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Prudential Financial, Inc. (PRU)

Investor and Analyst Meeting

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MANAGEMENT DISCUSSION SECTION

Alan Mark Finkelstein

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

All right, perfect. Well, I'd like to welcome everybody both here in person, as well as on the webcast, to Prudential's 2017 Investor Day. So, it's great to see everybody. Before getting started, if you open your own materials, I will walk through a couple of important disclosures.

Today's presentation includes forward-looking statements. It is possible that actual results may differ materially from the predictions we make today. In addition, this presentation includes references to non-GAAP measures. The slide deck includes a reconciliation of such measures to the comparable GAAP measures and information of all factors that could cause actual results to differ materially from those in the forward-looking statements.

Perfect. Okay. In your materials, you'll also find an agenda. I'll make a couple of broader points about the agenda. John Strangfeld and Mark Grier will kick it off with executive overviews. Their Q&A session will actually be at the end with Rob Falzon, our CFO; and Scott Sleyster, our Chief Investment Officer.

The day is structured to include a heavier weighting on the strategies of our U.S. Businesses and more of an update on the International businesses, as we had a Tokyo Investor Day last September, and we'll have another one next September.

So, in the U.S. Businesses, you're going to hear from Steve Pelletier, our Head of U.S. Businesses along with each of the presidents of the respective business units in the U.S. Businesses. And so, they're going to walk through strategy both within kind of their business unit, as well as some initiatives that cross business functions. As part of that, we're going to do a deeper dive on our Asset Management business, PGIM.

In the financial portion of the program, which we'll kind of conclude today, you'll hear from Scott Sleyster, our Chief Investment Officer, and he's going to cover our investment portfolio as long as our investment strategies. And then, we'll conclude with Rob Falzon, who will cover a number of topical areas of interest. And then, we'll have the final Q&A which will be Rob, Scott, Mark and John.

Just a couple of logistical items, there will be three breaks during the day. One will be after the PGIM presentation, the second will be after the U.S. Businesses Q&A, and then we're going to have a short break after the International Q&A. We expect to conclude around 12:30, give or take. And if we can just ask that everybody's devices, phones, et cetera are on mute, we can get started.

And with that, I will hand it over to John.

John Robert Strangfeld

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you, Mark. Good morning, everyone, and welcome. And thank you for your interest in Prudential. We have a strong, tight, crisp agenda today, as Mark described, and most of it pertaining to strategy. We hope you [ph] come away (03:20) with four primary impressions. One is consistency of strategy and execution. Second is confidence in our ability to evolve our business to capture promising long-term growth opportunities. The third is our recognition of a need to strike a balance between strong results, financial strength and shareholder value creation. And finally, our conviction that talent and culture are strategic, meaning, critical to innovation and to execution and a major driver of our sustainability of performance.

I'd like to begin with mission and purpose because that's why we exist. Prudential's mission has been remarkably consistent since our inception in 1875, namely to assume risk of life that all of us face. Risks which are better borne by an institution with the benefit of large numbers versus an individual with a sample size of one. These risks include mortality and longevity, risk that can play out very different for the individual than the average expectation, risk that can materially impact quality of life if they go against you and your family and you're uninsured. These risks are best borne by a company with technical expertise and capability, trusted brand, unquestioned financial strength, and a track record of keeping our promises.

These days, certain risks, particularly in the retirement and longevity space, are being shifted from government and employers to the shoulders of individuals. And these risks are not naturally suited to most individuals to assume on their own. They're also not well suited to many sectors of financial services that primarily focus upon aggregation not outcomes.

This really makes what we do even more relevant and important in a societal sense and positions us better than other sectors of financial services to play a bigger role in the future because it's no longer simply about aggregation, it's about helping to protect the financial prospects of individuals and their families by creating predictable outcomes.

All of this gives us clarity of purpose in the things we do and the aspirations we have to become even better at what we do. We know when we perform well, from product design to distribution, we preserve and enhance quality of life of our customers, and those who depend on them.

When we perform really well, we earn a commercially attractive return and the opportunity to grow, and it's that simple. With a mission and purpose like this, to us, our strategy to deliver on it is very clear and very focused. The essence of how we think about strategy is to have a very carefully chosen mix of high-quality businesses, which concentrate on the mission and purpose that I described a few moments ago, coupled with consistent execution, thereby producing strong and sustainable performance. And I'll touch briefly on each of those attributes.

First, carefully chosen mix of businesses. Let me describe what I mean by offering a contrast. 15 to 20 years ago, we were a financial supermarket. Today, by design, we focus on just three things: Protection, Retirement, and Asset Management, taken together and in combination. This fits with market needs, it fits with our skills, our brand, our financial strength and it fits with our mission and our purpose.

That kind of focus enables us to achieve outcomes not otherwise possible, because we concentrate our time, our talent, and our capital exclusively on what we do best. We can also manage the risk effectively and efficiently. And we can hold very high performance expectations of each business.

An example of this focus is what enabled us to have higher degrees of freedom during the financial crisis; buying businesses from those who took TARP, hiring talent from those who were retrenching, pressing on not trimming back on our pipeline of innovations like PRT. And as a result, we didn't' just weather the storm, we came out of it a much stronger company. And frankly, we never look back.

Then there's execution, which means to us achieving high customer satisfaction, delivering strong business fundamentals within each business, achieving success in innovation whether it's PRT in the U.S. or retail distribution in Japan, achieving consistent good outcomes with M&A and meeting or exceeding the financial targets we set for ourselves, all while maintaining quality control and a balance set of risk. To us, execution is made possible by talent and culture. Talented people operating in a culture we describe as no drama, low ego, high professionalism, in an organization that understand and embraces the power and wisdom of teamwork, collaboration and diversity.

To some, I know this sounds like soft skills. But to us, culture is strategic. It drives execution, it drives innovation, and it enables us to develop, attract and retain our talent. And it's not about any one person or leader, it's all of us, we all own that, we all own the cultures.

Now, the proof points of the focus strategy and strong execution is superior performance, reflected – first, I'll comment on reflected in our market positions, a top U.S. Life company, a top five Japan Life company from a business that was built from scratch about 30 years ago and then supplemented with acquisitions, a top 10 Retirement player and a top 10 global Asset Manager with $1.2 trillion of active assets under management, largely built through investments in people and capabilities, not high multiple acquisitions, and a leader and innovator in PRT in the U.S. or a distribution in Japan.

Arising from those market positioning attributes is superior financial performance; ROEs which have been consistently and meaningfully above our peers, earnings growth 9% over the last five years, both achieved while investing in our businesses to maintain and build on our competitive positions over the long term, and from a financial reporting point of view, a very intentional and enhanced linkage between operating results and net income and book value growth.

Then, there's growth in adjusted book value per share plus dividends at a 10% rate the last five years. This is a key metrics to show the compounding of our value over time. We pay a lot of attention to this metric, and Rob Falzon will speak to this more extensively later in the agenda.

And finally, capital deployment. Over the last five years, we've distributed nearly $12 billion, including $10 billion in dividends and share repurchases. And we've done this while maintaining a very strong capital position, which provides significant flexibility to execute on future inorganic opportunities if and when they occur. All of this is accomplished while being highly conscious of the need to achieve balance between growth and ROE, cash generation and deployment, and volatility and risk.

As Rob will elaborate upon later, each of these needs need to be appropriately balanced. We don't put undue weighing on one at the sacrifice of either of the other two. They must all work in harmony. And this proper balance produces superior financial strength, shareholder value creation, and very importantly, sustainability.

So, in conclusion, our mission and purpose are to us clear as a bell. We strive for consistency in strategy and execution. Our choice and quality of the businesses reflects this. Our talent and culture drives innovation and execution, which in turn produces superior performance. It produces sustainability, and it produces an ability to grow over time.

And as we see it, given our mission and the needs of the markets, the opportunities for us to continue to grow and prosper are very promising. And you're going to hear about this during the course of the day, not just from a macro overall view as I've just described, but from the leaders of the businesses that make this happen.

Thank you very much, and I'm going to turn this over to Mark.

Mark B. Grier

Vice Chairman, Prudential Financial, Inc.

Thanks, John. Good morning. I'm going to divert the track from the strategic themes that John talked about and the strategic themes that you'll see reflected in the business presentations to talk a bit about regulation. And my objective this morning is some level setting around what's going on and some context with respect to how we're supervised and regulated right now and what real life looks like to us. But there is an extension of important strategic themes with respect to regulation as well.

You've heard us say repeatedly that effective transparent regulation is important and beneficial. And I would just emphasize that again, at least, partly in the context of John's points about our mission and the role that we play in providing financial security. The fact is, we do complicated things that last a long time. And the validation that we get from an effective regulatory regime is helpful to us in the market. So, there are very practical strategic aspects to shaping our regulatory and supervisory worlds so that we get that validation that actually does help us in the market.

Another reminder, by the way, is that in our industry, we support each other through guarantee funds. And so, if one company fails, we're all going to chip in and pay. So, we also have a financial interest in the quality of regulatory oversight with respect to the various insurance entities to which we are exposed through our guarantee fund structures.

So, there's a theme here about trying to get this right that you've heard us harp on for a number of years now. And it has practical strategic business consequences, again, in the context of the validation of financial strength and the ability of our clients to rely on us and what it means for us to be well regulated over the long term. But I want to go from there into a discussion of various elements of regulation and supervision that we're living with now. And part of this reflects the questions we get, the discussions that we hear about where we are in capital standards and what else that might mean. And what I'm getting at there is that there's sort of been a tendency to focus an awful lot of attention on capital standards without realizing how much other stuff is going on in different arenas. And so the point is, capital standards aren't the end of this, and capital standards aren't the only thing that we need to be focused on or worried about or paying attention to.

And starting with capital standards, the fact is, we do have capital standards. What we don't have is a set of GAAP-based consolidated tops-down capital standards that the Fed will develop ultimately according to their game plan that would affect Prudential at the group level. Now, you've also heard us say that we're not so sure GAAP can be relied upon as the primary way in which to develop capital standards for an insurance company. GAAP is not a robust, appropriate measure of risk, solvency or financial strength.

So, our view will always be that GAAP is just part of the equation, but, as I said right now, that's the thing that's missing and that's what we probably had a disproportionate amount of attention focused on in the marketplace because we have very robust and effective entity-by-entity capital standards in our insurance world, domestically and internationally.

We talk about our risk-based capital ratio. I'm reminded that during the crisis, people who couldn't even spell RBC were asking us what our RBC was. And they wanted to pay a lot more attention to that statutory world than to the GAAP world in the stress environment of the financial crisis. And so remember that there is an anchor out there that's consistent and effective and proven over time that is an important and robust capital measure for us. We also, as a matter of good hygiene, maintain a substantial volume of balance sheet targets and limits and standards internally taken to and approved by our Board of Directors.

So, we have limits, we have capital standards, we have pictures internally that run through our governance process in a way that is not arbitrary and casual, that has a lot of substance, that are carefully developed and that are monitored and reported as it relates to the board. We also have external capital standards as it relates to the rating agencies. So, there's a range of capital standards and capital-related activities that are in effect for us beyond that high-level macro consolidated, tops-down GAAP thing that we live with everyday.

So, the fact is, we're not operating in a void with respect to capitalization, capital standards and risk. And I would add, by the way, that internally we focus on GAAP measures, we focus on statutory measures, and we focus on economic measures. We top that off by tossing liquidity into the capital story sometimes because it also matters as part of the overall risk profile of the company.

So, with respect to capital, there's a lot going on, it's looked at a lot of different ways, it's enforced from a number of different directions. And, yeah, we're waiting to see what happens on the consolidated GAAP side of things, but I've said repeatedly, we expect to comfortably meet or exceed any reasonable standards that are set by regulators in that context. And part of the reason for being comfortable with that is that we are meeting or exceeding a wide range of capital standards right now in the context of either statutory authority imposed on us, in the context of our own governance processes or in the context of meeting market standards, particularly as that relates back to rating agencies. So, there's a lot happening in the capital arena.

Second thing, supervision. With respect to supervision, we have the Federal Reserve as a group supervisor; we have the state of New Jersey as a group supervisor. This [ph] isn't the (20:09) one you've just heard us starting to talk about this. And there's a new authority for the state and their assertion of New Jersey as our group supervisor is in the formative stages. But having said that, they are in the midst of a very comprehensive exam that's covering the group aspects of Prudential, not just the legal entity in New Jersey that would have historically been part of the franchise for the state of New Jersey. So, we have a more expansive approach to group supervision by our domestic state regulator in New Jersey and we also have the Fed.

Keep in mind, with respect to supervision, we also have supervisory processes going on around the world. John mentioned Japan and how important that is to us. We have a very strong, healthy, robust supervisory environment there under the Japanese FSA, and in all the countries in which we operate. We also have every state in the country in which we sell, looking at products, looking at suitability, and looking at complaints and anything else that they're interested in. So, again, with respect to supervision, the new element is New Jersey, asserting itself as a group supervisor, taking a more comprehensive view. But it's in the context of a wide variety of supervisory activities that touch many of the things that we do.

The third thing I want to touch on is stress testing. Yeah, we don't do what the banks do. We're not yet in that Federal Reserve Bank environment. But in the context of what we do with respect to state supervisors, we do an ORSA test which is an Own Risk and Solvency Assessment. That is extremely robust. It's thick. It's comprehensive. It's full of information about how and where risk springs up in the company. But it's also full of information about how and where we understand and mitigate the risks that we take. So, that ORSA process is important, very fulsome and very substantial.

We also run our own stress test which we believe are at least as severe as the stress test that the banks go through. And so, we're always doing this. It's part of capital planning. It's part of some of the things that we talk to you about, and it's part of what is regularly shared with our regulators. So, stress testing won't be new if we ultimately evolve into a world that looks something like CCAR, it won't be exactly because we're an insurance company, but it won't be new for us. We have the foundation of our own stress testing processes and we have the very robust foundation of what we do through the ORSA exercise. So, those three elements; capital, supervision and stress testing, are kind of core to the overall regulatory and supervisory world in which we live.

The fourth thing that would be on the list would be resolution and recovery, that's not really going anywhere right now, so I'm not going to talk about it. But if you really want to flush out the four things that are central to all of these supervisory regulatory initiatives, they would be capital, supervision, stress testing and then recovery and resolution.

So, the point of this is that when we do things like raise the dividend or initiate a share buyback or do a deal, these things are being done in the context of a lot of regulatory eyes always looking at everything. Now, I've refused to comment on specific aspects of our supervisory world and supervisory activities, but you should understand that the point of this discussion is you don't need to ask us if that dividend had been approved by the Fed or if that share buyback had been approved by the state of New Jersey. This is part of day to day life for us. We are involved all the time in reviews and exams and responding to reports and dealing at our supervisory level, our management level, and our board level with a wide variety of aspects of questions and examinations and work that's being done on Prudential.

So, again, you should be comfortable that everything that happens to us is going through a significant number of filters, and it's being looked at all the time. And so, the level-setting message is we have two group supervisors. They're very active in their supervisory worlds. Yes, we don't have tops-down consolidated GAAP stuff yet, but we have a lot of other stuff that we rely on, that the market relies on, that our regulators rely on, and that the board relies on.

So, just to close, we live in what is generally a world of non-disapproval as opposed to approval of things. So, when you're asking if something was approved or not approved, chances are it wasn't approved, but what really happened was it wasn't disapproved. So, there's tacit approval as opposed to explicit approval with respect to things that we do in product and capital and other actions. But take for granted that all of this is being looked at all the time. So, you don't have to be asking about whether or not such and such saw it. They saw it, they're living with us, they're here. And these are all parts of our regulatory landscape that work for us very effectively, and that make up what I think for us is that validation of our financial strength that we need in the marketplace and it provides comfort for our board and our customers.

And I will stop there. Thank you.

Alan Mark Finkelstein

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

We will now move on to the U.S. Businesses portion of the program, and I will invite Steve Pelletier to the stage.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Thank you very much, Mark. Good morning, everyone. I appreciate this opportunity to review with you Prudential's U.S. Businesses, our strong business performance, the growth opportunities that we see before us, and what we're doing in order to capitalize on those opportunities.

Our U.S. business portfolio comprises our Asset Management business, or PGIM; our Retirement and Group Insurance businesses, and our Individual Life and Individual Annuities businesses. This business mix, as John referred to, has been carefully designed over time. And it's distinctive in terms of the suite of solutions that enables us to offer the market, a suite focused on investments, retirement income and protection. And we're able to offer that to all of the clients we serve, be they institutions, employers or individuals.

Together, our businesses generate high-quality earnings from a diversified set of revenue sources; fees, spread, and underwriting. This mix of earnings and risk exposures, some businesses focused on mortality risk, others on longevity risk, businesses more or less sensitive to equity market outcomes, for example. All of this significantly contributes to the stability and sustainability of our earnings performance across economic and market cycles.

At the same time, our businesses are not immune to headwinds. For example, to cite a few, interest rates remain a headwind as we are still exposed to spread compression in various parts of our business. However, even the modest rise in rates over the past six months has significantly eased the pressure on product pricing and has enabled us to generate attractive returns on the sales that we create. Like others in our industry, certain of our businesses are exposed to fee compression, and in our Asset Management business, we are experiencing the secular trend of a shift from active to passive investment strategies.

Another headwind is simply the nature of certain businesses is that they're comprised of blocks that run off. This is particularly true in our Pension Risk Transfer business and our Individual Life business. And this runoff requires solid sales in order to offset that.

The regulatory environment is still uncertain and evolving in ways that Mark discussed. I'll speak to the DOL fiduciary rule as an example. Now, I want to emphasize right upfront that we are completely ready to go in terms of the aspects of the rule that go effective later this week, and we're well-prepared for January 1, 2018 when the bulk of the rule's operational requirements are scheduled to go into effect.

As we previously stated, we fully support the intent of a workable and robust standard of care for advisors that ensures that the best interest of their clients are being met. At the same time, we look forward to the outcome of the review process currently underway, and we'd be highly supportive if what emerges is a revised and clarified rule that clearly articulates that robust standard of care in a way that is readily and consistently enforceable by our regulators.

Despite these headwinds, our strong fundamentals bode well for continued strong business performance. There continues to be a very healthy Pension Risk Transfer pipeline, and our market leadership in this space positions us very well to compete for the opportunities that we deem to be within our sweet spot. More on this from Phil Waldeck later, but we remain very bullish on this opportunity.

