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BHF.OQ - Q1 2021 Brighthouse Financial Inc Earnings Call

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OVERVIEW:

BHF reported 1Q21 results with adjusted earnings of $428m, excluding the impact from notable items.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Brighthouse Financial's First Quarter 2021 Earnings Conference Call. My name is Olivia, and I will be your coordinator today. (Operator Instructions) As a reminder, this conference is being recorded for replay purposes.

(Operator Instructions) I would now like to turn the presentation over to David Rosenbaum, Head of Investor Relations. Mr. Rosenbaum, you may proceed.

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

Good morning, and thank you for joining Brighthouse Financial's First Quarter 2021 Earnings Call. Our earnings release, slide presentation and financial supplement were released last night. It can be accessed on the Investor Relations section of our website at brighthousefinancial.com. We encourage you to review all of these materials.

Today, you will hear from Eric Steigerwalt, our President and Chief Executive Officer; and Ed Spehar, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period.

Also here with us today to participate in the discussions are Myles Lambert, Chief Distribution and Marketing Officer; Conor Murphy, Chief Operating Officer; and John Rosenthal, Chief Investment Officer.

Our discussion during this call will include forward-looking statements within the meaning of the federal securities laws. Brighthouse Financial's actual results may differ materially from the results anticipated in the forward-looking statements as a result of risks and uncertainties described from time to time in Brighthouse Financial's filings with the U.S. Securities and Exchange Commission.

Information discussed on today's call speaks only as of today, May 11, 2021. The company undertakes no obligation to update any information discussed on today's call. During this call, we will be discussing certain financial measures used by management that are not based on Generally Accepted Accounting Principles also known as non-GAAP measures. Reconciliations of these non-GAAP measures on a historical basis to the most directly comparable GAAP measures and related definitions may be found on the Investor Relations portion of our website in our earnings release, slide presentation or financial supplement.

And finally, references to statutory results, including certain statutory-based measures used by management are preliminary due to the timing of the filing of the statutory statements.

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

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

Thank you, David, and good morning, everyone. Once again, I hope that everyone listening today and your loved ones are remaining safe and well.

Today, I will provide some perspectives on the continued execution of our strategy and the progress we have made on our 2021 focus areas, in addition to discussing our first quarter results.

Brighthouse delivered strong results in the first quarter. Global equity market performance and rising interest rates provided a favorable backdrop to both earnings and capital generation in the quarter.

Investment income from alternative investments was very strong given the fourth quarter market performance. The underwriting margin was modestly better than the prior quarter but lower than a more normal quarter. We delivered strong sales results, and we continue to prudently manage expenses. Reflecting on the quarter, I could not be prouder of the contributions from our employees and distribution partners to our strong results.

Our balance sheet and liquidity position remained robust in the first quarter, and our hedging program performed as expected. Importantly, we estimate that our combined risk-based capital or RBC ratio, its range was between 500% and 520%, well above our target of between 400% and 450% in normal markets. Additionally, we ended the quarter with liquid assets at the holding company of approximately $1.6 billion. Ed will provide more details on our financial results shortly.

As we have said before, one of our top priorities is balance sheet strength in order to support our distribution franchise and further enhance sales growth. We believe our distribution franchise will continue to contribute to the evolution of our business mix over time, by adding high-quality new business, which should increase the level and predictability of earnings and cash flows going forward.

Turning to sales. I am very pleased with our sales results in the first quarter. Annuity sales were approximately $2.1 billion, up 8% compared with the first quarter of 2020 and ahead of our expectations.

We reported record sales of both our flagship Shield Level Annuities and our variable annuities with FlexChoice Access. In addition, our VA and Shield product sales were up 6% sequentially. Fixed rate annuity sales were lower sequentially, as expected, due to additional repricing actions we took in the fourth quarter given the low interest rate environment.

Additionally, we generated approximately $23 million of life insurance sales in the first quarter of 2021, also ahead of our expectations. I am very pleased with the progress that we have made as we continue to execute on our life insurance strategy.

