Prudential Insurance Company of America

Credit Summary Report | April 2020

State of Domicile:	New Jersey	**Ratings as of:**	April 2020
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 insurance, investment management, securities and other financial products and services. 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 February 2011, PRU completed its acquisition of two AIG subsidiaries in Japan, Star Life Insurance and Edison Life Insurance Co, for $4.2 bln plus $600 mln in assumed debt. The Star/Edison companies have been merged with PRU's existing Japanese operations, Gibraltar, which further increases its market share in the lucrative Japanese insurance industry. Over the following 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 December 2018 PRU appointed new senior management with CEO Charles Lowrey (former COO) and Vice Chairman Robert Falzon (former CFO) replacing retiring executives.

In 4Q19 Prudential Financial closed acquisition of Assurance IQ, a startup online insurance brokerage service selling life, health, Medigap, auto and home insurance policies. The acquisition allows 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 adds a rapidly growing, technology-driven distribution platform. PRU will sell its own products alongside those of third-party providers. PRU paid $2.35 bn upfront, including $1.2 bn in cash, $680 mn in debt and $470 mn in stock and equity awards with earnout potential of another $1.15 bn in cash/equity contingent upon Assurance achieving multi-year growth objectives. In April 2020 Prudential announced that it has entered into agreement with KB Financial Group, a Korean financial services provider, to sell its Korean business for $1.9 bn. PRU will record a $300 mn loss on sale and closing of the transaction is expected by YE2020. In 2019 PRU's Korean business generated pre-tax operating earnings of $228 mn, which is less than 4% of the total company's earnings.

Prudential re-aligned its five U.S. businesses under three divisions oriented to the needs of specific customers: U.S. Individual Solutions (24% of pre-tax operating earnings) includes Individual Life Insurance and Individual Annuities, U.S. Workplace Solutions (20% of earnings) includes Group Insurance and Retirement, and Investment Management (13% of earnings). The fourth division is International Insurance comprising 43% of 2019 pre-tax operating earnings. Prudential Financial reported after-tax adjusted operating income for FY2019 of $4.85 bn, down from $5 bn in 2018. Total adjusted operating income before taxes was $6 bn in 2019, down from $6.4 bn in 2018. Investment management segment reported adjusted operating income before taxes of $998 mn, up 4% y/y primarily reflecting higher asset management fees and other related revenues, partially offset by higher expenses. Retirement segment reported operating income of $1.3 bn, up 24% y/y on a favorable comparative net impact from annual reviews and update of assumptions and other refinements, and higher net investment spread results. Group Insurance reported income of $285 mn, up 24% y/y driven by more favorable underwriting results, higher net investment spread results and lower expenses. U.S. Individual Solutions division reported operating income of $1.9 bn, down 10% y/y as Individual Annuities results decreased in comparison to 2018, inclusive of an unfavorable comparative net impact from annual reviews and update of assumptions and other refinements. Excluding this item, the results decreased primarily driven by lower fee income, net of distribution expenses and other associated costs, and higher expenses, partially offset by higher net investment spread results. International Businesses reported operating income of $3.36 bn, up 3% y/y due to favorable net impacts from foreign currency exchange rates and favorable comparative net impacts from annual reviews and update of assumptions and other refinements. Excluding these items, the results decreased primarily reflecting higher expenses, partially offset by favorable impacts from business growth, more favorable underwriting results, and higher net investment spread results.

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 December 31, 2019 PRU held $457 bn of general account investments: 35% in government securities, 25% in public corporates, 12% in private corporates, 5% in structured products, 12% in mortgage loans, 3% in equities/alternatives and 8% other. 77% of the investment portfolio was in fixed income securities of which 77% were NAIC 1 rated, 18% NAIC 2 rated and 5% 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). 74% 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 42% of general account investments relating to the Japanese insurance operations.

As of 12/31/2019, PRU (including closed block) had total assets of $897 bn, shareholders' equity of $64 bn and assets under management of over $1.5 trln. PRU targets operating capital levels and leverage consistent with AA ratings. At the end of FY19, PRU reported a Risk-Based Capital (RBC) ratio of 411%, with the target to maintain RBC above 375%. During 2019 PRU returned $4 bn to shareholders through dividends and share repurchases. Financial leverage as measured by debt to capital ratio was at 24.4% at YE19, slightly below the company's 25% target. PRU maintained a very strong liquidity position with $4.1 bn of holding company cash, short-term investments and U.S. Treasury fixed maturities as of YE19, in line with target range of $3-5 bn. In addition, PRU had $4 bn undrawn credit facility maturing in July 2022 and $1.5 bn in contingent capital maturing in November 2023. 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 its large and growing VA book, but the company has below average exposure to interest-sensitive products. 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 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.

- Governance & 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 .

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.

Key Statistics – Prudential Insurance Company of America

($ millions)	2019	2018	2017	2016	2015
Total Assets without Separate Account	$146,040	$133,493	$127,037	$123,992	$116,871
Separate Account Assets	$146,278	$137,672	$139,127	$136,303	$128,124
Total Assets	$292,318	$271,164	$266,164	$260,294	$244,996
Capital & Surplus	$11,483	$10,695	$9,948	$11,174	$11,544
Net Gain from Operations before Tax	$240	$1,580	$890	$6,088	$3,747
Net Realized Capital Gains (Losses)	($140)	($79)	($722)	($507)	$2,698
Net Income	($169)	$1,324	($217)	$5,213	$5,253
Return on Average Assets (Stat.)	-0.06%	0.50%	-0.08%	2.05%	2.05%
Return on Average Equity (Stat.)	-1.41%	13.01%	-1.92%	48.22%	46.60%
RBA Ratio (ACL)	821.16%	770.00%	820.13%	913.44%	967.46%

Sources: Company Reports and Statutory Filings

Performance is expressed in U.S. dollars unless noted otherwise. Performance results for one year and less are not annualized. Many factors affect performance including changes in market conditions and interest rates and in response to other economic, political, or financial developments.

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