We continue to deliver strong Asset Management third-party flows. 2016 represented the 14th consecutive year of positive flows from institutional investors, and the 12th consecutive year of positive flows from retail investors. That is a consistent track record of remarkable market success that we think is highly enviable within the asset management industry.

Sales in our Annuities business are increasingly of a diverse suite of products that enables us to advance a broader range of solutions to the marketplace and address a broader range of client needs, but also enables us to diversify our own risk exposures. More from this and other aspects of the Annuities business from Lori Fouché shortly.

We continue to experience high persistency in our Retirement and Group Insurance businesses, and sales in our Individual Life business both trend above-industry averages and are right in line with the targeted mix of sales that we seek to achieve. Strong fundamentals are further demonstrated here by a five-year picture of annual growth in assets under management, account values and in-force premiums. And that growth, as you can see, is virtually across the board. Positive net flows have been a key contributor to account value growth in Retirement, and AUM growth in assets under management.

Now, in Group Insurance, as you see here in this five-year picture, revenue growth has been constrained by our multiyear effort to raise the bottom-line profitability standards of our whole book of business. But you don't see it on this five-year timeframe. But in the past two years, the strength of the value proposition that we've been able to advance in the Group Insurance business has resulted in revenue growth. Andy Sullivan will speak at greater length later about that value proposition and the traction that it's gaining in the marketplace. In Individual Life insurance, we've seen solid growth in insurance revenues, a significant portion of which is attributable to our acquisition of The Hartford's individual life insurance business in 2013.

We're pursuing attractive growth opportunities in the markets we serve; institutions, employers and individuals. Now, the specifics of these opportunities will be addressed by each of the business heads in a bit. So, I won't go into too much detail here. But suffice it to say that key themes include a focus on broadening our solution suite, including more simplified, streamlined, outcome-oriented solutions; expanding our distribution capabilities especially into technology-enabled type of channels, and deepening our relationships with employers and their employees as individuals through the financial wellness platforms that we're creating.

To pursue these opportunities, we've been making investments across our businesses. We're focused on building foundational capabilities such as a comprehensive set of tools around education, counseling and solutions for individuals on those worksite platforms in the context of that financial wellness offering.

Simplified products and outcome-oriented solutions as I mentioned that are easy to understand and that enable us to address client needs as those needs evolve over their lifetime. In particular, enhanced distribution and advisory capabilities that enable us to deliver solutions in the ways that many of our clients are increasingly seeking and in ways that are highly scalable for us. And increasingly as I mentioned, this means through technology-enabled channels. And an improved customer experience across the board.

Now, building these capabilities has required investment on our part. However, a large part of that investment has been funded by the continuous and successful pursuit of cost efficiencies across all of our businesses in our established business platforms.

And we believe these investments will pay off in the form of long-term business growth. In fact, they're already starting to pay off, already generating tangible benefits as we deliver individual solutions to people who come to us via our employer-related businesses.

One example of this is Prudential Pathways, a distinctive and highly differentiated component of our financial wellness offering. Through this program, which we only launched in 2015, some of our top Prudential advisors are able to deliver financial planning and education seminars to employees of our group and retirement corporate clients. This not only benefits the individuals who participate in those seminars, but it also deepens our value proposition to employers. This program is a proof point of the momentum that we're stabilizing in advancing their financial wellness proposition into the marketplace, and it's already proving to be a differentiator for us.

As I mentioned, we launched this only in 2015, it's already been adopted by close to 250 employers representing 3 million employees.

We know that a number of our recent case wins in Group Insurance had been specifically attributable to this part of our value proposition, and we've been able to win that business at attractive prices. And the program also enhances our standing as a talent destination for top financial advisors in our Prudential Advisors channel. That top talent seeks to join us because of the reach and impact that they see they can have as part of this program. In addition to the program in 2017 include digital education, employee transition seminars, and executive services.

Each of our business leaders today, when we have the panel in just a moment, will elaborate on these important tenets of our collective U.S. businesses generating high-quality earnings from diversified revenue sources, pursuing growth opportunities in individual, employer, and institutional markets, and strategically investing both within and across our businesses in order to capture those opportunities.

And with that, I believe I'll turn it over to David Hunt for his discussion of PGIM.

Alan Mark Finkelstein

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

Thank you, Steve. Many of you will recall that David Hunt spoke at this forum about three years ago on our Asset Management business. This is a business that has undergone a number of strategic initiatives. We've rebranded the PGIM. There's been a number of distribution initiatives and there's been a number of product-related initiatives as well.

It's also an area that, as you all are aware, is an evolving industry. So with that, we wanted to have David come up and give an update on PGIM.

David Alexander Hunt

President & Chief Executive Officer, PGIM, Inc.

Mark, thank you very much. Ladies and gentlemen, good morning and thank you for the time you're taking today with us. As Mark said, I did talk in 2014 about the initial strategy that we had launched and the investments that we wanted to make in the business.

And so, what I thought I would do today is actually evolve the conversation now that we've had a couple of years of the strategy, to give you effectively an update on how those investments are playing out. I do want to spend a couple of moments in the beginning here to highlight the real strength of the business. But then I will come on to the investments where we see them paying off and the next couple of years of evolution of the business.

So let me start with a theme that John mentioned which has been consistency of strategy. PGIM has had its current form really since 1998. So we are going back about 20 years now. There's really only been four leaders of the business in that timeframe. And when John originally set the business up and separated it out from the insurance company and set it on a path to really build and grow a big third-party business.

That strategy has remained completely consistent now for almost 20 years. And I want to talk a little bit about how about it's played out in the mix of business and the diversification that we have. I want to talk about where we see ourselves in terms of the third-party client base and the real progress we've made in globalizing the business. So let's hit each one of these in turn.

First of all, in terms of our mix of fees, you can see that about 40% of the business is fixed income, which you would expect given our heritage. You'll see that about a quarter of it is public equities, but you'll see that moving up toward 20% of it is actually our real estate business and the balance of it is our two private businesses, which I will talk about more of in a moment, what we think of as particularly unique.

Some of the things that people at times overlook about the mix of business are here on the right hand side. When we did our strategy work, we identified a series of places that we thought would grow quite a bit faster than the industry overall.

And over 50% of our fees are coming from those areas. I would highlight in particular that we have about $630 million of our fees, our total fees are about $2.2 billion, in real assets and alternatives. And we believe that real assets and alternative, particularly in the institutional space will grow disproportionately over the rest of this cycle.

We have a big private credit business. As I mentioned, we have over $300 million in fees that come from private credit. We believe that quantitatively managed strategies, particularly in equities but also increasingly in debt will grow and we have a big business that drives its majority of its revenues from a quantitatively managed businesses.

And then consistent with the rest of the U.S. businesses, you'll see that we really do believe that outcomes are increasingly demanded by our clients. And our business and liability-driven investing and other forms of outcome which range from target date funds all the way up through asset allocation strategies is also a very big business for us at the moment. So, overall, our mix of business is nicely weighted toward those areas that we expect to grow in the future.

Our client base, about 20% of the fees from PGIM come from the general – from managing the general account. Sometimes people are surprised at that because the converse is that 80% of our fees are coming from third-party managers. You can see here that institutional is almost up about half of that and about a third of it then is retail. So we have a very nice mix of client base and we don't really want to change that overall mix as we go forward. We think that balance is really nice.

The success that we've had on the third-party side is on the right-hand side. Importantly, we have a large number of clients that have both been with us for a long time and who are very large clients. You can see 78 clients have more than $1 billion.

We have pretty much everybody who is of size in the pension world in the United States as a client. And we are closing in on 50% of the world's top 300 pension funds around the world. We also service the majority of the largest sovereign wealth funds and central banks right around the globe as well. So the third-party business, overall, is continuing to grow very robustly and is becoming a larger share of the overall total.

I mentioned global as an important strategic theme that's been consistent over the years. We now have about 1,100 professionals who are in investment roles. And these folks are really operating increasingly as a single global entity. You can see that we're now in 16 countries around the world. Our major hubs remain with the headquarters in Newark, in London, in Tokyo, and Singapore, but we also have offices in the majority of the financial centers right around the world. And you'll see later in the presentation the growth of this, particularly on the distribution side.

One of the things we realize, and Mark mentioned this in the opening as we built out our global footprint, was that we didn't have a brand for the investment businesses. We had a brand for many of the underlying asset managers, but that the overall umbrella asset management business didn't have a brand in the market place, it didn't have a brand with the media, and we needed to have a single global name that we could refer to ourselves that would take into account all of our capabilities and that we could use in London, in Tokyo, and Singapore in a consistent manner.

So, starting last January, we rolled out the PGIM brand and we've been very consistent in our messaging around it, that it is a brand that is built for decades not quarters, we are long-term active managers, and I'll talk a little bit more about the mission behind this in a moment.

In addition to rolling out that umbrella brand, over the course of the last 18 months, we've had four of our businesses, which has also adopted this brand. So we actually now have PGIM Fixed Income, our real estate equity business is now PGIM Real Estate, our commercial mortgage business is PGIM Real Estate Finance. And our retail business has recently rebranded to PGIM Investments. So you will see the network effect now of all of this rebranding come and really create much more of a halo around the PGIM brand broadly.

We're now the ninth largest asset manager in the world. And you'll see that a number of the very large asset managers also have a large share of passive in them. But, overall, when you rank it together, we are a top 10 manager, which I think is increasingly now well known and recognized.

But I pushed – on the right-hand side a number of facts that I find aren't as well known. For example, if you take our equity and debt capability in real estate, we are the number one real estate manager around the world. We are, at this point in Japan, the number one foreign manager of institutional assets. And overall, with all of the press interest and everything else in private debt, this may be new to the asset management world, but it's not new to an insurance company. We've been doing this for 100 years, and we have a long track record in private debt, and are a top 10 private debt player which includes our infrastructure business around the world.

The original architecture of PGIM which was set up as I said about 20 years ago, was a multi-manager model. And we truly believe in this as the way to manage money effectively for our clients. This is a model that you choose, because you have as your objective investment performance.

I cannot stand in front of you and tell you that it is the most efficient model that could possibly be designed. But what it is, is it's designed so that we have each business specializes in a particular asset class and we have deep expertise in each one of those.

Each of our businesses feel like a small investment partnership still today. If you went to one of the management meetings, you would not feel you're a part of a Fortune 500 company. You would feel very much that you're a group of people who know each other, who have worked together for a long time, and have an absolutely deep and abiding interest in the investments, in whether or not it's equities or debt or real estate, and we think that that is the special sauce. The fact that we are small, nimble, and flexible and yet we can invest as a trillion-dollar manager, it's that combination that allows us to deliver real investment returns for our clients.

Every business has its own virtuous cycle and this is ours, and it starts very much with investment performance. That is what we're about. When John and Steve call me up and say, how is it going, they mean how are you doing with investment performance and so they should, they're my largest clients. But that is really our sole objective. If we do that well, it leads to client trust and client flows that does lead then into earnings which we can then use to reinvest in areas for our clients. And that may sound very self-evident to a lot of you, but I can also tell you that I'm always surprised in the industry how many people start at different points on this.

The number of CEOs of asset managers who actually have an AUM target, I find quite stunning. We have a lot of targets and they're around investment performance for our clients. And let me just take you through how this has worked over the last five years in terms of the real fundamentals of the business.

So if it all starts with investment returns, here's what those look like. So over 3, 5 and 10 years net of fees, we have 78%, and in the case of 10 years, 88% of our assets actually outperformed their benchmarks.

On our retail side of things, 68% of our mutual funds are four and five-star rated. So we are an active manager, but we have the track record to show that we are delivering the alpha here for our clients.

And this is what's led to what Steve highlighted in his remarks. We've had 14 consecutive years of positive institutional flows, third party, and 12 years of consecutive positive retail flows. The makeup of this has shifted over time. There have been periods of time when a lot of this was equity.

More recently, most of this has been fixed income, and we, like others, have seen equity outflows. But as it's [ph] flowed (50:00) and gone through the cycle, we have a mix of business that will have strategies which will grow in all parts of the economic cycle. And I think that balance and diversification is really key to the consistency of this outperformance.

So that level of flows has led to a growing earnings stream. You can see here that over the five years, we've had our overall earnings grow at about 8% compounded annually. Importantly, during that time though, our core earnings which is the dark blue here, has grown at 12%.

And that's because we have, in a very conscious way, tried to actually have more come from core fees and less income that comes from transaction or other kinds of more capital-related activities.

And so we do think the quality of the earnings has increased even as we've been able to grow the business quite substantially.

Now, I mentioned the strategic plan and our investments. And I'm going to talk in the next section about what those investments are and how they've been directed. But I want to address right upfront how they've been paid for. So you can see here that if you go back to 2010, our margin within Asset Management was 26%. We have – because we've been growing very rapidly driven significant operating leverage in the business. And the idea here is fairly simple. The marginal margin on dollars that have come in, the strategy is that we already manage are very high. And we've had very significant inflows that have come in to businesses that are already very large for us. That's driven real operating leverage to the tune here of about 270 basis points during that period.

What we've done is to take the majority of that and reinvest it back in the business. Some has been returned to shareholders as you see with the higher margin. But the 230 basis points has been put back into the business in order to fund what we see as important future growth for the business.

And let me talk a little bit about the places that that has gone. So many of you will have seen before but this is our little strategy house. We have a very clear mission and objective, which is to be widely regarded as the premier active global investment manager and each of those words we've chosen very distinctly. We didn't want to be the largest but we do want to be premier. We have chosen active and I'm going to talk a little bit more about that in a moment. And we have chosen global as very important pieces of this overall. The foundation, clearly, has got to be superior risk adjusted returns across a broad range of both public and private asset classes. And the strategy relies on four pillars. One is the globalization of the business, the second one is broadening out our solutions capabilities. The third is the broaden up the range of vehicles that we actually offer our strategies in, and the last has been to acquire and I mean that in the broadest sense not just in M&A sense, but to acquire and achieve a select set of new investment capabilities around the world. And I'm going to hit on each one of these in a moment.

So let's see where we are on the globalization. The biggest investment that we have made on the global front has been to build out our distribution. So we now have a global sales force, which is representing all of the PGIM asset managers in Singapore, in Tokyo, in London, who are calling on about 200 of the largest CIOs around the world. And we think this has meaningfully shifted our overall position with those clients. And indeed, the overall globalization of the business you can see has meaningfully changed. So, in 2010, only 11% of our clients – of our assets were managed for non-U.S. clients. That number were here up to 27% from non-U.S. clients. That is a very significant shift.

We've launched our multi-asset class solutions capabilities very significantly. We know have almost $140 billion in multi-asset class solutions right across our businesses. The products and vehicle diversification has been very significant. I would particularly point here to the range of new mutual funds that we've launched, where actually 35% of our flows today are coming from products that we didn't have five years ago. So those are paying off actually more quickly than we thought.

And last, we have a very – I would say, successfully launched a full range of new capabilities. And for us, organic growth is our absolutely preferred method. We believe in taking some talented people from the inside, sometimes we will hire a couple of people to augment that and we will launch a new strategy with our own seed capital. That has worked exceptionally well for us and I think that when we look back in five years, that will always be the main source of how we grow.

Recent examples of that would be our global equities capability, our agricultural lending capability, our new global asset allocation capability in QMA and that's all been organic. We have occasionally looked at non-organic opportunities where we felt that there's an opportunity to bolt on a business within our multi-manager model. And you've seen a couple of examples of that. We bought a macro fixed income manager two years ago. Last year, we acquired Deutsche's Asset Management business in India. So we are open to those kinds of opportunities. But I would say, broadly, we like the organic growth that we've been able to achieve.

Overall, when you put – take the 230 basis points of margin that we put into this and you say, well, what did we get out of that? The answer is, over $50 billion of net flows over the last three years. Those are flows that we would not have if we had not put that money successfully to work in new distribution and new products. So, I would say, overall, we're actually paying off slightly faster than our internal models would have predicted.

Now, we launch into this very much with our eyes open. There are some important headwinds. Steve mentioned a number of them for the overall businesses and this is also true for the Asset Management business.

There is a very real rise of passive investing, and I want to spend a moment just on our response to that. And I also want to talk about fee pressure. Importantly, when we did our strategy work, we really looked at whether or not we should get into the passive business. And we came back very clearly with the answer of no. It was a low-margin business that we didn't see how we had anything special to offer to.

So rather than to get into passive, we have directed our equity strategy to be effectively high-active share strategies, which can be used with the passive portfolio, and into quantitatively managed strategies. And we believe both of those will exist very happily with passive strategies and will grow with the markets.

Fundamentally, we think that alpha will return to active equity managers. We've seen this come in the cycles before, but more important is the pressure on fees. And that's why we believe that passive investing in equities will actually grow even from where it is today and why we have wanted to design our business to work with passive rather than to fight against it.

It does bring [ph] the pressure (58:03) on fees. So there is real pressure in the Equities business on fees, and we think that that will, as I say, continue. What we've done to mitigate that has been to continue to invest in new product development in our Institutional business, for the most part around our Privates businesses and real assets.

So we've been launching a number of new real estate products, both debt and equity, our mezzanine funds, but we look very closely at our new private placement funds. And these areas really haven't seen the same kind of fee pressure.

And so, overall, if you look at five years track record, we have not seen any degradation in our overall realized fields. But that's not to say that there isn't price pressure on the retail side particularly in equities, which is effectively being made up for by new product and shift into alternatives and real assets on the other side. So, once again, very important to have this mix of business to be able to pull that off.

So let me just close then with a couple of comments about PGIM and how it fits into the overall Prudential family. First of all, in terms of the benefits that Prudential has from PGIM, I would point clearly to the financial ones which are we have a business that's growing at a nice clip. We have it growing at a very attractive margin. The Asset Management business as we run it does not use a lot of capital, and therefore, the ROEs are very attractive and we throw off a lot of the fees that we have here directly into cash.

So from a financial picture, it's very important. But I would say that that's important but narrow in terms of the benefit. The real benefits come from the fact that we have very much a fundamental role to play in helping Scott manage the general account by the use of our private placements. And he is going to talk more about that this afternoon. And we are the investment engine inside almost all the other U.S. businesses as they're launching new products. So as Phil talks about PRT, we are the investment engine behind that. When Lori talks about our new versions of annuities, we are the investment behind that.