We remain focused on further expanding our distribution footprint and continuously enhancing the way we support financial professionals and the clients they serve. During the first quarter, Brighthouse Financial annuities were added to the SIMON Marketplace. Over time, leveraging the SIMON platform further broadens our distribution footprint and helps make retirement planning more scalable for financial professionals.

We also remain committed to enhancing our products with a focus on Shield as well as rolling out SmartCare to more firms and adding more wholesalers as we continue to execute on our life insurance strategy.

Total annuity net outflows were $824 million in the quarter, as outflows returned to a more normal level and were partially offset by continued strong sales. As we've said previously, we expect to see a continued shift in our business mix profile over time, as we add more cash-flow-generating and less capital-intensive new business, coupled with the runoff of older, less profitable business.

Corporate expenses, which do not include establishment costs, were $203 million before tax in the first quarter, which was lower than our expectations. Establishment costs were approximately $17 million before tax. We previously committed to a cumulative $175 million reduction in corporate expenses relative to our first year as a public company. That was $150 million in 2020 and an additional $25 million in 2021.

We exceeded the target in 2020, and we are focused on achieving the remainder of the expense reduction commitment in 2021. With that said, we will continue to invest in our infrastructure with the goal of providing better support to our distributors and their financial professionals as well as our policyholders and contract holders.

Lastly, let me discuss our stock repurchase program. In the first quarter of 2021, we repurchased approximately $68 million of our common stock. And since the end of the quarter through May 7, we repurchased an additional approximately $55 million of our common stock. Since the announcement of our first stock repurchase authorization in August of 2018 through May 7 this year, we have repurchased more than $1.1 billion of our common stock. This represents a reduction of more than 29% of shares outstanding from the time we became an independent public company.

Assuming full utilization of our current authorization, we will have repurchased $1.3 billion of our common stock, more than 85% of the way toward our target of returning $1.5 billion to our shareholders by the end of 2021, and that's a goal we are focused on achieving.

To wrap up, Brighthouse delivered strong results in the first quarter. Sales were better than our expectations, we continued to prudently manage expenses, and we repurchased more of our common stock in the quarter. And our balance sheet and liquidity position remain robust. We remain focused on executing our strategy to deliver long-term shareholder value.

And with that, I'll turn it over to Ed to discuss our financial results. Ed?

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

Thank you, Eric, and good morning, everyone. Before getting into the results for the quarter, I would like to take a moment to discuss our updated projected distributable earnings scenarios, which we published March 16.

There are 3 key messages to take away from these updated scenarios. First, we have a significant level of projected total company distributable earnings, even though all the scenarios assume interest rates starting from year-end 2020, or a 10-year U.S. treasury yield of 93 basis points. The total company 10-year distributable earnings projections we published on March 16 are comparable to what we presented last year adjusted for the $1 billion capital release in 2020 related to the derisking of the variable annuity, or VA hedging strategy.

Second, VA distributable earnings were only modestly lower than what we published last year after adjusting for the $1 billion capital release associated with derisking our hedging strategy. This illustrates that the strong market returns in 2020 were an effective offset to the negative impact from low interest rates.

And third, interest rates today are substantially higher than what is reflected in the scenarios. The forward curve at year-end 2020 projected the 10-year treasury would reach today's interest rate level in mid 2025, and our current GAAP mean reversion to 3% over 10 years implies we would be at current rates at year-end 2023. Therefore, we believe that there is upside to the distributable earnings projections we published in March.

Now turning to the first quarter results we released last night. I'm very pleased with our strong financial results and robust capital position. As Eric noted, the continuation of strong equity market performance and a rising interest rate environment was a positive backdrop for the quarter.

Starting with preliminary statutory results. Our combined statutory total adjusted capital or TAC was approximately $9.4 billion, up $800 million from year-end 2020. We estimate that our combined risk-based capital or RBC ratio was between 500% and 520%. And we reported normalized statutory earnings of approximately $100 million.

