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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Brighthouse Financial's Third Quarter 2018 Earnings Conference Call. My name is Carmen and I will be your coordinated today (Operator Instructions). As a reminder, the conference is being recorded for replay purposes. (Operator Instructions) I would now like to turn the presentation over to David Rosenbaum, Head of Investor Relations. Mr. Rosenbaum, you may proceed.

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

Good morning, and thank you for joining Brighthouse Financial's Third Quarter 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 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 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, November 6, 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 on a historical basis to the most directly comparable GAAP measure and related definitions may be found on the Investor Relations portion of our website, in our earnings release, slide presentation or financial supplement. And finally, references to statutory result 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.

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

Thank you, David, and good morning, everyone. I'm very pleased with our results from the third quarter of 2018, including our strong adjusted earnings performance and outstanding quarter-over-quarter sales growth. I also feel very good about our progress relative to our plans.

In August, our Board of Directors approved the $200 million stock repurchase program, our first as an independent publicly traded company and significantly ahead of our base case scenario. I'm pleased to announce we repurchased approximately 982,000 shares in the third quarter and an additional 523,000 shares in October or approximately $64 million of our stock cumulatively.

As of the end of October, we have utilized approximately 32% of the authorization. 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 agreements or TSAs with MetLife. Exiting TSAs supports our goal of reducing our 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, we are actively managing through NAIC Variable annuity capital reform and growing our earnings power.

Let's begin with the TSAs. Exiting TSAs with MetLife and replacing them with more cost-effective solutions is essential to executing on our strategy. We began the year with 147 TSAs remaining, and we expect to end the year with approximately 85, demonstrating significant progress towards solidifying the Brighthouse operating platform.

Second, product and distribution. I am very pleased with our annuity sales results in the third quarter of 2018. Annuity sales of over $1.5 billion were up 43% quarter-over-quarter, our highest level of sales since we became a public company, driven by strong sales of our Shield product and our fixed indexed annuity. Sales of Shield annuities were $867 million in the quarter, up 33% quarter-over-quarter. The growth in annuity sales reflects the strength of our distribution relationships and the ongoing momentum from our branding initiatives.

We are continuing to see excitement from our long-standing distribution partners but we are also continuing to see inbound interest from distributors with whom we do not currently have a relationship. And we're working with all partners, both current and prospective to continue to make our distribution network as broad as possible as we help consumers in the United States achieve financial security.

In September, we broadened our annuity product offering with the launch of 2 new fixed annuity products. As interest rates rise, demand for fixed annuities increases, making this an important enhancement to our product portfolio. As part of the development of these products, we entered into a reinsurance agreement with Athene to launch products that are very competitive in the market. The early feedback from our distribution partners has been very positive.

Turning to life insurance. As we have discussed in the past, life insurance is an important market for us to be in, and we are following a strategy that we believe will help us reestablish a competitive foothold in this space. We have made good progress with the development of our forthcoming life product and are pleased that it has been approved in 46 states so far. We are still targeting a launch of this product by the end of this year.

Turning to our third quarter results. Our key financial highlights for the third quarter are summarized on Slide 3 of our earnings presentation. Adjusted earnings were strong in the quarter and improved from the second quarter. As we highlighted last quarter, the key drivers to improved performance in the second half of the year are equity market returns, investment results, lower expenses and lower severity in universal life with secondary guarantees. All of these drivers performed in line with or better than our expectations in the third quarter.

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Our corporate expenses were $242 million in the quarter, down $46 million sequentially and consistent with our expectations. Corporate expenses in the first 12 months post separation were approximately $1.05 billion, and we still expect to reduce these expenses by $150 million by the end of 2020.

We're also making necessary investments in our technology infrastructure and in our businesses. We refer to these investments as establishment costs. In the third quarter, establishment costs were approximately $87 million pretax.

Finally, we incorporated the new variable annuity capital reform framework and lower tax rate of 21% in our calculation of CTE95 and 98 during the quarter. Variable annuity assets were more than $600 million above the new CTE98 calculation as of the end of the third quarter. The result is in line with our expectations given favorable markets in the third quarter. We anticipate providing our variable annuity capital level relative to CTE98 on a qualitative basis until we implement the new framework into statutory reporting, which we hope to do in 2019. At that point, we will likely transition to a risk-based capital disclosure.

