholders.

So, let's start by taking a high look at our results over the last decade and flipping over to the next slide. This is very similar to a slide that you saw on Charlie Lowrey's presentation, and Scott alluded to, but with some added detail. The bars show the growth in our earnings over time. Through a combination of organic and inorganic sources, earnings have grown at almost 12% per annum since 2007.

The acceleration since 2010 was driven in part by the Star and Edison acquisitions and the subsequent synergies that were realized from those acquisitions. The lighter blue sections of each bar show the proportion of earnings that has been redeployed. Since 2007, almost $10.5 billion or 67% of our earnings have been redeployed. $800 million of this was used to fund a portion of the Star and Edison acquisitions in 2011, and the remaining $9.5 billion was returned to the U.S. holding company.

The yellow line at the top shows the ROE that we've earned over this period. It has and continues to be well in excess of our cost of capital and hurdle rates for this business, particularly in light of the relative risk and stable earnings profile. You will notice a dip that occurred in 2011, which coincides with the acquisition of the Star and Edison businesses. These businesses were acquired at very attractive returns, albeit below the ROEs that we were generating from our organic business. As we integrated Star and Edison, we incurred about $400 million in costs, but realized run rate synergies of about $0.25 billion, which were fully reflected by 2013. This then drove the subsequent recovery in our ROE that you see in the graphic.

While recently, there's been a flattening of our earnings growth and a modest decline in ROE, due in part to currency exchange rates and returns on non-coupon investments. We continue to achieve highly attractive absolute and risk-adjusted returns. At the bottom of the chart, you can see the average interest and FX rates for each year as well as the return on the Nikkei. I will talk about our FX hedging strategies later in the presentation.

Turning to the next slide. That earnings and returned picture, the sustained growth, the high ROE and the low volatility, is largely attributable to our business design as you've already heard this morning. Our unique distribution model and our needs-based selling orientation emphasize protection versus savings-oriented products, and produce a high level of policy persistency and repeat customer sales. This is a significantly better and more predictable business mix and model than that of our competitors.

In addition, unlike many of our peers, our legacy book in Japan is not burdened with policies underwritten at high levels of assumed investment returns. As a result, we have an attractive earnings and return picture, driven primarily from mortality and expense margins. This slide is an illustrative depiction of the relative contribution of M&E margins and investment margins by product.

The largest concentration of our book and sales is in the more protection-oriented products, as you've heard this morning. Earnings are largely derived from these protection products, including term A&H, or accident health, and whole life. As I mentioned, our business model also benefits from relatively high persistency and repeat customer sales. The virtuous cycle described by Ichitani-san this morning, helps to produce the attractive economics that we are able to generate.

Turning to the next slide. Moving in our operating metrics in that Venn diagram I showed upfront, from growth in ROE to volatility and risk, I'd like to first address the impact of sustained low interest rates, and then to turn to the impact of currency movements. We've operated in a low interest rate environment in Japan for about two decades, albeit not a negative one until very recently.

As I mentioned before, our business mix is concentrated in protection-oriented products, profits, mainly generated by M&E margins and therefore, we're less reliant on spread income. We have a number of other key mitigants to a sustained low interest rate environment. Our yen portfolio rollover, as Scott pointed out, only averages roughly 1% to 2% per year, and this includes investment maturities needed to meet expected returns – excuse me, expected claims.

As you heard from Scott, we have a strong ALM discipline, and we have access to investment grade securities that produce attractive risk adjusted returns. We have a long history of sales of U.S. dollar and Aussie dollar denominated products, dating actually back to 1999, and have pivoted further to U.S. dollar sales in the current environment.

We have, and we'll continue to reprice our products to mitigate the impact of low rates. And for certain of our more interest rate sensitive products, like fixed annuities, we built in features to enhance our flexibilities, like bi-weekly repricing for new sales and ongoing MVA adjustments, or market value adjustment features.

