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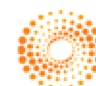

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Brighthouse Financial's Business Update for Investors and Analyst Conference Call. My name is Gigi, and I will be your coordinator today. (Operator Instructions) As a reminder, this 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 Business Update for Investors and Analysts Conference Call. Our slide presentation was released this morning and can be accessed on the Investor Relations section of our website at brighthousefinancial.com. We encourage you to review the slide presentation, and we will refer to it in our prepared remarks.

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

Our discussion during the call will include forward-looking statements within the meaning of the federal securities laws, including with respect to our projected distributable earnings and are summarized on Slide 2 of our presentation. Information discussed on today's call speaks only as of today, March 5, 2020. The company undertakes no obligation to update any information discussed on today's call.

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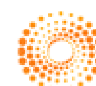

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During this call, we may discuss certain statutory based financial measures used by management as well as financial measures that are not calculated based on generally accepted accounting principles, also known as non-GAAP measures. Reconciliations of these non-GAAP measures on a historical basis to the most directly comparable GAAP measures and related definitions as well as definitions of certain statutory-based measures used by management may be found on the Investor Relations portion of our website, including in our fourth quarter 2019 financial supplement. Reconciliations of these non-GAAP measures are not accessible on a forward-looking basis because we believe it is not possible to provide such reconciliations without unreasonable efforts.

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. Thank you for joining us today for our investor and analyst business update call. Today, I will kick off the presentation and take you through our company mission, strategy and overview, and the progress we have made in building Brighthouse Financial into the franchise that it is today. Next, Myles and Conor will walk you through our product and distribution strategy, including our growth plans and evolving business mix. Ed will then discuss the financials with a focus on our approach to managing the business, our hedging strategy and the updated projected distributable earnings scenarios. And finally, I will end with a few closing remarks before opening the call up to your questions.

Let's begin on Slide 5. It's no secret that American consumers want protection and income. According to a 2019 Alliance for Lifetime Income study, 80% of Americans express anxiety that their savings may not be enough at retirement. Additionally, the study found 63% of Americans feel they are unprotected for retirement and have or will have to rely solely on social security to provide income beyond retirement. Rising health care costs, unforeseen health care needs and insufficient income in retirement are pervasive retirement concerns. We believe Brighthouse Financial is well positioned to help people achieve financial security and help address retirement concerns. We do that through our tailored set of annuity and life insurance products, which we sell through a diverse, independent distribution network.

We have a focused strategy, and we believe this strategy will generate long-term shareholder value. The key elements of our strategy are focused on offering simpler products, broadening our distribution footprint and being cost-competitive while fully aligned with our risk appetite.

Turning to Slide 6. Let me provide a few perspectives. We are focused on offering a tailored set of annuity and life insurance solutions that are simpler, more transparent and provide value to our distributors, their advisers and their clients. We sell our products through a diverse, well-established network of distribution partners, and we are focused on continuing to build strategic relationships and entering new channels as we expand our distribution footprint in the United States. And we are focused on becoming a cost-competitive manufacturer over time. The elements of our strategy are fully aligned with our risk appetite and our statutory approach to managing our business.

Brighthouse Financial became an independent publicly-traded company in August of 2017. Though we were not new to the life insurance industry as Brighthouse has a rich heritage with roots tracing back to 1863, we did have to build the Brighthouse Financial brand through focused marketing initiatives and through our strategic and diverse distribution relationships. Today, we are an established U.S. retail franchise and one of the largest providers of [annuities and] (added by company after the call) life insurance in the United States.

As you can see on Slide 7, we are large by many measures, and the strength of our balance sheet should be noted. At year-end 2019, our statutory combined total adjusted capital was $9.7 billion. Our combined risk based capital, or RBC ratio was 552%. And we had $227 billion of total assets. We have a well-established retail platform, serving more than 2 million customers. And we distribute annuities and life insurance to individuals through over 400 independent distributors.

We are very pleased with the progress we have made over the last 2-plus years. Brighthouse is a very different company now from what we were at separation in 2017. As we have laid out on Slide 8, in 2 short years, statutory combined total adjusted capital grew 47% to $9.7 billion, with $2.1 billion of ordinary dividend capacity for the year 2020. The growth in statutory capital and dividend capacity is related to actions we have taken over the last couple of years, in addition to favorable equity markets. The hedging strategy we implemented in 2017 was the right strategy for the company at that time. As a result, we captured approximately $1 billion of market upside. Furthermore, we successfully managed through early adoption of variable annuity capital reform.

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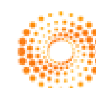

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Second, I am very pleased with our outstanding sales results. Over the course of the past 2 years, we rolled out a focused set of advertising campaigns designed to introduce our brand and showcase our flagship Shield annuities. These campaigns helped generate brand awareness in the market, allowed us to hit the ground running as a new public company and were instrumental in growing our sales footprint. Our annuity sales were up 68% since the end of 2017, led by Shield and fixed indexed annuities. Our 2019 full year annuity sales exceeded $7 billion, a significant increase over our target at separation of annual annuity sales in excess of $4 billion by 2020. And we have increased adviser awareness of our brand by 3x to 76% at the end of 2019. We are very pleased with our sales as well as the quality of new business we are adding each quarter, and we are continuing to see excitement from our long-standing distribution partners and remain focused on making our distribution network as broad as possible as we strive to help consumers in the United States achieve financial security.

And finally, we began returning capital to shareholders approximately 2 years ahead of our initial time line. Through our common stock repurchase program, we have repurchased approximately $592 million of common stock as of the end of February 2020, and we have reduced the number of our shares outstanding by more than 11% over the past 2 years. We remain committed to consistently returning capital to shareholders over time.

