Prudential Insurance Company of America

Credit Summary Report | June 2021

State of Domicile:	New Jersey	**Ratings as of:**	June 2021
Holding Company:	Prudential Financial	**Moody's:**	Aa3/Stable Outlook
Type:	Stock	**S & P:**	AA-/Stable Outlook
Incorporated:	1875	**Fitch:**	AA-/Stable Outlook

Prudential Financial Inc. (PRU) is the parent of insurance companies Prudential Insurance Company of America (PICA) and Pruco Life Insurance Company, formed in December 2001 after the firm demutualized and completed an initial public offering of stock. Through its subsidiaries, PRU offers a wide range of products and services including insurance, annuities, retirement-related services, mutual funds and investment management. PRU has operations in the United States, Asia (mainly Japan), Europe and Latin America. Prudential Insurance Company of America has a leading position in the US life and retirement market, with a top 10 positions in a number of life, retirement and annuity markets. In recent years PRU has exited numerous businesses, including group healthcare, P&C insurance, global commodities, real estate and relocation, residential mortgage banking, and investment banking, which had higher business risks or were non-core businesses in which the company lacked a competitive advantage. In July 2012 the company announced its decision to cease sales of group long-term care insurance reflecting the challenging economics of the long-term care market including the continued low interest rate environment. These divestments helped to reduce enterprise risk and to strengthen the company's overall credit profile. PRU has been changing its business mix away from interest sensitive products like long-term care insurance and growing in pensions business. Over the past several years PRU has experienced significant growth in the Pension Risk Transfer (PRT) business having accumulated significant pension account values from a large number of plans in the U.S. and the U.K.

In 2019 Prudential Financial acquired Assurance IQ for $2.4 bn plus $1.2 bn multi-year earnout contingent upon Assurance achieving growth objectives. Assurance IQ is a startup online insurance brokerage service selling life, health, Medigap, auto and home insurance policies. The acquisition allowed PRU to reach underserved mass market through this new digital direct-to-consumer channel. PRU has been focused on growing its financial wellness business and this acquisition added a rapidly growing, technology-driven distribution platform with PRU selling its own products alongside those of third-party providers. In 2020 Prudential sold its Korean business for $1.9 bn. PRU recognized an approximate $800 mn after-tax loss on sale in 2020.

In November 2020 PRU announced that it will discontinue sales of variable annuities with guaranteed living benefits and will explore strategic solutions for in-force blocks of variable annuities. In early 2021 Prudential Financial announced that the company will continue its transformation by executing on its $750 million cost savings plan and by taking additional steps to increase growth potential and reduce market sensitivity. Over the next three years Prudential plans to reallocate $5-10 bn of capital with the intention of doubling the earnings contribution of its higher growth businesses and halving Individual Annuities. PRU's Individual Annuities business contributed 22% of its earnings which it plans to reduce to less than 10% through run-off, reinsurance and block sales. PRU's higher growth businesses include PGIM, Assurance IQ and Emerging Markets, which together contributed 18% of its earnings which it plans to increase to more than 30% through organic growth and programmatic acquisitions in PGIM and Emerging Markets within International Businesses. PRU will also target $10 bn capital return to shareholders over the next three years.

Prudential operations consist of PGIM (global investment management business) that contributed 18% of earnings, U.S. Businesses (including U.S. Workplace Solutions, U.S. Individual Solutions, and Assurance IQ divisions) that contributed 40% of earnings, International Businesses that contributed 42% of earnings, the Closed Block division and Corporate and Other operations. The U.S. Workplace Solutions division consists of Retirement and Group Insurance businesses; the U.S. Individual Solutions division consists of

Individual Annuities and Individual Life businesses; and the Assurance IQ division consists of Assurance IQ business, which was acquired in October 2019. Japanese operations accounted for 95% of International Businesses earnings.