Turning to the next slide. In order to provide more transparency on the potential impact of sustained low interest rates on our earnings, we've pulled this slide together. It shows the hypothetical impact to the earnings generated from our existing block of business. Specifically, we started with our entire in-place block of business – all currencies, liabilities and assets back in the liabilities, as of year-end 2015. We froze the block, essentially putting it into a runoff mode, reflecting all cash flows. So, portfolio rollover, recurring premiums, claim settlements and any related costs.

We assumed that the interest rate environment existing as of June 30th of this year remained unchanged over the forecast period, and that we followed our existing long-term plan of investments. As you can see, over a three-period of time through 2019, the cumulative impact to earnings from investing at rates lower than the current portfolio yield is relatively modest, about $200 million pre-tax by 2019. This compares to $3.2 billion of pre-tax AOI from our international business in 2015, and to $6.2 billion of consolidated pre-tax AOI at the enterprise or PFI level.

While the effect compounds each year, the marginal impact actually declined each year, primarily due to the runoff of the block. This analysis reflects the earlier points I made about the relative contribution of our M&E margins, as compared to spread income.

So, moving to the next slide. Further concerns about the effects of sustained low interest rates have been raised in connection with the recent and anticipated changes in the statutory reserve rates, as you're undoubtedly aware of the standard rate reserves – excuse me, the standard reserve rates described – prescribed by the FSA changed from 75 bps to 25 bps for yen-denominated single pay whole life sales back in July of this year.

And the standard rates for yen-denominated recurring premium whole life sales is expected to decline by about 75 basis points that would be from 100 basis points, down to 25 basis points, effective April of 2017. These changes are only applicable to new business for yen-denominated products, commencing as of the effective dates. When we look at pricing for new business, we evaluate returns using multiple lenses for both capital, and under a range of interest rate scenarios.

Our capital lenses include statutory and economic frameworks, and our interest rate scenarios include, what I call a GAAP view, so that assumes that rates rise to a long-term reversion rate over the course of a decade. And that's – the benchmark is 1.9% for the 10-year JGB, over that decade.

Secondly, a market neutral view, which assumes that rates just follow the forward curve that's in place. And then finally, the other end of the – the other book end of it, which is a sustained low interest rate environment, which assumes that rates remain at the current prevailing levels for forever. When products don't produce returns on capital, consistent with our hurdle rates appropriate to each of the scenarios, we either reprice or redesign the products. We suspend or limit sales; and/or we place a greater emphasis on other products, including, for example, what we've done with our U.S. dollar-based products.

Turning to the next slide. Let me go now to the risks associated with sustained low interest rates to those associated with currency movements. We have a robust hedging program for our U.S. dollar, yen currency risk. Our objectives are to dampen annual reported earnings volatility due to changes in those exchange rates, to protect the enterprise earnings and ROE, to protect long-term value of our investments in the Japan business, and to mitigate the potential exchange rate impact on our solvency margin ratio.

So, turning to the next slide, before I jump further into the hedging program, I first thought it would be helpful to provide context by looking at the degree of our earnings sensitivity to currency movements. Recall that a significant portion of our products sold in Japan are U.S. dollar-denominated, providing dollar returns, dollar revenues and gross profits.

However, all of our expenses are yen-denominated. As a result, only about 34% of pre-tax earnings are actually yen-based. So, our earnings are significantly less exposed to the appreciation or depreciation of the yen than you might otherwise assumed. The graphic on this slide shows the impact to earnings of changes in our hedged FX rates. So, the center column represents actual results for the first six months of this year. Our hedge rate, or what we call our plan rate, that we share with you, is a result of hedges that we put into place over the course of the last three years and was at ¥106 to the dollar; earnings were $1.582 million.

Looking to the extreme left, if our hedged rate reflected a significant strengthening of the yen to ¥80 to the dollar, or a 25% appreciation, the pro forma impact would increase AOI by about $172 million or $1.754 million; that's 11% from our actual results. Conversely, looking to the extreme right, if our hedged rate reflected a significant weakening of the yen to ¥140 to the dollar, or a 32% depreciation, the pro forma impact would reduce AOI by $129 million to $1.453 million, or only 8% from our actual results.