These results were driven by the increase in equity markets and interest rates in the first quarter. The positive market factors, including favorable investment performance, were partially offset by elevated mortality and a $200 million to $250 million unfavorable impact associated with the prescribed decline in the 20-year treasury yield mean reversion point for statutory calculations.

In the first quarter, the mean reversion point was lowered by 25 basis points to 3.25%. And the $200 million to $250 million unfavorable impact in the first quarter reflects the full year effect of this change.

The decline in the mean reversion point and future declines were factored into our distributable earnings projections published on March 16.

Moving to the holding company. We ended the first quarter with holding company liquid assets of approximately $1.6 billion. We believe it is appropriate to keep a conservative position at the holding company. And as a result of favorable market moves, positive developments in the economy and the likelihood that the worst of the pandemic is behind us, we continue to assess the appropriate level of conservatism.

Shifting to adjusted earnings. First quarter adjusted earnings, excluding the impact from notable items, were $428 million, which compares with adjusted earnings on the same basis, of $272 million in the fourth quarter of 2020 and $273 million in the first quarter of 2020.

There were 2 notable items in the quarter, which lowered adjusted earnings by approximately $43 million. The notable items on an after-tax basis were: a $29 million unfavorable impact in the runoff segment related to actuarial systems conversions associated with the company's transition to its future state platform and establishment cost of $14 million included in Corporate & Other.

Adjusted earnings, less notable items, were above our quarterly run rate expectations, driven by favorable net investment income and lower corporate expenses, partially offset by lower underwriting results.

Net investment income was approximately $225 million higher than our average quarterly run rate on an after-tax basis, as the alternative investment yield was 12.8% in the first quarter, driven by the favorable market performance in the fourth quarter of 2020.

Performance was strong across all sectors of the private equity portfolio, particularly in venture capital. Keep in mind that we expect an annual yield of 9% to 11% over the long-term on the alternative investment portfolio.

Expenses were also favorable relative to a normal quarterly run rate by approximately $10 million after tax. This favorability is typical in the first quarter due to seasonality. As a partial offset to strong net investment income and low expenses, our underwriting margin was approximately $90 million lower than our quarterly run rate expectation on an after-tax basis.

The below-normal underwriting margin was the result of COVID-19 claims and a lower-than-typical benefit from reinsurance. Our direct claims in the quarter, excluding the impact from COVID-19, were in the normal range of $400 million to $500 million that I have discussed in the past.

Turning to adjusted earnings at the segment level. Annuities adjusted earnings, excluding notable items, were $336 million in the quarter. As mentioned earlier, the strong market performance had a favorable impact on results.

Net investment income was higher sequentially, along with higher fees, partially offset by an increase in reserves.

In the Life segment, adjusted earnings, excluding notable items, were $42 million in the quarter. Sequentially, results were primarily impacted by higher net investment income. The Run-off segment reported adjusted earnings, excluding notable items, of $105 million in the quarter. Sequentially, results were driven by higher net investment income and a higher underwriting margin.

Corporate & Other had an adjusted loss, excluding notable items, of $55 million. Sequentially, results were driven by a higher tax benefit and lower expenses, partially offset by higher total preferred stock dividends.

Overall, I am pleased with our results this quarter. We maintained our strong capital and cash position, while continuing to return a meaningful amount of capital to shareholders. We remain committed to using a multi-scenario, multiyear framework when managing the balance sheet to ensure that we protect our distribution franchise.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question coming from the line of Ryan Krueger with KBW.

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

My first question was, Ed, could you walk through some of the -- if you think about normalized statutory earnings in the quarter. Can you walk through some of the moving parts in terms of how actual to expected market performance and interest rates kind of impacted that and any factors that (inaudible) for this quarter?

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

Sorry, Ryan. What was the last part of the question? I didn't hear it.

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

And if there were other meaningful deltas within the normalized statutory earnings that you'd call out?

