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BHF.OQ - Q2 2018 Brighthouse Financial Inc Earnings Call

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OVERVIEW:

Co. reported 2Q18 adjusted earnings (excluding impact from notable items) of $197m. Expects 2018 adjusted diluted EPS less notable items to be $8.50-9.00.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Brighthouse Financial Second Quarter 2018 Earnings Conference Call. (Operator Instructions) And now I would like to do some work for today's conference, Mr. David Rosenblum, Head of Investor Relations. Sir, you may begin.

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

Thank you, operator. Good morning, and thank you for joining Brighthouse Financial's Second Quarter 2018 Earnings Call. Our earnings release, presentation and financial supplement were released last night, and can be accessed on the Investor Relations section of our website at www.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; followed by Anant Bhalla, 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 discussion are other members of senior management. 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, including those described from time to time in Brighthouse Financial's filings with the U.S. Securities and Exchange Commission.

Information discussed on today's call speaks only as of today, August 7, 2018. The company undertakes no obligation to update any information discussed on today's call.

During this call, we will be discussing certain financial measures that are not based on generally accepted accounting principles, also known as non-GAAP measures. Reconciliations of these non-GAAP measures 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 statuary results are preliminary due to the timing of the filing of the statuary 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. Today, we're celebrating our 1-year anniversary as a publicly traded company, and we believe we have much to celebrate. We have made significant progress over the past year. We are proud of what we have accomplished, and we remain focused on executing our strategy as we believe it will create shareholder value.

An example of the success of our strategy is the announcement we made last night. Our Board of Directors has approved a $200 million stock repurchase program, our first as an independent publicly traded company and significantly ahead of our base case scenario. From the beginning, we have worked diligently to enhance our financial strength and flexibility. This program reflects the progress we have made, the confidence we have in our strategy and our commitment to returning capital to shareholders.

We expect to prudently manage this over the next year consistent with the board's expectations. I'm going to focus the remainder of my comments today around the progress we have made with respect to our top priorities for 2018.

As a reminder, the top priorities are, first, we are focused on exiting our transition service agreement or TSAs with MetLife. Exiting TSAs supports our goal of reducing overall cost structure as a stand-alone company. Second, we are enhancing our distribution platform and network and developing new products that respond to the evolving needs of our advisers and the clients that they serve. And third, actively managing through NAIC variable annuity capital reform and growing our earnings power.

Let's begin with TSAs. Exiting TSAs with MetLife and replacing them with more cost-effective solutions is essential to executing on our strategy. We began the quarter with 139 TSAs remaining, and we were able to exit 12 in the second quarter. We currently anticipate ending 2018 with fewer than 85 TSAs. Consistent with our strategy, exiting TSAs will help us begin to reduce expenses while solidifying the Brighthouse operating platform.

Second, product and distribution. I am very pleased with our annuity sales results from the second quarter of 2018. Annuity sales of approximately $1.4 billion were up 42% quarter-over-quarter, driven by Shield and fixed indexed annuities. Sales of Shield annuities were $723 million in the quarter, up 27% quarter-over-quarter.

The quarter-over-quarter growth in annuity sales reflects the strength of our distribution relationships and the ongoing momentum from our branding initiatives. I also want to provide a few perspectives on our life insurance business. Product diversification is important to us. We have a large block of life insurance with approximately $421 billion of face amount in force. That's net of reinsurance as of June 30, 2018.

As I've said before, one of the key elements of our strategy is to offer a tailored set of annuity and life insurance solutions that are simpler, more transparent and provide value to advisers, their clients and our shareholders.

Consistent with the strategy, we are also focused on growing new sales of life insurance and intend to be a significant player in the industry in coming years. As such, we are targeting the end of this year or the beginning of next year to launch a new life product subject to regulatory approval.

Turning to our second quarter results. Our key financial highlights for the second quarter are summarized on Slide 3 of our earnings presentation.

Results in the second quarter of 2018 were mixed with outstanding quarter-over-quarter sales growth and stable variable annuity assets above CTE95 that were in line with our expectations.

However, our earnings were impacted sequentially by higher corporate expenses as expected and unfavorable results in the Run-off segment.

Sequentially, the Run-off segment was impacted by lower alternative investment income and higher claims, both of which can vary from quarter-to-quarter.

