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BHF.OQ - Q4 2018 Brighthouse Financial Inc Earnings Call

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OVERVIEW:

Co. reported 4Q18 adjusted earnings (excluding impact from notable items) of $199m and full-year 2018 adjusted EPS (less notable items) of $8.33.

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PRESENTATION

Operator

(technical difficulty)

(Operator Instructions) As a reminder, the conference is being recorded for replay purposes. (Operator Instructions) I would now like to turn the presentation over to David Rosenbaum, Head of Investor Relations. Mr. Rosenbaum, you may proceed.

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

Thank you, James. Good morning, and thank you for joining Brighthouse Financial's Fourth 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 brighthousefinancial.com. We encourage you to review all of these materials, and 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 discussions are Conor Murphy, Chief Operating Officer; John Rosenthal, Chief Investment Officer; and Myles Lambert, Chief Distribution and Marketing Officer.

Our discussion during this call will include forward-looking statements within the meaning of the federal securities laws. Brighthouse Financial's actual results may differ materially from the results anticipated in the forward-looking statements as a result of risks and uncertainties, 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, February 12, 2019. 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 on a historical basis to the most directly comparable GAAP measures and related definitions may be found on the Investor Relations portion of our website, in our earnings release, slide presentation or financial supplement. And finally, references to statuary results are preliminary due to the timing of the filing of the statutory statements.

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

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

Thank you, David, and good morning, everyone. 2018, our first full year as an independent company, was a strong year for Brighthouse, and we made significant progress executing our strategy. As we reflect on the year, we continue to believe that we have a solid strategy in place, and that it will generate long-term shareholder value. 2018 provided many examples of our progress, which are summarized on Slide 3 of our earnings presentation.

First, I'm very pleased with our outstanding sales results in 2018, which we capped off with approximately $1.7 billion of annuity sales in the fourth quarter, our highest quarterly sales since becoming an independent public company in 2017. Full year 2018 annuity sales of $5.9 billion are significantly ahead of our expectations at the time of separation and are a testament to the strength of our distribution relationships and the success of our branding initiatives annuity sales were up 36% in 2018 compared to full year 2017, led by shield and fixed indexed annuities. I'm especially pleased with the success of Index Horizon's, a fixed indexed annuity product that is sold through MassMutual, which had sales of over $1 billion in 2018. And this week, we are launching our new hybrid life insurance product, Brighthouse SmartCare. This launch marks our first life insurance product introduction since becoming an independent company and is part of our strategy to reestablish a competitive presence in the life insurance market. This product builds on our foundation of experience and knowledge in the life insurance space as we enter the expanding hybrid market. Brighthouse SmartCare is currently approved for sale in 47 jurisdictions and initially will be available through select distribution partners.

We are continuing to see excitement from our longstanding distribution partners and remain focused on making our distribution network as broad as possible, as we help consumers in the United States achieve financial security. In 2018, we added shield annuities to the platform of 2 major distributors, and we entered the independent marketing organization, or IMO, channel. And in January 2019, we announced that Brighthouse will be among the first companies to offer annuities through the Envestnet Insurance Exchange, a program that integrates insurance solutions into the wealth management process on the Envestnet platform. We believe we are entering 2019 with a lot of sales momentum and remain focused on growing sales moving forward. Over time, we expect to see a shift in our business mix profile as we add more cash flow generating and less capital intensive new business coupled with the runoff of less profitable business. To that end, during the quarter, our total annuity outflows increased in this quarter primarily driven by the outflow of a 10-year-old block of fixed annuity business that reached the end of its surrender period. Our variable annuity net flows were consistent with the third quarter of 2018.

The second example of the effectiveness of the execution of our strategy is the exit of transition service agreements, or TSAs, with MetLife. We began 2018 with 147 TSAs and ended the year with 81 TSAs remaining in line with our targets. We expect additional TSA exits will facilitate further expense reduction. We are also continuing to make necessary investments in our technology infrastructure and in our businesses. We refer to these investments as establishment costs. In the fourth quarter, establishment costs were approximately $49 million pretax, bringing the 2018 total to approximately $239 million pretax and in line with our expectations. We expect additional establishment costs of approximately $175 million to $200 million pretax cumulatively over the next 2 years. Annual establishment costs in 2019 are expected to be lower than the 2018 level and decline even further in 2020, helping to drive improvement in net income.

Third, let me touch on our earnings results. Focusing on the fourth quarter, adjusted earnings were unfavorably impacted by the challenging market conditions in the quarter. Full year adjusted earnings per share less notable items were $8.33, modestly below our guidance range, primarily due to the results in the fourth quarter. Adjusted return on equity less notable items was almost 8%, in line with our guidance.

