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BHF.OQ - Q3 2020 Brighthouse Financial Inc Earnings Call

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OVERVIEW:

Co. reported 3Q20 adjusted earnings, excluding impact from notable items, of = $388m.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Brighthouse Financial's Third Quarter 2020 Earnings Conference Call. My name is Sonia, and I'll 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 Third Quarter 2020 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, and we will refer to the slide presentation in our prepared remarks. 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, November 6, 2020. The company undertakes no obligation to update any information discussed on today's call.

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During this call, we will 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 including 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. I hope that everyone listening today and your loved ones are remaining safe and well.

Before discussing our results in the third quarter of 2020, I want to once again recognize our employees for their tremendous dedication and focus during these very challenging times.

As the COVID-19 pandemic continues to evolve, Brighthouse Financial's mission to help people achieve financial security is more critical than ever. Due to the pandemic, many people across the U.S. are facing increased uncertainty about their financial future, both those planning for retirement and those already in retirement.

As I have said before, despite the challenges created by the pandemic, we remain focused on our strategy and on delivering for our partners, our customers and our shareholders.

Importantly, we entered the current climate from a position of strength and remain confident in our focused strategy. Our balance sheet and liquidity remain strong, and our investment portfolio is high quality and well diversified.

Before turning to our results this quarter, I would like to give an update on our share repurchase program. As previously disclosed, we resumed repurchases of our common stock on August 24.

Reflecting on our repurchase program since the announcement of our first stock repurchase authorization in August of 2018, we have repurchased a total of approximately $980 million of our common stock through November 4 of this year.

This represents a reduction of more than 25% of the shares outstanding from the time we became an independent public company and significantly ahead of our initial expectations. I am very pleased that after the completion of our current share repurchase authorization, we will have repurchased $1.1 billion of our common stock.

As I have said before, we have a capital return target that we would like to achieve. With that said, we will continue to emphasize prudence and flexibility regarding future share repurchase authorizations as well as the completion of our $1.5 billion target.

So now let me turn to third quarter results. Our key highlights for the quarter are summarized on Slide 3 of our earnings presentation.

First, we continue to prudently manage our statutory capitalization. Our hedging program performed as expected in the third quarter of 2020. Importantly, we estimate that our combined risk-based capital or RBC ratio was in the range of 525% to 545%. Ed will provide more details on statutory results shortly.

Second, we had a strong sales quarter despite the challenging environment. Annuity sales were approximately $2.3 billion, up 29% compared with the third quarter of 2019 and up 27% sequentially. Additionally, we generated approximately $13 million of life insurance sales in the third quarter of 2020. I am very pleased with this progress that we have made as we continue to execute on our life insurance strategy.

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Third, let me turn to total annuity net inflows, which were $174 million in the quarter, driven by continued strong sales as well as the market environment as fewer contract holders surrendered policies. As we've said 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 less profitable business.

Fourth, corporate expenses, which do not include establishment costs, were $204 million in the third quarter. We remain committed to reducing corporate expenses by $150 million on a run rate basis by the end of this year.

Finally, we continue to make necessary investments in our technology infrastructure and in our business. As you know, we refer to these investments as establishment costs. In the third quarter, establishment costs were approximately $19 million before tax. As I have said before, we are being prudent in how we are managing our way through our expected final couple of years of TSA exits. These TSA exits and associated systems transitions put us 1 step closer to our future state operating platform. And importantly, we will continue to invest in our infrastructure with the goal of providing better support to our distributors and their financial professionals as well as our policyholders and contract holders.

To wrap up, we believe our balance sheet and liquidity positions are strong. We continue to believe we have the right strategy in place to deliver long-term shareholder value, and we believe that we are well positioned to continue the execution of our strategy.

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. Last night, we reported third quarter earnings along with preliminary statutory results. As these results illustrate, we have maintained a strong capital and liquidity position which is a function of our focus on prudence and flexibility.

Turning to key statutory metrics. Our combined statutory total adjusted capital, or TAC, increased to $8.4 billion at September 30.

Our estimated combined risk-based capital or RBC ratio increased to a range of 525% to 545%. And we had a normalized statutory loss of approximately $200 million in the quarter.

The improvement in our capital metrics reflects the continued strong equity markets in the quarter and the impact of the annual actuarial review.