I have given you this view of our earnings sensitivity to changes in the value of the yen, now I'll walk you through our hedging strategy and show how we achieve the objective for the hedges laid out on the previous slide.

So, turning to the next slide. There are two principle components to our hedging strategy. Income hedges, shown in the dark blue on the left, and equity hedges, shown in the light blue and the orange also on the left. The total size of our hedge program is about $15.4 billion.

Our income hedges are executed through four swaps, and protect the near-term earnings and cash flow. And I will show in the next slide these hedges smooth the impacts of the change in the yen by layering in swaps over a rolling 36-month period. We are always 100% hedged for the upcoming year, which allows us to forecast earnings, which is the basis of our guidance, and explain variances to that forecast that are independent to fluctuations in the exchange rate.

For 2016, our hedged or plan rate, resulting from that program of three-year rolling swaps, is a ¥106 to the $1, as I had mentioned in the previous slide.

Our equity hedge is primarily executed through the acquisition of U.S. dollar assets. We also have a modest amount of dual currency bonds. Matching U.S. dollar assets against our yen liabilities effectively predicts the dollar value of our investment in our Japan business by way of example. If the yen depreciates unhedged, the dollar value of our equity in Japan would also decline. However, because we own U.S. dollar assets, the value of the yen liabilities declines, but the value of the assets does not. This creates a gain.

We use an internal swap as a mechanism to move this gain out of Japan up to the parent company. We calibrate the size of the U.S. dollar portfolio to protect the economic value of our investment in Japan and to preserve the enterprise ROE. I'll walk through this in a little bit more detail in just a few slides.

So turning to the next slide. Taking a closer look at the earnings hedge component of our hedge strategy. As I mentioned before, we hedge earnings by layering in swaps over a 36-month rolling period. At any point in time, we've hedged 100% of the next four quarters of year one, about 85% of quarters five through eight, so year two, and about 40% of quarters 9 through 12, year three.

This has the effect of smoothing the impact of changes in value of the yen on our reported earnings. The dark blue line on this chart shows the actual spot value of the yen versus the dollar over time. The green line is a trailing three-year rolling average spot rate which would approximate our actual hedging strategy.

The red line shows our plan rates for each fiscal year, which is the average of our actual hedges over the course of that year. As you can see, it roughly follows that three-year smooth rolling average spot rate. So while the earnings hedge does protect against near-term volatility and the value of the yen, it does not protect the value of those earnings over the longer term. For that, we have our equity hedge.

So, turn to the next slide. As we described before, we use U.S. dollar investments in Japan to support the value of our yen-based business. And we established an internal hedge which facilitates cash flows from and to Japan, and protects the local solvency margin by creating yen denominated assets on our Japanese books. Look at the chart on the bottom part of slide. When the yen weakens, which is the top row of that chart, the value of U.S. dollar assets rises. The internal hedge transfers this increase in value from Japan to the parent over time through staggered cash settlements. This cash mitigates the decline in the value in our Japan business as a result of the expected lower dollar value of future dividends coming from Japan. Our solvency margin ratio is unaffected as our liabilities are yen denominated, and therefore, unchanged in yen terms, and the value of the U.S. dollar asset, net of the internal hedge, is also unchanged in yen terms.

Conversely, now look at what happens when the yen strengthens which would be the bottom row. The value of the U.S. dollar assets fall in this scenario. The internal hedge offset this decline in value by transferring cash from the parent to Japan through staggered settlements over time.

These cash payments from the parent are offset by the higher debt dollar value of future dividends from Japan over time as well. Our solvency margin ratio again is unaffected as the net value of the U.S. dollar assets, plus the mark-to-market on the internal hedge, is unchanged in yen terms.

Turning to the next slide. Our equity hedge target is about $13.6 billion, and that's on top of the $1.8 billion notional value of our income hedges. We size the equity hedge, thus, the cash settlements when redeployed are sufficient on an after-tax basis to fully offset the impact to our enterprise ROE from a change in the value of the yen.