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

Okay. So the normalized statutory earnings were approximately $100 million, as I said in my prepared remarks, reflected around the $200 million to $250 million impact from lowering the mean reversion rate under statutory, the prescribed mean reversion rate for the 20-year treasury. So this was a good quarter, considering that, that's the full year impact absorbed in -- fully absorbed in the first quarter.

The VA results, as you probably would expect, were very good in the first quarter, driven by the market factors. And this was offset by a weaker non-VA quarter. As you heard me mention in prepared remarks, this was a tougher mortality quarter. So the story for VA -- the story for norm stat earnings was really VA and again, the impact from the full year adjustment to the mean reversion.

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

Got it. And then on the mean reversion impact, and I know you already projected these in your distributable earnings scenarios. But just to understand, is that $200 million to $250 million something that occurs effectively every year from lowering the 25 basis points? Is that how we should think about it?

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

Yes. So -- I mean, this is as you said, we factored in future declines in the mean reversion point as well as this year's decline in the distributable earnings tables. This is really the impact of $200 million to $250 million from the reduction this year.

And so I wouldn't necessarily say that's an ongoing impact from the reduction this year. Now we did assume, based on the rate environment at year-end 2020, that we would see another 50 basis point decline in 2022 in the mean reversion point. If current rate levels were to hold, that 50 basis points would be 25 basis points. So obviously, there is some upside for next year given the mean reversion rate coming down less than what we had built into our tables in mid-March.

Operator

And our next question coming from the line of Elyse Greenspan with Wells Fargo.

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

My first question wanted to go to the capital side. So you guys have $1.6 billion at the holding company. You guys have obviously taken a conservative position as there's been a lot of uncertainty over the past year. But from your comments, it sounds like things are getting better.

So can you just help us think through whether thoughts around that number coming down over the year and going up closer to where you've historically had your holdco assets during more normal times?

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

Yes. Elyse, it's Ed. So as I said in the prepared remarks, we're continuously assessing what's the appropriate level of conservatism for holding company cash. And so I don't have a number to provide you. But I would say a couple of things generally about how we think about holding company cash.

Number one, I think it is appropriate to have a conservative view of holding company cash when you're a life insurance company, just as a general overarching comment.

And the second thing I would say is that I think a target for holding company cash is something that I would hesitate to put out, given the fact that I think that target will change over time based on a variety of factors. So all I can do here is just reiterate what I said in the prepared remarks that we clearly are in a better environment, market's better, the economic outlook is better.

We seem to have a light at the end of the tunnel in terms of the pandemic and we continue to buy back a lot of stock. If you look at our repurchases through early May, it was more than 3% of year-end '20 shares outstanding. So more than 3% over a 4-month period, obviously, is a very significant pace of buyback.

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

Okay. And then my second question, when you guys were talking about sales, I know you mentioned within annuities that you guys were ahead of expectations in this quarter. Can you just give us an outlook on kind of expectations for the rest of the year? And I'm assuming the Q1 was better, perhaps, things continue to look better than you would have previously expected just on the annuity side, that would be great?

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

Yes, sure. It's Myles speaking. So I guess what I would say is that our expectations are that we will grow sales in our core products with an emphasis of Shield, Flex and SmartCare. We do expect a decline in fixed deferred rate annuities. But at this juncture, we feel like the growth in our core product sales should be able to offset the decline that we should see with fix rate deferred annuities.

Operator

Our next question coming from the line of Tom Gallagher with Evercore.

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

First question, can you comment on the proposed changes to the economic scenario generator on the VA framework? How do you think this plays out? Is it a potential real risk here? Or do you think it's going to be manageable?

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

Tom, it's Ed. So there's a lot of work to do on the ESG. It's going to take time. And as you would expect, we're actively involved in the process. We believe that regulators in the industry are ultimately going to agree on an appropriate framework. So we'll see over time.

I would just point out that we've successfully managed through VA reform, which was a significant change in the regulatory framework for us and for others. And we have a very strong balance sheet. So I feel very good about our position.