Next, we continued to prudently manage our variable annuity capitalization. As we talked about previously, we are managing our VA business to CTE98 or higher. As of the end of the fourth quarter, our VA assets remained in excess of CTE98, consistent with that plan. Our hedging strategy continues to perform in line with our expectations.

And finally, the $200 million stock repurchase authorization that we announced in the third quarter reflects our commitment to returning capital to shareholders and the confidence we have in our strategy going forward. This capital return commenced approximately 2 years ahead of the time line we communicated at the time of separation. During 2018, we repurchased approximately $105 million of our stock, and we've continued repurchases in the first quarter of 2019 with approximately $19 million of our stock repurchased in January.

Before I turn the call over to Anant to discuss the fourth quarter results, let me touch on our longer-term financial targets. On our December 2018 Investor Outlook call, we provided additional insight into key drivers of near-term performance and demonstrated how our financial targets have improved significantly since the separation.

Our outlook reflected meaningful earnings growth, ROE improvement and robust capital return to shareholders. Despite the challenging market conditions experienced in the fourth quarter, we remain confident in our ability to achieve our longer-term financial and operational targets.

To wrap up, we made significant progress executing our strategy in 2018. Our annuity sales were very strong and our operational performance was very good, highlighted by the exit of 66 TSAs. I am especially pleased with our hedging program, which performed in line with expectations in 2018 in both favorable and unfavorable markets. As we move into 2019, we remain focused on executing our strategy and continue to believe that it will enable us to achieve our longer-term financial targets.

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

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

Thank you, Eric, and good morning, everyone. I will start with our fourth quarter results beginning on Slide 4, and then provide some perspective on the key underlying themes and our balance sheet position.

Adjusted earnings, excluding the impact from notable items, were $199 million in the quarter compared to adjusted earnings on the same basis of $314 million in the third quarter of 2018 and $197 million in the fourth quarter of 2017. These results were in line with our expectations, given the fourth quarter market performance.

I want to point out 2 notable items in the quarter. These items resulted in a $13 million after-tax decrease in adjusted earnings or $0.11 per diluted share. The notable items included a $26 million after-tax net favorable impact related to modeling improvements, which resulted from an actuarial system conversion, and establishment costs of $39 million after tax.

Now I'd like to provide some perspective on the market impact to adjusted earnings this quarter. Separate account returns were negative 9.2% in the quarter. This was favorable compared to various equity market index price decline of 13% to 20%, as about 1/3 of our separate account assets are invested in funds that are more fixed income oriented. Nevertheless, separate account performance was below our base case assumptions by approximately 11 percentage points. Overall, the market decline in the fourth quarter resulted in an unfavorable impact to adjusted earnings of approximately $95 million after tax or approximately $0.81 per share as shown on Slide 5.

The quarterly market impact is not linear or symmetrical, primarily driven by DAC amortization and SOP reserves, and can range from $0.07 to $0.11 per share for each percentage point change in separate account returns. Approximately 3/4 of the impact is from these 2 items, while the rest is from a change in fees on average separate account balances. Variable annuity separate account balances, which drives fee income, ended the year at $92 billion, down from $104 billion in the third quarter. Given the strong market recovery we experienced in January with separate account returns up approximately 6%, we currently anticipate no change to our annual adjusted EPS target of low-double-digit percentage growth. We expect the drivers of adjusted EPS growth in 2019 to be investment income and capital return.

Next, our alternative investment income in the quarter was slightly above our 2017 quarterly average. As is typical, alternative investment income is generally reported on a one quarter lag. Given the market declines in the fourth quarter, we expect alternative investment income to be lower in the first quarter of 2019, but it's too early to provide an estimate.

Staying with investments, through the fourth quarter, we have repositioned approximately $5.8 billion of treasuries into higher-yielding assets, putting us approximately 80% of the way towards completion of the repositioning program.

Turning to expenses. Corporate expenses in the fourth quarter were $233 million, down approximately $9 million pretax sequentially, consistent with our expectations. We anticipate 2019 corporate expenses to be in line with or slightly below the 2018 full year level as we continue to transition to the Brighthouse operating platform. We are still projecting $150 million of corporate expense reduction on a run rate basis by year-end 2020.

Now turning to adjusted earnings at the segment level, which exclude the previously mentioned notable items. Adjusted earnings in the Annuities segment were $163 million in the quarter. Sequentially, results were impacted by the fourth quarter decline in equity markets, resulting in higher DAC amortization and reserves, lower fees, partially offset by lower expenses. Adjusted earnings in the Life segment were $64 million in the quarter. Sequentially, results were favorable, impacted by lower claims, driven by lower severity in the fourth quarter. This was partially offset by higher DAC amortization.