Before discussing current period performance drivers, I would like to spend some time on the actuarial review completed in the quarter. As part of this review, we examine long-term assumptions, including capital markets and interest rates.

There was an impact on both statutory and GAAP results as a result of the 2020 review but in different directions. The statutory impact was a benefit of approximately 40 points on our risk-based capital ratio.

We have continued to refine our models and assumptions to better align with variable annuity or VA reform, which we adopted at the end of 2019. During this process, we determined that we had been more conservative than we needed to be with respect to how we reflected invested assets backing VA.

Specifically, the invested assets that support our VA total asset requirement have average yields above current market levels. And those yields were not fully reflected in the calculation of the total asset requirement.

A model revision to align with VA reform on this issue was the driver of a $600 million statutory capital benefit from the assumption update.

On a GAAP basis, the total net income impact was a $2.2 billion charge with $1.7 billion, driven by a reduction in the assumed GAAP long-term mean reversion rate for the 10-year treasury from 3.75% to 3.0%.

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We continue to assume that mean reversion occurs over 10 years. The interest rate-related charge was split between our runoff block of universal life with secondary guarantees and VA.

The change in the mean reversion rate had no impact on statutory results. The balance of the GAAP charge was related to a number of different items with mortality updates being the largest driver.

Turning to our third quarter results. TAC increased to $8.4 billion at September 30 from $7.7 billion at June 30. The increase was driven by equity market returns and the actuarial review.

Despite the favorable markets in the third quarter, we had a normalized statutory loss of approximately $200 million. This loss was driven by an increase in the 20-year swap rate which caused a modest unwind of the substantial unrealized gains in our interest rate derivatives.

Overall, we believe we are conservatively positioned in the hedge portfolio for both equities and interest rates given the elevated level of market, economic and political uncertainty.

Our estimated combined RBC ratio increased to a range of 525% and 545% as the normalized statutory loss in the quarter was more than offset by the favorable statutory impact from the actuarial review.

In the current uncertain environment, we continue to place heavy emphasis on the RBC ratio which, as a reminder, is well above our target range of 400% to 450% in normal markets.

To close my statutory comments, I'd like to focus on capital release and dividends. In the year-to-date, we have generated $1.6 billion of capital release related to our VA business.

First, early this year, we revised our VA hedging strategy. This revision contributed to a lower risk profile, allowing for the release of $1 billion of capital.

Second, by removing excess conservatism in our models to better align with VA reform, we released approximately $600 million of additional capital as part of this year's actuarial review.

Given our strong capital position, in the fourth quarter, we intend to take the remaining $450 million of our planned $1.25 billion ordinary dividend from Brighthouse Life Insurance Company, or BLIC as well as a $60 million ordinary dividend from New England Life Insurance Company, or NELICO.

As a reminder, this is consistent with the plan that we communicated on our business update call in early March.

Moving to the holding company. We ended the third quarter with cash of approximately $1.3 billion, which is consistent with the second quarter and roughly 5x annual fixed charges.

We believe it is appropriate to have a conservative position at the holding company in the current environment.

Moving to adjusted earnings. Last night, we reported third quarter adjusted earnings, excluding the impact from notable items of $388 million, which compares with adjusted earnings on the same basis of $39 million in the second quarter of 2020 and $260 million in the third quarter of 2019.

There were 2 notable items in the quarter, which lowered adjusted earnings by approximately $1.1 billion. The notable items on an after-tax basis were: a $1.1 billion charge from the actuarial review and establishment costs of $15 million included in Corporate and Other.

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When we look at third quarter adjusted earnings less notable items, there are 4 underlying themes. First, alternative investment returns were strong as our alternative investment yield was 7.6% in the third quarter driven by the favorable market performance in the second quarter. Our year-to-date alternative investment yield was 1.7% through September 30.

Second, separate account returns were 6% in the quarter. This was well above our assumed return and contributed approximately $0.15 per share above a normal quarter's results.

Third, expenses were lower than expected. Corporate expenses were $204 million, which was modestly below the second quarter and lower than a normal level.

The fourth and final theme, our underwriting margin was slightly lower than normal quarter as COVID claims remain modest. Net claims from COVID-19 were approximately $14 million pretax in the third quarter, which is down from $25 million in the second quarter.