Our corporate expenses were $288 million in the quarter, up $58 million sequentially and the high watermark for 2018. This expense level was in line with expectations, culminating with corporate expense in the first 12 months post separation of approximately $1.05 billion. We still expect to reduce these expenses by $150 million on a run-rate basis by the end of 2020. We are also making necessary investments in our technology infrastructure and in our businesses. We refer to these investments as establishment costs.

In the second quarter, establishment costs were approximately $56 million pretax. We still expect to achieve our guidance for adjusted earnings per diluted share less notable items for 2018 of $8.50 to $9 per share.

Additionally, we still expect an approximately 8% adjusted ROE less notables in 2018 with meaningful improvement in both 2019 and 2020.

The primary drivers of second-half performance are expected to be: Equity market returns, lower expenses, lower claims severity in universal life with secondary guarantees and higher investment income from continued investment portfolio repositioning.

We intend to provide additional guidance on adjusted ROE less notables before the end of this year. Finally, assets above CTE95 were flat sequentially at $2.7 billion or more than $0.5 billion of assets above CTE98.

Importantly, these results were in line with our expectations given favorable markets, lower volatility and normal aging of our block.

Before I turn the call over to Anant to discuss our second quarter results in more detail, I would like to provide an update on NAIC variable annuity capital reform, which is summarized on Slide 4.

We expect the NAIC will approve the framework for variable annuity capital reform today at the conclusion of the NAIC meeting. After approval of the framework, various NAIC committees will begin the process of clarifying certain implementation guidelines. The effective date of the reform is expected to be January 1, 2020.

We continue to be supportive of the principles behind this reform and believe it aligns with our view of managing to a total asset requirement.

Based on the framework expected to be adopted today, we believe Brighthouse is well positioned to adapt to the impacts of variable annuity reform and tax reform.

Let me provide two thoughts on impacts and implementation timing.

First, we intend to incorporate the new variable annuity capital and tax reform frameworks including the equity and interest rate scenarios, behavioral assumptions and the benefits from hedging in our calculation of CTE95 and CTE98 beginning in the third quarter. We expect that the total asset requirement will increase as a result. However, we expect this increase will be funded by the current assets above CTE98.

Secondly, we are currently considering the potential for early adoption of the NAIC capital reform for statuary reporting, if permitted, enabling us to potentially sunset the current standard scenario framework in our actuarial processes in 2019.

The new reserve framework should help pave the way for growth in ordinary dividend capacity in the years to come as we believe changes in reserves will better align with our hedge target.

To wrap up, we are very excited about the initiation of our first stock repurchase program and the value that it creates for shareholders. This program reflects the progress we have made, the confidence we have in our strategy and our commitment to returning capital to shareholders. We are pleased with our sales growth in annuities and with our strong operational performance in the quarter. While we had lower sequentially earnings this quarter, we still expect to achieve our targets for the year.

With that, I'll turn the call over to Anant to discuss our second quarter financial results in more detail. Anant?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Thank you, Eric, and good morning, everyone. Let me start with the second quarter results and provide some perspectives on the key underlying themes beginning on Slide 5.

Adjusted earnings, excluding the impact from notable items, were $197 million in the quarter compared to adjusted earnings on the same basis of $288 million in the first quarter of 2018 and $282 million in the second quarter of 2017.

The Annuities segment continues to perform well, and results in the Life segment were good but were impacted by higher expenses. The only notable item in the quarter was establishment costs, lowering adjusted earnings by $44 million after tax or $0.37 per share.

Now I'd like to provide some perspective on 3 themes related to our adjusted earnings this quarter.

The first theme for the quarter that I would like to discuss is expenses. Corporate expenses were $288 million in the quarter, up approximately $58 million sequentially, and the high watermark for 2018 and consistent with our expectations. On an after tax per share basis, that translates to a $0.38 per share sequential impact.

As seen on Slide 6, the corporate expense level in the quarter is approximately $20 million after tax or $0.17 per share higher than our average quarterly run rate for the first 12 months as a public company. Actual first year corporate expenses were right in the middle of our expected range of $1 billion to $1.1 billion.

The second theme is the investment portfolio. Net investment income was lower sequentially, primarily driven by a decrease in alternate investment income. This was partially offset by growth in assets and the investment portfolio repositioning that we started last quarter.