Adjusted earnings in the Run-off segment were $4 million in the quarter. Sequentially, results were unfavorable, impacted by higher reinsurance costs and lower recoveries. We still expect the run rate of adjusted earnings in this segment to be approximately $15 million per quarter with possible variation quarter-to-quarter.

Corporate & Other had an adjusted loss of $32 million. Sequentially, other expenses, including debt interest expense, were higher.

Let me now provide an update on our fourth quarter performance in terms of hedging and statutory results as well as our balance sheet positioning.

First, this quarter provides a great example of how our hedging program is well designed to work in times of market volatility and stress. Our variable annuity block continues to have assets in excess of CTE98. Balance sheet results, both on a GAAP and CTE98 basis, were in line with the sensitivity shared on our December outlook call.

Second, statutory total adjusted capital was estimated to be $7.4 billion, up $1.4 billion from the prior quarter, driven by gains attributable to the performance of our variable annuity exposure management program in the fourth quarter. Our 2018 combined risk-based capital ratio is estimated to be in the 475% area. Given the performance in the quarter, we have achieved a level of statutory results that enable our insurance subsidiaries to have meaningful ordinary dividend capacity even before implementing NAIC Variable Annuity Capital Reform. This is an important milestone for Brighthouse, and we will be prudent on both the timing and amount of any dividends we take out of our insurance subsidiaries over time.

Third, full year 2018 adjusted statutory earnings were approximately $320 million, slightly above our expectations.

Next, holding company liquid assets were approximately $750 million at year-end. On February 1, we refinanced our $600 million term loan facility, which was scheduled to mature in December 2019 with a new $1 billion term loan facility that matures in February of 2024. This results in liquid assets of the holding company that are currently in excess of $1.1 billion. Additionally, we have no debt maturities until 2024.

To close, given the strength of our balance sheet, our effective hedging strategy and our excess liquid assets at the holding company, we believe Brighthouse is well positioned to successfully navigate through market volatility and across market cycles. We remain focused on executing our strategy and committed to prudently returning capital to shareholders on a consistent basis.

With that, we'd like to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Josh Shanker with Deutsche Bank.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

I was curious, the market was down 9% in December. The 10-year treasury yield fell a little more than 30 bps and, obviously, you came close, I assume, to breaching the CTE98 level, maybe you can put some numbers behind that? Is that the kind of stress scenario that you're designed, I mean, to be able to succeed at? I mean, clearly, look, we were all stressful at work during those days, but a 10% market correction is not an apocalypse. We were more concerned about 20% or even more than that. Should we be comfortable with the performance of the buffer over that period of time?

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

You're right. In the fourth quarter, CTE98 did move around. Assets above CTE98 did move around as designed. So let me provide a little color on that. CTE98 requirements increased by close to $4 billion in the quarter with the market move, but they were offset by hedging gains and VA and shield statutory cash flows, resulting in assets above CTE98 absorbing, and that's the key word, absorbing, the market impact of just under $600 million. This demonstrates the effectiveness of our out-of-the-money hedging program as assets above CTE98 is the level we were at the end of the quarter even before putting in $200 million of capital into the company to continue to grow our out-of-the-money hedging program. So we ended at approximately $300 million over CTE98. The last point I would make on that is, capital is a shock absorber and we have flexibility in the way we designed this to go below 98 and build back up to 98 because remember the flow is at 95, so there is a huge amount of margin of safety for us to operate over time.

Joshua David Shanker - *Deutsche Bank AG, Research Division - Research Analyst*

And just for identification. If the market had fallen another 5% to 10% in December, but there was also the increase in volatility associated with that fall, not that we can say exact numbers, but hypothetically would those 2 factors be equally offsetting and it wouldn't have a dramatic difference in the ultimate CTE98 level at year-end?

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

The short answer is yes. Maybe I'll add to that little short answer, which is, vol going up is good for us. The bedrock of our program is a large number of long-dated options. So vol going up would help us. And I'll dimensionalize, because I'm sure this question will come up, the total market impacts were around $2 billion, you can see it in our NDGL line when you look at derivative gains. Of that, vol is a meaningful contributor, but most of it is level of market. And lastly, it doesn't matter if it says 10%, 20%, 30%, 40%, throw the shock at it, the program would sustain it as we showed in our sensitivities back in December.

Operator

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

Elyse Beth Greenspan - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

Just as a follow up question, I guess, 2 parts. You gave the RBC ratio in your prepared remarks. Could you comment about the target for that ratio, I guess, over time? And then can you give us an update where the CTE98 is at quarter-to-date?