To wrap up, we are very pleased with the results in the quarter and the continued execution of our strategy. Our sales and annuities were very strong and our operational performance in the quarter was very good, highlighted by improved adjusted earnings.

With that, I'll turn the call over to Anant to discuss our third 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 third quarter results and provide some perspectives on the key underlying themes beginning on Slide 4.

Adjusted earnings, excluding the impact from notable items, were $314 million in the quarter compared to adjusted earnings on the same basis of $197 million in the second quarter of 2018 and $294 million in the third quarter of 2017.

The Annuities segment continues to perform well and results in the Life segment were strong. There were 3 notable items in the quarter lowering adjusted earnings by $44 million after-tax or $0.37 per share. The notable items included establishment costs of $69 million aftertax, a $121 million aftertax net unfavorable impact from the recapture of reinsurance treaties, almost entirely impacting the Run-off segment, and a $146 million aftertax net favorable impact to adjusted earnings from our 2018 annual actuarial review review, which is done each year in the third quarter. The total impact to net income from the annual actuarial review was an unfavorable $32 million aftertax.

Let me provide some additional color on our annual actuarial review. Over the last couple of years, including 2017, as our first year performing the review as a stand-alone company, our actuarial reviews have focused on 2 themes: first, harmonizing the assumptions between GAAP and statutory accounting; and second, updating our actuarial practices. This involved being informed by the richest possible set of data available in the market on client behavior, including the quantitative impact study or QIS conducted as part of the NAIC's Variable Annuity Reserve and Capital Reform initiative.

These efforts resulted in Brighthouse being well positioned with what we believe to be prudent, conservative behavior assumptions. These assumptions include annuitization election rates of 2% for postretirement age GMIB contract holders and 1.5% lapse rates for all deep in the money living benefits.

This year's annual actuarial review focused on 3 primary outcomes. First, reflecting the new NAIC rules for variable annuity reserves and capital in our management metrics of CTE95 and CTE98, resulting in alignment with the new framework. This includes lowering the long-term mean reversion assumption for the 10-year interest rate to 3.25%.

Second, reflecting the new 21% tax rate, consistent with the Tax Cuts and Jobs Act, resulting in a higher statutory total asset requirement. And third, performing the regular annual review of models and assumptions, thereby incorporating 1 more year of experience on all of our businesses.

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Now I'd like to provide some perspective on 4 themes related to our adjusted earnings this quarter. The first theme is the investment portfolio. Net investment income was higher sequentially primarily driven by an increase in alternative investment income, the investment portfolio repositioning that we started in the first quarter and growth in assets. Alternative investment income was approximately $19 million after-tax or $0.16 per share, higher than the 4 quarter historical average for 2017 as seen on Slide 5. Through the third quarter, we have repositioned approximately $4.4 billion of treasuries into higher-yielding spread assets.

The second theme is the impact of strong markets on earnings. Separate account returns were approximately 3% in the quarter and above our base case assumptions by approximately 1.4 percentage points. This market outperformance relative to the base case resulted in higher fee revenues, lower reserves and lower DAC amortization adding up to a favorable impact to adjusted earnings of approximately $15 million aftertax or $0.13 per share as seen on Slide 5.

Let me also shed some more light on the underlying fund mix in our separate accounts, which drives the separate account return. Approximately 1/3 of our funds are bond like in nature, while the remaining 2/3 are across equity indices including large caps such as the S&P 500 and NASDAQ, mid-cap such as the Russell 2000 and international funds such as the MSCI EAFE. Hence our separate account return of 3% in the third quarter is consistent with this type of fund mix.

The third theme for the quarter that I would like to discuss is expenses. Corporate expenses were $242 million in the quarter, down approximately $46 million pretax sequentially consistent with our expectations. On an after-tax, per-share basis, that translates to a $0.30 per share sequential impact.

The final theme for the quarter is life insurance claims. Third quarter results improved from the second quarter, driven by both lower frequency and lower severity of claims and in aggregate were in line with our expectations.

Now turning to adjusted earnings at the segment level, which exclude the previously mentioned notable items. Adjusted earnings in the Annuities segment were $247 million in the quarter, sequentially results benefited from higher net investment income, lower expenses and favorable taxes.