The progress we have made over the past 2 years is a result of the execution of our strategy. Moving forward, we believe that we are well positioned to continue that execution, which we expect will drive shareholder value in 2020 and beyond. To that end, as you can see on Slide 9, we are focused on specific metrics that we believe are linked to creating value for our shareholders.

First is growth of the franchise. During our outlook call in December 2018, and we were targeting annual annuity sales of $8-plus billion in 2021. We are now targeting more than $8.5 billion in annuity sales for 2021, an annual growth rate that is in excess of the expected industry growth rate, and we continue to target life insurance sales of $250 million in 2021.

Second, we remain focused on reducing annual corporate expenses. We are committed to our target of $150 million of corporate expense reduction on a run-rate basis by year-end 2020, and an additional $25 million of corporate expense reduction in 2021. This results in annual run rate corporate expenses that are expected to be $175 million lower than the first 12 months post separation.

And finally, let me talk about capital generation and financial flexibility. As mentioned previously, we ended 2019 with a combined RBC ratio of 552%, above our targeted range of 400% to 450%. We have a strong capital position, we expect to take ordinary subsidiary dividends of $1.3 billion in 2020, and we are on track to return our target of $1.5 billion of capital to shareholders by the end of 2021.

You may notice that adjusted EPS growth is not one of the primary metrics we are targeting. However, we understand that analysts and investors project GAAP-based results, so we want to provide some guidance. Based on year-end market conditions, we would project adjusted EPS growth, less notables, in the double digits for 2020 and 2021. However, taking into account equity market performance year-to-date and assuming interest rates remain at current levels, we would anticipate single-digit growth in 2020. As you know, we manage Brighthouse primarily to statutory and cash, and the remainder of our comments today will demonstrate that approach.

Turning to Slide 10. We believe we are well positioned in the marketplace to help Americans achieve financial security. In a few minutes, you will hear more from Myles, Conor and Ed on our plan for growth over the next few years. We expect continued strong sales momentum in 2020, and we are continuing to identify opportunities for growth through product development and our diverse and expanding distribution network. 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. Additionally, we have taken steps to optimize our statutory balance sheet, resulting in significant capital generation. We revised our variable annuity hedging program, which was substantially completed in mid-February and prior to recent market declines. This revision fundamentally lowered the risk profile of the company and preserved projected distributable earnings across different capital market scenarios.

We are very pleased with the progress we have made over the past 2-plus years, remain confident in our strategy and are committed to continuing to work diligently to deliver long-term shareholder value.

With that, let me turn the call over to Myles Lambert. Myles?

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

Thank you, Eric. I'm very excited to be here today to discuss our growth strategy for the Life and Annuity businesses. As Eric mentioned earlier, we've had several years of excellent sales growth, driven by our focused distribution strategy and the strong relationships we have with our distributors and advisers.

As you can see on Slide 12, our growth strategy is driven by 4 pillars, which I will cover in more detail today. In regard to our core product suite, we are focused on expanding sales through multiple targeted approaches. As Eric mentioned, we have over 400 distribution relationships in place, and the feedback from our distribution partners regarding our sales and marketing support has been very positive.

Our first pillar focuses on increasing our wholesaler productivity. We achieved this by continuing to invest in resources for our wholesalers, such as technology and analytics to help them become more efficient and better serve our advisers.

Our second pillar focuses on expanding our existing product offering into new firms to broaden our distribution opportunities. We continually work with our strategic partners to gather insights into product design and client needs so that we can further our product portfolio.

The third pillar focuses on a number of digital platforms to widen our distribution footprint. We partnered last year with FIDx, a technology provider that integrates annuity solutions and wealth management platforms. The platform provides the adviser with a convenient digital experience around annuity transactions.

With respect to our life insurance business, we plan to partner with a digital platform provider later this year to offer a fully underwritten expedited issued term product. Our goal is to interface with advisers on their terms, whether it's traditional sales and marketing support or emerging digital platforms.

And finally, our fourth pillar centers on entering new and adjacent channels through IMOs and other partnerships. A great example of this is our most recent product launch of the Brighthouse SecureAdvantage 6-Year Fixed Index Annuity. The launch of SecureAdvantage 6-Year represents collaboration between Brighthouse Financial and Market Synergy Group. This relationship will provide us access to an exclusive network of independent marketing organizations and reflects our continued commitment to provide a tailored set of products that responds directly to the needs of clients.

Our growth strategy has proven to be successful for our annuity business, and we have leveraged that to build the foundation for our life insurance business. Since launching SmartCare in 2019, the feedback from our distribution partners has been extremely positive. I am very excited about the strong sales momentum we have and expect significant growth in 2020 and beyond. We've made great progress adding major distributors for our SmartCare product, providing us access to a network of over 56,000 advisers. Our goal is to roll out this product to additional distributors over time.

Turning to Slide 13. I wanted to share some key results showing the strength of our distribution strategy. Annuity sales increased 68% since the end of 2017. Our goal is to drive profitable sales, and that starts with the focus on firms and advisers. With the work we have done leveraging data and analytics, we have successfully increased multi-ticket sellers by 43%, growing our strategic firm relationships by 81% and increased wholesaler productivity by 45%. These results indicate to us that our growth strategy is working.

Turning to Slide 14. As we expand and diversify our business, one of our major objectives is to grow in the life insurance market. We currently have a large in-force block of business with roughly $400 billion of life insurance in-force, net of reinsurance.