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

Elyse, it's Eric. I'll start and Anant will jump in. As we said last year, as we get here to implementing VA capital reform in the statutory financials, we will come up with our RBC target. And then, of course, you're going to want to understand excess capital and that is all going to happen this year. We are not quite ready to do that yet, but it's on the way. Anant?

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

And in terms of -- Elyse, feel free to reframe the question if I didn't get your question, the second question, which is as markets would come back in January, would we expect the assets above CTE98 to go up.

Elyse Beth Greenspan - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

Yes. I just wasn't sure if you wanted to give us frame of reference where that could potentially sit today since markets have come back a bit in January?

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

So January came back 6% on separate account returns, as I said in my prepared comments. Fourth quarter was down 9.2%. While we're not going to run a clock on this to give it exactly, point to point, you can see, if it came down around $600 million, for that kind of decline, it's going to go back up in the same ballpark area for a 6% rise.

Elyse Beth Greenspan - *Wells Fargo Securities, LLC, Research Division - VP and Senior Analyst*

Okay. And one other quick question. The tax rate was about 13% for the full year '18. I know you guys have said kind of the target is high-teens tax rate. So when you say that you're going to target low-double digit EPS growth, does that assume that your tax rate will go from 13% to something in the high-teens over this coming year?

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

It's Anant, again. Yes, so we expect the tax rate to be in the teens, as earnings grow -- go to the mid-teens; while earnings are at the current levels, probably in the low teens. So that's the area we would be. We just had a benefit this time around, which is more one time in nature, and hence the tax rate being low where it was this quarter. Effectively, for the year, it was 13%.

Operator

Our next question comes from Andrew Kligerman with Crédit Suisse.

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

Maybe you could help me triangulate a little bit better on the CTE98 number. You reported -- let me start with adjusted statutory earnings. You reported $320 million for the full year. Last quarter on the call, you mentioned that you had earned in the third quarter alone $700 million of statutory adjusted earnings, and I assume there were some good earnings in the first and second quarters as well. So it would strike -- let me give another data point. Last quarter when the market was up 7%, it helped capital in excess of CTE98 by $400 million. So -- and that was with the management discussions. Now this quarter, the market is down 14% and you are saying your capital in excess of CTE98 is $300-plus million. Last quarter, you said it was $600-plus million. So that would only be $300 million drop off. Is it not linear? I think, I heard you allude to that. Help out with trying to triangulate why it was so different last quarter and why doesn't it seem to square with adjusted statutory earnings?

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

Happy to do so. It's Anant. Yes, I'm going to walk you through -- you laid out a very good construct for us to have a dialogue on this. So as you just said, last quarter statutory adjusted earnings were around $700 million. In the first half of the year, I had shared earlier in the year, in the second quarter earnings call, we had made $175 million. So $175 million in the first half of the year, another $700 million on statutory adjusted basis in the third quarter, with separate account returns being up 3% while equities were up 7% as you mentioned. That would have given us ending the third quarter, statutory adjusted earnings north of around $900 million. In this quarter, the swing in assets above CTE98 was $600 million, as I answered to Josh. So therefore, the net statutory adjusted earnings for the full year go from north of $900 million through the third quarter down $600 million to $320 million approximately. The reason we have -- so we would have ended the year, just based on results of the hedging program working and adjusted earnings in the year, of north of CTE98 with them having come down -- assets above CTE98 having come down $600 million in the fourth quarter. We ended at $300 million because we redirected $200 million of capital from NELICO into BLIC to support the VA business to continue our journey of going up in our deductible from $1.2 billion to closer to $1.5 billion sometime later in 2019. So as results stand, my answer would get you to CTE98-plus. As we add the additional capital to grow the hedging deductible, we would get to 98-plus $300 million.

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

I see. The NELICO would kind of get me closer. I'm missing by $100 million or so, but that was very helpful, Anant. And the second question, how much capital at risk do you have right now, and how did the markets affect that in the quarter?

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

Sure. I'll answer...

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

You know you have the deductible rather of the $1.2 billion, I think, it is. Is that right?

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

That is right. It ranges between $1 billion to $1.2 billion at this point in time. And I intend this to -- evaluate it from time to time and ramp up when it's opportunistic to do so. To answer your first question on the rounding part, it's because that we have $600 million plus and that's the reason why we will get within $100 million.