Alternate investment income was approximately $17 million after tax or $0.14 per share lower than the four quarter historical average for 2017 as seen on Slide 6. This performance is related to weaker results in private equity funds, which we report on a 1-quarter lag.

The third theme for the quarter is claims in the Run-off segment. Second quarter results were unfavorable sequentially, primarily driven by higher claims severity in the universal life with secondary guarantees book of approximately $9 million after tax or $0.07 per share as seen on Slide 6.

In addition, incidence in legacy payout annuity blocks in our Run-off segment was lower.

Now turning to results at the segment level. Adjusted earnings in the Annuities segment were $221 million in the quarter. Sequentially, results reflected higher expenses, partially offset by higher investment income and lower DAC amortization given the equity market performance this quarter.

Net flows partially offset by improved sequential separate account fund performance resulted in an approximate $800 million sequential decrease in annuity account values to approximately $129 billion.

Adjusted earnings in the Life segment were $37 million in the quarter, sequentially, results reflect higher expenses.

The adjusted loss in the Run-off segment was $6 million in the quarter, sequentially, net investment income was lower as a majority of our private equity assets are in the Run-off segment.

Additionally, we experienced higher claims, which can fluctuate from quarter-to-quarter. We currently expect the run rate in this segment to be in the $15 million area per quarter with possible variation quarter-to-quarter.

Corporate & Other had an adjusted loss of $99 million and included a $44 million unfavorable notable item for establishment costs. Expenses were higher sequentially.

Let me now close with an update on our capital position and on our VA hedging as of June 30, 2018.

First, we feel very good about our capitalization levels, including prospectively reflecting the expected impacts of variable annuity capital reform and tax reform.

Second, with respect to our variable annuity exposure management program, results were in line with our expectations.

As seen on Slide 7, assets above CTE95 were approximately $2.7 billion or more than $0.5 billion of assets above the CTE98 level on a pre-reform basis. Our hedging programs are working and delivering results in line with our expectations for the market movements in the quarter.

Third, total adjusted capital was $6 billion, down $0.5 billion from the prior quarter, driven primarily by the existing Variable Annuity Reserve requirements, which are less sensitive to market movements than our CTE95 hedging target.

As Eric mentioned, we are currently considering the potential for early adoption of the NAIC capital reform for statutory reporting, if permitted, enabling us to potentially sunset the current framework in our actuarial processes in 2019.

Fourth, adjusted statutory earnings were approximately $175 million through the second quarter in line with our expectations.

And finally, with respect to our $200 million stock repurchase authorization from the board, we expect the repurchase to be funded out of the existing $569 million of holding company liquid assets as of the end of the second quarter.

Additionally, our leverage capacity is consistent with the prior quarter's levels. As a reminder, we may access the debt markets as and when opportunities present themselves in order to enhance financial flexibility. With that, we'd like to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Humphrey Lee with Dowling & Partners.

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

Just related to the VA capital reform. So now with greater clarity, how you've changed your view related to your approach to your hedging strategy and the cash generation from the in-force block going forward, relative to kind of your -- what's your lay out in -- during the (inaudible) process?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Humphrey, with respect to our hedging strategy, no change in the way we think about it, exactly the same way. You would see us probably talk about capitalization with an RBC basis as the CTE98 framework comes in there, but that doesn't impact the hedging strategy. And we will update our sensitivity tables in terms of distributable earnings annually so with our year-end process. But primarily, no real change in our strategy, and how we think about it.

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

So basically, you'll still be over (inaudible) to expect to create a $3 billion of asset buffer above CTE95 level under the new regime? And then you said you kind of -- in a sense to reduce your hedging cost. That's still your thinking related to your hedging strategy?

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

Humphrey, it's Eric. Look, I think that lies behind it going forward. Right now, certainly the buffer is important. We've been looking at it and discussing it every quarter as we're doing it right now. But I think once we adopt the new framework, you're going to hear us start to talk about, as Anant just said frankly, capitalization with respect to RBC because that was the whole point of VA capital reform to make RBC more robust. So I think that answers your question.

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

Okay, got it. And then looking at your kind of realized investment losses, you have $75 million in the quarter or roughly $0.50 in your (inaudible) loss number. My understanding is that is largely driven by kind of repositioning your investment portfolio. I was just wondering like how much yield did you pick up in the process? And are you done with that repositioning, or should we still expect some realized losses to come through in the coming quarters?