In addition, with SmartCare, we developed a fully digital process with data-driven underwriting, which we plan to use for future product development. As we think about 2020 and beyond, we plan to launch additional life insurance products to further diversify our insurance portfolio and offer competitive solutions to advisers to help them address the needs of their clients.

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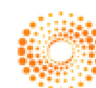

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With our targeted distribution strategy and the solutions we offer, we expect continued growth in both annuity and life sales. As you can see on Slide 15, we are targeting over $8 billion in annuity sales in 2020, reaching more than $8.5 billion in 2021. With respect to our life insurance business, we are targeting approximately $90 million in 2020 and approximately $250 million in total life sales by the end of 2021.

The products we currently offer are priced with double-digit statutory internal rates of return, and we expect to see a continued favorable shift in our business mix over time.

With that, I'll now turn the call over to Conor Murphy.

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

Thank you, Myles. The in-force business of Brighthouse's Financial has changed quite a lot in the past 2.5 years, and there are a few themes I would like to share with you to illustrate that change and why it is important.

Let me begin with net flows on Slide 16. Our outflows have been very consistent and are about $1 billion each month or approximately $12 billion of outflows each year. At the same time, our inflows have grown, and we are projecting more than $8 billion in 2020. While the overall gap is closing, it is still a net outflow, but it is already a good story for us. Over 1/3 of these outflows have been from our higher capital-intensive blocks, mostly older, guaranteed minimum income benefit products, or GMIBs, and some older fixed annuity business with higher minimum guarantees. This is positive for us. That leaves us with around $8 billion of other outflows, which are not surprising in the age of the underlying business. And we are adding $8 billion of less capital-intensive, high-quality new business, all of which we feel good about, so we are already pleased with our net flows and the associated improvement in our statutory capital profile.

To further underscore the net flow story, we've had around 30 months of $1 billion per month of outflows, equating to a significant amount of in-force, which has already moved off of our balance sheet and has done so on favorable terms for us without us having to share in the economics or enter into a new reinsurance agreement with a third party.

To provide another view of what this means to us, on Slide 17 you can see how our annuity business mix has already shifted and what we expect going out to 2022 and 2025. There are several key points I would like to make here. First, focusing on variable annuities. In 2016, the overall amount of VA products, both capital-intensive and noncapital-intensive, was 85%. You can see that 36% was the more capital-intensive blocks. By year-end 2019, the 85% had already declined 76%, with the capital-intensive portion down to 32%. Looking forward to 2022, using the sales projections Myles laid out in his prepared remarks, we expect a continued decline to 63% total VA. And using a fairly modest 5% outer year sales growth assumption, we expect VA to make up approximately 50% of our annuity block by 2025, with our capital-intensive block projected to drop to only 18%. Our noncapital-intensive VAs do not decline as much as we continue to write new VA business that meets our product and pricing standards.

Second, Shield was launched in mid-2013. It takes a while for a new product to be meaningful in size. By 2016, Shield was only 2% of the in-force. And with the strong growth we have seen in our Shield level annuities, as of 2019, it represented 11% of in-force. And you can see that trajectory expected to increase to approximately 22% in 2022 and reaching approximately 32% of our overall annuity block of business by 2025.

Third, by the end of 2019, the FIA product we launched with MassMutual in mid-2017 is beginning to have an impact on our in-force, and we expect that category will continue to grow and accelerate with our newly launched FIA that Myles just spoke of, the Brighthouse SecureAdvantage 6-Year.

Lastly, it's important to note that while we have had net outflows, total account values have been growing. This business mix shift contributes to our strong projected statutory distributable earnings profile over the coming years, which Ed will discuss in a few minutes.

Moving to Slide 18. I also want to emphasize that as we grow our Shield level annuity block of business, we are adding a natural complement or risk offset to our in-force block of variable annuities with living benefits. To provide an example of the benefits of Shield to our book of business, on a contract with a 10% level of protection, we cover the first 10% of loss in a down market. If markets are down greater than 10%, the Shield account value decreases while the underlying fixed income assets maintain their value. Conversely, in an upmarket, we hedge the increase in

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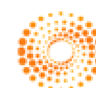

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account value. We're thereby able to maintain our pricing spread by purchasing hedge instruments that cover the difference between the market return of the linked index and our actual return.

Before turning the call over to Ed, I just want to wrap up with a few key takeaways on our business growth strategy. One, we have continued sales momentum that is driven by our diversified products and ongoing distribution expansion. Two, our continued sales growth, coupled with the runoff of less profitable business, is good for us. And three, that means we expect to see a continued shift in our business mix profile over time to a less complicated, less capital intensive, more diversified and more profitable book of business.

I will now turn the call over to Ed to discuss our financial strategy. Ed?

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

Thank you, Conor, and good morning, everyone. I'd like to start with our key messages on financial strategy, which are on Slide 21. First, we have substantially lowered our risk profile. Two words you will hear frequently from us are prudence and flexibility, and recent market movements serve as a reminder of the value of both for a financial services company. Second, we revised our VA hedging strategy at the end of 2019. As you heard from Eric, the repositioning of the hedge portfolio was substantially completed before recent market moves. Importantly, the equity repositioning was completed prior to the market decline. This revision has contributed to a lower-risk profile and preserves distributable earnings across more scenarios, largely by protecting approximately $1 billion of capital generated from market gains.

Third, it is critical that we maintain the strength of our balance sheet during periods of market stress. We have a franchise to protect, and making it through a downturn with as little disruption as possible is important to all stakeholders. Finally, we anticipate significant total company distributable earnings over the long term. We understand the attention paid to the VA distributable earnings tables. However, these tables represent only a portion of the total company and, therefore, only a partial view of distributable earnings. For a complete picture, it is necessary to consider our new business story as well as our existing non-VA business.