Adjusted earnings in the Life segment were $50 million in the quarter, sequentially results benefited from lower expenses.

Adjusted earnings in the Run-off segment were $35 million in the quarter, sequentially claims and expenses were lower and net investment income was higher. As we've mentioned previously, claim results can fluctuate it from quarter-to-quarter. We still expect the run rate of adjusted earnings 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 $18 million, sequentially expenses were lower and taxes were favorable.

In closing, let me provide an update on our balance sheet position and our variable annuity hedging as of September 30.

First, we feel very good about our capitalization levels, including a stock repurchase program in place supported by excess cash of the holding company. Variable annuity assets were in excess of CTE98 by more than $600 million reflecting the impact of both the new Variable Annuity Capital Reform and the lower 21% tax rate. Going forward, as we manage variable annuity assets at or above a CTE98 level in normal markets, in 2019, we will likely transition to talking about capitalization in the context of a total company RBC ratio basis, which will include CTE98 for variable annuities in that calculation.

Second, our hedging program is working and delivering results in line with our expectation for the market movements in the quarter.

Third, statutory total adjusted capital was $6 billion or in line with the prior quarter. This reflects the existing variable annuity reserve requirements, which we expect to sunset with the potential early adoption of the NAIC capital reform for statutory reporting by year-end 2019.

Fourth, holding company liquid assets were approximately $600 million, primarily reflecting our issuance of junior subordinated notes in

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September, a capital contribution to Brighthouse Life Insurance Company from the issuance proceeds in addition to share repurchases in the quarter.

We believe the capital contribution positions us well to begin reducing hedge costs further next year. And finally, financial leverage was approximately 23.5%. With that, we'd like to open up the call for question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Elyse Greenspan with Wells Fargo.

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

My first question, so in terms of as we think about investment income going forward from here. You guys highlighted the repositioning of investment portfolio, is this quarter kind of a good run rate to think about going forward or any other one timers other than the stronger alternative investment income you guys pointed to?

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

This is John Rosenthal. As Anant pointed out, this quarter benefited from higher alts, higher average asset growth and repositioning. Alts was predominantly the key contributor to the increase. I think going forward, as you know, alternative income is very difficult to predict quarter-to-quarter. I think having said that we wouldn't expect alternatives in Q4 to reach the elevated levels that they reached in Q3. However, net investment income will continue to benefit from portfolio repositioning, higher asset growth and investing at higher interest rates.

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

Okay. And then you guys -- the ROE picked up and results were stronger in the quarter. Is it -- is the assumption that you guys still expect full year earnings to come in in line with that previous $8.50 to $9 per share range?

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

Elyse, it's Eric Steigerwalt. So let me answer that question and then I'm going to actually add a little maybe longer-term strategic context for everybody.

First, it's not that often that we have equity markets like October. But as long as markets do reasonably well for the rest of the year, I think that range is still appropriate. That's why we broke out the excess returns in the presentation for the third quarter so that you can get a sense of how slightly abnormal markets affect us. Now obviously, we'll take a pretty good market to be at the top of the range. More importantly, on our December Investor call, we will talk about like a longer-term base case earnings growth percentage, okay? And we expect that to be in the higher range than our current mid- to high-single digits. So we'll talk about that in early December. And we're going to lay out our expense plans, our investment portfolio repositioning and our product strategy so that you'll see the drivers of that EPS growth.

I might as well just add because I know the question is coming here. With respect to assets above CTE98 post the third quarter, so post October, roughly where we stand today. We believe we're still well in excess despite the October equity market performance. However, again, it might be valuable to make a few strategic comments. As Anant said, and as we've said before actually, in the near future, in 2019, we intend to begin operating within a range of RBC levels, and I'm looking forward to discussing that with you as soon as we can. As I've said before, we intend to be a consistent returner of capital across market cycles and all of our efforts are centered around being able to adopt, VA capital reform in 2019 to that end.

So I hope I answered your actual question, but I thought that, that additional strategic context might help everybody.

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

Okay, great. That's helpful. One last question, corporate expenses lower than what was implied by your run rate in the quarter. Is that -- should we assume that they will continue to go down from this quarter's level?

