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BHF.OQ - Q2 2021 Brighthouse Financial Inc Earnings Call

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OVERVIEW:

Co. reported 2Q21 adjusted earnings excluding impact from notable items of $458m.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Brighthouse Financial's Second Quarter 2021 Earnings Conference Call. My name is Howard, and I will be your coordinator today. (Operator Instructions)

As a reminder, the conference is being recorded for replay purposes. (Operator Instructions)

I would now like to turn the presentation over to David Rosenbaum, Head of Investor Relations. Mr. Rosenbaum, you may proceed.

David Rosenbaum - *Brighthouse Financial, Inc. - Head of IR*

Good morning, and thank you for joining Brighthouse Financial's Second Quarter 2021 Earnings Call. Our earnings release, slide presentation and financial supplement were released last night and can be accessed on the Investor Relations section of our website at brighthousefinancial.com. We encourage you to review all of these materials.

Today, you will hear from Eric Steigerwalt, our President and Chief Executive Officer; and Ed Spehar, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period. Also here with us today to participate in the discussions are Myles Lambert, Chief Distribution and Marketing Officer; Conor Murphy, Chief Operating Officer; and John Rosenthal, Chief Investment Officer.

Our discussion during this call will include forward-looking statements within the meaning of the federal securities laws. Brighthouse Financial's actual results may differ materially from the results anticipated in the forward-looking statements as a result of risks and uncertainties described from time to time in Brighthouse Financial's filings with the U.S. Securities and Exchange Commission. Information discussed on today's call speaks only as of today, August 6, 2021. The company undertakes no obligation to update any information discussed on today's call.

During this call, we will also be discussing certain financial measures used by management that are not based on generally accepted accounting principles, also known as non-GAAP measures. Reconciliations of these non-GAAP measures on a historical basis to the most directly comparable

GAAP measures and related definitions may be found on the Investor Relations portion of our website, in our earnings release, slide presentation or financial supplement. And finally, references to statutory results include certain statutory-based measures used by management are preliminary due to the timing of the filing of the statutory statements.

And now I'll turn the call over to our CEO, Eric Steigerwalt.

Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

Thank you, David, and good morning, everyone. Once again, I hope that everyone listening today and your loved ones are remaining safe and well. Today, I will discuss our second quarter results and provide some perspectives on the continued execution of our strategy.

Brighthouse delivered strong results in the second quarter. Investment income from alternative investments was very strong given the first quarter market performance. As a reminder, alternative investment income is generally reported on a 1-quarter lag. The underwriting margin was in line with the prior quarter, but lower than a more normal quarter. We delivered another quarter of strong sales results, and we continued to prudently manage expenses.

Our balance sheet and liquidity position remained robust in the second quarter, and our hedging program performed as expected. We estimate that our combined risk-based capital or RBC ratio range was between 480% and 500%, well above our target of between 400% and 450% in normal markets. Additionally, we ended the quarter with liquid assets at the holding company of approximately $1.6 billion, which includes a $250 million ordinary dividend paid to the holding company from Brighthouse Life Insurance Company, or BLIC. Ed will provide more details on our financial results shortly.

As we have said before, our strategy has remained focused on growing sales, managing expenses, unlocking capital and repurchasing our common stock. Let me provide a few perspectives on each of these pillars. Starting with sales, I'm very pleased with our results in the second quarter. Annuity sales were approximately $2.3 billion, up 25% compared with the second quarter of 2020 and ahead of our expectations. We reported record sales this quarter for both our flagship Shield Level annuities and our variable annuities with FlexChoice Access. Additionally, we generated approximately $26 million of life insurance sales in the second quarter of 2021, also ahead of our expectations. I remain very pleased with the progress that we are making as we continue to execute on our life insurance strategy.

We remain focused on enhancing our existing suite of products as well as further expanding our distribution footprint. Earlier this week, we launched several enhancements to our Shield Level annuities. We believe these enhancements bolster the competitiveness of Shield, while also continuing to provide value to our distribution partners and the clients they serve. Also, in July, we further grew our distribution footprint for SmartCare. As we execute our life insurance strategy, we expect to continue to add distribution partners, bring on additional wholesalers and enhance and add to our product mix.

Total annuity net outflows were $735 million in the quarter, as outflows were partially offset by continued strong sales. As we've said many times previously, we expect to see a continued shift in our business mix profile over time, as we add more cash flow generating and less capital-intensive new business, coupled with the runoff of older, less profitable business.