The fair value of the equity hedge at June 30 of this year was a negative of $0.5 billion based on an exchange rate of ¥103 to the dollar as of that date. A 10% appreciation in the yen, which would have taken it to ¥92 to the dollar, would further reduce that value to about a negative $2 billion. A 10% depreciation in the yen to ¥113 to the dollar would increase the value of the equity hedge to a positive $0.9 billion.

The breakeven on the hedge as of June 30 was about ¥107 to the dollar. The projected settlements under the equity hedge using the ¥103 to the U.S. dollar as of June 30 were – are actually shown at the bottom of the slide here. These settlements are staggered over time and actually go out beyond 2020. So, how should you interpret this? What this means is that since inception, and certainly, we began implementing this hedge back when the yen was in the ¥70s against the dollar, the cumulative net settlements under the hedge plus the projected future net settlements when redeployed either in share repurchases or back into our businesses are and have been sufficient to offset the dilution to our enterprise ROE that otherwise would occur as a result of the depreciation of the yen over that time.

Turning to the next slide. I now want to turn to the third component of that operating metrics then that I showed you in the opening page, and that is cash generation and deployment. Upfront, I showed you the annual history of earnings and capital redeployment from international businesses. This slide shows accumulative picture of that history from 2009 through the end of 2015. Over this period, we've generated $13.4 billion in AOI, net of tax effecting, and redeployed about two-thirds of this or about $8.6 billion using a variety of mechanisms as shown in the pie chart on the right and as I'll describe on the next slide, if we could turn to that.

We have several mechanisms for redeploying our international earnings. These include dividends; affiliate debt repayment, of which we have about $1 billion outstanding; structured notes, for which we have an excess of $2 billion of capacity as of June 30; and acquisition funding including, for example, the funding of Star and Edison that we did in 2011; and other mechanisms such as internal reinsurance and intercompany hedges. We expect that these mechanisms will allow us to continue to achieve strong redeployment of earnings.

Turning to the next slide. Even with this level of earnings redeployment, we've maintained solvency margin ratios consistent with our target, including under moderately adverse stress scenarios, including the scenarios shown here where equities declined 55%, real estate values declined 35%, the yen depreciates by 20% against the U.S. and Aussie dollar, and interest rates spike by 100 basis points.

In such a scenario, we would still maintain solvency margin ratios in Prudential Japan and Gibraltar Life that are consistent with our 700% target and our desire to operate a AA criteria for financial strength.

So, turning to the final slide. What I hope that you've taken away from this presentation is that we're balancing what we believe to be the key drivers to optimizing both our international business and enterprise values, growth in ROE, low volatility and risk, and cash generation and redeployment. Specifically, our product focus, enabled by our unique distribution model and our needs based selling orientation, drives prospects for continued attractive returns and growth.

We have a very manageable exposure to macroeconomic risks, including interest rates and foreign currency markets. And we have a robust financial position that we've maintained due to our strong capital generation, net of the significant proportion of earnings that we've been able to redeploy.

So, thank you for listening. I think I'm going turn it, Mark, over to you, and Scott and I are ready to answer questions.

# QUESTION AND ANSWER SECTION

Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Okay. Thank you, Rob, and thank you, Scott. We'll now open it up for our third and final Q&A, and a whole bunch of hands just went one up. So, Nigel?

Nigel P. Dally
*Analyst, Morgan Stanley & Co. LLC*

Q

All right. Thanks. I'm Nigel Dally, Morgan Stanley. You provided details on the solvency margin ratio. Several of your peers are also talking about economic solvency ratio. So, would be interested as to how you would not come out under that alternate approach.

Robert M. Falzon
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Nigel, it's Rob. So, we do not calculate a solvency regime based capital ratio. There is lots of issues with that particular calculation varying from internal models to some concepts that don't particularly work well for insurers. Having said that, our risk adjusted capital framework includes an economic lens which is, in many ways, are similar to the types of economic solvency ratios that are calculated by others. Some key differences that I just want to point out is, one, we look at total available resources or TAR concept as opposed to looking solely at a capital construct, which particularly in Japan is important because of the very significant margins and reserves that we have on our balance sheet there.