Let's turn to Slide 22, which provides an overview of revisions to our VA hedging strategy. Our original VA hedging strategy assumed we would have a $2 billion first loss position in 2020, up from the $1 billion-plus range during most of 2019. Under our revised strategy, we plan to operate with a first loss position of no more than $500 million. Also, keep in mind that the first loss concept is related to the hedge target and normalized statutory earnings. The impact of statutory reserves, and thus total adjusted capital, could be greater than the maximum loss. But if it was, we would expect a substantial offset in required capital, which would mute the impact on RBC.

To implement this strategy, we have shifted from out of the money options to primarily symmetrical or at the money hedges for equities, which unlike options have no initial cost. The costs associated with symmetrical hedges are primarily realized and unrealized losses when the equity market rises. Remember, we define hedge costs as the time decay of options, plus market gains and losses on hedging instruments.

In flat and down markets, we have a substantial benefit from the revised strategy because of our reduced first loss position. In normal markets, our hedge costs are similar as realized hedge losses under the revised strategy are only slightly more than the time decay we would have experienced under the original strategy. In significant up markets, we expect our hedge cost to be higher as we are no longer capturing as much upside.

We continue to benefit when the equity markets go up, driven by the future fees associated with our VA account values. And in down markets, we have substantially reduced our equity sensitivity associated with VA guarantees. The result is less volatility in projected distributable earnings across market scenarios, as you can see on Slide 23.

We believe that the distributable earnings profile under our revised strategy is compelling, particularly on a risk-adjusted basis. I would suggest that the lower end of the distributable earnings ranges for the original strategy is more comparable to the revised strategy given the significant difference in first loss position. The lower risk profile of the revised strategy, combined with the previously planned operating company dividend, allows for a $1.25 billion dividend from Brighthouse Life Insurance Company to the holding company under all 5 scenarios.

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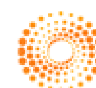

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Slide 24 illustrates the significant reduction in equity market sensitivity resulting from our revised VA hedging strategy. Under the lower separate account return scenario, we still expect to have $1.8 billion of VA distributable earnings, which is 18% lower than the base case. In contrast, the lower separate account return scenario would be 40% to 60% lower than the base case under the original strategy.

Under the equity shock low rate scenario, the improvement is even more dramatic as we would anticipate $1.3 billion of distributable earnings under our revised strategy versus $0 under the original strategy. This difference is even more pronounced than the distributable earnings comparison suggests, as we would remain above CTE98 under our revised strategy versus at CTE98 under the original strategy.

While VA is the most important risk we have to manage at Brighthouse, the investment portfolio is certainly a close second. And as you will see from Slide 25, this is a very good story. We have approximately $96 billion of general account invested assets, and our portfolio is high quality and well diversified. The pie chart on the left illustrates the level of diversification with U.S. corporate credit being our largest exposure. The chart on the right illustrates the ratings distribution of our fixed maturities portfolio. Approximately 3/4 of the investment portfolio is fixed maturities, of which roughly 96% is investment grade. Mortgage loans are 17% of the investment portfolio where the average loan-to-value ratio at year-end 2019 was 53% for commercial loans and 47% for agricultural loans.

As I said in my opening remarks, it is critical that our balance sheet remains strong during downturns, and we believe this expected strength is illustrated on Slide 26. We ended 2019 with a 552% combined risk-based capital ratio and approximately $800 million of cash at the holding company. Pro forma for the 2020 dividend of $1.3 billion, the combined RBC ratio would be approximately 475% and holding company cash would be roughly $2 billion. If after this dividend, we assume a 25% equity market decline, a credit downturn and the 10-year Treasury yield at 1%, we would estimate a combined RBC ratio of 350% to 400% and approximately $2 billion of cash at the holding company.

Finally, on Slide 27, I'm excited to provide, for the first time, our long-term view of projected total company distributable earnings, which means funds we expect to dividend to the holding company over time. This analysis is based on year-end 2019 market levels. Under the base scenario, we expect to generate between $9 billion and $11 billion of total distributable earnings over the next 10 years, and under the lower separate account return rate scenario, between $4 million and $5 billion over that same period. And return on statutory capital is expected to improve in both of these scenarios over this time period.

Let me take a minute to talk about new business strain. As my colleagues have mentioned, we continue to be very pleased with the quality of new business we are adding each quarter and the long-term benefit to distributable earnings. In the near term, however, our strong sales have a negative impact on distributable earnings. To give you a sense of the impact, we estimate new business strain of approximately $400 million in 2020. As is the case with most life and annuity products, the payback period for new business or the time to recoup the upfront strain is measured in years. For Brighthouse annuities, the payback period is generally between 5 and 7 years, which we think is an acceptable time to recoup our investment.

Slide 28 closes my section of the presentation and reiterates the key themes I hope you take away today. We have a strong balance sheet and cash position, and we will prudently manage both to maintain flexibility. We have established a brand and a strong new business story, and we will strive to protect this franchise by maintaining balance sheet strength through business and market cycles. Finally, we believe we have a compelling distributable earnings story over the short and long term.

With that, I will now turn the call over to Eric for closing remarks. Eric?