Turning to adjusted earnings at the segment level. Annuities adjusted earnings, excluding notable items, were $285 million in the quarter. Sequentially, results reflect higher net investment income, along with higher fees and lower DAC amortization, partially offset by higher expenses.

Life adjusted earnings, excluding notable items, were $87 million in the quarter. Sequentially, results were impacted by higher net investment income partially offset by higher DAC amortization.

The Run-off segment reported adjusted earnings, excluding notable items, of $33 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 $17 million. Sequentially, results were driven by lower expenses and lower taxes, partially offset by higher preferred stock dividends.

Before I conclude, I want to emphasize that our top financial priority remains balance sheet strength and excess cash at the holding company in order to protect our distribution franchise and validate that we have a full cycle business model. I believe our continued strong capital and liquidity position at the end of the third quarter highlights our emphasis on prudence and flexibility in the current uncertain environment.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Erik Bass of Autonomous Research.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

We recently saw one of your competitors execute a reinsurance transaction for an in-force GMIB block that freed up significant capital and was well received by the market. And I know you've consistently said that you'll evaluate any transactions that make sense. But just wondering, does the Venerable deal suggest that the market for VA risk transfer is opening up and that the bid-ask spread is closed? And is there a broad interest in the type of liabilities that you have?

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

Erik, it's Eric. Here's what I would say. First of all, for us, we have and have had a strategy to unlock capital, repurchase stock, rationalize expenses and sell new business. And as you see, including in this quarter, we've been doing all of that.

We're executing on that strategy. We'll continue to pursue that strategy. Now there could be a transaction at some point if, like I've said over and over, it adds value and is executable. From a market perspective, obviously, this was a pretty big transaction.

So I don't know if it -- if I can say whether the market has changed materially or not. But our stance has not changed. We're going to continue the strategy that I just laid out in 2 sentences there. And someday, that may include a transaction. That's what I would say.

I think Ed is going to jump in as well.

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

Yes. Thanks, Eric. First, every company has its own strategy. And our financial strategy is the prudent acceptance of capital markets risk supported by a strong cash and capital position. And this strategy does impact our view of the attractiveness of a potential block deal.

Second, we are focused on releasing capital from our VA business, and we have released substantial capital from VA without a block transaction. So just again, as a reminder, as a result of our revised hedging strategy earlier this year, which was a derisked strategy, we were able to release approximately $1 billion of capital.

In the third quarter, as a result of refinement of our VA models post VA reform, that led to a release of an additional $600 million of capital. And also, we're derisking every quarter with the natural attrition of our VA in-force block.

And when you take all these actions together, this is certainly a benefactor that's allowed us to repurchase more than 25% of our common shares over the past roughly 2 years.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

Got it. And then maybe, Ed, if you could talk a little bit more about the drivers of your adjusted statutory earnings? And I mean these continue to be pretty sensitive to market movements. So can you just help us think about the key items that can create positive or negative variances there?

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

Sure. Well, why don't I talk about the quarterly results. So I think as you know, we had a $200 million normalized statutory loss in the quarter.

I'd say 2 things. First, we are conservatively positioned in the hedge portfolio today. We do see a significant level of market economic and political uncertainty. So that's just an overarching comment I would make.

Specifically, in the quarter, the norm stat loss was driven by, I would say, some basis risk between our derivatives portfolio and the liability. So we saw a 16 basis point increase in the 20-year swap rate, which is the most relevant rate to look at when you think about market movements in our derivative book, our interest rate derivatives. And that was versus only a 5 basis point increase in the 20-year treasury yield, which is the relevant rate for our variable annuity total asset requirement.

And just as a reminder, we continue to have substantial unrealized gains in what were previously out of the money interest rate derivatives, and we've kept substantial protection in place in the event that rates go lower.

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Operator

And our next question comes from Humphrey Lee of Dowling & Partners.

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

Just maybe a little premature, but as we look ahead for 2021, how do you think about kind of your dividend capacity given your capital position now? But at the same time, considering you have a lot of holding company capital at the moment as well. So how should we think about that?

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

Humphrey. So a couple of things. First of all, as we said, we plan to take the remaining dividend that we had targeted for Brighthouse Life Insurance Company, or BLIC, in the fourth quarter, that's $450 million. So for the full year, we'll have taken $1.25 billion from BLIC, which is in line with the number that we had communicated to you on our March business update, so pre-COVID.