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

Andrew, it's Eric. I'll just jump in for a second, too. Anant, great job, and, Andrew, that's a great question. It's going to be hard for anybody to get closer than $100 million or $200 million. I mean, you'd have to anticipate how the vol worked in a downmarket and then how it works in an upmarket, et cetera, et cetera. I think the point that we're able to make now is the hedging program works in a lousy fourth quarter market. If you think about the answer to Andrew's question and Josh's question, hopefully, we're starting to build some credibility around this hedging program. While you're never going to be able to get it down to the penny, I mean, within $100 million or $200 million, I think can give people some real comfort. I know where this is going. If you think about Elyse's question, yes, the market is up, and I think all of you probably have a reasonable expectation of what would have happened if you sort of had a January close. So any follow-up, Andrew?

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

Yes. Just want to get a sense of where the $1.2 billion of deductible is right at year-end?

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

Yes. So in the quarter, we would have used approximately $600 million of that $1.2-ish billion. And it's dynamic, it ramps up and down as we look at it. But two data points I'd share with you. So we probably have around $400 million, $500 million of additional downside to absorb if markets continue to fall whatever level they fall to, but that's just a shock absorber. It'll come back as we build our capital through earnings, that's one. The second is, we don't have to really trade our program as actively as some others have to do. Frankly, the natural way our deductible would increase if we didn't take any hedges off was with the next large maturities, which is not till June. So very stable bedrock of hedges to protect the program. But to answer your question, we've used half the deductible and it's more of a shock absorber since the hedges are long-term in nature. As January would have shown, the shock absorber has given back.

Operator

Our next question comes from Tom Gallagher with Evercore.

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

Just a few follow ups there. The -- Anant, I think, did you also take a dividend out of NELICO to the holding company during the quarter? Was that the major driver of cash flow to the increased cash at the holding company? And if so, based on your comment you just made, you also redirected capital from NELICO to the VA company. So seems like a considerable amount of money coming out of NELICO. Was that just because there is significant excess capital there? Have you drawn it all down? Anyway, this is my first question.

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

Tom, yes, so with us having put NAIC reform behind us from a management point of view, it'll come through statuary reporting as we work through the year. It really allows us to think about excess capital, where it is, where we can take it out, where can we deploy it most judiciously for shareholders. We took $400 million out of NELICO, we put $200 million into BLIC because that's where the VA program is for all our entities. And then that helped holding company cash go up from around $600 million to $750 million in the quarter net of share repurchase.

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

Got you. And are there other -- as we think about enterprise-wide capital, so clearly the holdco cash is higher. I think you also have the SGUL captive. I mean, is that a potential source of capital or should we just think about that funding the required reserves and not necessarily a source of capital?

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

You've really seen us pivot from putting required behind us and talk about excess. So over time, you're going to see us looking at taking out excess capital where we generate it through earnings or where it might be. To answer your question where it might be and our views to come out over time, it's not going to come out overnight. Yes, so NELICO, we've taken some out. We still have around $200 million of capacity in there. We'll probably take some out over there over time and be more sustainable. BRCD, our life capital, specifically answering your question is capitalized in a very robust manner. We believe there is redundancy in BRCD in reserves, and we expect to work with the regulators, but that's more of a later part of 2019 or early part of 2020 dialogue as we can implement VA reform and start running the company on an RBC basis. And BLIC is very well capitalized and continuing to put capital in as we grow the deductible, and take capital out, as we generate statutory earnings, but these dynamics are over time.

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

Got you. And then final question, Eric. As we head to the 2-year anniversary of the spin, if all else is equal and the valuation doesn't change meaningfully, would you -- what are your thoughts on potentially doing something more strategic, like whether it's annuity buyouts, or a transfer, where is your head at for things like that?

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

Sure, Tom. It's in no different place than it has been since the beginning. We will always think about how do we create long-term shareholder value. I think we are demonstrating that we are doing shareholder-friendly things and we will continue to do that. I can tell you, our Board is extremely focused on shareholder value. But I get your point. Look, we are heading down a journey here down the road. We're executing on everything we said we were going to do. And -- but over time, our management goal is to add shareholder value, create shareholder value. So I'm open to anything long term. For the time being, we're going to keep sticking to our strategy and hitting or exceeding all of our marks, which is what we've done so far in the 2 years.

Operator

Our next question comes from Ryan Krueger with KBW.

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

On the 475% RBC, I guess, is that still under the old existing framework? And I guess, if so, when would you expect to fully shift to the new framework post NAIC VA reform?