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

[Henry,]it's John. I think, one, we're not done with repositioning. We're going to continue to reposition that out of treasuries. Two, you're right, most of those losses -- those realized losses in the second quarter were due to trading out of lower coupon treasuries. And three, it will probably be continued losses in the future as we do that.

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

Is there anyway to size the, I guess, the percentage you have done -- you've repositioned relative to your investment portfolio? So like where you stand right now? How should we think about the coming quarters?

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

Humphrey, we've rotated out of $3 billion in the first quarter -- first half of the year. As far -- and we're continuing to trend the position down. As far as ultimate timing and amount and impact, we're still evaluating that. But we have a bit to go.

Operator

And our next question comes from the line of Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

First, I just had a question on the expected timing and pace of your buyback plan in completing the program. Are you going to base it more on just a certain price? Or what's really going to drive? If you could give us any sense of how fast you're going to complete the program?

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

Jimmy, it's Eric. I know that, I guess, many of you would want me to break it down quarter-by-quarter or something like that but I'm not going to...

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Or just your strategy on it and not looking for actual guidance, but just how are you going to -- are you going to start right now? Are you going to evaluate based on where the price is? How would you approach it?

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

Look, we're thrilled that we're at this point. We are going to do all the above. At these prices, I certainly would like to buy back stock. We'll do it over time. And I think, you can kind of plug into your model, whatever you think is prudent. I think that, that might be a word to use. We're going to be prudent. Look, we've got to watch markets, we've got to think about the company overall, but we have an authorization, and we intend to repurchase stock.

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

And then on the -- you mentioned elevated universal life, I think, in the secondary guarantee part of the book. How much of that was related to the block that you recaptured -- where you recaptured it from the reinsurance company?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Jimmy, it's Anant. So our block that we recaptured from our former parent last year prior to separation was a large traditional block. So that's not ULSG, but there will be some aspects of ULSG as well. Really the driver over there was severity. It's...

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

No, I meant from a third-party insurer. The block you recaptured from a third-party insurer?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

It would be some portion of that, because there was a portion of the ULSG block that was recaptured. We don't know the exact percentages, but yes, there was a portion that was recaptured.

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

And we should assume that the reason you would have recaptured it just was basically increasing the insurance cost that, that book should behave worse than sort of -- or than a normal UL block, right? Because otherwise the reinsurance -- you would retain the reinsurance relationship, correct?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

We recaptured it because the reinsurance rate increase was higher than the current rates. And so this is pretty standard across the industry, a lot of -- when reinsurers do this, they don't do it for a particular company they do it for their entire block that they've got from multiple companies. So it's not something systematic to us or specific to us.

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

Jimmy, it's Eric. I hear something else in that question too. No, we don't expect it to perform any differently. If that was part of your question.

Jamminder Singh Bhullar - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Yes, no, that's what I meant. I -- and what my point was that if that's the block that actually had or part of your bad experience was in that block then that might be normal going forward. Obviously, not every single quarter but that's a block that would typically show worse results. Obviously, UL -- secondary guarantee UL is behaving worse than normal UL anyway for the industry as a whole. The last question I had is just on establishment costs. What are your views on how -- like what the total amount is going to be from here on out? And when do you think that you will be done with the majority of those expenses?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

It's Anant again. So it will be done in 2020. We view the expenses from here on to be basically around in the low 100s for the rest of this year. And this is in line with what we provided last quarter in terms of totals. Again, low 100s next year, and then just under $50 million in 2020. So cumulative from here on, we're talking around $250 million across those numbers that I said, $250 million, $275 million. So...

Operator

And our next question comes from the line of Ryan Krueger with KBW.

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

So in the past you've talked about from a hedging standpoint point putting $1 billion of assets -- of the cushion at risk and then moving that to $3 billion over time, I believe by 2020. Does that change at all now that there's this new VA capital framework and you're thinking more about managing to an RBC level, should we think about that specific strategy changing at all?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Ryan, thanks for the question, it's Anant. That does not change. The hedging strategy stays as it is as you very eloquently said, we were at $1 billion assets at risk or deductible that we colloquially call it. And that's why you've got the range of $2 billion to $3 billion above 95 because the deductible will grow from $1 billion to $2 billion. So almost think of holding a little more than the deductible for the strategy to work. When we talk about excess capital though, we can make that conversation all about RBC post reform being adopted. Because the CTE framework will make, as Eric said, RBC robust.