Turning to expenses. Corporate expenses, which do not include establishment costs, were $218 million in the second quarter. Establishment costs were approximately $29 million. We previously committed to a cumulative $175 million reduction in corporate expenses relative to our first year as a public company. That was $150 million in 2020 and an additional $25 million in 2021. We remain focused on achieving the remainder of our expense reduction commitment in 2021. With that said, as I've said before, we will continue to invest in our infrastructure as we seek to enhance the support we provide our distributors and their financial professionals as well as our policyholders and contract holders.

Moving to capital. We continue to focus on optimizing statutory capital to support our balance sheet strength and our share repurchase program. I am extremely pleased to announce that in July, we received regulatory approval to take a $600 million dividend from Brighthouse Reinsurance Company of Delaware, or BRCD as we refer to it, to its parent company, BLIC. Since 2019, we have unlocked almost $3 billion of statutory capital, including $1 billion related to the derisking of our variable annuity hedging strategy.

Lastly, let me discuss our stock repurchase program. In the second quarter of 2021, we repurchased approximately $125 million of our common stock. And since the end of the second quarter through August 4, we repurchased an additional approximately $53 million of our common stock. Since the announcement of our first stock repurchase authorization in August of 2018 through August 4 of this year, we have repurchased almost $1.3 billion of our common stock. This represents a reduction of more than 31% of shares outstanding from the time we became an independent public company.

Last night, we announced a new authorization to repurchase up to an additional $1 billion of our common stock. We are very pleased with this new authorization as it reflects our financial strength, positions us to achieve our goal of returning $1.5 billion to our shareholders by the end of this year and supports our ongoing commitment to return capital to our shareholders.

Before turning the call over to Ed, I'd like to take a moment to congratulate David Rosenbaum, who recently assumed the role of Head of Product Strategy and Pricing for Brighthouse. As I'm sure many of you know, David has served as Head of Investor Relations for Brighthouse since our launch in 2017, and his responsibilities expanded in 2019 to include financial planning and analysis. David has been pivotal in driving our financial strategy over the last number of years, and I and we are excited for him in his new role.

I am also very pleased to share that Dana Amante has succeeded David as the Head of Brighthouse's Investor Relations program. Dana has also been with Brighthouse since our launch as part of our finance organization and most recently as Director of Investor Relations, and we are thrilled that she has taken on this new role.

To wrap up, Brighthouse delivered strong results in the second quarter. Sales were better than our expectations. We continued to prudently manage expenses and we repurchased more of our common stock in the quarter. Our balance sheet and liquidity position remained robust. Additionally, we unlocked more capital during the quarter, and our new authorization supports our ongoing commitment to returning capital to our shareholders. We remain focused on executing our strategy to deliver long-term shareholder value.

And with that, I'll turn it over to Ed to discuss our financial results. Ed?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Thank you, Eric, and good morning, everyone. Today, I will discuss our robust capital position as demonstrated by the preliminary statutory results we reported yesterday. I will also provide a few comments on adjusted earnings.

At June 30, combined statutory total adjusted capital, or TAC, was approximately $9.4 billion, which was unchanged from March 31, even though we paid a $250 million dividend from Brighthouse Life Insurance Company, or BLIC, to the holding company. This BLIC dividend was consistent with the 2021 dividend plan I communicated on our fourth quarter 2020 earnings call. TAC benefited from the increase in equity markets in the second quarter and strong investment performance in our alternatives portfolio.

Capital strength is a top priority, and we continue to look for opportunities to optimize statutory capital. The regulatory approval of a $600 million dividend from Brighthouse Reinsurance Company of Delaware, or BRCD, is the most recent example of these efforts. We intend to take this dividend up to BLIC in the third quarter. This additional capital further enhances an already strong capital position at Brighthouse Life Insurance Company. And we plan to take another dividend from this entity to the holding company in the fourth quarter of this year.

At June 30, we estimate that our combined risk-based capital ratio or RBC ratio was between 480% and 500%. The change in the RBC ratio from the first quarter range of 500% to 520% is primarily explained by the $250 million BLIC ordinary dividend paid to the holding company. Additionally, in June, the National Association of Insurance Commissioners, or NAIC, adopted changes to the RBC factors for bonds and real estate. Assuming these factor modifications are effective on December 31, 2021, we estimate the changes will have a mid-single-digit negative impact on the RBC ratio. And this impact is included in the estimated range of 480% to 500%. The RBC ratio remains well above our target range of 400% to 450% in normal markets.