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

Thanks, Ed. Brighthouse Financial is a much different company today than its separation. We have successfully established our brand, produced significant sales growth, generated substantial statutory capital and have fundamentally lowered the risk profile of our company with our revised VA hedging program. We are well positioned in the marketplace to help Americans achieve financial security. We expect to continue our strong sales growth and expand our distribution network through targeted growth opportunities. As the Brighthouse Financial franchise grows and evolves to a more diversified business mix, we are committed to consistently driving shareholder value.

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

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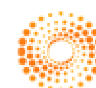

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QUESTIONS AND ANSWERS

Operator

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

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

On the total company distributable earnings over the next 10 years, how should we think about the, I guess, the holding company costs and the other sources of cash flows that go to the holding company outside of distributable earnings? I guess, do those roughly offset? Or can you give any more color on that?

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

Sure, Ryan. The nondividend flows to the holding company over that period, we would expect to cover all holding company expenses and interest and preferred -- interest and preferred dividends.

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

Okay. Great. And then second question was, can you give any more detail on what you assumed in the credit downturn within that stress case RBC ratio?

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

Ryan, it's John. I'd rather not give out any specific numbers, but I'm happy to share some of the important assumptions that inform this analysis. So probably, most importantly, we assume credit loss is consistent with actual experience during the financial crisis. Specifically, they're based on 2008 to 2010 Moody's data from migration and defaults.

With respect to structured finance, we use assumptions from our outside managers based on their best estimates of expected losses in migration. And for our mortgage loan portfolio, we used 1990 to 1993 data to estimate shocks to our LTVs, which informed expected credit migration and losses there. Hopefully, that's helpful.

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

And Ryan, just a follow-up, I want to make it clear that, that DE table does not include any of the nondividend flows that I referenced in my remarks.

Operator

Our next question comes from the line of Erik Bass from Autonomous Research.

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

I guess, first, I wish I didn't have to ask this, but I mean, you show the stress scenario being a 1% 10-year, which seemed pretty stressful until the past week. Can you just talk about cash flow sensitivity to interest rates below 1% level? And are there any unusual impacts to consider?

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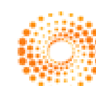

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Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Erik, so obviously, a 1% 10-year Treasury presents challenges for the financial services industry. And you can see from our DE tables that -- our distributable earnings benefit when returns and rates are higher. The only thing I would say on the current environment is, with the 1% 10-year Treasury, we still plan to take the $1.3 billion of dividends in 2020.

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

Got it. And maybe for Myles or Conor. Can you just talk about the challenge of designing profitable products that are also attractive to consumers in a 1% rate environment? And how are you responding to this as you think about pricing and developing new products?

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

Hey, Erik. It's Conor. I'll start. So the bulk of our products are priced or we have the opportunity to price them every 2 weeks. Clearly, we're watching what the achievables are on the investment portfolio, so that's probably the most significant impact right now. So we'll keep managing that closely.

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

Got it. And I guess, as you think about it, should we assume Shield is relatively less rate sensitive, but the other products would probably see more challenges just from a demand perspective in terms of being able to offer kind of an attractive crediting rate to consumers on annuities? Or even kind of an attractive return on life products?

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

Yes. I mean, that's fair. I mean, clearly, in a market like this, there's -- there are sales opportunities associated with Shield as well. There's the higher interest in a higher level of protection. We've seen that phenomenon come through even just -- we're already seeing that through 2019. Obviously, it's a little early to tell about the future. Momentum has been strong so far in the first quarter of 2020. And obviously, higher volatility helps Shield, obviously. And then the upside of that, of course, is the earned rates are a headwind. But the higher volatility decreases the option costs.

Operator

Our next question comes from the line of Alex Scott from Goldman Sachs.

Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I guess, first question I had was just -- and thinking through some of these scenarios that include more challenging interest rate and separate account returns, what are you assuming in there around policyholder behavior? Because I think that's sort of one of the bigger concerns when you get into these scenarios is, do you have this convexity risk where policyholders start to act differently around how they're annuitizing and utilizing the benefits that you provide. So are you assuming like close to 100% efficiency in those choices? Or how do you think about modeling that when you do these?

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

Alex. So I guess the first thing I'd say is there are no assumption changes, but keep in mind that our assumptions assume dynamic lapses and other factors that are going to change based on market factors, so that's factored in.

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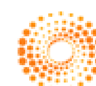

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Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. Some other companies have talked about asset adequacy testing, having a more near-term, like next couple of years impact if rates stay around 1% because of, yes, I guess, some of the subtests on SGUL and so forth. And I would just be interested if that is something that impacts you guys and how that's kind of factored into the non variable annuities part of the distributable earnings you're showing.

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

Yes. So first of all, as you know, we do asset adequacy testing at year-end, and so I can't get ahead of that. I mean, we just completed asset adequacy testing for 2019. I think it's premature to talk about 2020.

And when it comes to VA, obviously, the impact on the total asset requirement, et cetera, is factored in based on the different rate environments that are built into the scenarios.

Operator

Our next question comes from the line of Andrew Kligerman from Crédit Suisse.

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

All right. Two quick clarifications. On Slide 16 and 17, you highlight VA cap -- VA noncapital-intensive, VA capital-intensive and Shield. Could you put in a very basic way, if you generated $100 of deposits on each type of variable annuity, how much capital would each require? I want to get a sense of relatively how capital-intensive each is.

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

Well, so first of all, we're not writing higher capital-intensive business today. And I think, Ed in some of his prepared remarks gave an overall perspective of the capital strain of all of the business that we're writing.

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

And Andrew, I would just add that when you look at that 10-year total company distributable earnings tables, we see a material improvement in our statutory return on capital at the end of that period versus where we are today. And building on something that I said in my prepared remarks, the strain from new business today is, we think in 2020, is around $400 million. The impact of new business over that whole 10-year period is minimal. And so I think what you're seeing and you will see is there is a significant ramp-up in the back half of distributable earnings coming from this low capital-intensive, high-return business that we're putting on the books today.