So while we're operationally separate, we're strategically absolutely linked to all of the other businesses. And on the other side of it, we obviously achieve enormous benefits from being part of the Prudential family, not least of which is the investment that you just saw from a long-term investor who wants to grow this business. So we have been investing at those levels because of Prudential's willingness to believe that this will pay off and that it will become better for clients over time. And so we really do believe that having a stable, long-term owner that's investing in the business and where we have a stable anchor client in the general account is a really powerful combination.

And so, with that, Mark, I will pause and will take questions at the end. Is that right?

Alan Mark Finkelstein

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

We'll take questions at the end. So we will have a short break now. If you could return eight or nine minutes, that would be great. Thank you. And I believe that there's coffee in the room that you had breakfast as well. So...

[Break] (01:01:22-01:01:54)

Alan Mark Finkelstein

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

We'll get started. We are now going to provide some brief comments on the other Presidents of the U.S. businesses. There are slides that you'll find in your binder or on the PDF if you're viewing on webcast. These serve as backup to support the commentary but we are not going to go through them in detail. Each presenter will spend a few minutes providing higher level commentary around topics like strategy, growth, market dynamics.

It's an opportunity to hear directly from the business unit presidents and really set up for a Q&A session which will follow this one. I will introduce the panel and then hand it to Steve who will emcee this section. Sitting to Steve's left is Phil Waldeck. Many of you recall that Phil spoke at this event couple of years ago. He is the architect of our successful Pension Risk Transfer business and recently became the President of the Retirement business succeeding Chris Marcks who has retired.

Next to Phil is Andy Sullivan, President of Group Insurance. Andy has been in his role for little over a year. Before that he was Chief Operating Officer of the Group Insurance business. To his left is Kent Sluyter, President of Individual Life. Kent has been in that role since about 2013, early 2013, right around the time we acquired the...

Kent D. Sluyter

President, Individual Life, Prudential Financial, Inc.

Not aged 13.

Alan Mark Finkelstein

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

Exactly. And then to Kent's left is Lori Fouché, President of Individual Annuities. She took over that role about little over a year ago. Prior to that, she was President of the Group Insurance business. So that is the panel that you'll hear from each of them and I will hand it to Steve to kick this off.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Thank you very much, Mark. As John mentioned in his opening comments, we really emphasize talent and talent development and talent management at Prudential. It's no accident that the two people to my left, your right, Phil Waldeck and Andy Sullivan are both recently named business leaders at Prudential absolutely seamless transitions by people who have deep expertise in their space. So we'll start off with the employer-based business discussion and starting off with Phil.

Phil Waldeck

President & Chief Executive Officer - Prudential Retirement, Prudential Financial, Inc.

Great. Thank you, Steve. Well, Prudential is a leading provider in our chosen institutional and full service retirement markets, with a broad range of retirement products and services.

Increasingly, we are leveraging the full power of PRU by broadening our capabilities and expanding our customer solutions and we'll talk a fair amount about financial wellness as a part of this panel is a great example of that.

And central to how we approach the Retirement business is managing risk to support solid results across market conditions. And we've had a pattern of growth over the last five years. You've seen our account values for Retirement have grown by 11% annually.

A key part of that growth has been Pension Risk Transfer and the funded PRT market is continued to be well positioned for growth. And we're particularly well positioned in that market given our execution capabilities and credibility especially with jumbo sponsors who really value that execution skill. And having been there done that experience.

Additionally, our capital capacity is attractive for that segment of the market. Interestingly, that segment of the market had a new opportunity that emerged last year and that was smaller slices of Pension Risk Transfer from jumbo sponsors which I'll describe in a moment.

Using that strategy, we are able to capture once again the largest market share in pension risk transfer in 2016. We also enjoyed significant growth in the smaller and medium-sized part of the market often what's called the cash market.

Let me start with the large plan sponsors, an interesting trend that we think we'll see more of is jumbo sponsors taking their smallest balance of retirees and packaging them for annuity transfer.

So, an example of that, United Technologies. Last year, United Technologies took 40,000 roughly retirees and did a pension risk transfer that was smaller in size, but large in complexity given the sheer execution dynamics of 40,000 retirees.

Additionally, we've been able to drive growth in the cash market, the under $500 million market, applying both data and analytics to be efficient, but also to target those segments of liabilities we've found most attractive. And for all these reasons, we see opportunity and steady growth in the PRT market.

We've also introduced new solutions in the longevity reinsurance market, and we have packaged smaller transactions into a bundle to execute flow reinsurance transactions, and we're just starting with that approach, but we think that has promise as well.

Additionally, we see opportunities with stable value in adjacent markets and products for stable value. A couple of examples of those would be the 529 savings plan market and bank-owned life insurance. And finally, in terms of areas of opportunity, with full service we see an opportunity for aggregation. So, an efficient platform to pull together smaller employers cost effectively.

And two areas that may emerge that could be potential for us are the aggregation enabled by state legislation. Several states have passed legislation that enables the aggregation of small employers. And there's a potential for a similar structure to emerge on a Federal basis.

In fact, just yesterday, we announced a sizeable new client, the Joint Industry Board. This is 33,000 electrical workers that are aggregated in a multi-employer framework with $5.7 billion of 401(k) balances that we'll be taking over this client at the beginning of July.

Now, what's been key to our ability to grow has been our differentiated capabilities and increasingly those capabilities will be fueled by the full power of PRU. And let me give a few examples, but just as David described in terms of PGIM's tight connection to the businesses, I'll give a couple of examples there.

So, specifically, PGIM has launched a series of target date funds. The Day One Funds that are central to our full-service value proposition. Additionally, PGIM has extraordinary asset origination capabilities that give us an edge in the stable value in funded pension risk transfer markets, specifically, our private debt origination and our private commercial mortgage capabilities.

And then more broadly, we see real potential, and Andy and my colleagues will describe it further in terms of building a financial wellness platform. A platform that can deliver value to employers and to their underlying employees that will be Retirement and beyond in terms of introducing broader financial security.

Now, central to how we navigate our Retirement opportunities is how we manage risk. And we've been very thoughtful in terms of how we've grown pension risk transfer, and you'll see that over the last five years, we've established a sizeable block of retiree benefits for pension risk transfer with small slices of deferred participants only if it enables retiree opportunities. But when you look at the average age of the retirees that we brought on of that block of business, it's aged 75, At acquisition it was aged 72.

So, it's a mature population, and it's very thoughtfully underwritten, in terms of understanding the liability and the diversification of that liability and concrete examples there are diversification by geography, by industry, by collar blue versus white, gender, very thoughtfully built, and you'll see that this business has produced returns that are consistent with our expectations and we continue to view this business as one that will produce internal rates of returns, at or above our targets of 11% to 15%.

Now, all of that is built on the rigor of our underwriting and our risk selection and our ongoing strength in risk management and asset liability management. Now, that said, we do face some challenges, and so I'll give a couple of example of headwinds.

The first is the nature of the PRT business. It's a runoff business. Every year, we need to produce $3 billion of funded PRT and $1 billion of longevity reinsurance to offset that runoff. Additionally, it's lumpy and not predictable quarter-by-quarter or even year-by-year. So, there'll be periods where we'll need to be patient and wait for the market to come to us, but that market opportunity is right, the timing is the part that's uncertain.

Additionally, we face challenges in terms of interest rates. Interest rates are headwind that creates a pressure on our margin for the full-service business. The spread compression is associated with stable value and our [ph] mitigant (1:11:18) strategies there include our ability to set crediting rates and our asset liability management capabilities.

And then finally, we face uncertainty. The industry as a whole faces uncertainly in terms of tax reform and regulatory reform.

If you pull it all together though, the Retirement business is one for which we're optimistic, because of our leadership position across the selected markets that we've targeted. Our best-in-class capabilities for pension risk transfer, all built on proven risk management and underwriting capabilities.

And then finally, our demonstrated pattern of innovation and the opportunity that's in front of us in terms of innovating across the U.S. businesses connected together, the best example being financial elements that we'll talk more of.

But in sum, we've got strong and well-managed in-force business, with future growth potential that provide solid earnings and return potential.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Thanks, Phil. For the other part of our employer-based businesses, Andy, regarding Group Insurance.

Andrew Sullivan

President, Group Insurance, Prudential Financial, Inc.

Thank you, Steve, and good morning, everyone. I'm pleased to be here with you, to share the current state of Group Insurance, as well as give you an outlook for our future.

Prudential Group Insurance is the second largest group life insurance carrier in the marketplace. We are privileged to hold a 14% market share, and we're the ninth largest disability insurer in the marketplace, with a 5% market share. We have a very strong reputation, a very strong brand, and we are privileged to have very strong relationships with the intermediaries in the space.

We have established a strong track record over the last several years of steady AOI growth and improving margins. That strength has come from a laser focus on fundamental execution. Specifically, we've invested a lot of time and energy into improving our underwriting and claims operations. That work led directly to strong improvement in our benefit ratio, specifically going from 92.4% in 2012 to 87.5% currently, a level that's within the target range for our given block of business.

In 2015, we began to resume disciplined controlled growth, and I would emphasize the word discipline from a pricing perspective. We're on track in 2017 to accomplish growth that is ahead of market growth rates. As we look forward, we are excited as we see solid opportunities to continue growing the top line, as well as to continue expanding the margin in the business.

There are three primary areas of focus that I'd like to cover that we believe will produce both the growth as well as the continued market margin expansion going forward. First, our work to deepen our financial wellness value proposition, which you've already heard Phil speak about, and you'll hear more about as we continue this morning. Second, the diversification of our core business. And third, our work to improve the efficiency in our business.

So, let me start with financial wellness first. We see a very real need in the marketplace that is accelerating. Employers absolutely want to help their employees become more healthier financially. They see this as an area that's impacting their employees' productivity and performance, and therefore, it's having an impact on their bottom lines and their outcomes.

Our proprietary research shows that 70% of HR professionals believe that financial stress in the workplace is impacting employee performance. We are able to respond well to this marketplace need. And when I use the word we, I'm talking about collectively the businesses represented in front of you, and in particular, the partnership between the Retirement business and the Group Insurance business.

The fact is we already have a strong value proposition. Our Retirement business has strong capabilities around saving and investing. And our Group Insurance business has strong capabilities around protection. We're building on that strong foundation. Over the last two years, and you heard Steve discussed this earlier, we delivered a very capable onsite education program that we call Prudential Pathways. That program is now utilized by nearly 250 large employers to deliver onsite education in the workplace to their employees. And that – those seminars are conducted out by Prudential Advisors and that's a group that you're going to hear Kent speak more about as well.

Within the last quarter, we delivered new digital capabilities that include an employer digital financial wellness portal, that include digital financial education, which is important. That means we can educate employees no matter where they may be located, as well as a new individual self-assessment tool. And that self-assessment tool help individuals understand where they are from a financial wellness perspective, but also importantly, help employers understand where their employee population stands.

We have clear evidence that these capabilities are resonating in the marketplace. They're helping us win new business, and they're helping us retain clients at the right margins. Our financial wellness value proposition and capabilities have been cited by several large employers recently in their selection of us to provide protection benefits to their employees.

The second area that will propel our growth and margin expansion is diversification. 79% of our block of business is life insurance, and 85% of our book of business is national accounts. And we define national accounts as employers that have 5,000 or more employees.

We have an explicit strategy to further diversify into disability as a product, and that includes absence management, short-term disability and long-term disability, as well as further into what we call the premier segment. In the premier segment is those employers that have between 100 and 5,000 employees. Disability and premier are areas where we see good margin and growth opportunity.

I want to be clear though as I talk about diversification. We intend to maintain our leadership position in large national account life. So, nothing that I'm talking about looks to detract from that.

So, let me go further with disability. We've made significant investments in our core claims and operations, in our talent, and in our technology.

We've invested in delivering new consultative solutions to our clients, and we've also invested in core absence management capabilities. Included in this, is investments in improved customer experience, improved digital interactions including two-way texting and improved status capabilities. We focused on communicating all these new capabilities to our producer partners, and it is resulting in a rising reputation and prominence in the disability space.

All of this effort is paying off for us. We are seeing stronger benefit ratios, improving admin ratios and growth on the top line. Year-over-year, our admin ratios and disability have improved by about 280 basis points, and we are growing at an above-market rate from a revenue perspective with year-over-year growth of approximately 9%.

On the premier segment and today, as I mentioned, it's approximately 15% of our business. It is a key focus for us. We believe we have the capabilities that we need to win in this segment. In addition, we're investing in distribution leadership and talent in key markets. And we're in the process of expanding our premier distribution force by about 10%. We also have done work to rationalize our service model in the space, and in this segment, it's all about local service. So, we are working on having a better local service model for premier.

Finally, we have been investing quite heavily in predictive analytics, and in particular, predictive analytics aimed in the pricing arena. Predictive modeling with pricing has genuine applicability in these medium-size cases. Similar to what I discussed in the disability side, we are seeing a payoff for these efforts as the premier block of business has grown year-over-year by approximately 10%.

As a final point, we are focused on improving efficiency across the board as a key lever for us for margin expansion. We have a lot of ongoing effort to improve our administrative ratio. That's coming through both in efforts to reduce real year-over-year expenses, but also making sure that as we grow the top line and as we grow revenue, we're disciplined, and we capture the benefits of scale. Our admin ratio had peaked at over 15% and is now trending down towards 14%. We believe we have more room to improve upon this, and we will continue to improve upon it over time. It's important to remember that our administrative ratio that will shift as our book of business diversifies.

So, in summary, we are pleased with where the business stands today. We feel that we are competing from a position of strength. We see opportunity to grow the top line in our areas of financial wellness, disability and premier. We also see opportunity to continue to expand our margins with our diversification in general and our expense work.

And with that, I'm going to give it back to Steve.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Andy, thank you very much. Let's pivot now to our businesses that serve individuals and we'll start with Kent Sluyter, Head of the Individual Life business.

Kent D. Sluyter

President, Individual Life, Prudential Financial, Inc.

Thank you, Steve. And good morning, everyone. The Individual Life business has grown in a measured and disciplined manner over the last five years. Our sales growth has outpaced the industry and our insurance in-force has grown by 60% over that time period. Now, about half of that growth in insurance in-force is distributable to the Hartford acquisition.

In addition to providing solid results from the in-force, the Hartford acquisition has really taken this business to the next level, in terms of scale, in terms of capabilities and in terms of distribution. The business is well-positioned for sustained growth going forward. Our success is rooted in our strong business fundamentals, our strong risk management, as well as distinctive product, service and distribution capabilities.

And I'd like to take a couple of minutes to elaborate on the strengths we have around product, service and distribution. [ph] We really believe (1:21:10) that this is a very broad product portfolio. That gives us relevance and reach to a wide range of customers and distributors. Maintaining a broad portfolio is contrast with what we have seen from some of our competitors who are retrenching or recalibrating their product portfolios driven by changing in priority or changes in market conditions. Now, for whatever reason, this is really kind of an advantage we've gained in the marketplace and we see that continuous – continuing opportunity to facilitate growth going forward.

Our fund portfolio provides substantial mortality risk for the enterprise. That is a risk that we like and a risk that we manage well. As you will see in the takeaway slides you have in your deck, over a long period of time our mortality experience has been very consistent with our expectations over that period, recognizing that it can vary either positive or negative in shorter periods of time.

We manage our product portfolio to achieve diversification of risk. The key focus of ours makes us comfortable with the mix we have of risk and exposure. And we continue to adjust that mix going forward as economic and competitive conditions change.

Since 2013, we've been managing our portfolio to be about one-third Guaranteed Universal Life or GUL; one-third term insurance; and a third other UL products, which includes products like Variable Universal Life and Indexed Universal Life. This is a reduction in the level of Guaranteed Universal Life sales, which is our most interest-sensitive product and our most capital-intensive product, and an increase in sales of – proportion of sales of other products in our portfolio.

I will also highlight that earlier this year we introduced a new version of our Guaranteed Universal Life product that really reflects the adoption of principle-based reserves. The other advantage of this new version of product is that it no longer requires captive financing, which really kind of contributes to a more simplified approach to this business going forward.

Like our competitors, we are continuing to evaluate the impact of principle-based reserves on our product portfolio, and we will be migrating the rest of the products in our portfolio to that reserved structure over the next couple of years as the rest of the industry does the same.

At this point in time, I would expect there might be some pricing and some product feature differences as we transition over to principle-based reserves, but overall we don't expect it to have a material impact on the risk and return profile of our product portfolio.

In terms of our strong business fundamentals and risk management, we have always taken a very granular and disciplined approach to product pricing and adjusting our product pricing as warranted. We ensure that our products reflect the appropriate returns under various scenarios including when rates remain low for a long period of time. As a stress test, we specifically look at low rate environments and our IRRs that we achieved under those scenarios.

I'd like to shift for a minute to talk about our distribution and servicing strengths as well. Our multichannel distribution network gives us a footprint that is sizable, scalable, unique in the industry, providing us with balanced profitable long-term growth opportunities and expanded market opportunities.

According to LIMRA sales results, we are considered the market leader in third-party distribution and sales of life insurance. In addition, we are recognized as an industry leader for superior service and underwriting, which we believe is a competitive advantage.

I mean the independent advisor space, we have [ph] long been (1:24:40) strong in the brokerage general agency space and with producer groups. We have folks on partnering with the retail producers at a local level providing value through the depth and breadth of our talent and our solutions.

In the banks and wirehouse space, we are optimistic about our ability to continue to see strong sales. We see more opportunities for strategic alliances to generate new sales in this space. As an example, our partnership with Edward Jones in 2016, Edward Jones chose just a handful of distributors and manufacturers to establish an alliance to exclusively serve their 15,000-plus advisors.

Prudential was selected as both a distributor and a manufacturer in that space. And we see opportunity with Edward Jones and other partners in the space to increase the focus on life production going forward. In our captive distribution – we also see advantage in our captive distribution space.

Prudential Advisors continues to be the leading seller of life and annuity products for the Prudential life and annuity products in the U.S. Their national footprint allows us to develop deeper client relationships and enhance our service offerings across the U.S. businesses, and you've heard some of that here today, and you'll hear more of that as we talk further. And as we explore new and better ways to engage with customers, Prudential Advisors platform provides a natural platform for development.

The combination of our consistency of strategy, distribution strength, product breadth is very attractive to today's marketplace, allowing us to compete effectively on more than just price. Our distribution partners look at Prudential for financial strength, brand recognition, competitive products and services, our ability to deliver on these fronts in a consistent client-focused manner differentiates us in a competitive market environment.