Continuing with preliminary statutory results, we reported breakeven normalized statutory earnings during the first 6 months, as the positive equity market performance in the first half of 2021 was offset by the negative impact from interest rates and non-VA results. Holding company liquid assets were approximately $1.6 billion at the end of the second quarter, unchanged from the first quarter.

Shifting to adjusted earnings. Second quarter adjusted earnings, excluding the impact from notable items, were $458 million, which compares with adjusted earnings on the same basis of $428 million in the first quarter of 2021 and $39 million in the second quarter of 2020. We had 1 notable item in the quarter, establishment costs of $23 million after tax, which was included in Corporate & Other.

When we think about the adjusted earnings results compared with our quarterly adjusted earnings expectation, there are 2 key themes. First, net investment income was very strong, primarily due to an 11.5% alternative investment yield in the quarter. This was the second quarter in a row that the quarterly return in alternative investments exceeded the 9% to 11% annual return we anticipate for this asset class. Excess return is the primary driver of approximately $225 million of additional after-tax earnings relative to the quarterly run rate expectation.

Second, while the underwriting margin was consistent with the first quarter, it was approximately $70 million lower than the quarterly run rate expectation on an after-tax basis. The underwriting margin included $37 million of pretax net claims related to COVID-19. And overall, we had a lower-than-normal benefit from reinsurance in the quarter.

We anticipate potential volatility in underwriting on a quarterly basis, driven by fluctuations in a number of factors, including frequency of claims, severity of claims and the offset from reinsurance. Overall, we believe that our quarterly adjusted earnings run rate is in the range of $3 to $3.20 per share.

Turning to adjusted earnings at the segment level. Annuities adjusted earnings, excluding notable items, were $338 million in the quarter. Sequentially, results were driven by lower reserves as a result of the favorable market, mostly offset by higher expenses and lower net investment income. In the Life segment, adjusted earnings, excluding notable items, were $68 million in the quarter. On a sequential basis, results reflect lower DAC amortization, a higher underwriting margin and higher net investment income.

Run-off segment reported adjusted earnings, excluding notable items, of $122 million in the quarter. Sequentially, results were driven by higher net investment income, partially offset by a lower underwriting margin. Corporate & Other had an adjusted loss, excluding notable items, of $70 million. Sequentially, results were driven by higher expenses and a lower tax benefit, partially offset by lower total preferred stock dividends.

To conclude, I am very pleased with our results this quarter. We maintained our robust capital and cash position, and we continued to return a meaningful amount of capital to shareholders. We announced a new common stock repurchase authorization of up to an additional $1 billion, which supports our ongoing commitment of returning capital to shareholders. And we received regulatory approval to unlock $600 million of capital from BRCD. We remain focused on executing our strategy and committed to using a multi-scenario, multiyear framework to determine the appropriate level of capital return to shareholders.

With that, we'd like to turn the call over to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question or comment comes from the line of Ryan Krueger from KBW.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Ed, I think you mentioned in the prepared remarks that you plan to take another dividend from BLIC in the fourth quarter. Can you give us any sense of upsizing there?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sure. So we have almost $500 million of remaining ordinary dividend capacity at BLIC. And I would expect we to take at least half that amount.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Got it. And then I guess, does the -- now that you've gotten another $600 million out of BRCD, does -- I guess, how does that influence your dividend plans out of BLIC beyond this year? I guess, it gives you a bit more cushion to think about, it seems.

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Well, I'd start by saying we feel very good about the capital position at our operating companies as well as the holding company cash position. And we're better -- we're in a better position today with the RBC ratio than we would have anticipated at the beginning of the year. And as you know, the number in the second quarter does not reflect the $600 million BRCD dividend.

So I would just say that we continue to manage the company to make sure that we are appropriately capitalized in using this multiyear, multi-scenario framework that we've talked about, and that we show you when we disclose our DE tables. And that's going to continue to drive our decisions about capital management.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Just 1 more follow-up on this. I guess now that you've got $1.2 billion of dividends approved out of BRCD, are the reserves now, I guess, closer to your view of appropriate reserves? Or do you still think there's additional capacity longer term?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

So as you've heard us talk about, the primary means to assess the capital position of BRCD is our cash flow testing margins. And even after this dividend, we continue to have, I consider, very strong cash flow testing margins in BRCD. And remember, we look at that under a multitude of scenarios.