If we look at -- we also plan to take about a $60 million dividend from NELICO. So we've got about $0.5 billion dividend that we're going to be taking here in the fourth quarter.

If we look to next year, I'm not going to preview what we might do. I'll tell you that our unassigned funds at BLIC improved to approximately $1.5 billion at the end of the third quarter. So there's plenty of capacity based on the third quarter. However, obviously, we decide on our dividend considering a number of factors. It's not just clearly what the unassigned funds number is.

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

Just looking at your kind of corporate expenses, it appears to be trending favorably relative to your target of kind of $150 million improvement.

I guess how much of that is kind of pandemic related or just you have been gaining extra efficiency? And then kind of how should we think about that additional $25 million improvement in 2021?

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

Humphrey, it's Eric. Yes, we're doing well against the $150 million target. There is some in there. I think last quarter, I got asked, do you -- are you experiencing any real estate savings? And the answer to that is no. But we are getting a little help from travel, for instance, and I'm sure some other companies are as well. Travel costs are well down and will be certainly for the rest of the year.

We have a target out for '21, as you know. And look, generally, I'd like to hit that target. We'll talk about it as we finish our planning, so I'm sure we'll talk about it on the next quarterly call. The only thing I might say is, as we go through the planning work, maybe there are some investments we might want to make. That's the only sort of offset that I can think of right now. We've got some pretty good opportunities here, and you see how our sales are doing. So that's the only real possibility.

Ed, do you want to add anything?

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

Yes, I would. So just to add a little on expense and maybe anticipating a question we might get about run rate. So we reported $419 million of adjusted earnings ex notable items in the quarter.

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The biggest adjustment, as I'm sure you can appreciate, would be related to our alts performance and also some benefit from strong markets. So you'd probably take about $1 out of that just in total for those 2 items. But there's also probably about another $0.15 that I would adjust for on expenses being favorable in this quarter relative to what we have thought about as a more normal level.

So bottom line is, you did have favorability in expenses here in the third quarter. And if you're thinking about putting all these together, you're talking about run rate EPS round number of about $3 a share on a quarterly basis.

Operator

And our next question comes from Elyse Greenspan of Wells Fargo.

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

My first question, I was hoping to get a little bit more color on the sales that the sales within annuities in the quarter. Your fixed annuity sales are still pretty strong again. Shield did show some growth sequentially. So just any color on how sales have trended in this environment versus expectations and how we should think about that going forward?

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

Yes, sure. It's Myles. Happy to take that question. So we remain incredibly pleased as it pertains to our sales results for the quarter.

As Eric mentioned, we did about $2.3 billion of annuity sales, which is our best quarter yet as a publicly-traded company. We continue to see solid results in our Shield -- or with our Shield product and in our Shield category. And we're really pleased with the growth that we're seeing with both our flex access product as well as our FRA sales. And the teams, the sales teams have pivoted quite well in this environment and continue to support our advisers to the best of their ability.

Conor, do you want to add anything on the fixed rate products?

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

Yes. Let me do that. Just for everybody's benefit, so we are -- fixed products are core to our strategy, both fixed indexed and fixed deferred annuities alongside of our VAs and our buffered annuities.

At Q3, from an industry perspective, numbers reporting a 47% increase year-over-year. We do offer a suite of competitive products and specifically with the fixed rate annuities, we reentered that space with a lower expense base. And we have a reinsurance agreement in place, which is beneficial to us.

And to follow-up on Myles', we've been focused on a few select firms and customers have been looking for the product. So yes, it was a decent amount of volume in the quarter.

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

That's helpful. And then my second question, as we think about capital, you guys highlighted the dividend you'll be taking from BLIC and NELICO in the fourth quarter and then also point to queue, just trying to have some level of conservatism just given the uncertain environment. As we think about your buyback of plans from now to the end of 2021. Should we just think as you work towards that your target that is kind of evenly spread throughout the quarters? Or is there any kind of updated view on timing of buyback relative to the conservatism on the capital front.

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

Elyse, it's Eric. Yes. So as I've said before, look, here we are getting near the end of 2020. We've got the $1.5 billion capital return target out there. We'd like to hit it. We're buying back stock now, as you know, and you can see the levels.