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

Okay. With regard to Slide 24, where you talk about 250 basis points lower separate account return, is that off of, what, 6%, 6.5%, 7%? Just want to get a sense of what 250 basis points is lower than.

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

Sure. That is off of 6.5%, so that's a 4% return.

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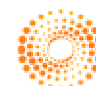

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Andrew Scott Kligerman - *Crédit Suisse AG, Research Division - MD & Senior Life Insurance Analyst*

Great. And then just lastly, the markets have gotten quite strained and talk about the $1.5 billion return over 3 years, which would be $1 billion over the next 2 years, roughly 2020 and 2021. And then you've got this slide showing you'll ultimately have $2 billion of capital at the holdco. Any scenarios or thoughts on why you wouldn't return $1 billion plus over the next 2 years to shareholders. Are there any scenarios where you see that wouldn't happen? Or are you highly confident that you can do that?

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

Yes. So Andrew, first of all, I guess, I would say, and maybe this is just rounding, but to achieve the $1.5 billion target, we would need to repurchase a little bit more than $900 million of stock. And so when you look at $900 million relative to our current equity market cap, it's about almost 25% of the total equity market cap. So we think that's a pretty shareholder-friendly action, and we feel good about that amount of capital return.

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

So even today, as we [shook] at the equity markets down 3% and 10-year at 1% and if it got strained even more, you would still feel pretty good?

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

Yes. Andrew, it's Eric. Let me just clarify your question. You're saying with markets where there are, interest rates where they are, do we think returning $1.5 billion is good? Or are you concerned that maybe we wouldn't return $1.5 billion?

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

So you've already -- you've already done $600 million, so the remaining $900 million, can -- no, any impediments? Anything we should be concerned about? Or do you just feel extremely confident, especially as I look and you're going to have $2 billion sitting at the holdco when you dividend up more capital?

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

Right. Yes. Okay. I got it, Andrew. Look, as Ed said, the 2 words are prudence and flexibility. Having said that, right? And always keeping that in the back of our mind, we intend to return the $1.5 billion.

Operator

Our next question comes from the line of Tom Gallagher from Evercore.

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

Just to come back to the question Erik asked you earlier. And I get that the sensitivities you put out are the sensitivities, but the -- how do we think about if we went down another 50 or 100 basis points in interest rates over the next, call it, 3 years, would that be a game-changer? I just want to -- I'm not asking for an exact number. I'm wondering, based on your current hedging profile, would that meaningfully impact your ability to deliver on capital return? Or -- I don't know how you want to answer that or if you can answer it, but I think it would be helpful given I think most people are looking at it now saying, how about some sensitivity to stretching the current environment even though I think it's clearly worse than we've ever been from an interest rate standpoint.

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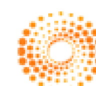

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Eric Thomas Steigerwalt - *Brighthouse Financial, Inc. - President, CEO & Director*

Hey, Tom, it's Eric. I'll start, and Ed will probably jump in here. So it seems to me there's 2 pieces of your question here. So rates go 50% lower, like what does that mean potentially for capital return? And then with respect to some of the scenarios, can you give us some sense? That's what I got out of your question. Look, this has been interesting here as we prepared for this and literally watched what's happened over the last 7 days here. As I've said before, we got to manage this company through all times. I mean, we don't get to choose which scenario, we have to manage through whatever scenarios actually occur. So I would say, given what I said to Andrew before, right? Prudence and flexibility, I don't see anything that strikes us, just staring me in the face where we would be concerned about continuing to repurchase stock, especially at these prices whether or not the 10-year continues to go down or not.

Having said that, you've got to think about what's going to occur when, mark if -- and when markets continue to change, and we've been doing that since we came public and we will continue to do that. So there's nothing I see right off -- right on the edge of the horizon here, but we've got to maintain a sense of prudence and flexibility, given what markets might throw at us. Ed, do you want to add?

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

Yes. Tom, the only thing I would add, I guess, is if you look at our scenarios and you look at this lower -- the lower separate account return scenario or what we call scenario 3 or the lower separate account return and rate scenario, which is scenario 4, so just as a reminder, under scenario 3, we have rates mean reverting to 3.75% over 10 years. And that was from a 1.92 10-year Treasury at the end of '19. And under scenario 4, it's a 1.92 10-year Treasury following the forward curve. So you see there's a $500 million change in those -- in the DE over that 3-year period. Unfortunately, we're not going to be able to provide you anything more than sort of what you might deduce from these tables.

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

Got you. And then the -- let's see, the -- if I look at the adverse scenarios here, it looks to me like it's essentially generating a little over 100 -- around $100 million a year, a little over $100 million a year for the second-worst scenario and $1 billion of release of capital. So is it fair to say at a high level, the way you're managing it for the adverse scenarios is, on the VA block, you're not going to generate much capital, but you're going to preserve capital, which is obviously the big change from the old strategy? And then I guess -- so that's my first part of that question. And then secondly, would you still expect to generate what would it be a couple of hundred million dollars a year of the non-VA businesses over that period? So at least, we'd have the cash flow from that under the second 2 worst scenarios?