Operator

Our next question or comment comes from the line of Humphrey Lee from Dowling & Partners.

Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

I guess thinking about the $1 billion of share repurchase authorization, how should we think about the pace of the buyback going forward? Is there any reason why we should not look at the historical pace as a guidepost?

Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

I'll start, Humphrey. I think it would be smart to look at history as a guidepost. Obviously, we feel great about our flexibility here. Ed, you're going to give a little help, right? Why don't you give a little help?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

A little help, all right. So we don't think it's in the best interest of shareholders to discuss future buyback plans. So I'll tell you what we've done and as Eric said, I think we have a strategy, and I would expect that, that strategy would continue. If we look at the last couple of years, our repurchases have typically been in the 4% to 6% of average daily market volume. And if you look at the early stage of the pandemic, because of the opportunity we saw, we ramped that up to about 16% of average daily market volume during a couple of month period.

So we know how important returning capital is to shareholders in financial companies. And I think the fact that through August 4, we've repurchased 31% of our shares outstanding since separation. I would say that, that illustrates our commitment to capital return.

Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

Okay. Got it. Just switching back to BRCD. Like I think the -- this is definitely a positive development that you get another $600 million out of it. I guess the timing was probably quicker than I thought. Any -- like now you've taken $600 million out of BRCD 2 years in a row. Like is that the pace that we should expect? Or is there any way to help us to think about like the dividend capacity out of BRCD?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

So I don't -- I wouldn't suggest that you start to build in some pace based on 2 data points. I would say that, again, we feel very good about the cash flow testing margins at BRCD, and that is the reason that we ask the regulator to allow us to take this out. And the reason that the regulator agreed, I believe, is because of the fact that those cash flow testing margins remain strong.

Operator

Our next question or comment comes from the line of Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

My first question, if we go back to the EPS that you reported and then I guess Ed, for a couple of items you pointed out being the underwriting and the better alts, I get to around -- something around $3.52, whereas you guys gave the range of $3 to $3.20 as the run rate. Were there some other one-off items in the quarter? Or is it just assuming some kind of normal level of underwriting volatility when you give that kind of quarterly run rate of $3 to $3.20?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

So as you can imagine, there are a number of items every quarter that are off of trend. And I would say, we called out the 2 big ones this quarter in our disclosures around underwriting and alternative investments. But the 1 notable item that we did not call out that was the bigger one of the remaining would be market impact, which was favorable in the quarter. And so that's really what drove our decision to give a different -- a lower range than what the 2 items that we highlighted would suggest.

Elyse Beth Greenspan - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

Okay. And then in terms of shifting back to capital, you guys, since the pandemic, right, have also maintained a healthy level of capital as a holding company. With the new buyback and also there are more certainty that we're coming out of the pandemic, are there any thoughts about kind of changing the buffer that you're looking to hold at the holdco, whether that's later this year or something that you guys are thinking about for '22?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Okay. So last quarter, I made some comments about how we were assessing the appropriate level of conservatism in our holding company cash position. And I think the answer to the outcome of that assessment was our decision to ask the Board for a $1 billion repurchase authorization, which is equivalent to 26% of our equity market cap and is 2x the largest previous authorization.

Operator

(Operator Instructions) Our next question or comment comes from the line of John Barnidge from Piper Sandler.

John Bakewell Barnidge - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Can you talk about the growth in the life insurance business sales, maybe expectations going forward? And do you anticipate -- like do you see this is coming from broadening out of distribution, a pull forward from raised awareness or really shifting to a higher gear?

Myles Joseph Lambert - *Brighthouse Financial, Inc. - Executive VP and Chief Distribution & Marketing Officer*

Yes, sure. This is Myles. Happy to take the question. So we're really pleased with the progress that we continued to make with SmartCare sales. And as Eric mentioned in some of his prior comments, we continue to expand distribution. Over the last few weeks, we've been able to bring in about half a dozen new firms. We have expanded strategically through 2 partnerships into the BGA space, and that's now providing us access to approximately 13,000 new advisors, which we're very excited about.