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

Anant and I are battling as to who gets to go here. So I'll start and you can jump in Anant. Look, again, strategically, they absolutely are going to go down. We are going to hit that $150 million goal, period. Obviously, there's quarterly fluctuations. Generally, a lot of companies have higher expenses in the fourth quarter. But we're very focused on this. And it's a little bit different for us in that we're on a journey over time here to lower expenses year after year after year. So the third quarter is a reasonable run rate, it could fluctuate a little bit around that, but you're certainly not going to see dramatically higher expenses in the fourth quarter.

Operator

Our next question comes from John Nadel with UBS.

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

So Eric, you sort of touched on the October market decline. And my question was going to be, how much volatility do you expect that we could see in that capital level above CTE98 as you think about some of the drivers including equity market performance?

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

Well, John, as you know, the markets are going to move around, we all know that. Our goal is to be in a position both with managing the CTE98 sort of in any regular market environment, and then having our CTE95 floor in more severe markets. That little fluctuations are not going to stop, I mean, I'm assuming that you're headed towards capital return. And what happened in October will have 0 effect on our share repurchases. We will continue to repurchase stock. I can follow up, if you want to direct us further.

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

Yes. No, I'll follow-up offline to get maybe a little bit deeper into the weeds, but I guess that's what I'm sort of trying to understand. You guys have laid out at the spinoff that over time you would take on more risk, effectively, your own deductible if you will. And just trying to understand how much that whole theme may have changed as a result of the VA capital reform.

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

Yes. I'll add a little, Anant, you can jump in there. Look, we put couple of hundred million down into the operating company that positions us even better with respect to that deductible going forward. So there is sort of 2 pieces to that keep in mind. But secondarily, over time, I've said and I will continue to say, the goal is to be a consistent returner, okay? So I sort of think of like we're transforming the company. We've come a long way in the last couple of years. And as we continue to execute on this strategy, the goal is to be more consistent with respect to returning capital. And again, it seems to be the overall notion of your question.

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

Yes. Understood. And then just maybe 2 quick ones. One for John and one for Anant. John, could you just tell us what the private equity annualized return was in the quarter? And then Anant, if we look at the year-to-date effective tax rate on an operating basis, it looks like it's about mid-13% range. That's definitely below your high-teens expectation. I'm just wondering whether this is more reflective of the level we should expect going forward. Or is this just a matter of timing, and we should expect the high-teens rate as we look out to 2019 and beyond?

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

I'll take the easy one. It's John. The actual return or the absolute return for the quarter was 4%. So the annualized return was about 16%, which is higher than we would normally expect, John.

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

It's Anant. On the tax rate, you're right, we have came in at on the lower end of our range, we actually expect to be at that lower end of the range for the rest of the year. But as earnings go up, we'll be at the upper end of the range.

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Operator

Our next question comes from Ryan Krueger with KBW.

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

I assume you'll give us updated variable annuity cash flow scenarios in the 10-K again this year. Just hoping to get some perspective on, I guess, how meaningful do those change or get impacted by the new NAIC VA Reform. And then I guess related to that, I guess, you'll -- I believe you said you'll reflect the 3.25% long-term 10-year going forward as well.

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

The answer to your second question is, yes. The 3.25% long-term treasury is already reflected in our numbers. Our annual actuarial review this year. So when we say we're at CTE98 plus more than $600 million, that's already factored in. To your first question on sensitivities, we will update them as we update our 10-K. But let me take a step back, adding on to the earlier answer and how we think about it, our hedging strategy is not changed. We're doing exactly what we laid out, diligently executing it and protecting the floor level while managing capital with a RBC range with 98 going -- CTE98 going into that calculation, which means we will grow our, what we've colloquially called, a deductible or assets that are a shock absorber from $1 billion, up to $1.5 billion and then up from there to $2 billion. We're on path to doing that. I'll take any follow-on, but I thought that would be a helpful context.

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

And I do have a question actually. Just in terms of the legacy SGL block (sic) [ULSG], do you see an opportunity to free up any reserves to either reinsurance transaction or renegotiating a bit the captive with the Delaware regulator?

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

It's a little hard to hear you, Ryan, but I think your question was freeing up capital from the ULSG block. Was that what you said?

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

Yes, right. And I guess either through reinsurance or renegotiating the terms of the captive with the regulator.