Now, looking forward, we also believe that growth in this business will be enhanced by our ability to deliver simpler, more consumer-friendly protection solutions. We continue to innovate around the underwriting process having introduced more sophisticated data analytics to replace [ph] social (1:26:53) medical underwriting requirements. We have innovation labs that are driving next-generation insurance concepts, the development of those. And we have launched capabilities that dramatically shorten the timeline to take new insurance concepts to the marketplace.

However, the ability to deliver a modern digital experience is not just about one product line. It is a cross-functional collaborative effort. We are exploring solutions that will plug into a more holistic Prudential customer experience. Advice will continue to be a very important role in the future of this business. Our ability to deliver advice through our Prudential Advisors system channel is differentiating factor as we seek to deleverage work site opportunities associated with our investment in financial wellness, as you've heard us already talk about here today. We're already seeing tangible benefits from the collaboration across group, Retirement and Prudential Advisors, with Prudential Pathways that Steve has mentioned, Andy has mentioned earlier in this program, and the introduction in 2017 of additional capabilities.

In summary, this business has solid fundamentals with broad product distribution and service capabilities and we are well-positioned for sustained growth. At the same time, we are investing in the development of more consumer-oriented experience and solution sets that span across our business and [indiscernible] (1:28:15) make our solutions more accessible to many consumers who we are not effectively engaging today.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Okay. Thanks very much. And now finally, we'll hear from Lori Fouché, Head of our Individual Annuities Business. Lori?

Lori Fouché

President, Annuities, Prudential Financial, Inc.

Thank you, Steve, and good afternoon, everyone. Our Annuities business today is a mature and seasoned block of business, with approximately $157 billion of assets under management. We are among the largest in the industry with a wide distribution of platform and enjoy strong partnerships with our distribution partners. It is a block with a solid ROA, strong cash flows and a lower risk profile with strong capitalization.

I'd like to take each one of these areas and make a few further comments about each one. Due to having a more mature and seasoned block, we have enhanced understanding of consumer behavior and market sensitivities. And we incorporate insights into the management of our block. We are continuously looking at and analyzing our data, using both standard as well as predictive analytics to better understand what's happening in the block and to gain additional insights to further improve our block management.

As a consequence, we have a higher degree of confidence in the performance of our block under a broader range of outcomes. As [ph] respect to our (1:29:34) ROAs. We have seen steady increase in our ROAs, as evidenced by the 105 bps that we achieved in 2016. As we have described in the past, we have guided to a baseline ROA between approximately 100 bps and 105 bps with [ph] a bias (1:29:51) towards the upper side of that range. Today, we think 105 bps ROAE is achievable with a couple of bps of potential upside in the near term.

Regarding our cash flows, we believe our Annuities business will be a strong source of cash flows for the enterprise. In 2016, we deployed $2 billion of capital, which included $1 billion from the implementation of our risk management, approach for the variable annuity block of business, as well as $1 billion, and that was generated driven by earnings.

Over the next few years, we expect the business to generate at least or equal to above the targeted cash flows of 60% of after-tax AOI that we expect to – for the Prudential overall. Rob Falzon will cover annuities cash flows in greater detail during his comments.

We believe our business also has a lower risk profile that's really driven by two main drivers. One, as I mentioned our enhanced risk management approach, not only enhance our cash flow position, but also allow the Annuities business to ensure that the block can absorb a wider set of shocks with existing capital and reserved resources.

And two, we have a more diversified block of business due to the actions we've taken over the last several years. To highlight a few, for perspective in 2012, our highest daily product or HDI was approximately 91% of our gross sales. In 2016, that product represent approximately half of our sales. The diversification has been mainly driven by an increase in gross sales of our PDI product with a potential [ph] defined (1:31:29) income product, which is more of a fixed income product.

We believe that offering alternative value propositions in the equity and fixed income products offers appeals to both the consumers and reduces our risk profile. It is the combination of all the areas that I just mentioned that results in high quality, stable and predictable block of business. It is also a block that delivers on our return expectations, and, therefore, we like the business that we have on the books today.

The position that we have taken in the industry from our brand to our market share, in addition to all the other areas I have mentioned, give us the foundation to confidently address the challenges and opportunities that we have.

There are three primary challenges that we're experiencing: regulatory certainty, primarily driven by the Department of Labor Fiduciary Rule implementation; attractiveness of our products in a low interest rate environment and rising equity markets; and some modest pressure on fees as contracts mature, particularly as certain contracts move out of the surrender charge period.

To address what we're currently experiencing with the Department of Labor Fiduciary Rule, I'd make a few comments. To date, we've heard from all of our major distributors, only two have made the decision not to operate under the best interest contract or BIC exemption. As our distributors begin implementation, we will have to see if any of them change their positions as well as understand how individual financial advisors and financial professionals choose to act in the short-term as they become accustomed to the changing requirements that they are now under.

We have also seen some slowdown in our sales due to the rule itself given the uncertainty, with the greatest slowdown occurring in our banks and wirehouse channels.

That said, despite those challenges, there's a body of research that's been done that suggest that the number one financial challenge for Americans is retirement. That's true for whether you're a millennial or a baby boomer. There's a critical role that annuities and other income solutions play in helping people achieve secure retirements. We also believe that focusing on driving these better financial outcomes for consumers in partnership with other parts of Prudential provides us with a very unique opportunity.

As a result, we believe there are opportunities to evolve how we think about the Annuities' business in three distinct ways. First, we're changing our lens from a product lens focused on features and benefits in and of themselves through solutions. Offering solutions means that we think about what we're offering from the position of the consumer need both in terms of outcome consumers are looking for, and, as well as, the experiences they expect to have when they are purchasing or experiencing interactions with our products.

By shifting to a solution lens, we believe that we are able to consider creating solutions that are actually outside of the product set that we currently offer today, and we are actively doing so. Second, we are actively looking at developing potential solutions that better leverage the products that we already have.

For example, we recently leveraged products that we have to launch our legacy product which was an evolution of the Prudential Premier Retirement product. And it also developed – it also enhanced the value proposition to consumers as it was specifically focused around a death benefit.

And finally, given the unique business mix at Prudential, we are working across the organization to develop solutions that leverage the full capabilities of Prudential. For example, we are working with Andy and Phil's teams to develop a workplace income solution that has broad demographic appeal.

The solution leverages the knowledge of Annuities' ability to provide guaranteed income, solutions with the knowledge that they have and access to their employer base and the employees. It gives us an opportunity to serve a long-term retirement needs through a different access point, which when combined with digital and analytic abilities that we're investing in from a larger enterprise organization allows us to also provide a different customer experience.

And while we may not see immediate impact from this from an earnings perspective for quite some time, we also know that by doing this it allows us to strengthen the financial wellness value proposition that you heard Andy and Phil talk about relative to the value proposition that they offer. At the same time, it expands the universe of buyers for annuities as well as diversifying our risk profile and our product portfolio.

We anticipate that future solutions that we offer through Annuities will be more simplified products with more transparent pricing, lower fees, as well as lower cost options, and we will also do that through leveraging both the distribution channels we have today, as well as expanding through other channels [ph] that are not our (1:36:24) traditional channels in which Annuities are sold.

In order to do all of this, it means that we have to make investments in the business and we are doing that through our investments in people, our investments in process, and our investments in technology, and building a pipeline of potential solutions to bring to market over time.

In summary, we believe our Annuities business has a solid long-term outlook and is a business that fits well within the broader strategic themes that you have heard discussed today that we are pursuing as a company.

Our confidence is based on a block of business having a well-managed risk profile, solid returns with expected ROAs in the 105 bps range with a potential slight upside in the near term and strong expected cash flows that are again at least equal to Prudential's overall targets.

Over time, we'll continue to enhance our ability to offer outcome-oriented solutions, further diversify our product portfolio, and broaden our buyer universe, including access to the work site.

Now, I'd like to turn it back to Steve.

Stephen P. Pelletier

Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.

Thanks, Lori. Before we go to Q&A, I thought I'd share a few final thoughts about our U.S. businesses. We've spoken today about how our mix of businesses creates an attractive financial risk profile, that's been part of our messaging for quite some time. We've also spoken about how each of our businesses has value in its own right, and faces a range of strategic opportunities in its established markets. Again, part of our messaging for some time.

What may not be brand new, but what you're hearing more emphasis on today are efforts to ensure that the collective value of our U.S. businesses is significantly greater than the sum of its parts. As we pursue that objective, we feel that we're in a highly advantage and differentiated position in doing so. No other company offers a complete set of capabilities in quite the way we do.

This is true in terms of our strong market standing, in each of the markets that we serve, individuals, employers and institutions. It's true in terms of the range of capabilities that we offer to those clients. That range covering a spectrum of retirement income, investment and protection needs.

It's true in terms of the customer engagement model. We serve over 20 million individuals in our U.S. businesses. A relative minority in terms of that number comes from our retail channels. A far significant, a far greater number, comes via our employer businesses, people joining us and doing business with us via their employer.

We significantly enhanced our ability to engage with those individuals in terms of their individual needs to understand those needs and to offer solutions that align with them. I'd also say that we're in a strong position to pursue a strategy like this, because of the cultural attributes that John mentioned in his opening remarks.

Collaboration across businesses is what the strategy calls for. Collaboration is nothing new for us at Prudential. As a proof point, our stature as a global market leader in pension risk transfer, was absolutely created via collaboration between the retirement and the asset management business and collaboration across all aspects of our company to create that strong value proposition.

So, I'm very excited about the future that we face, both within our businesses and across them. And we're making investments as we mentioned to make sure that we capture that opportunity.

And with that, we'll go to questions.

Alan Mark Finkelstein

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

Okay. So, we're going to start the first Q&A. David, if we can invite you back up. Okay. Usual rules apply. Please wait for the mic. Please state your name, your firm name and one question and a follow-up. We'll start with Erik Bass here in the...

QUESTION AND ANSWER SECTION

Erik Bass

Partner, Autonomous Research

Q

Thank you. Erik Bass with Autonomous. A question for David. I was just hoping you could talk a little bit more about the outlook for PGIM margins. Do you expect the level of investment to continue for a period or at some point should we see more of the margin drop to the bottom line?

David Alexander Hunt

President & Chief Executive Officer, PGIM, Inc.

A

No. Thank you very much for that. As we think about margin, we very much think about that through a cycle, since obviously we're one of the most market's dependent businesses in the family. And we think that given the mix of businesses that we have that a kind of mid-to-high 20 margin through a cycle is a very reasonable kind of proposition. We believe that the investments that I outlined a moment ago really have probably hit about their peak.

And so, we would expect actually that more of that margin would be begin to drop to the bottom line for two reasons. One, because we say that vintaging, so the new investments going in will be less in the next couple of years. And then secondly the investments that we made in the early years are starting to really come up that J curve, and we're starting to see some very attractive payoffs from that.

So, I think you can think about our margin through a cycle in those kinds of ranges. And I think it would be a reasonable expectation that all else being equal in particularly the markets that you would begin to see the margins begin to uptick from where they are. So, that investment piece will be begin to payoff along a J curve.

Erik Bass

Partner, Autonomous Research

Q

And I'm assuming decompression, you're factoring that into the outlook as well?

David Alexander Hunt

President & Chief Executive Officer, PGIM, Inc.

A

We are a bit. As I mentioned, we so far have actually been able to launch sufficient amount of new products on the private side and on the real asset side such that we've actually had our realized fee grow on that side, which has sort of made up for the fee compression that we've seen on the retail side, in particularly in the equity's business. That's a headwind though. That's an upward fight, so far we've been at least holding steady and I would hope that that could continue.

Erik Bass
Partner, Autonomous Research

Q

Thank you.

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

A

Just right there. Seth?

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

Hi. Thank you Seth Weiss, Bank of America Merrill Lynch. Phil, I wanted to ask on the PRT market. In the past, the narrative has always been on jumbo market, which I assume will still continue. But you had spoken a little bit about both smaller tranches as well as the cash market. How should we think about returns of those business considering that the cash market is going to be more price-competitive, and on the smaller market or the smaller tranches of jumbo market, get the same scale benefits? And then you also had spoken something about flow business, I missed that [ph] point, (1:43:40) if you could expand on that as well?

Phil Waldeck
President & Chief Executive Officer - Prudential Retirement, Prudential Financial, Inc.

A

Sure. So, there are several pieces there. First, our return expectations haven't changed. And when it comes to jumbo transactions, that's a sweet spot for us for which we have significantly differentiated capabilities and real market credibility. So, as those jumbo opportunities emerge, that's front and center for us.

What's developed though, as I described earlier, is the opportunity to take smaller slices with large number of participants. And as we've been building out our platform and expanding our capabilities over the last five-plus years, we have been preparing for the ability to take on larger volumes, both to underwrite them, but also to physically onboard them, be it asset in kind or be it thousands of retirees.

So, that same execution cred that we have in the jumbo market applies for jumbo sponsors that are taking their small balances, there are a large number of retirees, but relatively smaller asset transfers in total. Hence, the 40,000 retiree, example, I gave of United Technologies.

In the cash market and the mid-market, we found niches of liabilities where we can compete successfully relative to others. We've also found that our asset in kind capabilities can be incrementally deployed on the larger transactions there. And at the end of the day, to the extent that the margins are not available, we will be patient.

And this year is a good example of that. We have declined the majority of the opportunities that have emerged, because we didn't like the risk profile including heavy weightings on deferred younger participants. And where there have been auctions, where the market opportunity hasn't [ph] been a fit (1:45:29) for us, we have been patient. But if I look at the market opportunity overall, whether it be jumbo transactions, smaller slices of jumbo sponsors or targeted niches that we can win in the cash market, that combination is what gives me confidence for PRT overall.

And the last example in your question in terms of the flow business, that is the packaging of reinsurance transactions, where the primary insurer in the UK does a series of risk transfers. And rather than coming to us with a series of small individual transactions, it's one packaged efficient transaction.

So, overall, as Andy described, we're looking for efficiencies in terms of operationally how can we deliver PRT with less operating expense, but still with disciplined underwriting.

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

A

Let's go to other side there, John Nadel [indiscernible] (01:46:21)? Yeah.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. John Nadel from Credit Suisse. I guess a couple of questions for Lori on the Annuities business. The first is, if we'd look back on 2016, and I think, the first quarter of 2017, there may have seen some timing issues here. But, I think, sales were already down 8% or 9% year-over-year in 2016. First quarter was down solidly, over 20% year-over-year. You're talking about maybe some incremental pressure from the implementation here. Can you give us a sense for how we should think about the outlook for sales maybe on a year-over-year basis?

The second question is if we think about those two, who have already said they won't sign the BIC, about what proportion of your sales over the last one, two or three years that those two distributors contribute. And then the third is, just as I understood it, I think the full use of the BIC doesn't going to effect until January. Is that correct? So, should we expect really that the sales impact of the Department of Labor standard if it stays as it is, is really more of a 2018 event?

Lori Fouché
President, Annuities, Prudential Financial, Inc.

A

Okay. There's a lot in there. So, let's talk about sales vis-à-vis 2016 and 2017. So, certainly, I characterized some of our sales pressure due to the uncertainty surrounding the Department of Labor Fiduciary Rule. There is another dynamic in there as well. As many of you know, we have the opportunity to be able to manage on a monthly basis, making changes on our pricing, which we decided to do in the back half of 2016. And so, as we made that change in the back half of 2016, which impacted our PDI product, we saw in the back half of 2016, the changes in our sales due to making that that pricing change specific to the PDI product.

So, that for us was about making sure that we are getting the right returns on that product. And so, we saw the impact from that. Those changes that we made in the back half of 2016, then also rolled forward into 2017.

In February of this year, we made the decision to increase our rates again, which became affected in March. And so, what we saw in the month of March relative to PDI sales was a rebound in that product very specifically. So, you're seeing a blend of us being prudent relative to making sure that we're getting the right returns on that block of business and at the same time also seeing on both primarily our HDI and our PDI products, we're seeing the impact of uncertainty around DOL.

So, that's how we characterize sales relative to 2016 and into 2017. [ph] As respects, (1:49:23) the outlook in terms of when the Department of Labor Fiduciary Rule actually takes effect, which you're correct relative to it being 2018. What's effective this week is certainly around beginning to operate as if one was operating under the best interest contract.

The challenge for some of the distributors, particularly at the financial professional and financial advisor level is the uncertainty that they feel particularly related to the legal aspects of potentially having a private right of action underneath that, and how they feel individually relative to that. And so that uncertainty that they feel both about their ability to sell variable annuities in particular, but not solely, as well as, dealing with the legal piece of it creates just an uncertain environment.

So, as we look forward into 2018, as we know it to be today, we would expect to have greater certainty. So, it's this uncertain part of the market that creates some of the behavioral things that we're seeing coming out of the FPs and the FAs.

Relative to the third part of your question, I have to ask you to say it again.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC

Q

Sorry. The contribution that the two who have indicated that they won't sign the BIC, what proportion of your sales approximately have they generated?

Lori Fouché
President, Annuities, Prudential Financial, Inc.

A

Yeah. So, the two that have made the decision not to participate in the BIC, a, we knew that at the end of the year and so we've taken that into context of how we thought about guidance for this year. And relative to those two, they were in our top 25. I don't remember the relative size of them. But it wasn't significant relative to the overall block of business and expectations [ph] of sales (01:51:08).

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you.

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

A

Let's move down that aisle, to Sean.

Sean Dargan
Analyst, Wells Fargo Securities LLC

Q

Thanks. Sean Dargan from Wells Fargo Securities. In the recent past, the previous Investor Day, there was a slide showing almost perfectly offsetting longevity mortality risk. I think that was enterprise-wide. But in the U.S., it sounds like PRT will increase longevity risk at a faster clip than you'll grow your mortality business. I guess a few of you [ph] up there (01:51:38) can answer this question. But how are you thinking about the interplay of that risk? And if cancer drugs bend the mortality curve, what does that do to your risk profile?

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

A

Let me, actually, can we [indiscernible] (01:51:51) that question in the last session? Rob Falzon has quite a bit on that particular topic. So, I think, why don't we cover it all at that point, if that's all right. Do you have anything else? Or is that – okay, good.