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

Ryan, it is under the old RBC framework. Only to the tune of RBC is based on CTE90, the new framework will be 98. We did, though, move to using the new framework for all our CTE calculations. So when we talk to you about CTE95, 98, 90, even for RBC reporting, we are reflecting the new framework assumptions. All the proposals that we worked through, we're largely reflecting those, so when it's market returns or behavior assumptions or anything like that. For us, we put that behind us. The only change that will happen is CTE90 will become CTE98, so they're 2 moving parts. For statutory reporting, when this year we get to adopt it, reserves will come down, which will take up -- TAC will help unassigned funds, and I'll talk a little bit about that in a minute. So the numerator will benefit, the denominator will go up, but 475% area is a good place to be. And later in the year, we'll update you about our long-term views on running the business. You can see us being very robustly capitalized relative to single A targets because we have this out-of-the-money hedging program. Lastly, on unassigned funds, one very important milestone for us with the program working and the results being strong is that unassigned funds is no longer a constraint or a [governor on] us. We have positive unassigned funds to the tune of $1 billion, 80% of that being in BLIC now. So if we generate -- as we generate over time adjusted statutory earnings, those have the ability to come out as regular ordinary dividends, and all the dynamics I said to Tom about capital in the earlier questions still hold.

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

Great. And then similarly, I think in the past you talked about the non-VA businesses, the cash flow generated from them roughly equaling statutory strength from sales as well as, I think, holding company interest expense. Is that still roughly the case today?

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

Pretty much so.

Operator

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

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

Can you talk about the rational for upsizing the term loan outstanding, and your plan to use your proceeds? And also given the increase in your debt outstanding, how are you thinking about the level of the holding company liquidity you want to maintain going forward?

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

Eric, thanks for the question. Yes, so the term loan upsize was because largely it provides us a lot of financial flexibility at the holding company. We've refinanced our existing 2019 December maturity. So we have no debt maturities for the next 5 years. Sitting where we are in the economic cycle, that sounds like a good position to be in from the balance sheet holistically. So we can focus on executing our strategy and creating value for shareholders. In terms of what that puts us in leverage and how we think about holdco cash, leverage is in the low 20s, which is where we want it to be, as we prepare for GAAP accounting change in the coming years. And holding company, no change in our thinking. We want to hold 2x annual interest costs, that's in the $300 million to $400 million range, but this excess liquidity at the holding company is a good place to be, and I'll let Eric add in if he wants to add something to that.

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

I would just say, demand was fantastic for this, so we took advantage of it. Most of our planning was, we would just refinance it and term it out in another 5 years, but when you have that kind of demand it was very nice to take advantage of it. So nothing mysterious in there and the rest of Anant's answer stands.

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

Got it. And is it something that -- I mean, if you felt comfortable with dividend capacity and other things that it would give you some flexibility to potentially accelerate capital return or other things in the back half of the year?

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

Look, overall, the name of the game here, as we've said since the beginning, is flexibility. Capital is fungible. You've seen us put some down. We are very excited about the fact that now unassigned funds is not a constraint, as you heard Anant kind of walk through. And by the way, that's only going to get better, okay. The unassigned funds number is just going to get better in 2020. So yes, overall, it's flexibility. With respect to capital return, obviously, you see we're buying back stock. I don’t want to get ahead of my board and I never will. But as I said before in my answer to Tom's question, it is our notion, it is our desire to return capital to shareholders. And I am hoping that we will continue to do that. One thing that I will add, as I usually add each quarter is, look, the name of the game is to get to the point where you can return capital, then continue to have added flexibility, but finally, the ultimate position to be in is to be a consistent returner of capital, and that is where we're focused here. And you've heard a number of things today that I think are helpful for us, not the least of which is the conversation around unassigned funds. So that's what I'll add.

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

And I guess, Anant, on the outlook call, you talked about eventually getting -- excuse me, to a point where GAAP net income becomes a proxy for statutory earnings dividend capacity. As we look at 2018, really, you had adjusted statutory earnings, but I think the net income was a loss of $1 billion. Is switching this dynamic all of a function of reducing the hedge costs, or is there something else that we should be expecting too?

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

Yes. So hedge costs are the biggest driver of it. The way I'd probably dimensionalize it is adjusted statutory earnings has a liability measure, CTE95, and hedges that are moving in tandem with each other. Therefore, you've got a liability that's, in our view, a realistic view of the liability, the economic lability, and we're protecting that. GAAP is not there yet and statutory is going to get there with the VA NAIC reform. And therefore, once GAAP gets there with accounting change down the road, that's when it will be closer to adjusted statutory. But yes, reducing hedge costs along the way will really converge those two.

Operator

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*

The fee environment in the asset management industry is certainly a buyer's market. Have you thought about how much you may be able to save on the investment management agreement with Met when that comes up for renegotiation?