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

Okay. So yes, there is certainly a possibility, it'll happen over time because it needs regulatory approval, et cetera. So again, like we've said many times, there could be potential opportunities, it's just one of the arrows in the quiver. It's not something that's going to happen tomorrow. But over time, yes, there could be some capital potentially freed up with respect to the ULSG block.

Operator

Our next question comes from Erik Bass with Autonomous Research.

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

Sounds from your comments that you feel pretty confident about being able to early adopt the new NAIC framework in 2019. I guess, if you can, would this enable you to potentially contemplate an extraordinary dividend from BLIC in 2019?

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

Eric, it's Anant. We can do an extraordinary dividend even without early adapting it. But yes, the short answer is yes, and we feel very good about that.

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

Okay. And then Anant, do you have any perspective on, realizing it's early, on the new GAAP accounting standards that will come into effect and the potential implications for Brighthouse?

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

It is pretty early to talk about that. It's an effective date of 2021. What I would say, it does not impact our stat results. We don't expect it will impact our plans for capital return. We as a management team have demonstrated with VA stat reform that we can successfully

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navigate through regulatory and accounting changes. And finally, we believe we are very well positioned with the leverage ratio that's in the low to mid-20s, lower relative to rating agency expectations for a single A financial strength rating. So we feel good about our ability to navigate things over time.

Operator

Our next question comes from Andrew Kligerman with Crédit Suisse.

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

With regard to the $600-plus million in excess of CTE98 versus what was quoted as $500-plus million last quarter, what if the market were locked in today, where it is now down since the quarter started? Would you be back at the $500-plus million? Where do you think you would be?

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

Andrew, like I said before, I think on the first question. And I'm going to try not to get into this like on a weekly basis, okay? But we would still be well in excess.

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

Okay, I'll leave it at that. And then with regard to the portfolio repositioning, how much more do you have to go? And what types of securities do you want to do with the remainder of this repositioning?

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

Andrew, it's John. As Anant said, through the end of Q3, we've rotated out about -- out of about...

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

$4.4 billion. Yes.

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

$4.4 billion in the treasuries. We're continuing to rotate out of treasuries and to spread assets that's the predominant portion of our repositioning. And we will provide more details about the size of the program, it's timing and the ultimate income pickup during our call next month.

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

Is it more than $1 billion? What kind of spread assets are you looking at?

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

Remaining more than a $1 billion? Is that what you're asking?

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

Yes, and then where to go in terms of repositioning, I mean, it would've been more...

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

There's more to go, and we'll talk about exactly how much or relatively how much next month. And we're investing in our really high-quality, well-diversified normal asset mix. So nothing unusual on the reinvestment side.

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

Okay. And Eric, just one last one. You talked last to quarter about being measured and prudent in terms of the buyback. And certainly at $40 million plus, that was sort of a 1/4 of your -- or close to a quarter of your $200 million. Then you did that $300-plus million debt offering, so I thought you might accelerate that. Is there a chance you might want to accelerate the buyback as we move forward?

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

So are you talking about the current buyback authorization, Andrew? Is that what you're...

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

Correct, correct, yes.

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

Okay. Look, it's worked pretty well for us during the period that we've repurchased, the stock has been up and down, and we've got pretty nice dollar cost averaging there. I would expect it to be just like we're doing now, a measured but consistent repurchase plan.

Operator

Our next question comes from Joshua Shanker with Deutsche Bank.

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

Curious if internally you have any goals around a timeline for turning to net positive flows in annuities? And if we were to think about losing $5 billion a year in net flows of annuities that probably have higher capital charge given their older vintages than the ones you're writing today. Is that a capital and ROE positive event losing those assets?

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

It's Conor. Let me start on, and I'm sure Eric may want to join in as well. So look, as we've discussed previously, we have a large book to begin with. Clearly, we had a good quarter in regard to flows, and we're very pleased with the business that we're putting on both in terms of the quality of the business and the returns on that business. And as you know and as you acknowledged, much of what comes off is less profitable. So this isn't preventing us from expanding our profitable growth goals here.

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

Is it positive to lose that those flows? Is that actually beneficial to you over time?

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

Much, it's mixed, much of it is. Now remember some of the flows is just the normal course of what's happening - deaths, annuitization, some of it is surrenders. And a reasonable amount of those surrenders are positive to us because there are surrenders that are in the money, some of its significantly in the money. So that helps us from a profitability and capital perspective.