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

Okay. And my follow up: just, I guess, on the product side, first question is you're hearing a lot more chatter about companies entering the buffer annuity space. Curious what you're seeing there? Is that negatively impacting pricing? Or is it actually helping because of the awareness and kind of that aspect?

And then also, do you -- is the recent momentum and improvement in life insurance, you think, kind of the beginning of a bigger part of a diversification strategy for Brighthouse, where you think this could become meaningful from a production standpoint down the road?

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

Tom, it's Eric. I'll start off and then I'm sure Myles and Conor might jump in. To your second point, yes, on life insurance, we said we were going to get back in this as a new business proposition. We kept all of our infrastructure as we were coming up with our flagship product, SmartCare, and we intend to grow it year over year over year.

We also entered the institutional spread margin business, as I think you know. We got a lot of experience in that. That should provide both good returns and diversification. So I'm very happy with how things are going on the product front. Myles, you want to add anything there?

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

As it relates to the competition in the RILA category, I think it is having some impact on our market share. But ultimately, we've always felt that good thing for financial professionals as well as consumers. We really like the competitiveness of our product. As Eric mentioned before, the first quarter marked our best quarter ever for Shield sales. And we're really excited about some of these new enhancements that we're going to be introducing to the product later this year.

So as I just answered with the prior question, we do believe some of the momentum that we have with Shield and Flex and SmartCare could potentially offset the decline that we're seeing with fixed deferred rate annuities.

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

Tom, it's Conor. I think part of your question at the outset was given the competition on the buffered space from a pricing perspective. But everything remains consistent there as well. We're very happy with the economics, and there's no change to that given the entrants. Like you said, I think it's just made the awareness in the space even broader, and that's helping everybody.

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

So Conor, no feature drift or arm -- beginning of arms race occurring that might compromise margins?

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

No. So we haven't had anything noteworthy in recent quarters. We do have some changes that are coming, but they are more -- remember, we're one of the older products in this space, though we have some changes that are -- they're enhancements to the product, but not ones that are difficult to hedge or that would impact the economics in a meaningful way or really in any way of note.

Operator

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

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

My first question is on the fixed annuity deferred annuity sales. I understand you've talked about the repricing actions in the fourth quarter that you would expect sales to come down. But I think the drop-off was pretty a surprise to me.

I was wondering if there's any color that you can share in terms of the pricing changes that you've made as well as the general kind of competition in the marketplace?

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

Humphrey, it's Conor. So you're right. We had a couple of rate declines last year, 1 in August 1 in December. The December 1 was more meaningful. And we had expected that we would have a significant decline. The nature of this space is that those with the most competitive prices do get a lot of the business. And on our rate changes moved us down the ranks a little bit, as I said, in late fourth quarter. So the results for the first quarter in the fixed rate space very much in line with our expectations.

Now when we're talking broadly, we also have a couple of fixed indexed annuities in this space, and they're performing very much in line with expectations. They remain core products. We'll be somewhat opportunistic in the fixed deferred space. I think everybody knows, we're in that space with a reinsurance partner. So we reconsider rates frequently. We do that in partnership with our reinsurance partner. So again, given the changes, this is very much what we expected in the early part of 2021.

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

Got it. And then my second question is related to the RBC ratio, which at 500% to 520% is definitely very strong. I was just wondering if you can provide a walk from the 485 at the end 2020 to kind of where you are today, given the relatively dampened statutory earnings this quarter?

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

Yes. Humphrey, it's Ed. So I guess I would start out by saying that for the balance sheet metrics this quarter on a statutory basis, overall, we had a material benefit from market factors. So the performance -- of the increase in interest rates and the performance of equities in the first quarter as well as the lagged impact of market returns on private equity.

So that was really a driver here of statutory metrics across the board. If you look at the balance sheet metrics of TAC and RBC, the key drivers for both of those would be the increase in interest rates in the quarter. So that's really what I would highlight as driving the sequential improvement in both.