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

It's John. We actually filed an 8-K last Friday suggesting that we have renegotiated the IMA within Met and entered into a new IMA. Met's going to be an important asset manager for us going forward. We're also going to be -- as we've suggested in the past, we're moving to a multi-manager model. So we're going to be onboarding other managers during the first half of this year. The IMAs with them are not complete, so it's premature to name any names, but they're all world-class managers. And I would say, just in total, we are saving a material amount of money and that's all in our corporate cost savings projections that we have been discussing with you over the last 2 years.

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

Okay. So not like additional savings, per se?

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

No.

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

Okay. And then you talked a lot about, not a ton, but going more into the IMO space? Will you consider doing that inorganically if there was something compelling?

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

Sure. This is Myles speaking. Yes, we launched in the IMO space last year and we're partnering with a large national IMO, and they are distributing our shield product to certain broker dealers. We've begun having conversations with that organization on about a joint product opportunity, that we'll speak about more in the future.

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

What about M&A for that?

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

John, it's Eric. Look, right now, we're using excess capital to buy back stock. So over time, certainly something like that could be a consideration. The right situation at the right time, et cetera, et cetera, but right now, we are focused on capital return. Obviously, with the stock where it is, that has to be our number one focus.

Operator

Our next question comes from the line of Jimmy Bhullar with JP Morgan.

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

I had a couple of questions. First, can you just discuss what do you expect your dividend that you're able to take out from the subs to be net of any sort of contributions you might be planning to make to BLIC? And then secondly, on sales, on the indexed annuity side, I think your results are benefiting a lot from the Index Horizon's product with MassMutual. If you could just discuss whether there is room to ramp that up further, or do you feel that you are sort of getting your full level of production through those agents?

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

I will take the first one, Jimmy, on the BLIC dividends. Look, I think, BLIC having unassigned funds of north of $800 million is really constructive because while we might put capital in to continue to grow the deductible to $1.5 billion and then to $2 billion eventually, earnings, as they come out through adjusted statutory earnings, we can take those out as ordinary dividends whenever. So if you ask me what is our plan, our plan is right now to grow capital in BLIC through earnings or contributions to get to $2 billion deductible, but once we get there, we'll take adjusted earnings out.

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

It's Myles speaking. So as it relates to our FIA solution at MassMutual, we couldn't be more pleased with the results that we've experienced. In the quarter, we did $368 million of sales, that's up 81% quarter-over-quarter, and it marks the best quarter that we've had so far. We feel that the advisers there really like the product, it's simple, it's competitive, it provides them flexibility around protected accumulation and potentially providing income to their clients. So we're quite optimistic that we're going to continue to see sales growth with that product moving forward.

Operator

Our next question comes from the line of John Nadel with UBS.

John Matthew Nadel - *UBS Investment Bank, Research Division - Analyst*

Anant, I was hoping you could actually walk us through the moving parts below the line on a GAAP basis. How much of the hedge results, overall, would you characterize as sort of true mark-to-market gains versus the actual cost of the program? And sort of back to Eric's question, I know you've been targeting a reduction in those ongoing hedge costs and a convergence between net and operating income, so I was just hoping you could sort of parse that out for us.

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

Happy to do so, John. So I'll answer your question in 2 parts. First of all, you asked, what's the cost of the program relative to the total change? If you look at our VA hedges line, it changed by around $1.84 billion. The gain of the -- the market movements were north of $2 billion positive and then there is a cost of just the time value of options around $200 million a quarter, hence the net $1.8 billion. So that goes up, as we said, in the past and really feel good about the fact that the gains played out as we expected. Walking from really adjusted earnings to net income, which is I think where you're going with the question, adjusted earnings post tax of around just shy of $200 million, $185 million, going to net income of $1.4 billion, you have the gains on the derivatives. So you have the overall variable annuity net derivative gain and loss driven by the hedges. And the fact that the embedded derivative, while it moved, the rider liabilities moved, there was a benefit from shield that offset a lot of that line. So net-net, we have gains from shields, gains from hedges, north of $2.7 billion offsetting an embedded derivative movement of around $1.5 billion. The net of that is a $1.2 billion swing. And there is $200 million more to explain roughly, it's driven by the fact that [owned] credit that other FAS 150's adoptions was around net $200 million to $300 million good [guide] . Let me pause there. I threw a lot of numbers at you, so is that -- [in computer,] I can go back.

John Matthew Nadel - *UBS Investment Bank, Research Division - Analyst*

No, no, no. That's very helpful. And then if I switch over to statutory, Anant, and we think about the $1.4 billion increase in statutory capital 3Q to 4Q, how would you advise us to think about that? How much of that is market driven, i.e., we've got a nice bounce in the market to start this year and maybe some of that is a giveback. And how much of that would you categorize more as sort of a permanent increase in statutory capital?