Prudential Financial reported after-tax adjusted operating income of $4.1 bn for 2020 compared to $4.7 bn for 2019. Total adjusted operating income before taxes was $5.1 bn in 2020, down from $5.9 bn in 2019. PGIM reported adjusted operating income of $1.3 bn, up 26 % y/y on higher asset management fees partially offset by higher expenses. Retirement segment reported income of $1.4 bn, up 10% y/y on higher reserve gains and lower expenses. Group Insurance segment reported loss of $16 mn in 2020 compared to income of $285 mn in 2019 due to less favorable underwriting results in group life and group disability businesses, and lower net investment spread results. U.S. Individual Solutions division reported income of $1.4 bn, down 26% y/y driven by Individual Annuities (income of $1.47 bn, down 20%) on unfavorable impact from annual assumptions review and lower fee income, while Individual Life (loss of $48 mn) reflected lower underwriting results. Assurance IQ division reported loss of $88 mn in its first full year of reporting since acquisition of the business in October 2019. The loss reflects net revenues that were more than offset by operating expenses as well as amortization expenses related to intangible assets recognized as part of purchase accounting. International Businesses reported adjusted operating income before taxes of $3 bn in 2020, down 5% y/y. Results for 2020 were negatively impacted by currency exchange rates, unfavorable impact from annual reviews and update of assumptions, as well as lower net investment spread results and lower earnings from joint venture investments, partially offset by favorable underwriting results including business growth. Corporate and Other reported loss of $1.8 bn in 2020 (compared to loss of $1.77 bn in 2019) driven by lower investment income and higher interest expense on debt, partially offset by lower charges related to corporate costs and initiatives, as well as favorable pension and employee benefit results.

During 1Q21 PRU reported record high after-tax adjusted operating income of $1.7 bn compared to $897 mn for the year-ago quarter. 1Q21 results were driven by increase in variable investment income, favorable reserve developments in the Retirement segment and one-time gain on sale of an Italian JV in PGIM.

PRU's general account investment portfolio is well diversified across asset classes, industry sectors, geographic regions and issuers. Risk limits and exposure ranges for the investment portfolio are approved annually by the Investment Committee of the Board of Directors. PRU underwrites their own credit risk through direct originations of commercial mortgages and private placements. As of March 31, 2021 PRU held $455 bn of general account investments (excluding closed block): 39% in corporate securities, 30% in government securities, 12% in mortgage loans, 5% in structured products, 2% in policy loans, 1% in short-term investments, 1% in equities and 10% other. 76% of the investment portfolio was in fixed income securities of which 72% were NAIC 1 rated, 22% NAIC 2 rated and 6% NAIC 3-6 rated. High yield exposure is weighted towards higher quality and asset-rich sectors, with an emphasis on allocations to private placements with strong covenants and ability to restructure. Higher risk investments include CMBS (2% of investment portfolio; 99.9% rated 'A' or better), ABS (2% of investments), and commercial mortgage loans (12% of total investments). 83% of PRU's ABS investments comprises of AAA-rated collateralized loan obligations (CLOs), which is the most senior tranche with the strongest structural protections in each transaction. PRU has substantial insurance operations in Japan with 44% of general account investments relating to the Japanese insurance operations.

As of 03/31/2021, PRU (including closed block) had total assets of $907 bn, shareholders' equity of $59 bn and assets under management of over $1.7 trln. PRU targets operating capital levels and leverage consistent with AA ratings. At the end of FY20, PRU reported a Risk-Based Capital (RBC) ratio of 394%, with the target to maintain RBC above 375%. Beginning in 2Q20 PRU suspended its share repurchase program due to the uncertainty of the pandemic. In February 2021 the insurer's Board of Directors authorized the repurchase of up to $1.5 bn of its shares in 2021. PRU plans to return approximately $10 billion of capital to shareholders via dividends and share repurchases over the next three years. Financial leverage as measured by capital debt to adjusted capital ratio (excluding AOCI) was at 25.4% as of 03/31/2021. PRU maintained a very strong liquidity position with $5.6 bn of holding company cash, short-term investments and U.S. Treasury fixed maturities as of YE20 versus $4.1 bn at YE19 and above the target range of $3-5 bn. In addition, PRU had $4 bn undrawn credit facility maturing in July 2022 and 2 contingent capital facilities of $1.5 bn each maturing in November 2023 and May 2030. Despite having a relatively large CP program in place, PRU has significantly reduced its use of short-term debt in an effort to better manage assets and liabilities. PRU also uses hedging and sophisticated ALM strategies to keep asset-liability mismatches within reasonable tolerances.