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

Yes, it's Eric, I would add to it. Look, I we don't pray each day for lapses, okay? Because over time, they will affect your earnings. But the comment that I made at the beginning of this Q&A period, you're going to see pretty good EPS growth power out of Brighthouse in the December call and that factors in the net flows, right, for years here. Having said that, there are some lapses that we prefer not to lose but there are a meaningful amount that qualify for what you said, Josh, at the beginning of your question, that in the end you'd have to say our sort of ROA or capital positive to us. So we're in a little different position may be than some other companies here. So I hope that was -- I'm -- we're trying to give you the balanced answer, but the answer to your original question is, yes.

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

And is there an internal target for the idea of Brighthouse returning to a net positive flow company?

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

I don't have a target. Look, I've said this before, it's going to take a number of years, okay? Notwithstanding the fact that as we just discussed, some of these lapses are actually positive for the company, but it's going to take a while. So I'm not ready to give out a target yet because it would just sort of be a quarterly, wow, you're still a ways away from it. But overall, in December, you're going to see that despite the level of negative net flows, we've got some real EPS growth power here.

Operator

Our next question comes from John Barnidge with Sandler O'Neill.

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

I get it's a difficult thing to quantify but some other companies did provide it last week. So maybe I'll ask the question this way. If last night was the quarter close, can you quantify how much of a headwind on an EPS basis the market would be to guidance?

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

John, it's Anant. No, we did give you the sensitivity, which was right. If you translate that it'll be like $0.09 for a 1 percentage point of separate account return. So I would just point you to that.

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

Okay. And then how much of the growth in the increase in fixed sales do you find benefiting from the market volatility versus maybe higher rates and better distribution?

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

This is Myles speaking. So if you take a look at sequentially, most of our growth has come from our Shield product as well as our FIA product that we distributed to MassMutual. If you look at the industry as a whole, in light of some volatility, you're seeing fix products up. And as we mentioned earlier on the call, we just introduced 2 new fixed deferred products in September that we're optimistic, we're going to be able to gain some sales traction with. So we like the fixed space, we're a player in the fixed space, and we're going to continue to focus on the fixed space moving forward.

Operator

Our next question comes from Suneet Kamath with Citi.

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

So for Anant, on the CTE98 moving from $500-plus million to $600-plus million. Over the course of the call, you talked about several pieces changing the interest rate assumption, tax reform VA capital reform and then a capital contribution. Can you help us think through sort of sizing those pieces as we think about a potential walk from 2Q to 3Q?

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

Suneet, happy to do so. So let's start with -- we expected to be at CTE98 post VA reform both the capital reform and the tax rate change and making a capital contribution. We contributed $200 million down into the life company to that effect. We ended up with with a better outcome with assets over $600 million above CTE98 due to strong business results. These was driven by 2 real factors. Approximately 2/3 of that came from market upside in the hedging program. So our hedging program is working very well, frankly, over the last 5 quarters, we've had more than $1 billion of market upside by putting $1 billion of assets as a deductible. So that's really great results, a lot of that coming through this quarter as well. And the other 1/3 of the growth came from statutory net income, which if you look at Page 21 of the supplement you'll see we had good core stat returns and then market upside because of the hedging program. I can pause and take any follow-on you have on it.

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

And what was the impact of tax reform just on the -- on that CTE98 buffer?

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

Tax reform was actually a bigger driver, if you think about the assets above CTE98. It was actually closer to like more than half.

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

Sorry, more than half of what?

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

More than half of the impact of implementing VA reform.

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

Okay. Maybe I'll follow up afterwards. And then I think you had said that you maintained your lapse rate assumption at 1.5%. And I think there is some commentary around that being consistent with the study. But as I think about other companies, I think their lapse rate assumptions are less than 1%. So maybe if you could comment there. But also if you were to reduce the lapse rate to 1%, any sense of what the sensitivity would be in terms of required VA assets?