Operator

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

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

Andrew, this is David. We can't hear you, maybe you're on mute. Hey, operator, maybe we'll just go to the next question. Andrew can dial back in.

Operator

Our next question coming from the line of Tracy Benguigui with Barclays.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

I'd like go back to the conversation on NAIC's economic scenario generator and couple that with your distributable earnings scenarios that is forward-looking. Just wondering at this point, are your projections influenced at all by the proposed methodology, which I understand is arbitrage free includes negative interest rate scenarios and linked interest rates to equity market movement?

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

Yes. Tracy, it's Ed. No, and I would -- I don't know that I would say that there is even really a proposal. I think there's a lot of things that have been going back and forth. And so I would be very careful to draw any conclusions around anything that's come out early on here. I think that, obviously, this is complicated, and there are knock-on effects, some changes you might make to 1 input. And I think all this stuff has to be considered.

So I -- there's really nothing to factor in, in my opinion, first of all. Second of all, those distributable earnings tables all were built upon the current statutory framework and the current ESG and reflect the mean reversion point declines over time based on the different rate assumptions, which were basically either mean reverting to a 3% 10-year treasury in 10 years or following the forward curve at year-end 2020.

And by the way, the forward curve at year-end 2020, I think, as I said in my prepared remarks, had the 10-year treasury at 1.65% at the end of 2025. And here we are 4 months into 2020, and we're 5 basis points from there.

Tracy Dolin-Benguigui - *Barclays Bank PLC, Research Division - Director & Senior Equity Research Analyst*

Okay. It sounds like a little bit too early to tell then. Also, could you contextualize for us how you balance preserving capital for growth versus buybacks? And how reinsurance flow may fit in the mix to achieve both objectives?

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

Well, it's Ed again. I'll start and maybe others will want to chime in. We are -- a key driver of this story long term is our distribution franchise, the growth in our sales and the diversification of our book of business over time. So the way we're going to create real value, we believe, is through this high quality, good return, organic growth, supplemented by substantial capital return.

And it's a pretty simple playbook, I think. We don't see any issue about having the capital to reinvest. That is all built into our -- the total company distributable earnings tables that we provided in mid-March. And as you know, new business is a strain upfront and then it produces cash over time. So over time, obviously, new business becomes a more significant contributor to the story.

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

Tracy, it's Eric. I'll jump in as well. Look, we are extremely pleased with our holding company cash, RBC ratio, et cetera. The balance sheet is in great shape. As we think about that dynamic of capital versus buybacks, I can tell you, as Ed already said, we've repurchased more than 29% of our shares outstanding, more than 3% of our shares outstanding this year and I can tell you we are very focused on hitting both our expense goal this year and our capital return target.

Operator

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

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

Just hoping you could help us think about the linkage between higher interest rates and distributable earnings? And is it roughly equivalent to the $200 million to $250 million per 25 basis point change in the scenario generator? Is that a reasonable kind of estimate? And then how quickly does that emerge in terms of your distributable earnings?

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

Yes. Eric, it's Ed. So let me try to help a little bit here. So if we go back to the tables that we disclosed on distributable earnings in mid-March, we included a comparison between 2 scenarios where the only difference in the scenarios were the interest rate assumption.

So under the 1 scenario, we had rates following the mean reversion path. So there's 3% at the end of 10 years for the 10 year. Now just clearly, that -- to be clear, that's the GAAP mean reversion assumption that we've assumed, not -- has nothing to do with the scenario generator. And the scenario generator is right now, 3.25% for the 20-year treasury and the mean reversion period for that is much longer than 10 years, multiples of that.

So anyway, if you looked at the difference between these 2 scenarios we showed in March, one had this following our GAAP mean reversion path, which had the 10-year treasury at 197 basis points at the end of 5 years, I believe it was 197.

And the other was following the forward curve. As a year-end '20. So that had it at 165 basis points at the end of 5 years. So the only difference in this scenario was ending at a 32 basis point higher 10-year in 5 years. And that led to an $800 million difference in distributable earnings over a 5-year period.