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

And then in terms of the shift, is that going to be something that will occur gradually over the next -- over time? Or will it be more of a, you get to a certain point in time that you think it's right time to do it, and you'll completely move from $1 billion to $2 billion or $3 billion?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes. Well, as we laid out in our projections, we expect to go up like $0.5 billion a year with the passing of each year.

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

Okay. And then just one last one on debt issuance that you mentioned. Should we think about the debt capacity that you have as something that would be potentially available to you for future share repurchases going forward after you get done with this program?

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

It's Eric. I wouldn't think of it that way. I think about it as we've said from the very beginning. We targeted a 25% leverage ratio, and there's all kinds of things you can use it for. And if we see opportunities, we want to take advantage of that financial flexibility, and by the way, term out our capital structure.

Operator

And our next question comes from the line of Erik Bass with Autonomous Research.

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

I guess, has anything changed in terms of your expectation of not taking a dividend from BLIC in 2019? And if you can early adopt the VA capital reform, does this change anything for 2019 or is that more of a 2020 impact?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Eric, Anant here. So let me answer your second question first. We will work with the regulators to see if we can early adopt. It's beneficial for us, and we would like to look at it, but we have to see how everything comes together, hopefully this is passed [shortly]today. Secondly, on taking BLIC dividends, we're not contemplating BLIC dividends till we early adopt and have the RBC framework drive the requirements. So hopefully that answers your question.

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

So my guess is it right to think of your near term interest expense and any other cash needs are still going to be largely funded by dividends from NELICO?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes.

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

Okay. And then I understand, you plan to keep your hedge program set at CTE95, this is the floor rather than changing that to CTE98. If you can just talk about what the impact would be if at any point in the future, kind of, you dipped below a CTE98 level at any point?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

So CTE98 in the new framework will basically translate to a 400% RBC company. As we've shared, we're already above CTE98, and we'll probably operate above CTE98 in normal markets, which means we're going to be above 400% RBC. When we protect 95 that means from being above 400% RBC, whatever numbers you -- we end up being at, meaningfully above it, will basically come back to that range of 400%. That's the way you should think about our program, more details to come once the framework is finalized.

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

Got it. So there wouldn't be any sort of triggered problem for dipping below. You just need to sort of rebuild back to your RBC target if that were to happen?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

That's correct. There would be no trigger. We would be very robustly capitalized even when we were at 95, because it would see us being at 400% or higher.

Operator

And our next question comes from the line of Randy Binner with B. Riley FBR.

Randolph Binner - *B. Riley FBR, Inc., Research Division - Analyst*

I wanted to go back to expenses and the timing. I think Jimmy asked the question. But Anant, when you answered low 100s this year and next, I think were you referring to the Corporate segment? I just want to clarify that, and if that is the case, also get a feeling of the timing kind of in the other segments, because we saw higher expenses in the Annuities segment as well. So I'm just trying to get a kind of a fuller picture of the pace of those expense improvements that help to guide in the back half of '18.

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Randy, sure. So when we talk about expenses, let's break it out in 2 categories. Establishment costs, those are the notable item, and when I was answering the prior question, I was answering what are your establishment costs from here on, right? So around $275 million between here and 2020 with the break out that I gave. When it comes to actually expenses that go through each of the segments, it's our operating expenses -- our corporate expenses, as we talk about it, and those were higher. As Eric and I mentioned, we had a high watermark of $288 million a quarter. Those expense, which are our corporate expenses, our range was to be $1 billion to $1.1 billion. We came in right in the middle of that range in our first year and that is what we will reduce by $150 million by 2020 run rate.

Randolph Binner - *B. Riley FBR, Inc., Research Division - Analyst*

All right. And then the other -- I had another question about one of the run rate items you mentioned near the end of your commentary. It was a $15 million or $50 million run rate, and I think you were referring to the Run-off segment. Could you -- we just couldn't hear that on our end.

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

No worries. Happy to clarify. Yes, it was a Run-off and 1-5, $15 million area.