Secondly, we discount our assets and our liabilities using similar yield curves to avoid non-economic volatility. And depending on the type of calculation you do under a Solvency II type regime by way of example, you might not do it that way, and you get some odd results that overstate ratios in certain environments and significantly understate them in others.

This is an internal management tool and we've not made it public. So, I can't share with you the actual ratios coming from that, but let me share a couple of other observations that might be helpful. What you haven't seen from us that you've seen from others is a significant run up in a published SMR ratio. And in some instances, that significant run up then doesn't seem to connect very well with the economic solvency ratios that are then published.

In our particular case, you haven't seen that run up because of, in part, the very disciplined ALM model that Scott described, and I'll come back to that. The fact that we have a very low equity exposure, less than 3%, we have a very low exposure to AFS securities, which are mark-to-market, it's less than 20% of our portfolio. We use the whole to maturity and whole for reserve designations, which requires that you operate within a – with a relatively tight duration quarter, which gets back to that disciplined ALM. Because we have much less in the way of mark-to-market assets, we haven't seen the run up in valuations, and therefore, in SMR due to a decline in rates and the raising global equities that are – and sort of inflating the value of assets. And if you're only marking the assets, but not marking the liabilities, which is that construct in Japan solvency if you're not using – if you're using AFS, you wind up with results which could overstate the true strength.

Also, as you've seen in the presentations, about 30% of our liabilities are non-yen, and so we're not subject to the negative interest rate environment that the yen assets of others are otherwise subject to. So, the combination of low equities, disciplined ALM, a high use of held for reserve and held to maturity and non-yen business means that we have less volatility in our solvency margin ratio. And it's probably a lot more representative of our economic strength than maybe the case in other instances that you're seeing. So, I hope that, that's helpful and responsive to the question, Nigel.

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**Nigel P. Dally**
*Analyst, Morgan Stanley & Co. LLC*

Q

Great. Thank you.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Erik Bass?

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**Erik J. Bass**
*Analyst, Autonomous Research*

Q

Thank you. Erik Bass for the Autonomous. Scott, you commented a lot about the tight ALM match. Was hoping you could provide a little bit more, I guess, clarity on specifically the durations of the assets and liabilities for both the Japanese portfolio and the U.S dollar portfolio.

---

**Scott G. Sleyster**
*Chief Investment Officer & Senior Vice President, Prudential Financial, Inc.*

A

Well, I think I can provide a little, but I'm not sure how helpful that would be in the sense that across Prudential, for example, we – as I described, we break out our – we look at legal entities, then we look at currency buckets, and then we look at products with similar characteristics. And across the organization, we have over 150 segments where we apply ALM discipline. So again, as you can imagine, when you start looking at the durations, we've got 150 durations on different sets of segments. So, I'm not sure how helpful aggregating them, but as it relates to Japan, I would just make – I'd make a couple of observations. The durations on the yen liabilities are pretty long. It's not uncommon to see some of those protection products that you heard discussed to have actual durations of 15 years to 20 years or so, and that's just as true in POJ as it is in Gibraltar.

On the other hand, the U.S. dollar liabilities tend to be shorter, and Australian, even shorter than that. So, you might see durations, call it, in the five-year to seven-year range for Australian dollar products, and in the eight-year to 10-year duration for the U.S. dollar products.

Maybe the last thing I'll take, because I think you were asking a little bit more about the technique as well, without getting too in the weeds, we actually create individual replicating portfolios for each of those liabilities. And I think for over 140 of those, we're able to do that with a lot of precision without a custom model. And then, we chop that into zero to two, three to five, seven to 10, 10 to 20 and beyond 20. And those end up being our buckets, and then we match against those buckets with corridors around each. So, that's what gives you the tight ALM matching that Rob was referring to.