Maybe right behind you, Suneet.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Thanks, Mark. Suneet Kamath from Citi. Just a couple on PRT. I think, Phil, you had mentioned competition has been increasing. And I think, you had said that you'd walked away from transactions this year. Can you just give some more color in terms of where you're seeing that competition? Is it in terms of underwriting? Is it in terms of just pricing. I mean, where are you seeing it? And are there any particular areas of the market that are more competitive? Traditional insurance companies or reinsurance companies or non-traditionals, et cetera?

Phil Waldeck
President & Chief Executive Officer - Prudential Retirement, Prudential Financial, Inc.
A

Sure. Well, I think there's probably two stories here. In terms of what we've walked away from, there is a larger pie down market. So that market has expanded, which has enabled us to be more selective. We've been very disciplined in terms of our underwriting and, in particular, on our focus on the longevity improvement risk associated with pension risk transfer, which is specifically why we target retirees. So to the extent that there are small slices of deferred participants, occasionally we'll use the ability to take on large attractive blocks of retirees in combination with deferreds. But that's opportunistic to get the right block of retirees.

This is our existing block. It's 95% retirees, 5% deferred and our new business will reflect that sort of profile over time. So what we've walked away from are either industry or liability mixes that we find on a relative basis to be less attractive or on a heavier weightings of deferred.

In terms of the competition part of your question, there have been new entrants to the PRT market. So down market that can create more of an auction environment, which is why when we think the profile is less attractive, we're not going to bid.

And specifically, we've seen new entrants that I think create some competition Athene has entered the market, Securian is another example, Legal & General entered the market. So there is a few insurers that have entered, one, Voya exited. But that competitive landscape is one, should rates rise, that's where we think we're particularly well positioned, because there will be execution constraints that competitors will face. And we think we'll be well positioned to pick the liabilities that we like.

And then to have the execution capabilities, particularly the on-boarding capabilities I described that are attractive now as jumbos do slices of their small balance retirees and will be attractive when Jumbo transactions merge over time, if that addresses your questions.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

No. It does, thanks. And I guess for Lori on the VA side. Couple of carriers you're talking about, ETF-based products or passive-based products, is that a strategy that you're pursuing? And if you're not, what are your thoughts on those products?

Lori Fouché
President, Annuities, Prudential Financial, Inc.
A

Certainly from other perspective of fitting inside the strategic framework that I laid out in terms of how we think about potential new products coming out from us, those are in the consideration set. I would say that how we're thinking about it may not just be kind of in the traditional way of taking those investments and repackaging them relative to creating annuities that look and feel the way they do today, but was just in different investment set. We may look at that, but we're also looking at it more expansively relative to creating income solutions, not just annuities as VAs as we know them to be today.

I think if you look at what's come out from some of the competitors, there's been a lot that's come out in the last couple of months relative to those kinds of products. They've been slow to move so far. I think there's a variety of different reasons for that. And so, certainly, we're keeping our eye on both those kind of product sets but believe that the path forward may be a little bit different than perhaps even some of those are out there. But certainly taking into consideration those type of lower cost types of options.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Thank you.

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

Let's go to Tom [indiscernible] (01:56:03).

Thomas Gallagher
Analyst, Evercore ISI
Q

Thanks. Tom Gallagher, Evercore ISI. A question for Andy Sullivan just on the expansion into Group Disability. Can you expand a little bit more on that? From the way you described it, it sounded like you have good market share in Group Life particularly in national accounts. Is that really where the opportunity is to where you only have the Group Life contracts for the national accounts moving into Disability and how much of an opportunity is that?

Andrew Sullivan
President, Group Insurance, Prudential Financial, Inc.
A

Yeah. Absolutely, so, first of all, as I've mentioned, we're the ninth largest carrier today in Disability. So I'd start by saying, we're very capable in the space. Candidly, it's more about focus for us. Most of our national account business is mono-line life insurance. So we see a real opportunity especially in context of financial wellness which, if you think of working with an employer to really help their employees be financially well in total, there's a real opportunity to add the protection benefit of Disability for those large cases.

But additionally, in the Premier segment in particular, as we're working to expand into that segment, that business is very frequently packaged between the Life and the Disability. So as we're expanding and growing in Premier, as I mentioned, we grew 10% year-over-year. Very naturally we'll be growing the disability block of business.

But it's an area that we have all the right capabilities and we've been investing in over the last several years.

Thomas Gallagher
Analyst, Evercore ISI
Q

How about on the dental or voluntary side?

Andrew Sullivan
President, Group Insurance, Prudential Financial, Inc.
A

So we are not in the dental business, as you're probably aware. On the Voluntary side, we are a very capable voluntary carrier. We offer critical illness and accident, and we do see the Voluntary products as an important part of the portfolio that we work with employers on. Again, if you put it -- you'll hear me everything in the context of financial wellness because that's the overarching value proposition, but we need to deliver solutions to employees that include core benefits paid for by the employer, voluntary benefits which we are making good traction with critical illness and accident, both in the core employer space as well as in the association space.

And then, obviously, over time working to offer, we see promise in offering individual outcome-oriented solutions to employees in the work site.

Thomas Gallagher
Analyst, Evercore ISI
Q

Thanks. And then just a question for Steve. MetLife and AIG had sold off their retail advisory distribution businesses. Just curious, your view on it. What it – clearly, some uncertainty with DOL fiduciary standards and the like. But just curious, what your view of your franchises?

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

Why don't you start that and then Kent, maybe.

Stephen P. Pelletier
Executive Vice President, Chief Operating Officer, U.S. Businesses, Prudential Financial, Inc.
A

Sure. Tom, thanks. We see Prudential Advisors as being an absolutely integral part of our overall set of capabilities. First of all, we see it as – we don't feel ourselves under any kind of financial pressure to do things regarding Prudential Advisors. When you take a look at the expenses of the channel, and you take a look at the embedded value of the business that we write through the channel, the net-net is a positive. So from simply that standpoint, we like it.

We also think that Prudential Advisors gives us deep insights into emerging client preferences and behavior that even the strongest and the best third-party relationships don't always afford. And then, also, we feel especially as we embark on this path of seeking to individualize our relationship with people who come to us via the employer channel in the ways that I mentioned Prudential Pathways is absolutely reliant upon the strength and the recognitions of the strength of our Prudential Advisors channel.

Now we're looking to extend those capabilities and the ways I mentioned by making the Prudential Pathways experience more and more scalable through the digital enhancement of it. But the Prudential Advisors is still at the root of it, very much plugged into our overall financial wellness offering.

So, I'd say, if there was one particular area where I'd say we're distinctive, it's the connection of our captive distribution to our overarching U.S. business strategy especially this effort to individualize relationships to people who come to us via the worksite. Kent?

Kent D. Sluyter
President, Individual Life, Prudential Financial, Inc.
A

Yeah. The only thing I would add to that is that as we proceed forward the strategy to really engage consumers in the ways at which they want to business with us, really thinking about an omni-channel experience for consumers is really something that's inherent in our cross-business strategy. So we see [ph] advice (02:01:13) being very central to that omni-channel experience.

So, [ph] advice (02:01:14) could come in different ways. It can come digitally, but we also believe it also comes in a face-to-face flavor as well. All the customer research suggests that you can gauge people up to a point digitally, but many of them still want an advisor to speak to. So we think it's architecting this future world of consumers being able to engage with us through the channels and the ways and the solutions that they want, that having that advise capability becomes not only relevant to today's world but also extremely relevant to a future world in which we can deliver that directly to consumers and having a captive distribution really enables that. As well as, I think Steve mentioned this, the ability to really experiment in the marketplace. It is hard to experiment in a third-party distribution space where you are trying to change process.

Keep in mind that one of the things we're trying to drive in this business is making it easier for consumers to understand our products and to consumers to acquire our products. And we're introducing new process into the mix. It's far easier to do that in a controlled distribution environment than in a non-controlled distribution environment. So, advancing the ball on new ways to engage with consumers is far easier, when you have access to distribution.

Alan Mark Finkelstein

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

Okay. I think we're going to try to keep on schedule here. There's two more Q&A sessions. So, I think, we're going to take a 10-minute break, and then we'll proceed with the International section.

[Break] (02:02:35-02:02:46)

MANAGEMENT DISCUSSION SECTION

Alan Mark Finkelstein

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

If people could find their ways to their seats, please. We're going to move into the international portion, which will be a strategic update from Charlie, Charlie Lowrey, Head of International. Go ahead.

Charlie F. Lowrey

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

Thank you. So, I'm delighted to be able to talk to you about our International business today. I will be using one acronym during the presentation, and that is PII for Prudential International Insurance. I hope that will be the only acronym that I will use.

So, let me start with four key messages. And the first message is that PII continues to enjoy sustained growth in the underlying business metrics, while also delivering strong returns and generating capital back to the parent.

You heard in previous sessions and you'll hear me talk a lot about execution today, especially the execution of our business model, which we think is a competitive advantage in the countries in which we choose to operate. Obviously, Japan remains our largest market, but we believe there are ways that we can continue to grow in Japan going forward. And finally, you'll hear us talk a lot about selectivity. Selectivity in terms of countries in which we want to operate, and by focusing on higher growth regions, we hope to be able to reduce Japan's percentage of international earnings over time.

Obviously, we're faced with both challenges and opportunities as all the businesses are. Low interest rates have forced us to re-price or discontinue product as we look to protect margin, and we're very aggressive about protecting margin.

Regulatory changes exist and you saw that certainly in the first quarter of this year with the standard discount rate change in Japan, or the tax law changes in Korea. There's increased competition in some countries for certain products, as an example, in the bank assurance market in Japan for U.S. dollar product.

On the other hand, challenges bring opportunities and you saw that during the Great Recession, when we are able to acquire Star/Edison, and in the U.S., the Hartford business. Most recently, we made acquisitions in Chile and Brazil, and increased our interest in our Indian joint venture. We also continue to expand distribution and create product for needs of an aging population, for instance, in Japan, Korea and Taiwan. And while we face headwinds, the combination of our superior distribution model, diverse product offerings, together with exposure to growth markets, should enable us to produce steady growth over time.

We've been able to generate consistently high ROEs. Obviously, there's been a modest decline in recent years due to the weakening of the yen and also low interest rates. And we can't eliminate the downside from the depreciation of the yen, but we can smooth the currency effect by the hedges we put in place that Rob Falzon has talked to you about before.

We can also mitigate some of the effect of interest rate declines by product and business mix changes and by re-pricings. And, again, you've seen us be extraordinarily aggressive about doing so. We also do a lot to protect margin. And we feel comfortable saying that the business will continue to generate mid-to-high returns over the next several years. The effect of interest rates on ROE will be manageable with a degradation of about 50 basis points per year for the next few years.

I mentioned before about strong momentum in our underlying business metrics. And examples of this would be sales and productivity, the number of Life Planners, but as importantly, the quality of the Life Planners. And that results in high persistency and also high retention.

Our focus on these business fundamentals has led to strong earnings growth over the longer term horizon. The dual headwinds of foreign currency and low interest rates have essentially flattened AOI in the past few years. But, again, the underlying performance metrics of the business have been growing.

One of the fundamental metrics to grow is the LP count. And on the left-hand side of the page, you see the LP count has grown consistently over the past few years. Now, the growth isn't media work. In fact, it's just over a 2% CAGR over the past five years, reflecting growth in Japan and Brazil, offset by Korea and Taiwan, where we've intentionally increased validation requirements. And that's exactly what we said would happen that the LP count would likely grow at about 2% or 3% over the long term.

Given the growth in the underlying fundamentals of the business, it shouldn't be surprising that, on a constant currency basis, we've seen modest core growth in AOI, as you see on the right-hand side of the page. Again, interest rates do affect the bottom line, but given our business mix and our focus on M&A margin, they affect us less.

Let me just talk for a moment about the overall strategy of the International business. And the focus is on fundamentals, and that is the foundation of our strategy. So, you can consider our strategy to be a stool with four legs. And the first leg of the stool is the expansion of distribution in a variety of ways. You can think about Bank Assurance or the Group Insurance business.

The second is product development and that's not product development for its own sake, but it's product development to create solutions for our clients to best meet our customer needs. Digital, data and mobile is the third leg. Meeting customer needs faster and better and by a medium of their choosing and at a time and a place of their choosing is becoming table stakes, and we need to meet these challenging consumer needs. In addition, using data analytics to predict customer behavior and to mitigate risk is moving quickly from being a competitive advantage to being a competitive reality.

And the final leg of the stool is M&A, which we do selectively and carefully, going deeper into the countries in which we already do business and entering a handful of additional countries where we see growth opportunities in the future.

But if these are the four legs of the stool, the center of the stool or the seat has to be execution, and we strive for flawless execution. We are big believer in focusing on what you have and on doing it well. So, we focus on customer needs, product profitability and business mix to find the right approach that will continue to lead high quality and profitable growth in the future, which leads us to a discussion of business mix. Quite simply, we focus on meeting customer needs, and we focus on selling profitable product. We also focus on selling the right type of product, ones that deliver consistency of return over time, which means protection product.

And as you can see from the chart, we primarily sell protection-oriented product. Looking to the right of the page, you see the fixed annuity product, which we re-price every two weeks. The vast majority of which also has a market value adjustment.

So, the purpose of this page is to demonstrate something I spoke about before at the beginning of the presentation, much of the income we derive from the International businesses is from the M&A margin, not from spread margin.

So, let's look at Japan to see how we managed its product portfolio over time. On the left-hand side of the page, as interest rates declined in Japan, we shifted to a U.S. dollar product sales. And in 2016, in fact, over half of our sales, 54%, were from U.S. dollar product. This is logical since we've sold U.S. dollar product for a long period of time. And our distribution in all our channels who has been trained to sell foreign currency product, which has been a real advantage as Japanese interest rates have declined.

On the right-hand side of the page, you see an increasing amount of recurring premium product being sold, leading to a reduction in the amount of single premium product by over half over the past five years. And, again, remember that almost all single premium product that we still sell is a fixed annuity product, which is re-priced twice a month.

While still small relative to our business in Japan, we're having success in some of our higher growth markets such as Brazil and Chile. The Life Planner model has adopted well in Brazil, as you see on the left-hand side of the page. And what you see is an increase in the in-force face amount, despite a slowdown in the economy. The LP count continues to grow as well, with productivity, persistency and retention metrics rivaling those of our Life Planner operations in Japan. And in Chile, we became the number one AFP in terms of AUM in the fourth quarter of last year, with exceptionally strong investment performance and the lowest fees of any of the top four firms.

We will continue to investment in high growth markets, going deeper into existing markets and selectively entering new markets. And you saw examples of both these activities last year. We went deeper in Brazil through the acquisition of the group insurance business of Itaú, and increased our exposure in India by raising our interest in our joint venture from 24% to 49%. But you also saw us enter Chile, which was a new market for us to capitalize on the pension market opportunity there.

We believe our strategy is both simple and clear based on a differentiated distribution model and a very focused business strategy. We see our International business is having steady growth prospects and a highly stable source for earnings and cash flow, which will further benefit from some of our growth initiatives, some of which we acquired this past year. And we will continue to try and execute on this strategy to the best of our ability.

And with that, I'm willing to take questions. The only thing I would ask is that you ask me the easy questions, and Mark Finkelstein the hard questions, that would be appreciated. Thank you.

QUESTION AND ANSWER SECTION

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

Okay. We're going to try to hit some folks that haven't asked questions now. You can raise your hand. Humphrey, I see you first.

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

Humphrey Lee from Dowling & Partners. A question regarding international M&A. You talked about kind of looking into deeply in some of your existing presence or looking to new markets. Like, what are the markets potentially could be an interest to you when you look ahead?

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

So, Humphrey, we're in most of the major markets we want to be in. So, we're in most of the markets where – or countries which have the largest population. And many of the markets which have some of the largest insurance. So, being – as an example, U.S. and Japan are the number one and number two insurance markets for life insurance.

Other markets we might want to look into would be few and far between, but we might look at Southeast Asia as an example of countries where we might want to go. But we will not enter into a flag planting exercise. We don't want to beat our chest, and say, were in 60 different countries. So, I would say there may be a handful of other countries that we might be interested in, if the right opportunity were to arise, but we're going to be extremely selective and extremely careful about countries in which we would like to go. Having said that, we are also interested in going deeper into the countries in which we already exist, and the acquisition in Brazil is a perfect example of being able to do that.

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

And a question about the Life Planners in Japan. A lot of your competitors are talking about raising their – the quality of the agents or even kind of adopting something similar to the Life Planner model. Can you talk about the recruiting landscape in Japan for Life Planners? And is this just sustainable for the 2% to 3% that you target going forward?

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

Sure. I'll make a couple of comments. The first is it is extraordinarily difficult, if not impossible, to transform an existing tied agency system into a Life Planner system. You really almost have to start from scratch in order to get the kind of quality of the people that you really want. So the key for us is to keep that quality and to be very selective about the people we choose and to do it right. The Life Planner model is an extremely expensive model to operate. And it's predicated upon getting the quality of the people and those salespeople being able to sell the right product in order to achieve the persistency, and also have the retention of Life Planners.

So, if you look at our persistency numbers and you look at our retention numbers in Japan, they're extraordinarily high. So, this is a very difficult model to replicate. We have been and continue to be successful in terms of attracting good people to this business. And we've done that in a couple of ways.

First, you'll note, in the first quarter, as an example, the sales managers were up 8% year-over-year, that's key to attracting new people. And so, there are new markets in which we can enter in Japan. So we're very large in Tokyo and some of the other cities, but there are other areas in which we can go. So we are able to expand.

The other point I mentioned in the first quarter call was our emphasis on attracting and trying to hire women, which is new to the business. When we first started, we only hired men 30 years ago. So, we made a big effort over the past couple of years. And last year, we hired 82 women. So, that is a whole other area that we can go into and are, in order to increase diversity but also increase the talent pool. So, we believe there's still room to grow in our Life Planner.

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

Let's keep it on that side. Nigel?

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

Thanks. Nigel Dally, Morgan Stanley. Just trying to get an update on the Chilean pension market. There's been about talk about fees coming in pressure, various reforms going ahead, so just an update there would be helpful.

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

Sure. Two parts to your question. I'll answer them in the order in which you stated. So, we should see next month, President Bachelet is thinking about sending or is intending to send something to Congress. Her plan is for a 5% increase in the savings, and that would come from employers. Whether any of that comes to the AFPs, or whether it goes to a government-sponsored pension plan provider is yet to be determined. So, there's a lot of moving parts there. And we're seeing – we'll kind of play it by ear and see what happens. So, unclear as to what's going to happen, but we're monitoring that very closely.