But the product itself is a great product. It's very competitive as it relates to the indemnity benefit that it has. And the policy has the opportunity for cash value growth based on industry performances. That, coupled with the fact that a few major national distributors have really embraced the product and are doing a great job of selling it, coupled with the fact that we continue to grow our sales force, is the reasons why we expect to see continued growth with SmartCare moving forward.

Conor Ernan Murphy - *Brighthouse Financial, Inc. - Executive VP & COO*

And John, it's Conor. Let me just add, well, 1 comment to underscore. We filled almost as much SmartCare in the first half of 2021 as we sold in all of last year. But we have -- we're also working on some other life products to round out that suite as well. So you'll see those in the future.

John Bakewell Barnidge - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Maybe the follow-up to that is -- and thanks for the answers there, that was helpful. You're obviously having good distribution on the annuity side on top of life. Some of your expenses are variable. Obviously, some are fixed. Given the outlook for distribution is constructive, how should we be thinking about operating expenses within that thing?

Operator

Our next question or comment comes from...

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sorry, sorry -- wait, sorry. We have to answer that.

So on operating expense, corporate expenses were, the first half of the year, $421 million. That's lower than what we would anticipate it would be in the second half of the year. As you can imagine, travel is still low relative to what we budget. And there are some other areas where we would expect more expense in the second half of the year.

But, I don't know, Eric, if you have any further comments.

Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

Well, I'll just say, sort of strategically, we're investing in distribution. We're investing both operationally and in distribution itself, and that's going to continue. So I'm pleased with where we are in expenses, and that includes investments that we're making now and are going to make in the future.

Operator

Our next question or comment comes from the line of Zack Byer from Autonomous Research.

Zachary Byer - *Autonomous Research - Equity Research Associate*

Just had a quick question. You've done a few funding agreements year-to-date. Curious kind of how big of an opportunity do you see this becoming? And how quickly do you expect it to ramp up? And also kind of where should we find the results for this kind of nascent line of business in your reporting?

John Lloyd Rosenthal - *Brighthouse Financial, Inc. - Executive VP & CIO*

Zack, it's John. Look, we think this is really an attractive space to be in, as it will enhance our overall business profile and provide good risk-adjusted returns and product diversification. It's a bit premature to talk about how big we think the business is going to be or what kind of earnings power it may have, as we're just beginning to grow it. But so far, things are going extremely well. The program started in April, and we currently have about $4 billion of outstanding balances. And we look forward to talking to you more about it in the future as this business grows.

Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

I'll -- it's Eric. I'll just add. It sits in Corporate & Other, and that's where it will probably sit for a while.

Operator

(Operator Instructions) We have a follow-up from Mr. Ryan Krueger from KBW.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Ed, could you provide a little bit more detail on the normalized stat earnings? And I guess, in particular, I would have thought, given the favorable equity markets and the favorable alternative investment income, they would have been a bit stronger. Can you give some perspective on the offset?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sure. I mean I think the first thing to recognize is that most of the benefit that we're seeing from the alts is coming through in unrealized gains, and so that's going directly to TAC. It is not included in normalized statutory earnings. So that's one of the reasons that you see the disconnect between perhaps some of the other statutory metrics and norm stat.

The second thing is that, we have had 2 quarters. So the year-to-date results for non-VA have been less favorable than what we would normally anticipate. And you've heard us talk about mortality now for 2 quarters, and that's a factor. And then the first quarter, we talked about -- I believe we talked about good VA results despite the fact that we absorbed the full year impact of the lower mean reversion point for the statutory accounting framework. And I think we identified that as being a $200 million to $250 million hit in the first quarter, which represents the annual amount of that change. And in the second quarter, as you know, interest rates came down. So we did have a negative impact from rates in the second quarter, both in the VA business as well as a modest impact in our fixed indexed annuity liabilities.

Ryan Joel Krueger - *Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research*

Just on that last point on -- so on the lower rates, you have to reflect the lower starting point, but there was no additional mean reversion impact. Is that correct?

Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

No.

Operator

I'm showing no additional questions in the queue at this time. I'd like to turn the conference back over to Ms. Dana Amante for any closing remarks.

Dana Amante

Thank you all for joining us today and for your interest in Brighthouse Financial. I look forward to working with you. Have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect, everyone. Have a wonderful day.