Given that the 10 years at 160 today, I think it's fair to assume that the benefit is probably more than what was indicated by that scenario comparison.

In terms of the question about the mean reversion point, I think, as you know, from following this industry closely for a long time, I think you've got to be very careful about assuming linearity when it comes to anything. I would say that if you look at the mean reversion point change next year, we do see some consistency in the impact we would expect next year with what we just realized in the first quarter.

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

Got it. That's helpful. And then maybe one other one on the distributable cash flow slides. I think you show a projected cash flow from non-VA blocks and new business of roughly $3 billion-plus over the next 10 years in your base scenario. Over what time frame do you expect to start generating material distributable earnings from your non-VA block? And kind of what does that assume for sales growth over that period?

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

Yes. So I think if we look at the breakeven period for our annuity sales, I think we said it's in the 5- to 7-year range. So I mean that should give you some sense of how it plays out in the DE tables.

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

Got it. So sort of halfway, you're showing a 10-year period, so about halfway through is when, I guess, you had reached that crossover point where it becomes a contributor to cash flow?

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

I mean that's a reasonable assumption.

Operator

And our next question coming from the line of John Barnidge with Piper Sandler.

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

You've done a great job of reducing operating expenses. Is there any way to dimension how much of the reduction in 1Q '21 is maybe onetime COVID-related lack of activity in nature versus planned reductions?

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

John, it's Eric. It's small and as we think about our projections going forward, look, nobody knows exactly what's going to happen a year from now, 2 years from now. We're going to be focused on having a super tight expense ratio, no matter what, but it's not that meaningful.

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

Okay. And then the follow-up to that is, with presumably employees returning to office in the coming months, is there like a step function higher in operating expenses that we should be thinking about or no?

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

No. I think if anything going forward, like longer term, let's -- John, let's call it, like medium term, I think it would be a little lower versus a little higher.

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

Yes. John, it's Ed. The only thing I would add to that, there is some seasonality, as you've seen in the expenses. So they tend to be lower in the first quarter and higher in the fourth.

Operator

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

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

Just on a statutory basis, I noticed that you didn't take any dividends out in the first quarter, is that just because your holding company liquidity position is so strong? And what are your expectations for dividends in the balance of the year?

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

Yes. Suneet, it's Ed. Yes, there's no change in what we've said before, which is we expect to take around $300 million this year.

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

Got it. And then I guess, Ed, if we think about kind of your prior comments about earnings power, I know there are some notable items and then some other variances. But if we kind of adjust for everything that you have in your slide deck, we're getting to something like $3.21 per share. I think on prior calls, you've talked about more of a $3 run rate.

Was there anything kind of onetime in nature related to kind of market impacts or anything like that, that we should be thinking about that could have impacted first quarter results here? Is the $3.21 million pretty close to your roughly $3 run rate?

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

Well, I'm going to leave the penny out of the discussion here. In the past, I've said approximately $3 a share, which there was a reason I used the word approximately. I do think it's fair to say that given the market increase, the increase in separate account balances, I think you probably do shade it a little higher than where we were in the last couple of quarters.

Operator

Our next question coming from the line Andrew Kligerman with Crédit Suisse.

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

Can you hear me now?

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

Yes, we can hear you, Andrew.

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

Good, good. Just wanted to follow-up on the question Humphrey was asking a bit earlier about fixed annuities and the pricing action. Could you be a little more specific on how much you cut the crediting rate? And then given that rates have come up so much in the first quarter, can you be back in the mix pretty soon and competitive?

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

Yes. Andrew, it's Conor. So we have some various products in this space. We have a 3 year, 5 year or 7 year. We -- the changes that we made in the fourth quarter, we were aggregating previously around that kind of 2% level, a little less for the 3 year. Now we're aggregating a little closer to the, call it, the 1.5%, but again, below that for the 3 year.

We actually had a modest increase in the second quarter, but it really was modest again in partnership with our reinsurer that I would say keeps us roughly in the same competitive position we were in Q1 as well. So...