Prudential maintains a competitive position in its global insurance business and benefits from diverse revenue streams, but partially offsetting these factors is the company's above average exposure to equity market volatility given its large VA, retirement, and asset management businesses. PRU has a strong international presence, robust capital adequacy, solid financial flexibility, and consistently generates good operating profits. The company benefits from a strong competitive position and favorable pricing environment in Japan, where it generates high returns, and growth in the U.S. is being driven by higher return businesses such as asset management, retirement, and annuities. Prudential's International business (Life Planner and Gibraltar) focuses on protection-type products with lower risk profile and strong growth opportunities. PRU remains sensitive to equity market volatility given VA book, however, it announced reduction in this business going forward. Rapid growth in the company's pension risk transfer business in recent years results in higher investment, asset liability management and longevity risks.

Environmental, Social and Governance (ESG):

- PRU is rated A by MSCI which highlights the insurer's strong efforts in establishing talent management initiatives and its solid data protection practices.
- PRU is committed to promoting long-term sustainability. The Board introduced a multi-stakeholder framework that extends the Board's accountability to investors, employees, customers and society at large.
- Investment Strategy: adopted U.N. Principles for Responsible Investing, ESG-focused Investment Philosophy, Investing to Mitigate Climate Change, Global Environmental Commitment.
- Disclosure & Transparency: Adopted Task Force on Climate-related Financial Disclosures (e.g. quantifying greenhouse gas emissions, recycling and water usage). Published metrics in accordance with the Sustainability Accounting Standards Board.
- Environmental: First U.S. insurer to issue a green bond. Received A- on CDP's 2020 Climate Change Survey. Included in FTSE4Good Index Series for 10th year.
- Social: Introduced nine commitments to advance racial equity. Renewing and expanding executive compensation plan's Diversity and Inclusion Performance Modifier for 2021-2023.
- Governance: Welcomed new independent board member. Prudential's 13-member board is 85% independent and 82% of independent directors are diverse.

Strengths:

- Very strong competitive position in the U.S. and Japan and strong brand recognition.
- Good earnings diversification by line of business and geography, including in unregulated businesses.
- Strong capitalization and liquidity.
- Strong risk management and control.

Weaknesses:

- Higher-risk products with potential earnings volatility, such as variable annuities, no-lapse universal life insurance, legacy long-term care block.
- Significant captive exposure with off balance sheet financing exposure.
- Emerging risks in a fast growing pension risk transfer business.
- Aggressive capital management and complex capital structure.

Key Statistics – Prudential Insurance Company of America

($ millions)	2020	2019	2018	2017	2016
Total Assets without Separate Account	$154,208	$146,040	$133,493	$127,037	$123,992
Separate Account Assets	$156,445	$146,278	$137,672	$139,127	$136,303
Total Assets	$310,653	$292,318	$271,164	$266,164	$260,294
Capital & Surplus	$11,597	$11,483	$10,695	$9,948	$11,174
Net Gain from Operations before Tax	$1,998	$240	$1,580	$890	$6,088

Net Realized Capital Gains (Losses)	($205)	($140)	($79)	($722)	($507)
Net Income	$1,770	($169)	$1,324	($217)	$5,213
Return on Average Assets (Stat.)	0.58%	-0.06%	0.50%	-0.08%	2.05%
Return on Average Equity (Stat.)	14.98%	-1.41%	13.01%	-1.92%	48.22%
RBA Ratio (ACL)	787.60%	821.16%	770.00%	820.13%	913.44%

Sources: Company Reports and Statutory Filings