Look, the daily, obviously, if you do the math changes a little bit, but it's at a reasonable pace, which I would expect to continue. Obviously, I don't want to get ahead of our board here, okay? We'll eventually run out of this authorization, and we've got to have a conversation at the board level.

But I'd like to hit the $1.5 billion, and it'll be some sort of average level on a daily basis. But to your point, look, we're going to have a lot of money up at the holding company, which is great, a lot of cash at the holding company. But part of our strategy in this environment, which is now heading into a full year soon is to make sure that we've got the flexibility that we need.

Some things are looking good from the macroeconomic perspective, but who knows? We got to keep watching. And part of the strategy is to have a lot of cushion at the holding company. So you should think that, that will continue.

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

Elyse, it's Ed. Just to follow-up on that. Just first of all, to echo Eric's comments. I mean we are prioritizing balance sheet strength in the current environment. So I would just say that generally, and I think you can see from our statistics 525% to 545% RBC ratio, $1.3 billion of holding company cash, no debt maturities until 2027.

All of that speaks to prioritizing the balance sheet. And then I would -- just to give you the numbers, I think you know this, but there's approximately $120 million remaining on our existing authorization.

Operator

(Operator Instructions) Our next question comes from Tom Gallagher of Evercore.

Thomas George Gallagher - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Eric, I wanted to circle back on variable annuity risk transfer just for a little more color, if you wouldn't mind. Do you think kind of balancing out the changes that have occurred on counterparties that are looking to transact whether it's looking at the equitable deal and evaluating that from your perspective or looking at the number of counterparties. Do you think it might make sense to do something sooner rather than later for Brighthouse considering the terms of trade that have emerged bid-ask spread, whatever you want to call it? Or do you think more realistically, the macro and low interest rates are enough of a headwind that you might be better off waiting a bit?

Just wanted -- just really thinking more about do you think this is something that you want to do more due diligence on like sooner or do you think this is more of a longer-term situation for you?

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

Tom. All right, let me see if I can help out a little bit here. Look, I said before on, I guess, the first question. The strategy that we have has been pretty consistent, and I think you would agree with that, right?

Unlock capital, repurchase stock, rationalize expenses, sell new business being sort of the highlights. Here we sit after 3-plus years, with an RBC ratio, we threw the range of 525% to 545% and $1.3 billion of the holding company. So we're in pretty darn good shape. We've unlocked a lot of

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capital, and we're using some of that, obviously, to repurchase stock here. As you heard Ed say, 25-ish percent, we've been able to buy back of the company in the last couple of years.

So it's not like we're not looking at these transactions, okay? I don't want anybody to think that we're not paying attention here. We'll continue to think about whether something like that makes sense for us, right? Equitable obviously decided it made sense for them, and that's fantastic. So we'll just keep watching here. I don't think I can take sort of the next step would there be a transaction? And if so, would it be sooner rather than later. But I guess my overall message is you can at least be assured that we are paying attention to everything that's going on here.

Ed, I'm sure you're going to add something.

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

Yes. Thanks. So Tom, I would say, you mentioned something about over time, you just heard about the statistics that Eric quoted on the balance sheet and in addition, what I said about no debt maturities until 2027.

We have plenty of time. And our balance sheet suggests that our ability to weather an uncertain environment for years, not quarters is pretty clear. And so I would just reiterate something we've said in the past, anything we would ever do here would be from a position of strength. We don't need to do anything. We're very happy with where we sit today.

Thomas George Gallagher - *Evercore ISI Institutional Equities, Research Division - Senior MD*

That makes sense, guys. And my follow-up is it's pretty interesting development on statutory capital this quarter moving in different directions. The net impact was positive. But when I -- I guess my question is just considering you had this favorable $600 million reserve review. What I should say is, had you not had that, you would have had some serious hedge breakage in the quarter based on the difference in swap versus treasury rates and the difference in hedges versus the way the reserving is calculated.

So does that -- is that something that you've thought about in terms of the basis risk there? I mean I don't even know if you could practically change that based on the structure of the types of derivatives that you can buy. But any thoughts as to maybe ways to narrow that gap of basis risk? Or do you think that's just going to smooth itself out over time?