Erik J. Bass
*Analyst, Autonomous Research*

Q

Thank you. I guess, within the yen denominated portfolio though, what is the duration mismatch? Or can you quantify how wide that would be?

Scott G. Sleyster
*Chief Investment Officer & Senior Vice President, Prudential Financial, Inc.*

A

I guess let me put it this way, because remember, for example, Rob was telling you that we hold U.S. dollar assets for – as part of our surplus. And obviously, I don't want to take 30-year interest rate risk on my U.S. dollar assets, I want to pick up the belly of the curve, and I want to pick up private placement premiums on mortgages and private corporate.

So, I guess, I think within 30 years, we're more than – we're north of 90% tightly matched for 30 years [indiscernible] (02:44:43) in Japan. Now, we do have a fair amount of cash flows that run beyond 30 years and 40 years, and I guess our philosophy on those is, first of all, each calendar quarter, think about it, each year, year 31 rolls into year 30, and then it's very tightly match. And for the – all of the liabilities are tested in the actuarial testing every year with current rates. So, if we think those – if rates have come down, those long tail assets may require us to strengthen reserves a little bit, so the balance sheet is getting stronger. So, but nonetheless, we tend to think of those tail liabilities as sort of benefiting more from the surplus that we have. And to the extent that we take some high yield risk, some real estate or some alternative assets, we think of the total returns on those really sort of being earned against the tail liabilities. And I think you can see, you could take a fair amount of comfort from that.

Robert M. Falzon
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Erik, it's Rob. The only thing I'd add to what Scott said, which I think was a very full answer, is simply that the question seems straightforward, the answer isn't always as straightforward because depending on the character of the liabilities, some have very predictable cash outflows, and others are more sarcastic and have convexity associated with them. And so, the – where there's high predictability around the cash flows, you're going to find that we're, within the investible universe, 100% matched. And then where there's convexity in those cas h flows, you're going to find that we're not entirely 100% matched because we're trying to – we're doing a series of scenarios in ensuring that we've got the right exposure under a variety of potential and straight scenarios, not a single best estimate.

Scott G. Sleyster
*Chief Investment Officer & Senior Vice President, Prudential Financial, Inc.*

A

And then just sort of completing Rob's comment there, in the case of Japan where you have these long duration liabilities, to the extent we had a rate spike, not a further decline, we – and it would have to be pretty significant, we could have some surrenders, and therefore, we're going to run a little bit short.

Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Jimmy Bhullar.

Jamminder Singh Bhullar
*Analyst, JPMorgan Securities LLC*

Q

I had a couple of questions. First, can you discuss what your discount rate assumptions are for yen denominated liabilities and for the U.S. dollar liabilities, both near-term discount rate that you're using and the ultimate forward rate? And then I have another one.

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**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

So, Jimmy, our – and [indiscernible] (02:46:52) about this from a U.S. GAAP standpoint, I think is the question you're asking. And so, the convention we use in Japan is the same as the convention that we use globally, and include – and obviously in the U.S. And that is that we use the forward curve for the first two years. And then after that, we do a linear extrapolation to our long-term reversion rate. In Japan, that long-term reversion rate, we moved in the second quarter from 2% down to 1.9%.

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**Jamminder Singh Bhullar**
*Analyst, JPMorgan Securities LLC*

Q

And then just on slide 7, I think, of Scott's presentation, there was – the $4.5 billion of the portfolio that's invested in dollars hedged back to the yen, can you detail the nature of those? I guess that they're forwards, but what type of hedges are you buying and the duration of those hedges versus the duration of the underlying investments?

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**Scott G. Sleyster**
*Chief Investment Officer & Senior Vice President, Prudential Financial, Inc.*

A

Yeah. Let me give you – I think maybe the best thing to do is to say what have we been experiencing year-to-date. So, first of all, we have hedges, as you can imagine, there is a portfolio of hedges, some as short as three months and others running out all the way to two years. But our average is, call it, five months. Year-to-date, the assets that we've been purchasing had a gross yield of 3.3%. The hedging cost has been, call it, 1.1%. So, we've been netting 2.20% on that portfolio. And then I would contrast that with, on our yen denominated purchases year-to-date, we were earnings 58 basis points. So, we would still say we're picking up 165 basis points on that trade. Some of that is securities that we've underwritten, so we're really quite comfortable with when you think of the credit profile. Nonetheless, I would say that is starting to feel like a very crowded trade.