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

Sure. So you're right, as I said in my prepared comments, we've looked at not just one study, we've looked at every study that's out there. And participated in the QIS as part of NAIC reform. We feel really good about our assumption changes on lapse, elective annuitizations in all of those that we've made. We hope everybody is actually feeling as good as we're feeling about it given the changes we have made. So I don't see us given where our data is and our experience is, as Connor and other mentioned, we have in the money policies lapsing, I don't see how we have to go lower than 1.5%.

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

Okay, but no sensitivity if you did?

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

It's sort of hypothetical at this point in time, doesn't make intuitive sense because it's -- I don't see how the data would ever go there.

Operator

Our next question comes from Tom Gallagher with Evercore.

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

The first question is, you've been talking about how you're going to manage to a total RBC standard by the end of 2019, that's the goal. Right now, I guess, all we've talked about is VA CTE. What is -- what would a total RBC standard entail in terms of -- and the reason I'm asking is, obviously, you have other businesses, other assets outside of VA? Would everything else, if you kind of characterize it separately, give you a significant excess over the 400% RBC, if that's what you're going to be managing to or how we should think about that?

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

Let me start and Anant you can jump in. Tom, it's Eric. We're going through that with our board now. So we're not going to get there until we adopt VA capital reform. But as you said, and as I've said, we are hopefully going to do that for 2019. So we've got to come up with a range here of where we're going to manage the company with respect to RBC, and we're working that through as we speak, literally. As you very well know, the VA capital reform makes RBC robust, right? So now you can sort of use that as a global metric for the whole company. So the idea is that we get to some sort of range that we will certainly make public where we want to manage this and that could give you some sense of if there's any dividendable excess capital of the operating companies. And then obviously, you'd take a look at what we've got at the holding company, and like many other companies, we hope to be able to give you a sense over time here of what we think our approximate excess capital position might be. Anant, you want to add anything?

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

I think you covered it but Tom if you have any follow-ups, we are happy to take it.

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

Sure. So I guess just one follow-up to that. So Eric or Anant, at this point would you say everything that's kind of measured outside of VA, is it -- does it look like it would be above -- would there be excess or cannot clear at this point? Just a higher level directional.

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

Yes, Tom, it's Anant. We think of the company to be capitalized in the OPCOs at like single A rating level, so you should think of sort of RBC levels relative to that. And then going forward, as Eric mentioned, we'll be at 98, 98 plus, so we'll be at like 400%, 400% plus. And we need to come back to you guys on what the actual target is next year.

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

Okay. And then my other question is just on, Anant, I know you said you mentioned you're going to be shifting to lower hedging costs in 2019, is the plan. Would that primarily be focused on lower use of options. Because I think right now, you're spending around $800 million a year on option premium. Is that the main area? Or would it be much more -- much broader in terms of how you would change the hedge program?

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

We would -- yes, we would grow the assets that act as a shock absorber from $1 billion to $1.5 billion in 2019. We're actually already working on that. And what it allows us to do is strike things to be a little more out of the money. So you still use an options-based program little predominantly. But you go a little out of the money and you reap the benefits of that. And I'm sort of reiterate the point I made, the fact that we've had this option-based strategies allowed us to actually have the program allow us contribute $1 billion of upside in the last 5 quarters. That's really meaningful and we look to grow that.

Operator

Our next question comes from Jimmy Bhullar with JPMorgan.

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

Most of my questions were answered, but I'm not sure if you mentioned what the impact of VA capital reform was on your assets above CTE98, how did that affect you? Can you quantify?

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

Jimmy. Sure. So if the question is, what was the impact of VA reform on our assets above CTE95 and tax. Tax reform was a big driver of it. The combined impact of both of those was about $1 billion, driven majority by tax reform and then some amount by really the capital market changes, really nothing material other than those 2 to really call out, right? We entered 3.25% and the biggest drop was coming from 21%. Net of that, we would have still ended up at CTE98, and we're at 98 plus more than $600 million because of the really strong business results for the 2 factors I gave in my answer to Suneet earlier.

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

Okay. And then on the Shield product, obviously you've seen pretty strong sales over the last several quarters. Are you seeing any impact on the business or are your expectations changing as competitors are coming out with similar products? Like Lincoln has a buffer annuity, many others are -- there are few other companies that are thinking about coming out with something similar.

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

It's Myles again. No, we feel very confident about our current Shield product. Our advisers love the competitiveness of the product and its simple nature. We're continuing to bring on new distributors, selling the product, further broadening distribution. And that as always we'll monitor the competitive landscape, and we'll make changes if appropriate. But we feel really good about our market position right now.