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

Okay. So just -- yes, it sounds -- okay. And with regard mortality, it's just been very interesting with the different performances of the companies, but you cited basically a $90 million impact from weaker-than-expected underwriting out of which $45 million was attributable to COVID.

So I'm kind of curious as to what the drivers of the non-COVID figure were? Was this partly indirect pandemic-related claims? And then with regard to the $29 million charge that you cited from actuarial system conversions associated with the company's transition to future state platform, was this driven by universal life with secondary guarantees?

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

Yes, Andrew. So a couple of things. First of all, the driver of the $90 million, the primary drivers of the $90 million to get to a normal quarter, and when we say normal quarter, we mean kind of the average of the full year quarter. So there can be some noise related to seasonality, okay?

So just keep that in mind. But the big drivers we highlighted were COVID claims as well as the reinsurance offset. So we obviously have a reinsurance benefit in every quarter and that percentage benefit can bounce around. And this quarter happened to be one of the lowest quarters we've seen.

It's nothing more than noise, I would say. And if we look at our direct claims, which to me is, I think, more indicative of the health of the block of business. You've heard me say in the past that direct claims in the neighborhood of $400 million to $500 million a quarter is sort of where we hang out.

And if you look at our direct claims ex COVID, we were right in that range. So I don't see anything going on with mortality that makes me worry about any systemic issue with severity or frequency.

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

Got it. So...

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

Sorry, go ahead.

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

Yes. So generally, if you isolate it out, the reinsurance, it would have been a pretty normal -- and the COVID-19, it would have been a pretty normal mortality quarter then?

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

Yes. Sorry. And then you asked about the $29 million.

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

Yes.

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

Yes. So we're in the process, as you know, of transitioning to our future state operating platform that involves actuarial transformation, which includes moving to new models under our new platform.

And what you saw this quarter was the impact of converting the ULSG business. And $29 million, if you consider it relative to a reserve balance for ULSG on a GAAP basis of almost $8 billion, it's less than 40 basis points of the reserve balance.

So I don't consider that to be a material movement for a model conversion of that size. And the other thing I'd say is, you're going to see this from time to time. As we have conversions -- I mean, we have future conversions planned for this year. You will see this. And I would just caution you that it can be positive or negative. So it's not always going to be a negative number, would be my guess.

Operator

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

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

Ed, I just wanted to come back to I guess a discussion you had with Erik. The -- and I realize these things are never linear, but I think I heard you say if we roll forward to year-end 2021 or 2022, that you would have a favorable adjustment of 25 basis points for the mean reversion assumption that you embedded that caused what, negative $200 million to $250 million negative adjustment this quarter.

If all of that's right, and I just want to be clear on the timing of this, would you expect to have directionally similar positive adjustment to statutory capital of $200 million to $250 million going the other way? If you can sort of give a little more clarity on what you would expect?

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

Yes, sure, Tom. So what I said was in our distributable earnings disclosure, we had assumed that the mean reversion point would come down by 25 basis points this year and an additional 50 basis points next year.

Where rates are today, the decline next year would be only 25 basis points, not the 50 basis points that we had factored into our assumptions. And what I also said is that while I would caution against assuming linearity for anything that we talk about, it's -- I think it's fair to say, at least based on what we're looking at today, that the next 25 basis point impact on would probably be in the range of what you saw in the first quarter this year. That mean reversion change for next year would also be in the first quarter as it was this year.

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

Got it. So it would be 1Q 2022 is when the adjustment would be made?

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

Right. And what we're saying is that, that adjustment today would still be down, but it would be down by less than what we had built into the stuff we've provided you.

Operator

I'm not showing any further questions at this time. I would now like to turn the call back over to David Rosenbaum for any closing remarks.

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

All right. Thank you. And thank you all for joining us today and for your interest in Brighthouse Financial, and have a great day.

Operator

Ladies and gentlemen, that does conclude conference for today. Thank you for your participation. You may now disconnect.