In addition, I would say that Habitat has been a leader in terms of reaching out to its own customers. We did the first town hall to our customers. We're reaching out to them to make sure they understand what's going on and to make sure that they feel good about Habitat.

In terms of fees, we are substantially the lowest of the big four. You did see some fee revisions by a couple of other competitors, but those fee revisions were only on the voluntary part of their business, which represents between 3% and 5% of their total business. And so, they didn't reduce fees on the basic part. Our fees are substantially lower on the base part, so the 95% as well as on the voluntary. We just run a very efficient operation.

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

Thanks.

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

Jay Gelb?

Jay Gelb
Analyst, Barclays Capital, Inc.

Q

Thank you. Jay Gelb from Barclays. On the ROE slide for the International business, I just want to make sure I understood what you're getting across there. So, I believe you said, Prudential International should continue to be a mid-to-high teens return business over the next several years, but there would be a 50 basis point annual headwind from lower rates. Am I capturing that right? And is there anything that could help offset that impact from low rates?

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

A

You did hear that correctly. Little scary that they write all this stuff down. But yes, you did hear that correctly. And the impact of new business is not going to affect the ROE significantly. So, I'll say a couple of things, because the book of business is so large, right? Our in-force is very large. The amount we sell each year will only have a marginal effect on that.

Now, I will say that the business we're writing in all countries meets our hurdle rate. So, we are very comfortable with the business we write. We're very conscious of protecting margin. But you do have some rollover. Let's just take the Japan portfolio. You do have some rollover that is reinvested at lower rates. Now, we try and mitigate that by the privates that we do in the U.S., by some of the other things we do, and we're able to mitigate some but not all of that.

The good news is that rollover is not large, because the persistency of the business we write is extremely high and the duration, for instance, of the business that we – the duration of the portfolios is quite long. So, the LP for Life Planner duration for BoJ is about 16 years; for Gibraltar, it's about 11 years. So, the rollover isn't as large as you might think it is, but that rollover is creating a slight degradation to ROE over time.

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

A

Yeah. Let me just add one point to that, which is kind of pivoting Charlie's point, which is we're not overly interest rate-sensitive in our business but we're also not completely immune to it. At the Tokyo Investor Day, we gave the sensitivity that looks out three years. And if rates were to sort of stay where they were at that point in time, it would have been a cumulative effect of about $200 million over that three-year timeframe. Rates are a little bit higher now than what they were at that time, but that'll give you a frame of reference for how to think about it.

Jay Gelb
Analyst, Barclays Capital, Inc.

Q

On that basis of $3.1 billion?

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

A

Yeah. I mean, it's – I mean, it's a Japan comment, but that's the – you can think about it as a $200 million over three years.

Ryan?

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

Q

Thanks. Ryan Krueger, KBW. Just had a quick question on Brazil. I just curious, is it generating a profit at this point? And it's – you've had a fair amount of business growth and, I guess, over what time period, would you expect Brazil to become a more meaningful contributor to earnings?

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

A

The answer to your first question is, thankfully, yes, it is. It is generating a profit. It has generated a profit for a number of years. And I think as the in-force builds, it will become more material. So, if you came back to us in five years and ask the same question, we probably be reporting on it in a different way than we are now.

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

A

Go to Tom.

Thomas Gallagher
Analyst, Evercore ISI

Q

Thanks. Tom Gallagher, Evercore ISI. Charlie, just had a question on slide 8, which shows recurring pay whole life is your largest source of earnings. Now, I assume most of that is the yen recurring pay whole life, but I think that might be a mix of dollar and yen. But my main question related to it is, isn't this the product that you would have just re-priced? And just curious, what the impact you would expect on sales? I realize sales doesn't equal in-force earnings necessarily, but I assume it's directionally in the ballpark. So, just out of curiosity, do you think the re-pricing is likely to have a significant impact on a go-forward basis on Japan sales?

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

A

So, a couple of comments. The first is, we sell a great deal of recurring premium whole life around the world. So, for instance, in Brazil, that is the main product that we sell there, along with A&H writers and some other things. So, this is all of PII or Prudential International Insurance, so you have to take that into account.

Secondly, I would say, over the longer term, it would not affect – the re-pricing would not affect overall sales in the shorter term, because there were an acceleration of sales into the first quarter. You may see some effect going forward. Now, there would be sort of a holdover from the surge into the second quarter, you might get a little bit in the second quarter. But, overall, I think, if you were to look at this over a two-year period, you wouldn't see any diminution in sales.

Thomas Gallagher
Analyst, Evercore ISI

Q

But near term, we're unlikely to see like a cliff in Japan's sales or anything that extreme? I just want to understand directionally would that change have a big impact or not. It sounds like it's more moderate in terms of the impact.

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

A

I've been told that I should talk over the longer term and not the shorter term, i.e. next quarter, although that was a very good try to find out what was happening next quarter.

Thomas Gallagher
Analyst, Evercore ISI

Q

All right. Thanks.

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

A

All right.

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

Okay. I think we're good with the International Q&A, as I see no hands. We're going to just stretch legs for five minutes, and then, we're going to resume the financial portion after that. So, please, if you do leave, don't go very far. We are going to convene in five minutes. Thank you.

[Break] (02:27:18-02:27:28)

MANAGEMENT DISCUSSION SECTION

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

Okay. If we can all find our seats, please. We are in the homestretch. So, I will turn it over to Scott Sleyster, our Chief Investment Officer.

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

Okay. Good morning. I have several topics that I was asked to cover today. Big-picture level, I want to talk about the guiding principles we use to construct our portfolio and how that helps us preserve our margins when we're dealing with low rates in challenging credit environments. I want to talk about the overall quality of the portfolio. And I'll do a little bit of a drill down on real estate and alternatives, because when I do get questions these days, it's a pretty quiet part of the credit cycle, but when I do get questions, those are usually the two areas that people are interested in. I do want to reinforce and talk about the benefits of being associated with a world-class asset manager like PGIM. And then finally, I want to touch at least one metric for how we measure our performance over the full cycle, over the full credit cycle, if you will, or product lifecycle.

So, let me start with the four key principles that guide our portfolio construction over time. First of all, it starts with a fundamental understanding, a deep understanding of the product liabilities that we priced and essentially, how to hedge them over their lifecycle. We then couple that, once we know the liability really well, with a really disciplined approach to interest rate risk management, which is why you've actually seen so little effect or damage from the low-rate environment that we've been in.

We then construct a really broad, diversified, largely fixed income portfolio to spread our risk out across a lot of different credits and markets. And then, finally, again coming back to PGIM, we benefit from really strong initial underwriting and continuous monitoring from the deep credit skills that exist in David's organization.

So, what that will leave you with, what I think you'll see that leaves you with, is a very high-quality and extremely well-matched investment portfolio, which is I think, what you want to be looking for when you're looking at a life insurance portfolio. So, let me start with the discipline liability-driven investing. For over 10 years now, we've organized our asset liability management or the chief investment office at Prudential, so that each of our teams supports a direct business for one of the executive you saw up here before for the various regions of the world that Charlie covers. And those teams are assigned to those liabilities. They work with those actuaries, those finance people and those product development people.

In many cases, they're collocated and they sit with those teams. And the best way to protect your margin and to achieve the margins that you're pricing in your product is to be sitting at the table when they're created, because if you know the assumptions that are being put in there, and you know you can achieve them, then for what's largely a buy-and-managed portfolio, you can go put those to bed and lock those returns in over the life of the product.

Our teams, while they're sitting there, actually participate in product design and pricing meetings. And then, the ultimate portfolio that we design is really extremely liability driven. It is – the portfolio is constructed to protect our pricing margins throughout the life cycle of their product.

And the most important element around that is how do you manage your interest rate risk. And in particular, just going back, you've heard a lot of talk about the impact of low rates, the challenge of low rates, the way you ultimately mitigate your low rates is by having a really strong interest rate risk management discipline.

So, once we know those liabilities and their sensitivities under the range of outcomes that we expect, we largely go out and buy a bond portfolio. We're typically looking at seven or eight key rate duration sensitivities. And so, we make sure we line up our interest rate sensitivities of the assets that David's organization underwrites for us, so we get those sensitivities right. And then, we manage the credit and security selection over time.

The risk management organization in Prudential also sets limits to make sure that we stay within those sensitivity. So, we've actually given you a chart here around the kind of limits that my group lives within. We have a short, medium and a long-term bucket for interest rate sensitivity. Not surprisingly, when you look at the short and medium bucket, we're extremely tight out through 10, 15 years.

You'll notice we are a little bit short at the long end. The reason for that is, in fact, twofold. Mostly in the international markets, we have not wanted to lock in 30 or even 40-year rates, when we can cover a lot of the horizon at the 20-year mark. We've avoided buying negative coupon instruments, but we've also selectively brought in some U.S. dollar assets typically available more at the 10-year range, and then we swapped some of them back. That's not a big component of what we do, but on the margin that's helped offset some of the pressure that we feel.

The great corridor around that chart is actually the limits that we have to work within. Okay. Once we line up those key rate durations, we've largely substantially managed our interest rate risk, then it starts to come down to the things like the quality of the portfolio. So, the first thing, I'd like to draw your attention to is the pie chart on the left part of the screen. That green portion represents roughly 33% of the portfolio, and 33% of our portfolio is in risk-free securities. A lot of that is in Japan, in JGBs. But in the U.S., following Dodd-Frank, we've actually had to move up our holdings of U.S. government and agency securities, because we have to post a collateral. So, you can kind of take that third off of the table.

I think the second thing I would point you to is the fact that our risk assets we would call below investment grade or high-yield bonds, and non-coupon investments are about 70% to 80% of the portfolio. So, quite frankly that's relatively small. And then, if you go over and you look at our corporate bonds which is the dark blue and the light blue, about 40% of the portfolio. Let me make a couple observations there. On the top part of the chart, you'll notice that the light blue, the private placements are skewed in the BBB and A.

We like to put our private placement capacity into those spaces because we benefit from strong covenant packages. And so, we get paid and I'll talk a little bit about more about this later. We get a nice premium for the illiquidity element of that product. But when the winds are blowing in your face in a credit cycle, it's really nice to have the covenants and to have that weighting in the BBB portfolio is really good to have.

On the bottom of that chart, that's a combination of the public and privates combined. You can see it's well-diversified across industry. A couple of observations I would make there. If you consider those weightings versus the Barclays' aggregate, the Barclays' aggregate for finance is about 31%. I think you'll see that we're 19%. I think the aggregate is about 9% on energy and we're 7%. And on technology, I think you'll see we're about 40% lighter in communications as well. So, it's a conservatively constructed portfolio both across publics and privates.

All right. Let me just make this observation. So, this is really a 10-year chart of what's going on in the portfolio. And I just wanted to point out the consistency of the portfolio in the riskier sectors, and in the core corporate lending areas, where we put most of our money to work. So, if you look at the bottom of the chart, it's actually fairly hard to see, but in fact, the non-coupon assets have been consistently in the 2% to 3% range. They're up a little bit because they've actually performed quite well over the last year-and-a-half or so, and our high yield portfolio was actually 6% back in 2006, and it's at 4% today. So, the risk assets, you do get questions about have you been reaching per yield or what have you. I think that largely kind of puts that question to bed.

The one big observation, I guess, that jumps off the screen is the green section, which is the government securities. When we acquired Star and Edison in Japan, we picked up a lot of JGBs and we wanted to get our durations locked down there. And the Insurance business generally consist of three margins in the United States. So, Charlie had talked about the M&E, the mortality and the expense. And in the U.S., you tend to have an investment margin that's pretty key component of that.

In markets like Japan, it's primarily been M&E because the debt markets are not very broad, primarily because the society has been very well banked. And when there's a deep bank market, there aren't great credit markets. And therefore, if you can't get paid as an insurance company for providing credit, you can't really embed it in the product. And so, we have somewhat different models in the international markets versus the U.S.

In Japan, this year, I think probably over half of our sales or about half of our sales will be U.S. dollar or Australian dollar. So, when we bring on those kinds of liabilities, we actually have the ability to further leverage David Hunt's global capabilities in U.S. dollar and Australian dollar assets. But for the Japan business, you will continue to see this kind of profile.

Let me just talk a little bit about our below-investment-grade exposure. As I said, it's about 4% of the total assets, 5% of the bonds. I think I just make two points off of the slide. First of all, you can see that the vast majority of the holdings are in the highest quality sectors of the high-yield sector, the NAIC 3 BB. But I think the most important point here is that 40% of our below-investment-grade portfolio is made up of private placements. And that's really a big deal because there is no such thing as a covenant life portfolio in a below-investment-grade private placement, and this is where we really get paid and protected, when we hit the end of our credit cycle.

Let me talk a little bit more about privates generally, both investment grade and below investment grade. We see a lot of benefits from the unique capabilities in both private corporates and private mortgages that David's organization can bring us. The primary distinction that they have is that both of these organizations have really robust field offices, local presence actually around the globe now, and that allows them to be very close to the issuers and have deep relationships with the issuers put covenants in place and modify them as you go through a cycle.

So, second, it gives us a big diversification benefit. If I didn't have access to these channels, my only choice would be to double or triple down in the big public names that are in the portfolio. So, the diversification benefit from these private placement areas is really big.

The line chart down there points to what a lot of people will point to as the most obvious benefit. So, that shows where privates were getting done versus where the public industrials were at the time. We would typically say that, over the cycle, we expect to pick up somewhere from a quarter to three-eighths of illiquidity premium. Sometimes, that's been as high as 50 basis points. But it's a very attractive premium over and above all the other items that I just listed.

And I'd like to give one more anecdote, if I can, on this just to drive the point home. In our private placement of portfolio through the last credit cycle, which was a pretty, pretty severe economic cycle for the world, when one of these private placements gets downgraded, we have the ability, through the covenants, to bump the interest rate. Now, we're not really doing that to harm the client. We're doing that to get paid for the risk we have. But it also creates a strong incentive for that credit to get back in order, because when they get back to their covenant levels, we'll bring that rate right back down.

So, the anecdote I'd like to share with you is, over the last credit cycle for our corporate lending group, we actually earned more premium rate bump on the credits that migrated than we actually rode off on the credits that defaulted. And that is a really attractive asset class when you're putting portfolio [ph] together (02:41:08).

Let me talk a little bit about mortgages. I think the first place I'd like to take you on this chart is the sector mix on the bottom. Two things will jump off of the screen. First of all, we're very light on retail, and we're very light on office versus our ACLI peers. If you're light in one section, you have to be heavier somewhere else, and what you'll see is we're heavier on apartments and industrial and in something in there you see called other. The biggest category of that other sector is actually senior living. So, this is, from a sector perspective, the kind of quality portfolio that you'd like to see on a buy-and-hold or buy-and-manage portfolio.

The debt service coverage is about 2.4 times. And the loan-to-value ratio across the portfolio was only 55%. Only 2% of the portfolio falls into that category of an LTV greater than 70% and debt service under 1.2. Some of that maybe a weak credit, but other things in there are areas where we're doing some redevelopment on a property. I've highlighted the retail sector and I just really like to point out there. One, it's only 16% of this portfolio; and two, the loan-to-value ratio is really essentially the most conservative in the group, other than ag, at 50%.

Let me talk a little bit more about retail overall in the portfolio, since I think that's the liveliest topic that you get these days. So, we would consider our holdings about 4.5% across the entire portfolio. If I jump into a little more detail on the commercial mortgages, you can see that that's about 1.7% of the portfolio, about two-thirds of that is in dominant malls and in grocery anchored type situations and less than a third is in the areas where you might be more concerned about your risk, which should be the kind of the community centers and regional malls.

In addition to the mortgage portfolio, we do have public bonds over 90% of them are investment grade, really high quality names. We have about $9 billion in CMBS. Those properties trade, so any one point in time, you don't know exactly all the retail exposure, but we think it's about a third. And so, we put in another $3 billion there. But, of course, we're only investing in the senior most tranches, the AAA and, on occasion, AA tranches. And if you went back and looked at our performance or I should say PGIM's performance in the CMBS space over the last credit cycle, I think it was arguably the best in the industry. We really have done a good job there and we've stayed in a very high-quality sector. We have very little exposure to equity real estate. It's less than 0.3%.

Let me just talk briefly about the non-coupon portfolio. We have about $9.3 billion in what we refer to as non-coupon investments. You can see it's very well diversified across private equity, hedge funds, real estate and public equity. The public equity is essentially all in Japan, and that's a high-dividend strategy of portfolio that we've held for a rather long period of time. And that's sort of where that lives in its purpose.

The private equity and hedge funds are actually managed in my group. They're not in David's group because selectively, David runs hedge funds in certain of his asset classes, but he hasn't wanted to be a manager or manager in that business. And so, the fund selection for hedge funds and private equity actually occurs in my group. On the other hand, with real estate, we almost completely rely on PGIM Real Estate for our underwriting on both individual properties and funds. And we've been very pleased with that.

If you move over to the other side of the page, the contrast that you see, the black line on the bars is our expectation, if you will, our pricing expectation for these assets. And so, you see we've either been at or significantly above on the performance side.

I would think the one other thing that jumps off of the page is the big increase between 2012 and future years. I had wanted to put in a private equity program and we had a disciplined approach to putting that money to work, expected to take about five or six years. And when those big PRT transactions came along, those funds were often very full of private equity. And so we were able to sit down with them and through the two largest deals bring in about 150 funds. And we were able to diversify that by manager, by vintage, by strategy, by region of the world.

And so, we were actually able to get that portfolio in quite a bit faster than we originally thought. And I guess I'll call it good fortune, but markets have been very well and that actually served us. That served us extremely well. And it's another example of the portfolio delivering the performance that Phil Waldeck originally priced into those deals.

So, let me kind of start to wind things up. They say that the proof in the pudding is in the eating. And when you manage a portfolio our size, and you manage it on a buy and hold, buy and manage type of framework because you're trying to protect your interest rate risk, then you have to live – you have to eat your own cooking when you go through a cycle.

And what this chart shows is that in the 2004 to 2010 cycle, we had expected losses built into our pricing assumptions for these products. We'll call it at 100%; it really depends on the mix in any individual portfolio based off of quality. And obviously those expected losses were higher in the U.S. where we take more credit risk than in Japan where we take less.