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

Yes. Tom, I guess, what I would do on the non-VA and new business is point you to Slide 27 and the fact that you can come up with some numbers based on the percentages we give you on these slides. And then you could think about how you might want to look at what those numbers might be under a variety of different scenarios. But clearly, there are -- this is -- one of the things that we think is important about the disclosures we're providing today is we spent a lot of time talking about VA tables. And it's a look at 1 portion of our company, and it doesn't factor in any new business. And so what we've tried to do is show you that we're more than a VA company. And we've got a very strong new business story, and that is contributing significantly to the value we think we're creating over time.

Operator

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

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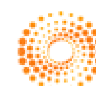

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Humphrey Lee - *Dowling & Partners Securities, LLC - Research Analyst*

The first one is just a clarification question. For the distributable earnings on table, does that -- is that including the $1.3 billion that you are planning to dividend up in 2020? Or is that above and beyond that $1.3 billion?

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

Humphrey, it includes the $1.3 billion.

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

Okay. Got it. And then in terms of the capital deployment for organic growth, you mentioned $400 million for 2020. How should we think about the, I guess, the rest of your projection for 2021? Should be notably better just because you do anticipating more insurance sales in 2021?

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

Yes. That's a good question, Humphrey. So when you look at what we call the new business contribution over this 10-year period, it's really looking at everything we write starting from 1/1/2020. So new business in 2020 is sort of the in-force in '21, but it's considered new business for the purposes of this analysis. So over that 10-year period, you see the $400 million roughly strain what we think you're going to have in 2020. And over the 10-year period, there's a minimal impact from new business. So we're not going to get specific about year-by-year, But I would say that the strain does come down in year 2 because of the fact that you're layering on -- you have a year of business that you wrote in '20 and you have the new business you're writing in '21. And then as you get out to the outer years, we talk about a 5- to 7-year payback period on our -- most of our annuity products, you start to see the contribution from this in-force book. And this is a -- really an important story. Now I understand it's a 10-year projection. And obviously, you have to think about all the caveats around a 10-year projection, but we're seeing a material increase than in the contribution from this high quality, low capital-intensive, good return business in the outer years.

Operator

(Operator Instructions) Next question comes from the line of Peter Troisi from Barclays.

Peter Vincent Troisi - *Barclays Bank PLC, Research Division - Director & Senior Analyst*

Just a question on Slide 26. So if I just -- I look at the RBC ratio at year-end of 552% versus the 350% to 400% in the post dividend stress case, there's obviously 2 things affecting that, if I just break them apart. So the planned dividend from the Opco looks like it will account for about 75 points of that decline. So is it fair to say that the rest of the decline or the incremental 75 to 125 points, would that be attributable just to the stress market conditions?

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

Yes, that would be attributable to the equity market stress, the credit stress as well as the 10-year at 1%.

Operator

Our next question comes from the line of Suneet Kamath from Citi.

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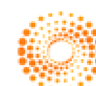

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Suneet Laxman L. Kamath - *Citigroup Inc, Research Division - MD*

Just 2 numbers questions. Just starting on Slide 23. Just want to confirm, the original strategy column, those ranges that you give there, those also include that VA capital release of $1 billion, correct?

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

Well, I think under the original -- the point I think I made in my prepared remarks is that releasing capital under our new strategy, the comfort level around that is because we had -- our first loss position is up to $500 million. Under the old strategy, it was a -- up to $2 billion first loss position. And so the comment I made about the original strategy targeting a certain buffer above the total asset requirement, operating at the low end of that buffer was, I would consider a reasonable amount of risk, given the fact that a shock -- one shock event could take you to the low end of your total asset requirement. Now we're talking about a first loss position where you could theoretically absorb multiple adverse events before you would be close to your floor for total asset requirement. So I would say no. I would say, when you look at this, you have to think about it from the standpoint of what's your comfort level in terms of cushion above the total asset requirement, targeted total asset requirement. And I would, I think make a pretty strong argument that, that cushion has to be less when your max loss is 1/4 of what it was before.

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

Right. No, that makes sense. The other question I had is on Slide 33, in the base case, the $1.2 billion of distributable earnings before the VA capital release. So that's -- over the 3 years, it's about $400 million per year. And I had thought on the fourth quarter earnings call, Ed, you talked about maybe a $250 million dividend coming out of the VA business. So maybe that's an apples and oranges comparison, but I just want to understand the difference between the 2?

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

Sorry, Suneet, could you repeat that? Because I think there's some rounding here, but can you just give me that question one more time?

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

Yes. No problem. So the $1.2 billion in the first column on Slide 33, that's over 3 years, so that's $400 million a year. And then if I go back to the fourth quarter call -- I mean, maybe I have this wrong, but my recollection is you'd said we could take $1.25 billion out of BLIC and we would expect kind of a normalized to be $250 million. So I was trying to understand the difference between the $400 million in the table and the $250 million. That's all.

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

Yes. So I think the $250 million, first of all, it was a 2020 view, and it was -- it was BLIC. And I'm trying to remember what I said on last quarter call, I think I also talked about the NELICO dividend, which is, we think normal dividend, about $60 million to $70 million a year. So total dividends we would expect from operating companies at normal year would be something like $300 million, which is what you're seeing in the $1.3 billion we planned for 2020. And you will see some -- you would see some increase in that number.

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

Right. But the $1.2 billion here on Slide 33, that doesn't include NELICO, right? That's just BLIC...

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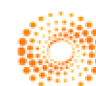

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Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

It does not. It does not.

Operator

Our next question comes from the line of Alex Scott from Goldman Sachs.

Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

I was just interested how expense reduction plays into what you're outlining here? I think clearly, there's still a lot of overhead from the spin-off that you guys are planning to reduce. I mean, how does that play into VA distributable earnings and sort of the overall distributable earnings that you're outlining?