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

Yes. Sure. So there are a few questions in there. I mean, I guess the first thing I would say is that I would take issue with the concept that this was significant hedge breakage in the quarter. As I've said in the past, I think the way you assess a hedge program is not in a normal quarter. The way you assess a hedge program is when bad stuff happens.

And if we look back to the first quarter, when a lot of bad stuff was happening, our total asset requirement for VA went up by $8.1 billion. That is the quarter you do not want to have hedge breakage. And our VA assets went up by 8.4%.

So just to be clear, from our standpoint, these are numbers that can move around. I think we've said in the past, the $200 million to $300 million movement in these types of numbers is not unusual. And when we look at this quarter, I think as you correctly pointed out, there was basis risk. And it is the nature of the instruments we're using. I mean we have a lot of swaptions. So by definition, the swap rate is the relevant rate for us.

And the other thing I'd point out, as you know, you know about the fact that the derivative assets are more reactive to rate changes than the total asset requirement given the nature of the ESG. So all of that stuff together, I think, would suggest that this is not a quarter that I would define as particularly unusual.

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And sorry, just one other point of clarification. So the $600 million benefit was at CTE98. If you look at the increase in our total adjusted capital in the quarter, which was up $700 million sequentially, about half of that was as a result of the strong equity market. So you know that convergence, divergence phenomenon that you've heard us talk about.

And the other half was due to the assumption update. Did I get it all? Or was there something I missed?

Operator

And our next question comes from John Barnidge of Piper Sandler.

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

The withdrawal activity ticked down quite a bit from a year ago as a percent of the beginning period assets and annuities. Are there any trends to note how are you thinking about this prospectively?

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

John, it's Conor. So from a flows perspective, it's -- so that's like Q1 was a normal flow quarter from an outflow perspective. Q2 was definitely subdued. So instead of running at the kind of $1 billion a month, $3 billion a quarter, we were down closer to $2.1 billion. We were back up to about $2.3 billion this quarter. So I would say still subdued starting -- continuing to maybe trend up a little bit every month, but not all the way back yet.

We've talked before the components. The amount of outflows from death and annuitizations remains very, very consistent every quarter. So we're seeing a continuation here of a subdued level of outflows in both full and partial withdrawals.

So as I said, it's hard to predict from here. It's trending back up, but it's not back where it was first quarter or indeed the average for 2019, which was very consistent as well.

Operator

And our next question comes from Andrew Kligerman of Crédit Suisse.

Andrew Scott Kligerman - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Yes. Just a few update items. So you have a sensitivity out there of $70 million COVID-19 claims, pretax per 100,000 mortalities. You came in at about $14 million this quarter. That's great relative to what you were expecting. Do you think you need to take down that sensitivity a bit?

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

Andrew, so first, just a slight correction. The sensitivity we gave was $70 million after-tax for every 100,000 U.S. deaths. So if you look at where we are, at the end of the third quarter, you were right around 200,000 U.S. deaths. And we've had year-to-date COVID claims of $42 million pretax.

So that compares to what our guidance would have implied of $140 million after-tax. So clearly that initial guidance does not apply and we are not providing an update. The difference between where we are today and what we had assumed earlier is that the impact of COVID on the general population has been more pronounced than on the insured population.

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Andrew Scott Kligerman - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

And just you know you previously also on credit, you expected about 50 basis point negative hit from your stress scenario, how does that stand right now? Are things better than you expected? Where are you coming out on your stress scenario?

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

Andrew, it's John. On our first quarter call, I suggested that our investment stress scenario would impact RBC by about 50 points over 2 years. Since then, we've been doing more modeling and I would say our stresses range from a roughly 50 point RBC impact to 100 point over 3 years. But those are the stress scenarios. If you're asking how do we feel at the moment? I would say the severe stress scenario where that 100 basis point case is probably less likely than it used to be.

Andrew Scott Kligerman - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Anything emerging worse than you tried?

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

Actually, no. And I -- I mean this is a good, I might as well just say so far impairment has been minimal. Downgrades have been within expectation and both are moderating. In the third quarter, we had no net impairments and year-to-date, pretax impairments have only been $37 million.

As to our expectation for future losses, I mean well the damage today has been quite modest and certainly lower than we would have expected, it is too early to say we are out of the woods. Thus, we would expect some amount of additional losses going forward.