But we came in through one of the most severe financial crises that this country has ever experienced, we call it the Great Recession. We actually came in at 18% less in credit losses over that cycle than we had built into our pricing expectations.

And so, to me that's the heart of the benefit of the security selection, the private placement, the private commercial mortgage team, and quite frankly, the incredibly strong public bond analysts that we benefit in David's organization.

Now, look, I don't know what's going to happen in this cycle. They're all different. To date so far, we've only consumed about 30%. Each year now, that gets longer that blue bar, if you will, will get higher. So, I don't know where we'll end in the cycle, but I would say the kinds of benefits that we had in place from PGIM in the last credit cycle are probably only stronger today.

So, let me just conclude with a couple more comments about PGIM. When I started this job 10 years ago, I had come out of the business. I knew quite a few of the other CIOs; actually if you check pedigrees you'll see a lot of the CIOs in the industry have spent time at Prudential. The discuss you have is gee, if I develop a third-party asset management capability in my team, when they wake up in the morning, they'll have to think about the general account, but they'll also have to think about third-party clients. And I wonder if I'd really give up something if I had to deal with that. And having been in this job and been a customer of this organization, I can tell you, I wouldn't trade hands with any other CIO.

To have an organization that, one, understands what we do extremely well; and then secondarily, has to be on top of their positions all the time because they're managing against benchmarks in third-party money on 60% or 70% of their assets, I really think we get the best of both worlds. And I can say that unequivocally as it relates to the private and mortgage origination capabilities, there is only a couple of companies in the world that have anything close to the kind of capabilities we have.

So, that's really a unique proprietary advantage. It means you don't have to reach so far, reaching for yield in other sectors of the portfolio.

And then lastly, and I think Phil already mentioned it, when we go in to close out a pension risk transfer sale, or we go in to pitch a sale, often the investment team is part of the initial call because they want to know that they can move those assets over instead of being forced to sell them and deliver cash. And that strong PGIM capability coupled with the portfolio construction that my team does, I think, really supplements Phil's competiveness in the marketplace.

Why don't I stop there? Thanks.

Alan Mark Finkelstein

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

Thank you, Scott. Turn it over to Rob Falzon, our CFO.

Robert Michael Falzon

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

Terrific. So, I'm up last and I want to try to bring it all together using a financial lens to provide some perspective on this. What you see here is something that we call the balancing act. This is maximizing shareholder value by balancing priorities that are both complementary and competing.

As John noted in his presentation, each of these priorities needs to be appropriately balanced. Using his words, we don't focus on any one absent considering the impact on the other two. They work in harmony with each other.

At the top-left side of the slide shown here is growth in ROE. More specifically, this is growth at an ROE that exceeds our cost of capital. Our growth is driven organically by our business mix and by the competitive positioning of those businesses. This is enhanced through capital redeployment and M&A and share repurchases which are enabled by a high ratio of free cash flow to earnings.

Our ROE target exceeds our cost of equity and is derived from a bottoms-up view of the company. It is the sustainable level of return from the mix and competitive positioning of each of our businesses without the use of financial engineering or excess risk-taking.

Moving to the right is cash generation and deployment. We look to manage our free cash flow to further enhance shareholder value, by creating flexibility and optionality through financial strength, redeploying cash and capital into attractive M&A and into super organic investment opportunities like our Pension Risk Transfer business. And by returning it to shareholders through a sustainable and growing dividend and a program of share repurchases. We believe we have a demonstrated track record as a good steward of our capital and our cash capacity balancing and executing against these priorities.

The last component of this balancing act is volatility and risk. Increasing risk, either business or financial, in the short-term, could enhance our performance in either of the other Venns like growth and ROE. The risks of such a strategy are less apparent in the [ph] ebullient (02:52:21) portion of the markets. However, it can come back with a vengeance in down markets. We believe that exposure to market-sensitive businesses and leverage, both operating and financial, can lead to volatile financial results, which negatively impact market valuation.

Our business mix is our first line of defense against this volatility and drives a risk profile that we believe is balanced between market and insurance risks. Our business – and they are well-capitalized and we have a robust capital protection framework that ensures our ability to withstand both cyclical and extreme market stresses. We've also taken significant actions to reduce the complexity and excess volatility in our reported financial results. We believe that getting this balancing act right creates value for our shareholders and also produces financial strength, which is core to our value proposition, to customers, to investors and to our employees.

Going a little deeper into the first part of that Venn, growth and ROE. We have a complementary mix of businesses that are well-positioned competitively, and together, have produced earnings per share growth of 9% per annum over the last five years. Book value per share growth adjusted for dividends was at 10% per annum over the same period, and a superior ROE that is in excess of our cost to capital; recall that we set and then in 2013 achieved our 13% to 14% objective.

And in our guidance call last year, we moderated that objective to 12% to 13% to reflect the sustained low-interest-rate environment here in the U.S. and in Japan, reflecting the things that Charlie spoke about in his presentation. And to a lesser extent, our elevated level of initiative spending.

If you were to look even further back, our earnings per share was about 70% greater than the peak earnings we had pre-crisis, and our book value per share has increased 85% after distributing about $15 a share in dividends.

These results were driven by strong organic growth, particularly in our Asset Management and annuities businesses, by super organic growth in the form of our jumbo pension risk transfer transactions in Retirement, which began with the landmark General Motors and Verizon transactions at the end of 2012 and have continued with a steady flow of transaction since then.

By the successful acquisition and integration of the Star and Edison Life Insurance businesses in Japan from AIG and the U.S. life insurance business from Hartford; as well as other more modest investments and acquisitions called out by Charlie including, for instance, the Afore investment in Chile; and by the redeployment of significant capital to shareholders in the form of share repurchases that supplemented our growing dividend distributions.

We also benefited from some market tailwinds during this period, primarily from equity markets, which both increased our AUM and enhanced returns from the non-coupon portfolio as Scott discussed.

These drivers generated growth and produced high returns, overcoming headwinds in the form of sustained low interest rates and increased spending in response to enhanced supervision and to support long-term growth.

Looking ahead, we expect to continue to generate superior growth and returns driven by our business mix and the competitive positioning of these businesses, the gradual realization of the benefits of our customer product and distribution initiatives that cut across the institutional employee and individual platforms and continued capital redeployment. We expect to navigate market headwinds to continue investing in long-term growth initiatives and to maintain a balanced risk profile.

Pausing for a moment on market headwinds. Since the crisis, we've been through a period of sustained low interest rates. While rates are currently above the lowest levels reached during this period, they are nonetheless low by historical standards, and they are putting pressure on our ROE. Having said this, the year-over-year negative impact to earnings growth is moderating and should dissipate.

As could be seen in this graphic, over the last few years, our new money rates have been significantly below our portfolio yield. Now, this is a simplistic way to look at the impact of low interest rates. But it's a useful headline metric that demonstrates the drag on earnings growth and ROE caused by low interest rates.

This drag's begun to moderate as our new money rates and portfolio yield begin to converge both in the U.S. and in Japan. While the convergence of the yen portion of the Japan portfolio is more extended as is reflected in Charlie's comments with regard to the diminution in our ROE, this is somewhat offset by the very long duration and very low turnover that's in that portfolio. This projected trend would create some relief to the headwinds on growth, but at these levels, would still be consistent with our moderated view of 12% to 13% sustainable ROEs in a low interest rate environment.

Shifting to the second part of our Venn, cash generation and deployment. In 2015, we provided guidance that we expected future free cash flow generation of about 60% of our pre-tax AOI on average over time. Recall that we view this as a managed outcome that reflects balancing reinvesting in the organic growth of our businesses that are producing superior ROEs, with other forms of capital redeployment including enhancing our financial strength to create flexibility and optionality, M&A, and returns to shareholders through a sustainable and growing dividend and a program of share repurchases.

Over the past five years, nearly $12 billion of capital was returned to shareholders or deployed in M&A, representing about 55% of our cumulative AOI. We also improved our financial strength including reducing our leverage ratios over this period of time.

Dividends per share grew at a 14% per annum rate, consistent with our philosophy of having a sustainable dividend that grows along with earnings. At the end of 2016, our board increased our quarterly dividend by 7%, or $0.05 a share, to $0.75 a share on a quarterly basis.

Share repurchases have been used to supplement our dividend return to shareholders. We expect share repurchases to be more variable, primarily reflecting the availability of alternative capital redeployment opportunities. For example, in 2012 and 2013, we reduced share purchases from our board-authorized level of $1 billion each of those years in order to help fund a portion of The Hartford Life acquisition.

Share repurchase activity is also impacted by periodic opportunities to release capital. For example, in 2016, we generated significant excess capital from a combination of the cumulative gains on our yen equity hedge and the series of actions that were associated with the recapture of our variable annuities captive. These, and the normal capital generated from our businesses, allowed us to fund that $700 million in M&A, primarily the Afore joint venture in Chile, while also increasing also increasing share repurchases to $2 billion. For 2017, our board has authorized $1.25 billion in share repurchases and we completed about $312 million of that in the first quarter.

We're frequently asked about our ability to repatriate capital from our international operations and in particular from Japan. Since 2012, we have redeployed about 60% of our international after-tax AOI. This excludes capital returned from Japan to the U.S. through our yen equity hedge.

We've used three primary lenses to redeploy capital from our Japan operations – repayment of debt from the holding company that was used to provide additional funding for Star and Edison; affiliate lending, those are loans from Japan to the holding company or any of our other subsidiaries; and dividends. We expect to be able to continue distributions consistent with our historical levels using these and other available means.

Financial strength straddles two of the three Venns that we've shown. It reduces our risk profile and enhances our capital deployment flexibility. It is also central to our value proposition to customers, to investors and to employees.

Our basic business model as you've heard it described here today is simple. As John succinctly summarized it, we make promises and we keep promises. Given the long-tailed nature of many of those promises, counterparty risk is a central concern, sometimes even a fiduciary one.

Our financial strength, brand, and track record are core competencies in this business model. As could be seen here, we've supported the growth of our businesses to increase capital while strengthening our capital structure through increased equity and reduced leverage. We're currently operating with our financial leverage ratio below our 25% target which gives us flexibility.

Our business mix is our first line of defense against risk. We have a mix of Retirement, Asset Management, and Insurance businesses which drive a balanced risk profile.

On the left of the slide, you see our mix of businesses represented by the relative contribution to earnings. As you travel clockwise, businesses move from primarily insurance-related risks to primarily market-related risks.

When we think about managing the composition of our businesses, we actually look through the businesses to the risks that underlie those businesses, and that's the view that you see on the right-hand side.

Risks are measured by our internal risk-adjusted capital framework and our gross of diversification benefits. We present it this way because we require that businesses price in their market to achieve hurdle rates of return based on their individual risk profile before any benefits associated with enterprise-level diversification.

As can be seen, we're roughly balanced between insurance and market-related risks. Our market risks are reasonably balanced between interest rates, credit, and combined equity and real estate risks. Our interest rate risk is relatively modest. As Scott articulated in the presentation that you just saw, we have a very strong [ph] A/LM (03:02:32) discipline and manage interest rate risk very tightly within the investable universe.

Our insurance risks primarily include longevity, mortality, and policyholder behavior risks. And turning to the next slide, we'll do a little deeper dive into the mortality and longevity risks, and hopefully address the question that was asked earlier.

We manage our business mix to maintain a complementary balance between mortality and longevity risks, such that the risks of life expectancy changes are largely offset, and we retain a spread on both the mortality and the longevity pieces of our business.

In actuality, we don't assume that our mortality and longevity are fully offsetting. However, they do provide offsetting benefits. Again, we don't reflect these benefits from an enterprise standpoint in our pricing.

The graphic on the left side of this slide shows our growth exposure to longevity and mortality risks due to life expectancy increases or decreases. You'll notice that the blue line, which represents our mortality experience, has a certain seasonality of experience in the first quarter of most years.

The green line, which represents our longevity experience, has been asymmetric with respect to our mortality experience and that's intuitive. The lighter dotted line shows the net experience. It is positive in almost all periods, with only modest dips, primarily due to that first quarter seasonality experience. It shows a net contribution to earnings above our expected returns from the spread that we earn on each of these businesses.

As a second deep dive into the topic of volatility and risk, we updated the analysis we presented at prior Investor Days on the economic sensitivity of our in-force VA book to various stress scenarios. The analysis present values future contract cash flows net of claims and expenses as of the end of last year, using baseline assumptions and then various levels of market stress. It does not reflect the earnings on or the release of our existing $11 billion of reserves and capital.

We believe that our VA business is attractive, well managed and high returning. As a result of the maturing of our experience and the restructuring associated with the recapture of our captive, we believe that the volatility of this business has been reduced. We earn attractive returns on our existing book. And given the size of the existing book relative to new sales, as well as the reduced volatility, the business generates significant free cash flow

Results of our sensitivity analysis have not changed materially since we presented it at our last Investor Day. On the far left, you can see our baseline scenario, the assumptions for this scenario are in the back of your decks, if you have questions about this.

Cash flow and all scenarios are discounted at the forecasted treasury rate. Based on these baseline assumptions, the present value of future contract cash flows, net of claims and of expenses is about $18 billion substantially the same as what we showed last time.

To the right, you see a range of scenarios that include positive and negative markets and lower lapses. As you can see, the assumptions for each of those is described in the rows that are below the bar graphs. In each scenario, the block is expected to generate strong future cash flows ranging from $27 billion in favorable markets to around $3 billion in the combination of negative markets and lower lapses.

Additionally business has on balance sheet capital and reserves to withstand cyclical stresses and still maintain a CTE 97 through CTE 97 total asset requirement through the cyclical stresses. In recall that our capital and existing reserve as I said before are not included in this values. This is just the present value of the net contract to cash flows.

Several years ago, we put into place a capital protection framework designed to ensure our ability to withstand the range of stresses including severe or tail market stresses and remain competitively capitalized. We hold capital and reserves to AA standards across our businesses which we ensure that we remain solvent in the event of a severe market stress.

We used our capital protection framework to ensure that we're not only solvent but sufficiently capitalized to remain competitive and to be able right new business. The tail stress scenarios are shown on the left. The only item which may be a little non-intuitive is the yen appreciation to ¥70 against the U.S. dollar or strengthening of the yen is a good thing for us in the long term. In the short term as a result of our yen equity hedge, it has a liquidity requirements associated with it.

The tools that we have available to us to maintain our competitive capitalization include existing on balance sheet capital capacity; macro hedges; bank credit facilities in both the U.S., about $4 billion; and in Japan, about $1 billion; and about $4 billion available under our Federal Home Loan Bank facility.

In addition to that, we have continued capital sources which primarily include our $1.5 billion P-Caps facility. We continually update this framework, running severe deterministic stresses, and adding where needed tools to ensure the strength and competiveness of our operating companies.

We manage our businesses and our financial profile to ensure that we have a well-balanced risk profile that generates attractive risk-adjusted returns and is able to withstand the broad range of insurance and market-related stresses. While remaining competitively capitalized, able to fulfill the promises we've made to customers, investors and employees and able to continue growing with the financial strength to make and fulfill new promises.

We also recognize that the economics of that business model, of promises made and promises kept, needs to be clearly and consistently demonstrated in our reported financial results. Frankly, GAAP accounting, as Mark mentioned, can sometimes make that challenging.

Wherever possible we've taken action to reduce our complexity and our GAAP earnings volatility. In 2014, we restructured our Closed Block and simplified the presentation of our consolidated financials beginning in 2015.

Also, in 2015, we implemented our foreign currency division structure in Japan which substantially mitigated the significant volatility in our reported GAAP net income that resulted from the entirely non-economic impact of FX re-measurement.

We also anticipate more stability in our VA results, due to the maturing of our experience and the restructuring associated with a recapture of our captive in 2016, including the elimination of the interest rate under hedge. These actions address about 80% of the historical breakage that we've seen between GAAP net income and our reported AOI over that period of time. In addition, we've reduced our duration management swaps by over 60% and we've implemented hedge accounting wherever permissible.

We expect that these and other actions that we've taken will result in a more clear and consistent representation of the economic business model in our reported financial results and will contribute to maximizing shareholder value.

Using the construct of the balancing act between growth and ROE, cash generation and deployment and volatility and risk, we believe that we've produced value for our shareholders, while ensuring financial strength, which is core to our value proposition to customers, to investors and to employees.

This is a summary of the key messages that we have as a takeaway to this presentation. I'll save you reading them. You could do that on your own. I'll thank you, and I think at this point, we'll take questions.

QUESTION AND ANSWER SECTION

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

If we can invite John and Mark back to the stage, we will have our final Q&A session. All right. I saw Jay's hand first. We'll start with Jay.

Jay Gelb
Analyst, Barclays Capital, Inc.
Q

Thank you. Jay Gelb from Barclays. Mark, can you update us on your perspective on, in what ways Prudential might be able to exit non-bank SIFI oversight?

Mark B. Grier
Vice Chairman, Prudential Financial, Inc.
A

Yeah. I think – well, the tone of things is directionally positive. There are statements being made about revision to designation processes and the elimination possibly of non-bank SIFIs. Different paths for us would include on one end actual changes to Dodd-Frank that would come from Congress, the Hensarling amendment for example would eliminate non-bank SIFIs. That's one possibility.

Another possibility is direct administrative action by FSOC. Remember that our designation comes up for renewal every year and could be rescinded as part of that annual renewal process, which right now is sort of on hold as we're waiting for some things to shake out with the respect of the third option which is the legal route.

And Met has gone down on a legal path that may set a precedent for us and allow us to do something in the legal arena. So, those are the three choices, Congress, the administrative possibility with FSOC or the legal route. And, as I said, the lay of the land is, I think, positive in terms of the tone around the designation. But it's not quite clear how or when things will be resolved.

Jay Gelb
Analyst, Barclays Capital, Inc.
Q

With the potential to change the makeup of the FSOC committee, could that also have a factor towards the end of the year?

Mark B. Grier
Vice Chairman, Prudential Financial, Inc.

A

Yeah. Just purely on the calendar, FSOC will rollover to a majority of new administration appointees in November.

Jay Gelb
Analyst, Barclays Capital, Inc.

Q

And then a follow-up for Rob. You pointed out that it looks like there is some debt capacity on the balance sheet, plus the cash conversion looks like it could move higher relative to the average over the past five years, what is that, 60% range as opposed to 55%. So, my question is, why hasn't there been a bit more of a shift towards share buybacks?