Operator

And our next question comes from the line of Andrew Kligerman with Credit Suisse.

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

First question around the CTE98, greater than $0.5 billion buffer so to speak. When they do implement the final format, tax reform, what might you estimate would be the impact of tax reform on that buffer?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Andrew, it's Anant. We have given it together. Tax reform, meaning going to 21% tax rate plus VA reform. We've answered all these questions with them being together, so we're not pushing that off into the future.

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

Okay. Do you have a sense of what the capital reform and tax reform together might impact the $500-plus million?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

We would expect to still be at 98.

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

I see. So it could reduce then some of that $500 million or excess of $500 million?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

That is correct. And we would organically grow it back.

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

Got it. And then with respect to drilling a little deeper into the expenses, in the corporate operating expenses, I estimated that if you take out the notables or the establishment costs, corporate operating expenses went from about $17 million to $40 million pretax, so you still got like $23 million pickup. And I was kind of curious, what the -- what that consisted of?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Happy to answer it. So that pickup was basically higher corporate advertising and some many onetime items that we had going through. For example, we had annual meeting, so shareholders service cost, we have a fair number of shareholders and some liquidity facilities that we're putting in place to, again, strengthen our backup resources. All those one-timers are what drove it. Maybe I can help everyone by providing a little view on how to think about corporate expenses on a run rate basis. There are 2 line items that you would look at, interest costs, which are pretty steady now in the last couple of quarters plus these other operating expenses, which should constitute basically around $50 million a year or just sub of $50 million a year driven by shareholder services, advertising, things like that.

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

Got it. And then with -- one last one, just with regard to your sales. I noticed that Lincoln National came out with a buffered product in mid-May. Maybe you could talk a little bit about the competitive landscape in products that are similar to the Shield?

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

Yes. Thank you for the question. It's Myles Lambert speaking. We welcome new entrants into the structured annuities space. We think it further validates the product category and it's a good thing for our consumers and our advisors. We really like the competitiveness of our product and as always we'll continue to monitor the competitive landscape and make changes to our product if appropriate, but hopefully, new entrants into the space just grows the overall category.

Operator

And our next question comes from the line of Suneet Kamath with Citi.

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

First question on the TSAs. It sounded like you're targeting some pretty significant reductions in the second half. Any quantification of what the cost savings would be associated with what you're planning?

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

Sorry about that. It's Eric. My mic wasn't on. Look, there -- it's meaningful, but they're not the biggest pieces, I would say, Suneet. We -- there's 2 ways to think about getting out of TSAs. One is, every time we can exit a TSA and do that activity at a lower cost, you're going to have an expense saved. So there are meaningful numbers there. I would say the biggest pieces though are in '19, and that's why we've talked historically about '19 really being the year where you're going to see a lot of downdraft in expenses. But we said previously that our second or third quarter would be our high watermark -- our second quarter is going to be our high watermark. So you are going to see some degradation of expenses in the third and fourth quarter. But '19 is really -- '19 and '20 are really the big years for us, I hope that helps?

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

Yes it does. And then on the buyback and the capital, since you are funding -- sounds like you're funding the buyback with excess holding company cash, and does not seem to be an expectation for dividends out of the VA business. Are we still looking at 2020 in terms of when you'd be comfortable taking dividends out at that kind of level that you provide in the past?

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

Let me start and Anant would probably jump in here. Look, here's what I would say. We're pretty thrilled to have gotten this buyback authorization from the board. And you're right, Suneet, we'll do it out of the holding company cash that exists right now. The next piece of course is, well, you know, over time here, at least shorter term, can you do more? And I'm never going to get ahead of our board, but, obviously, the answer is maybe. The real key and I think this is what you're getting towards is, we want to end up being a consistent returner of capital to shareholders. So that's the goal. I must admit sort of personally, the original goal was the first buyback, well, now we've announced that. As you think about the future, obviously, the next piece is, how do we come -- how do we become a consistent repurchaser of stock? And obviously, we hope to do that in the coming couple of years, Anant, you want to add anything technically with respect to 2020?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes. So with respect to 2020, I would approach it with like 3 items. I will think of 3 drivers to build on what Eric said. One is the adoption of VA capital reform and us early adopting that in 2019 is a great enabler, because it really helps our unassigned funds and dividend capacity. So that's 1, of getting money out of BLIC to answer your specific question. The second is continuing to see markets perform well and that's translating into separate account returns for us. That translation needs to happen. And then finally, what I would really say about this is that we want to make sure that as we implement these items, we -- you continue to see the block perform well and the growth of the new business. So we're going to see those 3 elements come through.