But to the extent of any -- the extent of any future losses and downgrades for that matter will depend to a large degree on the virus and its impact on the general recovery and certain specific industries sectors. But let me reiterate what Eric and Ed has said that the portfolio is well positioned to weather this uncertain environment, additional losses given its high quality and strong diversification.

Operator

And our next question comes from Sandy Kamath of Citi.

Suneet Laxman L. Kamath - *Citigroup Inc., Research Division - MD*

I wanted to start on statutory, if I could. So I guess, Ed, as you look at VA capital reform and your current assumptions, are there any other big sort of deviations that could lead to something like this $600 million sort of capital benefit that you got in the third quarter?

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

So the short answer is, I don't believe so. But let me just spend a second, talking about the impact that we had in the quarter.

So I mentioned in the prepared remarks that we've been aligning our models and assumptions to be consistent with VA reform, which, as you know, we early adopted at the end of last year. And late last year, we identified what we thought was a conservative assumption, an overly conservative assumption in the model. We did not -- we did not put it through at year-end because we wanted to make sure that we fully understood the impact that there was no unintended consequence in our models and assumptions as a result of changing this. And so we spent a decent amount of time this year making sure that we were very clear on the impact of this assumption in our model. And so we have gotten comfort that it is appropriate to make a change, and that's why you see it in the third quarter assumption update.

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As I said in the prepared remarks, the variable annuity assets that support our total asset requirement, which is a substantial number, are invested at an average yield above the current market yield. And this average yield was not fully factored into our calculation of the total asset requirement. So just to add a little more color, this average yield was reflected in the discount rate, but it was not reflected in the earned rate. And just to reiterate, our new approach is now aligned with VA reform.

Suneet Laxman L. Kamath - *Citigroup Inc., Research Division - MD*

Got it. And then on the GAAP side, when we think about the interest rate-related charge, can you give us a sense how much of that was from kind of a lower starting point versus the change in the mean reversion assumption?

And then should we expect any kind of ongoing impact on your operating earnings from this assumption review?

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

Okay. So let me start with of the total charge to $2.2 billion, $1.7 billion of it was related to the interest rate change. And that was split roughly 50-50 between universal life with secondary guarantees and VA.

So on the ULSG side, it was about, as I said, about $900 million after tax. And that's versus a $600 million after-tax charge last year for the mean reversion change that we put in place in the third quarter of '19.

So the impact is consistent with the change in the rate this year versus last year because we came down 75 basis points this year. We came down 50 basis points last year. So I would never suggest that we should always assume linearity in these types of things, but we are seeing it in terms of the interest rate impact on the ULSG block.

And just to highlight here, just to make it clear, this is GAAP. This has nothing to do with stat. And when you look at statutory, first of all, you have more conservative assumptions to begin with. And second of all, the GAAP mean reversion rate isn't even a relevant concept.

And when we look at ULSG for stat, we have about 70% of that in our reinsurance captive in terms of reserves, but a larger percentage of the risk associated with secondary guarantees.

And as you've heard me say, I think, repeatedly in the past, we have significant cash flow testing margins at BRCD, Brighthouse Reinsurance Company of Delaware, even at rates substantially lower than the current level.

So just to make sure we have that distinction here between GAAP and stat.

Turning to the GAAP impact for annuity. We had a bigger charge this year. We had $800 million versus essentially nothing last year. And the reason for this is that our legacy models for VA had assumed that credit spreads would move inversely to the risk-free rate.

And so if you go back over the last 40 years, you'll see a negative correlation of about 0.5 billion between the 10-year treasury yield and credit spreads.

So there's certainly a historical basis for this assumption, and we had assumed that last year, which meant very little impact.

With rates at a lower level, we've decided that the conservative approach is to assume that this relationship no longer applies. So we did not assume any credit spread offset. And the reason -- that really explains why we had a negative impact this year versus essentially nothing last year.

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Suneet Laxman L. Kamath - *Citigroup Inc., Research Division - MD*

Got it. And then any ongoing impact?

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

Yes, sorry. There shouldn't be any material ongoing impact on adjusted earnings from these changes.

Operator

Thank you. And ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to David Rosenbaum for any closing remarks.

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

All right. Thank you all for participating on today's call and for your interest in Brighthouse. And we look forward to talking with you again next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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