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

A

Well, we've actually increased the share buybacks from the $1 billion level that we had prior to last year. If you look at the combination of the forecasted share buybacks that we have of $1.25 billion, that's what we've been authorized, in combination with the dividend increase that we've done, that's annualized about $1.3 billion. That's around $2.5 billion. If you look at that against last year's earnings, that's right about 60% of last year's earnings.

Now, obviously, there's some upside to that. Our earnings are – per our guidance, we brought the guidance that it was going to grow, and we have, as you noted, both on and off-balance sheet capacity. That capacity provides us flexibility to think about a lot of things, and we'll continue to evaluate how we deploy that capacity. We'll talk to our board about that.

And there're kinds of things that we're considering are all the things that we've mentioned before. So, optionality around things we want to do in the way of investing in our businesses, organic and inorganic growth, as well as thinking about how we might optimize returns to shareholders through addressing buybacks.

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

A

We'll go right behind, Erik Bass.

Erik Bass
Partner, Autonomous Research

Q

Thanks. Erik Bass with Autonomous Research. Scott, it's striking in your presentation is how low credit losses have been over the last five years. Just wondering, how much of a tailwind has this been for earnings, capital ratios or cash flows over the period, and how do you think about sort of holding a buffer in the event that the credit cycle turns at some point?

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

A

Well, one of the real challenges with the credit cycle is you never really know how long it's going to run. We're seven or eight years into this one. And by historical standards, I think you'd be tempted to say, we must be getting into the very late innings. But as you can imagine with some regulatory changes, tax changes and what have you, it could actually be extended quite a while. So, that really isn't a job that we try to take on in the portfolio as far as holding reserves. What we try to do is price them into those pricing assumptions over the cycle. We do manage the mix of the portfolio. But as I think I pointed out, it doesn't change that much.

Given where we are later in the cycle, given where we see valuations on real estate and equities, I would say, we're a little shorter on the duration in our riskier asset buckets, and we're probably a point lower than we might otherwise be if we thought spreads were fatter and we have longer to potentially run.

But I think we're positioned where we want to be and we just don't know when that storm will hit. But I think the portfolio, particularly compared to our peers and compared to where we were going in the last cycle, we're in a good place.

Erik Bass
Partner, Autonomous Research

Q

Got it. Maybe Rob, just from your perspective though, in terms of the contributions that's made to the cash flow and RBC ratios and other things since you manage sort of capital from the top of the house, how do you think about credit?

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

A

I think Scott captured it actually well. So, as a shop, I would say, our discipline around one, asset liability management so, in the first instance, the greatest risk of making sure that we've got the duration matched appropriately. And then the second instance, ensuring that the portfolio that we've used to construct that has a high-quality nature to it and that where we're taking risk, we're getting paid well for that risk.

So, the strategy of taking risk in things where we have superior execution capabilities like privates and like mortgages, we think, produces a very attractive return that in part makes us competitive in the marketplace and in part allows us to generate a higher ROE that we then – ultimately forms the basis of our returns to shareholders.

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

And I think the other aspect of this is when you're into the adverse space, the inevitable adverse space of the markets, it's also an interesting question. How do you want to use that risk? How do you want to use that capacity? Do you want to use that in the form of investment risk or do you want to use it in the form of M&A opportunities that may be disproportionate and not commonly seen throughout the cycle.

And these are the kind of things where if you've watched us before, typically, in the adverse spaces of the market, we tended to be more active. Not so much in the form of investment risk when we're active in the form of opportunities that may not otherwise be around. So, it's a dynamic thought process that we collectively engage in.

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

A

Let me just go to that side of the room. Suneet.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.

Q

Thanks, Mark. Suneet Kamath from Citi. Just on the ROE target. Absent a sustained the increase in interest rates, do you have levers to get your consolidated ROE back to that 13% to 14% range?

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

Obviously, there were levers. As I think I highlighted in the beginning, those levers are not always healthy levers. So, we could look at introducing more operating leverage into our actually financial leverage. We've resisted doing that because we think that the fundamentals of our business actually produce in and of themselves very attractive returns. So, we look at the return relative to our cost of capital. If you look at the 12% to 13%, still well in excess of our cost of equity. And we don't think it either prudent or desirable to try to enhance that beyond that which is organically or fundamentally available within the businesses.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

But on an organic basis, so excluding any increase in leverage or anything like that, do you still – do you think you can get back to that 13% to 14%?

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

The 12% to 13% guidance we provided is reflective of a sustained low interest rate environment. If we stay at that level, we believe that 12% to 13% continues to be appropriate despite what we think is a very robust outlook for the businesses.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Got it. And then just a follow-up on the regulatory outlook. I think, Mark, you said that discussions have been constructive and all of that. If they remain that way, is there upside to your capital deployment framework? Are you sort of deploying capital in a way where you're not expecting any incremental pressure from regulators on your capital ratios?

Mark B. Grier
Vice Chairman, Prudential Financial, Inc.
A

It's the latter answer. We're not constrained on the deployment of capital by anticipation of some regulatory consequence.

Suneet Kamath
Analyst, Citigroup Global Markets, Inc.
Q

Thanks.

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

And to stay on that side with Sean.

Sean Dargan
Analyst, Wells Fargo Securities LLC
Q

Sean Dargan from Wells Fargo Securities. If the credit markets do turn or something impacts the public market valuations of insurance and investment-type businesses and you had dry powder, all else being equal, is there a type of business that you'd rather add inorganically?

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Well, let me take a kind of broad sense to that, to even step back a little bit from this. Right now, you can see from the, I think, hopefully get the sense from the presentations that we're really focused on organic growth.

And it's not just the vertical pipes of the three chosen lines of business we're in. What we're really seeing is very exciting, and therefore, it's especially reflected in the way we presented our U.S. businesses. It's where the very strong levels of excitement are and the ability to span across these chosen lines of businesses in ways that most people can't because they don't have that same mix of businesses or they don't have the culture that enables that kind of level of collaboration necessary to pull it off.

So, we're very focused on the organic aspect of it. In addition to the fact that what we see as a big opportunity right now is evolving our business system to be even in more – it enhances relevance even beyond where it is today. That's not achieved necessarily through buying someone else's old version.

So, in terms of our mind power, it's really concentrated on that. Now, having said that, we have complete confidence about our ability to do things in the M&A space were we to choose to do it, but we're – it's nice to do, not have to do. And whether it's internationally as Charlie said, that's mainly about – it would be mainly about enhancing our presence in the pre-existing markets with perhaps, one or two possible exceptions.

And I say within the U.S. it would clearly be remaining in our chosen lines of business. We're not looking to grow outside of it. We think the opportunity set is very strong where it is. You want to add anything?

A

No.

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Good.

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

A

Let's go to Tom. We'll get to you, Josh.

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Yeah, Josh. Okay.

Thomas Gallagher
Analyst, Evercore ISI

Q

Thanks. Mark, your comment on New Jersey looking at you at the group level from a supervision standpoint, can you comment a little more on what that means exactly. It sounds like it's early on in the process, but are they using GAAP consolidated numbers, figures to look at, or what's involved in that process?

Mark B. Grier
Vice Chairman, Prudential Financial, Inc.

A

Let me divide into two parts. The supervisory regime is evolving. It's an extension of New Jersey's view of Prudential to include the insurance subsidiaries that are outside of New Jersey, and also by the way, outside of the U.S., as well as a view of the unregulated subsidiaries like Asset Management.

So, in terms of supervision, the evolving process is right now around the relationships among the different businesses that we have and how they relate to the holding company for example and how they relate to their own local regulatory environments and also feeling out the way in which New Jersey will deal with and relate to other regulators like the JFSA in Japan. So, there is that supervisory world where it's a broader view, it's more comprehensive, and it's being defined right now as they're looking at how things work.

The second part of it which is related to your question about GAAP is around capital standards, and there is an initiative among the state regulators at the NAIC level around capital guidelines for domestic insurance groups that would extend basically the statutory framework to some indexed aggregated-type concept.

So, it's not likely that they will be on a track that sort of consolidated GAAP-driven. It's more likely to be bottoms-up, again something that looks like an indexed aggregation of statutory solvency margins or RBC ratios.

So, it's something that's closer to home in terms of the way in which the insurance regulators are already thinking about capital and a way to aggregate somehow, not consolidate, because that doesn't work; it's not consolidatable. Something that can be aggregated and somehow indexed.

Thomas Gallagher
Analyst, Evercore ISI

Q

And where do you think it's going down the road? It's just do you expect there to be some kind of framework that would evaluate group capital adequacy, taking a more holistic approach and then eventually a framework that looks today the way they regulate the insurance operating subsidiaries and limit dividends up to the holding company, like where is the endgame on what the process is starting now?

Mark B. Grier
Vice Chairman, Prudential Financial, Inc.

A

The endgame as you've described it is kind of hard to define at this point. The work that's being done is in the arena of guidelines and comparability across companies as opposed to either specific firm standards or a specific prescription of possible regulatory actions around the way in which capital is managed. So, I would say the way you asked the question, it's too early to say. We're in the process of understanding it, developing guidelines and seeing what may or may not be comparable, but we're not at the stage yet where it's much beyond that.

Thomas Gallagher
Analyst, Evercore ISI

Q

Thanks.

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

A

All right, Josh, your turn.

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

It's much fun as it is to watch him wait.

Josh Smith
Managing Director - Domestic Equities Insurance Analyst, TIAA

Q

Josh Smith, TIAA Investments. I just want to follow up on Erik's question because I don't think you'd quite grasped what he was asking. You've had tremendous credit, both through the crisis and since the crisis. And since we're trying to ask – because we don't know what your expected losses were, we're trying to get a way to size the benefits you've had from this great credit in your previous ROE or EPS. So, if you normalize that, how much of a drag would it be if you went from, say, 32% to 82%? And has it changed over the past five years, was a lot of it more in 2011, 2012, 2013?

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

A

Well, I think we've reported our actual realized losses in our financial statements. So, you can kind of go back and look at that. I guess I'd say, the portfolio has gotten bigger, so an equivalent loss would be a bigger number on a bigger portfolio. What we – we have a risk appetite framework and what we do is, we take – I think Rob referred to it in his discussion as a cyclical – a set of losses and what would we expect in a cyclical decline. So, just think of equities down 15% to 20% and you take a credit hit and what have you.

We then look at those numbers and we compare them – and I'll let Rob comment on this a little bit more – but we then compare that with our rating in RBC objectives. And what we really want to do is, is remain within our targets during the classic 1 and 10. And so that's how we size it up. Usually, these credit cycles, when they hit, they hit within about 18 months, right? They don't really smooth out over a long period of time. For the more severe scenarios, which John refers to, I think you have to – that's [ph] inaudible (03:27:06) when those come along.

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

A

So, from an ROE standpoint, recall that, as Scott pointed out, that the numerator actually does not reflect the credit losses, right? That's realized gains and losses or very good reasons why you wouldn't want that in the numerator because it's; A, volatile; and B, can be managed in a way that could distort results. So, what you've seen is, that's one of the below-the-line items that we have that creates breakage between our operating income and our GAAP net income. And I think the point of Scott's slide is that when you think about that over time, that's actually been a positive differential for us that it's been a contributor to not only closing the gap between net income and operating income because the experience has been more than what we would have otherwise provisioned for.

And so when we think about it from an ROE standpoint, we don't alter ROE on the basis of expected credit experience. But said differently, our expected credit experience is factored into the ROEs that we generate for each of our businesses, that's in the models that we generate from the businesses. The actual experience against that is just something that flows out below the line; it has been a positive experience for us.

Josh Smith
Managing Director - Domestic Equities Insurance Analyst, TIAA

Q

So, no impact on ROE, but obviously has helped on the book value growth side.

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

Correct.

Josh Smith
Managing Director - Domestic Equities Insurance Analyst, TIAA
Q

Thanks.

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.
A

Well, and conversely, if you write off assets, equity goes down and ROE goes up.

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

Yeah. [indiscernible] (03:28:20).

Josh Smith
Managing Director - Domestic Equities Insurance Analyst, TIAA
Q

Fair enough.

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

Let's go to that side. John Nadel.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you. I have a follow-up question on the Annuities side and then one, I know you're not on stage, Charlie, but you're still in the room, so maybe I can direct one to you. On the Annuities business, I'm just curious, if we think about net negative flows for the VA business for the next year or two, three with DOL as really the – I guess, the overhang deciding factor or swing factor here. How long can you maintain a 105, give or take, basis points ROA for that business before the net flow picture begins to actually have an impact on your efficiency there?

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

I'll defer it to someone from the Annuities [indiscernible] (03:29:12). I'd like to chip in. Let me take a shot at it. Well, he's not looking anxious. I think, as Lori indicated in her presentation, if you look at the installed book, you have two phenomena that results – that result as – as you – if we don't have an increase in sales that can replace the runoff, the first is actually a positive, which is that it throws off a lot of free cash flow. So, if the business doesn't grow and returns begin to moderate, the quid pro quo to that is it throws off a lot of free cash flow, which allows us to then reinvest to replace that growth in other areas or to return it to shareholders in order to preserve ROE and return to shareholders.

The second is though, the block over time would degrade in terms of its earnings, and that would happen both by a function of, as you said, not being able to absorb overhead. Now, obviously, if we were in a position where our business was not growing, we would address the cost structure that was then associated with that business. But secondly, that block over time actually has lower fees as you get outside the surrender period and, therefore, there will be some pressure on margins that would result as well.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC

Q

I appreciate the comment on the free-up of capital.

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

A

Do you want to add anything, Lori?

John Robert Strangfeld
Chairman & Chief Executive Officer, Prudential Financial, Inc.

A

Lori?

Lori Fouché
President, Annuities, Prudential Financial, Inc.

A

I'd maybe add one point too which is [indiscernible] (03:30:28-03:30:42) associated with them as well. So, as that book kind of changes over time, all other things being equal [indiscernible] (03:30:49).

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC

Q

Thank you. And then the follow-up question for Charlie. On a couple of occasions, Charlie, you indicated that the base – that 95% of the business in Chile, that the fees at Habitat are significantly below that of the peers. Just hoping you could give us some way of quantifying that. I mean, I'm sure we could probably go online and find them, so I'm just hoping you could just do that for us.

But, I guess, separately from that, if there's that substantial a difference, if there is that substantial difference, why don't you have even a greater market share, or would you expect that three years from now, something along those lines, you'll have significantly greater market share if competition doesn't come down to you?

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

A

Am I allowed to give the answer on the fees?

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

A

Sure.

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

A

Okay. Our fee – our average fee is [ph] 1.27 (03:31:43) and for our competitors, it's [ph] 1.43 (03:31:44). Just to be specific.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC
Q

Okay.

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

In terms...

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC
Q

That's specific. Thank you.

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

You're welcome. In terms of market share, I think there are a number of dynamics going on. You saw in the fourth quarter of last year when there was noise around some of the tax issues with our competitors, and foreign versus domestic, and we're considered a domestic company, we actually had significant flows come into Habitat. You might expect to see more come in over time. The issue is that with pensioners, they tend to be fairly sticky. And so, it takes an event of some sort in order to have the move, and there's some movement back and forth. But we have seen very consistent flows coming into the portfolio over time such that there was significant year-over-year growth if you look at first quarter last year to first quarter of this year that we grew quite significantly. We grew by, I don't know, what, 10% or 15%.

So, I think we'll continue hopefully to see it. And it's based on perception. It's also based on performance. We have exceptional investment performance far above some of our other peers. And over time, that tends [ph] to be near to our (03:33:06) benefit. But people are fairly sticky and there is some resistance in moving.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC
Q

So, you think you're gaining share though in terms of new deposits?

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

We have been gaining share in terms of new deposits, yes.

John M. Nadel
Analyst, Credit Suisse Securities (USA) LLC
Q

Thank you.

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

Yeah.

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

Let's go to Ryan Krueger.

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

Q

Thanks. Ryan Krueger, KBW. It looks like the longevity exposure, I guess, exceeds mortality exposure by at least a little bit at this point based on the chart you provided that given the historical tendency for mortality to improve at a greater pace than expected over time, does that give you any hesitation going forward to grow the longevity business at a faster rate from the mortality block?

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

A

So, Ryan, a couple of thoughts on that. First, these things are roughly in balance. The materiality of the differences is not material, particularly in the context of overall amount of capital that we hold and the size of our book. So, I would look at those as roughly being in balance. And while we look to keep them in balance, it's not with the level of specificity that that line should be drawn exactly in the middle of the two.

Secondly, with regard to how we think about the risk, actually that risk of extended longevity is factored into how we think hold capital both against our mortality business and our longevity business. So, we look at under extreme outcomes – both extreme outcomes from a mortality standpoint, but from longevity. So, when you're looking at that balance, it reflects the fact that there could be a cure for cancer and that cure for cancer happens very rapidly, is adopted by society, in hospitals over the next five years and is 50% effective I think in the next 10 years would be sort of a representative example of the level of capital that we're holding. And so, we're not pricing or holding capital against current levels of expected mortality. We – actually our best estimate provide a provision on top of that and then in a way in which we hold capital, we provide a further provision for that which anticipates more extreme outcomes from longevity than we think are probable but nonetheless we hold capital for it.

So, our view on that is that we're getting well paid for the risk that we're taking and particularly the returns are attractive given the amount of capital we're holding against extreme outcomes on that risk. The other thing I'd mention that perhaps you're alluding to in your question is, when we think about longevity and mortality, we're keeping them roughly in balance.

Remember the Pension Risk Transfer book, as Phil pointed out, we've got about $4 billion of that that rolls over every year. And so, Phil's job is a little daunting and that he's got to run at the pace of $4 billion just to stay even. So, we have substantial capacity to continue to do longevity business given the runoff in the book relative to that.

And then the other point I'd make on the mortality side is, as we saw our longevity business growing, we adjusted our reinsurance levels in our Life, our mortality book. We brought that from a 90% level of reinsurance, we're only retaining 10%. We actually expanded that, so now we're now retaining about 30% of the book that we're writing. Well, we're still not retaining 100%. So, we've got a lot of ability to continue to calibrate our mortality and longevity exposure in order to keep these things roughly in line with each other.

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

Q

Great. Thank you.

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

All right. Seeing no more hands, I'd just like to thank everybody in attendance, as well as on the webcast. So, that will conclude our program. Thank you.

John Robert Strangfeld

Chairman & Chief Executive Officer, Prudential Financial, Inc.

Thank you.