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

Got it. And then Anant just one last one for you, if I could. The $2.7 billion buffer, it was sort of flat versus the first quarter despite some pretty decent markets and higher rates. Any sense -- can you give us a sense of kind of the moving pieces? I know you've done this on prior calls in terms of how markets impacted you versus volatility, just as we tracked this going forward?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Sure. So volatility came down a little bit in the quarter, and markets were up, both those were -- have a mark-to-market impact and then you have the passage of time along with interest rates. Those are the items I would look at that drove the derivative mark-to-market. Another important consideration, as you think of that derivative mark-to-market and my prior comment answers, we are going to be building up our deductible from $1 billion to $2 billion over time. And that's something we keep in mind, because that also drives A, is the mark-to-market will go down when that happens, but B, that also drives cash flow out of the life block -- come out of life company annuity block.

Operator

And our next question comes from the line of John Barnidge with Sandler O'Neill.

John Bakewell Barnidge - *Sandler O'Neill + Partners, L.P., Research Division - Director of Equity Research*

With your updated guidance, apologies if you already said it, but can you give us your latest thoughts around the tax rate for the year or the balance of the year rather?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Our expectations stays the same as earlier, mid-to high teens. Knowing that we sort of true up in the third quarter, so that's the quarter where we do a tax rate true up -- to provision.

John Bakewell Barnidge - *Sandler O'Neill + Partners, L.P., Research Division - Director of Equity Research*

Okay. And then my other question, Run-off, obviously, has lower margins than annuity and also Life. I know there's market conditions, but is there's anything structurally preventing you from pursuing a divestiture for some or all that segment?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

I'll start and maybe anyone else would chime in here. Structurally, we have to think of Run-off as having a large ULSG block as we've talked about, and that would require us working with Delaware, our regulator too. It's a complex reinsurance transaction, it's not as easy as just divesting it.

Operator

And our next question comes from the line of Alex Scott with Goldman Sachs.

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

I guess the first question is just a follow up on the comments on the uses of capital from a potential debt issuance. I know you are not ready to talk about what would you potential to do with it, but should the expectation be that, that'll be sort of sitting at the holding company until you decide or is there any need to put it into an operating company?

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

It's Eric. I'll start, Anant you can jump in. I would say, general flexibility. We'll have to see. I mean, look, it's very nice to be sitting here talking about the 27 Oliver Wyman proposals here and now having agreement from the regulators, and us understanding it to a pretty great degree. But we'll have to see. I consider our excess leverage capacity to be exactly what we've said since the beginning. Financial flexibility. So that's how we would answer it, Anant anything to add?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

I think you covered it, Eric.

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

And then follow-up question was just on the adjusted statuary earnings you gave. I guess, that was $175 million, I think you mentioned that was for the first half of the year. So a little less than 40% of GAAP earnings. And I was just wondering if you could help us think about what are some of the differences that make that significantly lower? And what do you -- like is that a metric we should we looking closer at. Is that a better sort of indicator of the earnings power?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

The short answer is, yes. That is a better indicator of us being able to grow the assets above CTE95 and talk about capital return out of the life company. Now technically to answer your question, how does that differ from stat earnings? In essence, we manage the VA block, as you know, to funding CTE95 and that level of assets above that. This is taking out -- so start with adjusted statutory pretax income almost line 33 of the stat blanks and take out the existing reserve AG 43 reserve change, which will be sunset with the passage of VA reform and include CTE95 as the required reserve and capital, plus bring in unrealized gains and losses from the hedges, which are not in stat pretax income, but they go through TAC, because at the end of the day you have to grow you total adjusted capital to be able to return any.

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

Okay. And maybe 1 quick follow up on the sunsetting of the standard scenario. If you were to remove this standard scenario today, how much would the -- like I know, not necessarily implications for total asset requirement, but how much would the reserve requirement go down and how much would that benefit your stat surplus if it was removed today?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

That is a great question. It would be meaningful and it's the driver behind my comment about dividend capacity goes up meaningfully.