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

Most of that is market driven, as you can see, with the movement. It's really adjusted statutory to earnings to what we can bank.

John Matthew Nadel - *UBS Investment Bank, Research Division - Analyst*

Got you. Okay. That's helpful. And then if I can seek one last one in. Just thinking about the Life segment earnings, it's been sort of all over the place. I know you'd characterize your expected run rate for the Run-off business at about $15 million quarterly give or take. Any change in your thoughts around the Life segment?

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

Sure. So Life results this quarter were very good. And I would look at the last 4 quarters and really 2018 as a good gauge of the earnings power of that business because we've come in pretty steady; second quarter, fourth quarter have had some ups and downs, but if you even average those out and look at all of the 4 quarters of last year, that's a good view on the Life business. Did you have a Run-off question as well or largely Life focused?

John Matthew Nadel - *UBS Investment Bank, Research Division - Analyst*

No, no. I'm all good.

Operator

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

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

A lot of the questions have been answered. But I just had a follow up on the RBC. I guess, the BLIC RBC has been higher, significantly higher, getting back to the VA elements of the existing framework. So I guess I was just interested to hear some of the dynamics that lead to the 475%, because it was a little bit lower of a number than I would have guessed before implementing the VA capital standards. So just interested to know to what extent did the SGUL captive dragged that down, or are there any other dynamics I should be thinking about?

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

Alex, let me start with the last part of your question. The SGUL captive does not drag that down at all. The operating companies are separate from BRCD. So BRCD's capitalization does not impact those. Over time, we expect to release some capital out of BRCD, but is not reflected in RBC ratios. In respect to what drove RBC ratio of around 475% million area for year-end '18 relative to like north of 600% in the prior year-end, I'll make a few points. And as we previously said, RBC on a pre-VA reform basis is less meaningful, which is what we were at year-end 2017. It did not reflect aspects of VA capital reform. In 2018, though, we have implemented all the assumptions that need to go in to CTE calculations in RBC. The only thing we have left to do now is to actually start reporting financial results where you'll go from CTE90 to CTE98. Therefore, the RBC today in the 475% area is we feel pretty good. And as the next step of VA capital reform when statutory financials come through, TAC will go up with reserve release and denominator will go down -- will go up with going to CTE98, but RBC ratio is in a good area. The good part is the standard scenario headwind is behind us and unassigned funds are in a positive situation.

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

Anant, I might add...

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

Okay, got it. Yes.

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

Alex, hold on a second, it's Eric. I might ask you I think one thing that might be confusing is you're saying pre-, right? It's sort of half pre-, half post, right? I mean, if you think about the RBC ratio.

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

I agree this is...

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

I'm asking him questions for Alex. This is interesting.

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

Thank you, Alex and Eric. That's right. 2017 pre-VA reform. 2018 was sort of semi-post-VA reform. That's the key point Eric is rightly making over here. Because we are reflecting post-VA reform in our CTE90 calculation, so we're already there.

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

That's really helpful. I think I got what I needed. And maybe if I could just do a quick follow-up. As it relates to the deductible that you talk about, I think it sounds like the deductible is still intact, partly because the markets come back, partly because there was some injection. I mean, if we had a scenario where the deductible got hit, say, half of it was gone and it stayed there, is there anything you'd have to change around your hedging program? Can you continue to implement the same strategy? Or does it sort of work both ways, where if you were able to increase, the deductible hedge costs go down. But if the deductible is hit, and it's got to be go back up over time, are there things you have to do to the hedging program that could increase costs?

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

It's a great question. We've got a lot of flexibility around how we manage the hedge program on the deductible. Because as we've shown, so 5 quarters, still the end of third quarter, we made $1 billion with the way we were running the hedge program with market upside participation. Now even if we eat into the deductible, I'll make 2 points on that. First of all, we have to between CET95 and CET98, we can go below CET98. So there's a large margin of safety there. The second point is, we can always toggle to being a little more at the money than out of the money. It's not that, that toggle isn't there for us. This margin of safety that we have and the peace of mind that we've been able to work with all our stakeholders to understand gives us a lot of flexibility here to generate capital in good times, to absorb loss in stress times and then rebuild capital over time.

Operator

Thank you. Ladies and gentlemen, I will now turn the call back over to Mr. Rosenbaum for closing remarks.

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

Thank you, James, and thanks to everybody for joining us today for our fourth quarter earnings conference call and for your interest in Brighthouse Financial, and we look forward to speaking, again, next quarter.

Operator

Thank you. Ladies and gentlemen, that does conclude today's conference. Thank you very much for your participation. You may all disconnect. Have a wonderful day.

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