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**Jamminder Singh Bhullar**
*Analyst, JPMorgan Securities LLC*

Q

Thank you.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Yaron?

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**Yaron J. Kinar**
*Analyst, Deutsche Bank Securities, Inc.*

Q

Thank you. Yaron Kinar with Deutsche Bank. A question for Rob. If I go back to your presentation and look at, I think, at slide 14, the redeployment of excess capital of about 65% of earnings since 2009. Could you normalize that for the Japan equity hedge, what that ratio would be without the hedge?

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**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Actually, Yaron, no, I don't have that number handy. I would say that the hedge has been one of multiple mechanisms that we've used in order to bring capital back. It was one – it's just one that we will continue to use on a prospective basis. If you think about it, it kind of normalizes itself out depending on whether there's an appreciation or depreciation of the yen. So, – but I don't have at my fingertips, a number that I could give you.

**Yaron J. Kinar**
*Analyst, Deutsche Bank Securities, Inc.* Q

Okay. Would it be fair to assume that in a strengthening yen environment at least for the next, let's say, two years, three years, we'd see that ratio come in a little bit?

**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.* A

I think – let me answer the question more broadly, which is how we're feeling about the sustainability of sort of the distribution rate for – or distribution of our earnings from Japan. What I said, Yaron, is that we targeted – while we've articulated a 60% level, and – important to understand, when we established that 60% level, as we do across our businesses, it's really a balance. It's not so much how much we can get out of the business, it's how much we should take out of the business. It's a balance between reinvesting for internal growth and distributing back to the parent. And we continue to earn very attractive returns in Japan from our business, and well in excess of our cost of capital. So, we're continuing to grow there and we want to finance that growth. And we believe the 60% sort of strikes the right balance between reinvesting for growth at attractive ROEs as we're able to redeploy there, and then bringing capital back. In any given period, you're going to find that there is – we could be more or less than that 60%, but over time, it's expected to average to that number. There are challenges in the current environment with that around interest rate levels, around changes in the stack rate, which I'm sure I'll get some questions on that as well, but we believe that our earnings will continue to be sustained, and that our ability to take those earnings and take that same ratio of cash flow back to the parent company is sustainable over a long term as well.

We have multiple mechanisms for doing that, the affiliated debt that's outstanding that I mentioned, the structured notes that I mentioned, the internal hedges that were just asked about, and our internal reinsurance, which to-date, we've only used for our U.S. dollar business in order to enhance or maximize our ALM capabilities. So, while on the margin, there could be some impact on that in any given year as a result of the settlements that are occurring on the hedge running one way or the other, we think over time, that noise sort of works itself out and that we'll be able to sustain that targeted 60% ratio.

**Yaron J. Kinar**
*Analyst, Deutsche Bank Securities, Inc.* Q

Thank you. That's helpful. And maybe one quick clarification question on slide six. When you talk about the current interest rate environment, is that both in the U.S. and Japan or just Japan?

**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.* A

This represents the total portfolio, so that would be both U.S. and Japan. The total existing book portfolio, including our U.S. dollar assets and our yen assets.

**Yaron J. Kinar**
*Analyst, Deutsche Bank Securities, Inc.* Q

Thank you.

### Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Tom Gallagher.

### Thomas Gallagher
*Analyst, Evercore Group LLC*

Q

Tom Gallagher, Evercore ISI. Is this on? Yeah.

### Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

A

Yeah.

### Thomas Gallagher
*Analyst, Evercore Group LLC*

Q

Rob, just quick follow-up question on the economic solvency ratio. You are calculating that and reporting that to the FSA, is that correct? From everything we've heard, it's in field testing stages, and that is a – that is information that's being shared with the FSA. I just wanted to confirm that it is something that you calculate.