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

So should I take that, I mean, like over $1 billion?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

You should take that to mean, it's very meaningful.

Operator

And our final question comes from the line of Tom Gallagher with Evercore.

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

Yes. Just first a follow-up on Alex's question on the sunsetting of the current framework. The -- Anant, is the way to think about that, that could sort of pull forward the -- some of the cash flow guidance you've given that initially, or at this stage, looks like it was a couple of years out? And that might pull forward some of that into 2019, if it all worked out on the sunsetting or any clarity on sort of mechanics, and what the output of that would look like would be helpful?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Tom, yes. It helps. Let me explain where it helps the most. To my earlier answer, it really helps with dividend capacity. So it removes any clouds, and one may have thought we had because of standard scenario and it allows the flow of capital out of the life company to happen in an unencumbered manner through ordinary dividends. That's what it really allows. The core underlying cash flows and the hedging targets and dynamics, all that, none of that really changes.

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

So it's more the -- would you say the volatility of outcomes related to capital would improve?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Yes, pretty much.

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

Okay. And then Eric, just a higher level question for you. Anything under consideration right now, whether it's -- with regard to risk transfer, whether it's VA, life insurance, spread products? I can appreciate when your stock was in the 50s or 60s how that may not have made sense, but given where how the markets valuing your stock now, does that really change anything for you?

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

I don't think it changes with respect to where the stock price is. Our goal is to create shareholder value in the ways we can do it. The market values, the stock I understand that. I've said previously that everything is on the table. Now I've also said, look, there is resource constraints to some degree. We can only do so much in any given year, Tom. But here's what I would say. Nothing is off the table, nothing. We will consider anything if we think it's executable and will add shareholder value. So it -- the stock at any price, we will still consider anything if we think it's executable and will add shareholder value, and we have the resources to do it. I guess that's inherent in the notion of executable. Hopefully, that answered, and I'm happy to do a follow on if you want?

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

No, that does. And then just to be clear, based on what you know today about your initial evaluation of the new rules, you have more than enough capital in the OpCo to deal with the reform? Or is there still some risk that you're going to be doing a debt deal downstreaming capital into the OpCo to deal with initial VA reform requirements?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Tom, I'll answer the way Eric added answer, and I'll add a little more, which is issuing a debt deal when the market opportunity is there to add to your financial flexibility and term out your capital structure makes sense to us. Now in respect to your point of downstream into the OpCo. There are 2 dynamics at play here. One is, we are looking to be very shareholder friendly by growing our deductible from $1 billion to a higher number. Being able to do that by downstreaming capital or whatever is useful or organically grow in capital that is core to our strategy as well as reducing hedge cost. VA reform, we've talked a lot about the upfront impacts it also changes sensitivities, which we'll update at year-end. So we want to make sure that we can continue to deliver hedge cost reductions. Capital can be helpful for both those things.

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

Yes. Tom, I would just add, look, you heard Anant say, maybe we'll run it more than 98. So we're -- in the end, we're starting to talk about $100 million, $200 million, $300 million here, we're not talking about $1 billion. Does that make sense? Do you get what I'm saying?

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

Yes, I do. And then just final question for you guys. Heading into 3Q, balance sheet review season, anything that you would flag as kind of watch areas?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

No, we do have an annual actuarial review in the third quarter. Nothing we would flag for you at this point in time.

Operator

And we do have a follow-up question from the line of Erik Bass with Autonomous Research.

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

Tom, actually, just asked the question I was going to, but I guess as we think about your third quarter annual assumption review, would we expect you to align your GAAP assumption's with the NAIC scenarios? Or would you continue to set your own best estimate macro assumptions?

Anant Bhalla - *Brighthouse Financial, Inc. - Executive VP & CFO*

Eric, it's early to answer that. GAAP is based on best estimate. We got to work through the third quarter process. I'd maybe like to make one point, which may help. We do not expect our third quarter actuarial process to impact our capital return that was just announced.

Operator

And that does conclude today's Q&A session. And I'd like to return the call to Mr. David Rosenbaum for any closing remarks.

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

Thank you, Sandra. And thanks everybody for joining us today for our second quarter earnings conference call and for your interest in Brighthouse Financial, and we'll speak again next quarter. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.