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

Yes. Alex, so these numbers reflect the targets that we've shared with you for expense reduction.

Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Okay. All right. And then one more question for you. I know you're not ready, I'm sure, to provide anything on the FASB accounting changes on GAAP, but I think it's probably safe to say that GAAP-based metrics won't necessarily be the way that you view leverage on the other side of it, or at least it maybe won't be the primary way that you measure your financial leverage. So I'd just be interested, like how you will think about financial leverage. Will you think about it in terms of these distributable earnings and their coverage over interest expense? Or are there other metrics that we should be looking at to assess where the appropriate leverage levels are?

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

Yes. Sure. So I would start off by saying that generating cash to service and repay debt and to distribute capital to shareholders is a function of our statutory results. So that does not change under new GAAP versus old GAAP. So that's where I would start.

The second thing I would point out is we've highlighted multiple times, prudence and flexibility. And having $2 billion of cash at the holding company gives us a lot of flexibility. So I think we will look at this, and we will obviously be engaged on LDTI with all of our stakeholders. It's a very significant change. But in terms of the fundamentals of this company, we have $9.7 billion attack at year-end. We have roughly $4.8 billion of debt and preferred outstanding, we have $800 million of cash at the holding company at year-end 2019. None of those numbers change regardless of the accounting model.

Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Got you. So the cash coverage in your base case and maybe even thinking through some of the stress cases that are more in line with where the market is at right now, the cash coverage on interest you have in those scenarios, you're comfortable with today?

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

Yes.

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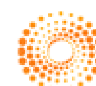

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Operator

Our next question comes from the line of Tom Gallagher from Evercore.

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

I just had 2 sort of mechanical questions. So we heard from another company with a big variable annuity block that has also early adopted the VA reform, that they would expect to have an RBC benefit because they've hedged to the economics, and the new rules aren't fully economically based, but they're close. Would you guys have a similar outcome in 1Q? Or would you expect to have a similar outcome in terms of, at least, if you just isolate the interest rate client? Should there be an RBC benefit of hedge gain versus movement in the new RBC rules?

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

Yes. Tom, so I'd start off by saying that we're not going to comment on what peer companies are saying. I go back to something I said earlier. Clearly, a 1% 10-year Treasury presents challenges for the financial services industry. For Brighthouse, we have significant low rate protection. As you know, we added to that protection in the first part of 2019 when interest rates were substantially higher than where they are today. And again, I would go back to the tables where you can see that distributable earnings go up when returns and interest rates are higher. And then finally, again, just going back to even in the current environment, we're still comfortable with the $1.3 billion of dividends from the operating companies. Just a general comment on RBC ratio, ending the year at around $550 million, showing a stress environment where it's $350 million to $400 million with $2 billion of cash to the holding company, that builds in a 1% 10-year credit downturn, which includes losses as well as migration and a 25% decline in the equity market, and oh, by the way, 25% from here, if you wanted to assume that. We feel pretty good about where our RBC ratio is.

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

Okay. That makes sense. And then another question I've been getting a lot, and it is more just a mechanical question. As we think about your 2020 GAAP balance sheet review, I know it's too early to give any indication, but just mechanically, will you use the spot interest rate and forward interest rate levels that would be a 2Q [N] to compute your 3Q balance sheet review? And then how formulaic is that? Like, do you overly rely on spot rates and the current level of forward rates to do that formula compared to the 3.75% 10-year assumption you use today? Can you just provide a little bit more like what goes into the math behind it?

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

Yes, Tom. So I will agree with the first part of your question, which is it's a little too early to start talking about 2020 assumption updates. And I would also say that there were a couple of times in your question you mentioned formula and mechanical, and I don't know that that's the way I would describe the process of coming up with a mean reversion rate. There are a lot of inputs. I mean, we take into account our internal views based on what we're seeing from economists here, from economists externally, from what the current market environment is, from what nominal GDP is. There are a lot of different factors we look at, and we certainly look at a lot longer period than a 2-month period, which is sort of where we are right now with a decline from 2% to 1%. So I think there's a lot of things that we consider. But I would not say it is a mechanical process.

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

That makes sense. But Ed, do you really use the rate level that you use as your beginning input? Is that a quarter prior to the review? Or is that not firmly set? Can you -- in terms of the starting point?

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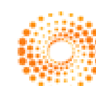

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Edward Allen Spehar - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes, it is generally the quarter prior. And it's -- we have a 10-year mean reversion rate.

Operator

At this time, I am showing no further questions. I would like to turn the call back over to Eric Steigerwalt for closing remarks.

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

Thank you, and thank you all for participating in today's call and for your interest in Brighthouse Financial. We covered a lot of ground today, and I want to leave you with just a couple of takeaways.

First, we have a focused strategy, and we believe this strategy will generate long-term shareholder value. Second, Brighthouse Financial is growing in both Annuities and life insurance, and we believe we're well positioned in both of those product categories. Third, as Conor pointed out, our business mix continues to evolve and will continue to evolve. And we expect to see that shift in our business mix profile over time, as you saw in his 1 slide. And that gets us to a less complicated, less capital-intensive more diversified, more profitable book of business. And by the way, that doesn't include -- all of those tables that we showed don't include those nondividend flows up to the holdco, okay? So our distributable earnings across market scenarios, I think, are very compelling, and we anticipate significant total company distributable earnings over the long term, as you could see in the tables. Finally, we have a strong balance sheet and cash position. And as we've said a number of times on this call, we will prudently manage both to maintain flexibility. So we look forward to updating you on progress in the future, and thanks for joining today.

Operator

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

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