### Robert M. Falzon
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

Yeah, Tom. But to be very clear, that's very different than a Solvency II ratio. That is the IAIS economic construct that they're developing, which is in development, and the first field test on that was that construct looked very different than the second field test on it, and they're making some progress migrating, frankly, towards some of the things that I highlighted are as being the key differences between how we calculate that economic lens and how it's calculated on a pure Solvency II basis. But, yeah, we calculated that during the first field test, we've calculated that in the second field test.

The Japan FSA is going to be running a field test, a further specific field test on the Japanese companies, we will participate in that. And we're doing all of those calculations, and we're participating in sort of the formulation and the evolving formulation of that international capital standard. So, yes, we are doing that, but it is very different than a pure Solvency II calculation.

### Thomas Gallagher
*Analyst, Evercore Group LLC*

Q

Understood. But I guess my question is, based on what you've seen, I don't know much you can share, do you feel like you're in a good position? I mean, that's – as you think about where that's likely to evolve to, is there some – how do you stack up?

### Robert M. Falzon
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

So, we don't have – we're not privy to everyone's results on that sort of stuff. What I would say, Tom, is two things. One, we're working very closely with the Federal Reserve and with the rest of Team USA, so Treasury and the NAIC, working in conjunction with them, the international players, to further evolve this international capital standard. I – we believe that it's made progress and that there are indications we can continue to make progress in having it be more reflective of an insurer's actual capital strength. And that on that basis, we think we will show well on that because we have a very strong capital position. The results that we've seen to date, we think, understate our capital strength but by no means in a way that leave us overly concerned. They just – we just don't think it's quite right and it's not meant to be quite right if there is a range of different outcomes based on – they've got a variety of different calculations that they're using in order to sort of calibrate sensitivities and ultimately, migrate toward a construct that will make more sense.

So, I would say, Tom, there is nothing that we see out there that would cause us to be concerned that we would show more poorly than our peers under that ratio. But that isn't to say that we think that, that ratio is where it needs to be at this point in time. We think it actually needs a fair amount of additional work.

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**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

And then, I guess my last question is the – when you showed that information about the capital redeployment, I guess only 14% of the capital redeployment has been dividends. So, earnings based. And the rest has been various other mechanisms, including internal leverage.

When you think about the new framework, does that source of capital repatriation end up being a negative against you? When you think about the internal leverage that you've used to deploy capital over the years, is that, under that new framework, somehow a negative or is that not a big consideration?

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**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

It's not a large consideration, Tom. The – it's a consolidated framework, and in consolidation, the intercompany stuff goes away.

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**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Okay. Thanks.

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**Alan Mark Finkelstein**
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

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Connie?

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**Connie Fang DeBoever**
*Analyst, The Boston Company Asset Management LLC*

Q

Thank you. Connie DeBoever, The Boston Company. Just following up on Tom and Yaron's questions. So, when you think about up streaming capital to the parent, how much of a factor should we consider for either the ESR or the SMR?

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**Robert M. Falzon**
*Chief Financial Officer & Executive Vice President, Prudential Financial, Inc.*

A

So, we want to maintain robust solvency margin ratios, whether they be the Japan FSA solvency margin ratio or our own internal calculations of economic capital. We believe we are at very strong ratios in both those metrics. And so, when we look at the capital we're generating on an annual basis, the idea that we would be distributing 60% of those earnings up in any given year is not constrained by either of those views. They are relevant and they are at strong levels, and they can be – those strong levels will be sustained through the reinvestment of the 40% to support the growth that we're experiencing in our businesses.

Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

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Any further questions?

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## Alan Mark Finkelstein
*Senior Vice President & Head-Investor Relations, Prudential Financial, Inc.*

Okay. Well, thank you for your participation today. We do have lunch. [ph] This floor (02:58:35) café, so we are here. And for those that are running off to flights, have safe flights, and thank you again for your participation.