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

And then just lastly on buybacks, I think Eric alluded to this. But is it safe to assume that despite the market, sort of, volatility that we've seen recently that you're going to keep buying back stock in the near term?

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

Jimmy, it is very safe to assume that.

Operator

Our next question comes from Alex Scott with Goldman Sachs.

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

First question was just on the GAAP changes to the actuarial review for variable annuities. I think you mentioned the election rate assumption is 2% now. Could you give us a feel for how that changed? I mean that sounds kind of low, but I know annuitizations have been -- or election of annuitizations have been pretty low. Just wondering like how much data you have on that and how big of a change it was.

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

So the good news on that Alex is -- great to hear your voice again. The good news is, there was no change on that. The data is coming in and showing we're conservative relative to that, and we actually made that change 2 years ago to 2% in annuitizations. So across the board if you look at these assumptions, the data's coming in, showing us we were proactive, we moved early, and we're informed by the richest data available to make those changes. So really not -- nothing material to call out with respect to actuarial behavioral assumptions this year.

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

Got it. And then next question I had was just a follow-up on the hedge costs. I think the VA distributable earnings assumption -- or estimates you guys have provided in the past suggested maybe you'd get to a point where hedge costs were below the rider fees by, it looked like, maybe year 4 or so. I mean is that expected to significantly speed up? I mean does that speed up to year 2 or 3? Or do you think 2019 could be a year where hedge costs were actually below the rider fees?

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

Yes. I wish they could be below the rider fees but I think where we're thinking about them is, they're not going to be below the rider fees. They're just going to be in that $1 billion range, so slightly above the rider fees. So there's going to be some modest amount of drag from those fees but still a meaningful amount of reduction, which will allow net income to emerge in addition to just operating income or adjusted earnings.

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

Last quick one. Did you guys say what adjusted statutory earnings were this quarter?

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

We did not, but they were around $700 million. Now that's because largely our 2/3 of that coming from our hedge program and 1/3 coming from core business earnings of around $200 million, which you can see in the supplement. So they were very strong, well above our plans and in October we would've probably given some of that back but still good year outcome for the year.

Operator

And our last question comes from Humphrey Lee with Dowling & Partners.

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

In -- Eric, in your prepared remarks you talk about you expect the TSA would reduce to 85 TSAs by the end of the year. I guess as we think about the expense saves impact from these kind of TSA terminations, how should we think about that for the fourth quarter and then maybe into 2019?

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

Sure, Humphrey. It's kind of backend loaded to be honest with you. Like you're seeing expense decreases occurring here and you're going to see more in 2019. The biggest piece will be end of '19 into '20, where we really get the leverage of getting off some of the largest ones. All of the smaller ones or even medium-sized ones are contributing to our ability to lower expenses like you saw in the third quarter. And again, there'll be more of that in '19 but as you get near the end and into '20, then we get off the biggest ones.

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

Okay, so more good to be on. And then I guess maybe shifting gear a little bit. So related to the recapture of the reinsurance runoff, can you provide some color in terms of the size of the recaptures? And then how should we think about the earning's impact on may be from volatility standpoint? Any color you could provide would be helpful.

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

Humphrey, it's Conor. The size of the block is a $5 billion block, from the face amount perspective.

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

And I'll add into Conor's point of view is, as we moved this block of business really ULSG to runoff in the second -- in the fourth quarter of 2016,

(technical difficulty)

this is answering your point of view of how to think about it on an earnings basis, it's all reflected now in the earnings. When we recapture block of business, it changes our profit pattern the present value of that change in profit pattern gets reflected in the reserves, there's no ongoing impact from it.

Operator

And ladies and gentlemen, this concludes our Q&A session. I would like to turn the call back to David Rosenbaum for his final remarks.

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

Thank you, Carmen, and thanks to everyone for joining us today for our third quarter earnings conference call, and for your interest in Brighthouse Financial. We look forward to speaking again during our Investor Outlook conference call in December 3. And again, thanks for joining today.

Operator

And with that ladies and gentlemen, we thank you for participating in today's conference. This concludes the program, and you may all disconnect. Have a wonderful day.

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