Q3 2013 Earnings Call

Company Participants

- Charlie Lowrey, Head of Domestic Businesses
- Ed Baird, Head of International Businesses
- Eric Durant, SVP IR
- John Strangfeld, CEO
- Mark Grier, Vice Chairman
- Rob Falzon, CFO

Other Participants

- Chris Giovanni, Analyst
- Erik Bass, Analyst
- Jimmy Bhullar, Analyst
- Joanne Smith, Analyst
- Kenneth Lee, Analyst
- Mark Finkelstein, Analyst
- Nigel Dally, Analyst
- Ryan Krueger, Analyst
- Seth Weiss, Analyst
- Steven Schwartz, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Third Quarter 2013 earnings teleconference. At this time all lines are in a listen-only mode. Later, we will conduct a question-and-answer session. Instructions will be given to you at that time.

(OPERATOR INSTRUCTIONS) As a reminder today's conference call is being recorded. I would now like to turn the conference over to Mr. Eric Durant. Please go ahead.

Eric Durant {BIO 3932339 <GO>}

Thank you, Cynthia. Good morning, and thank you for joining our call. Representing Prudential on today's call are John Strangfeld, CEO; Mark Grier, Vice Chairman; Ed Baird, head of International Businesses; Charlie Lowrey, head of Domestic Businesses; Rob Falzon, Chief Financial Officer and Peter Sayre, Controller and Principal Accounting Officer. We will start with prepared comments by John, Mark and Rob and then we'll have at your questions. In order to help you to understand Prudential Financial, we will make some forward-looking statements in the following presentation. It is possible that actual results may differ materially from the predictions we make today. Additional information regarding factors that could cause such a difference appears in the section titled forward-looking statements and non-GAAP measures of our earnings press release for the Third Quarter of 2013, which can be found on our website at www.investor.prudential.com. In addition, this presentation may include references to adjusted operating income or to earnings per share, or EPS, or return on equity, or ROE, which are determined based on adjusted operating income. Adjusted operating income is a non-GAAP measure of performance of our Financial Services Businesses that excludes certain items. Adjusted operating income is not a substitute for income determined in accordance with Generally Accepted Accounting Principles, GAAP, and the excluded items are important to an understanding of our overall results of operations. For a reconciliation of adjusted operating income to the comparable GAAP measure, please see our earnings press release on our website. Additional historical information relating to the Company's financial performance is also located on our website. John.

John Strangfeld {BIO 14004907 <GO>}

Thank you, Eric. And good morning everyone. Thank you for joining us. We appreciate your interest in Prudential. I'll be brief in order to leave time for Mark and Rob's more expansive comments as well as for your questions. To sum things up regarding Q3, and in fact year-to-date as well, Prudential's never performed better. In comparison to the Third Quarter of last year, EPS and an adjusted operating income increased 85% this quarter. Excluding the effect of market driven and discrete items, such as DAC unlocking from the results of each period, earnings per share increased by 32% from $1.81 in the Third Quarter of 2012 to $2.39 in the Third Quarter of 2013. And on the same basis, our earnings per share for the year-to-date amounted to $6.76. This is an increase of 37% from $4.95 in the first three quarters of 2012. Our results thus far this year reflect the step function increase in both the level of earnings and of ROE. Our focus on the productive deployment of capital, which was contemplated in our ROE objective first articulated three years ago, is clearly paying off. The successful execution of the Star and Edison acquisitions in Japan, the emerging success of the Hartford Life purchase and the addition of the large pension deals we closed late last year are all contributing meaningfully to this year's results. We've also realized strong organic growth across our businesses, consistent with our strong execution. Pricing discipline, expense and risk management and focus have all served us well in building both current results and future opportunities. Importantly, we've also balanced investments in our business with distribution of capital to our shareholders in the form of dividends and share repurchases. That said, our results also reflect certain items that while very real, do tend to fluctuate. As we said last quarter, the things that tend to fluctuate have generally been fluctuating in a positive direction this year. In particular we benefited from higher than expected income from non-coupon investments, especially at Gibraltar, and from favorable mortality, especially in Individual Life. All in all then, our businesses are performing exceedingly well and we've been helped by fairly strong tailwinds. We're on a pace to achieve an ROE for the full year that meets or exceeds the top end of our stated ROE objective of 13% to 14% for 2013. We have a quarter to go to close the books on this year, but even then we never viewed our goal as a one year, once and done objective. As we've said, our goal is to achieve the 13% to 14% ROE in a way that's convincingly sustainable and then prove it out over a cycle. To us ROE is an outcome, not only a number. And our goal is to achieve and sustain superior performance. Doing so will be the financial manifestation of our unique business mix, the quality of our individual businesses, the talent of our people and really good teamwork and execution. And I have to say that in all of these areas, we have never felt better about the Company and its prospects. And with that, I'll stop and turn it over to Mark.

Mark Grier {BIO 1391186 <GO>}

Thanks, John. Good morning, good afternoon or good evening. Thank you, all for joining us. We appreciate the fact that we're competing with the Twitter story today. We're glad you're interested in listening to what we have to say. I'll take you through the results for the quarter and then I'll turn it over to Rob Falzon who will cover our capital and liquidity picture and our guidance for next year. I'll start with slide 2, an overview of our financial results for the quarter. On a reported basis, common stock earnings per share amounted to $2.94 for the Third Quarter, based on after-tax adjusted operating income of the Financial Services Businesses. This compares to EPS of $1.59 a year ago. After adjusting for market driven and discrete items in both the current quarter and the year-ago quarter, EPS was up 32%, amounting to $2.39 compared to $1.81. On that basis, pre-tax earnings for our operating divisions increased 24% for the quarter. This increase is largely the result of organic growth in the base of account values and assets under management, driving higher fees in our US businesses, reflecting both market appreciation and positive net flows over the past year. A greater contribution from investment results in our Retirement business, driven largely by the Pension Risk Transfer business we put on the books late last year. The contribution of the business we acquired from Hartford in January to our Individual Life results and continued growth of our International Insurance business, which also benefited from strong investment results in the current quarter and cost synergies as we near completion of the Star and Edison integration. On a GAAP basis, we reported net income of $981 million for the current quarter. This includes the net effect of a charge to increase our embedded derivative liability for annuity living benefits which was driven by our annual actuarial review. And it also includes a benefit to net income this quarter from the accounting impact of foreign currency remeasurements of non-yen liabilities on the books of our Japanese insurance companies. The comparison of book value per share, excluding accumulated other comprehensive income, or AOCI, is affected significantly by the accounting geography mismatch from asset and liability changes driven by foreign currency fluctuations where the impact on non-yen liabilities runs through the income statement while the offsetting impact on the assets is included in AOCI rather than in net income. After adjusting the numbers to remove the impact of this mismatch, book value per share is $60.12 at the end of the Third Quarter, up $1.88 from year end, after the payment of three quarterly dividends totaling $1.20 per share. When we evaluate our ROE performance in relation to our goals, we also adjust for this accounting geography mismatch, which benefited our reported ROE by reducing the denominator. After removing this benefit, along with the net benefit to results from actuarial unlockings and other market driven and discrete items, our annualized ROE for the Third Quarter would be about 16% reflecting the very strong performance of our businesses in the quarter. Presented on slide 3, this year's annual review of actuarial assumptions had a favorable impact of $280 million on pre-tax adjusted operating income, or $0.38 per share. In our annuities business the main drivers of the favorable unlocking of $301 million were a reduction in our last assumptions and updates for expected benefit utilization based on emerging experience, along with some calculation refinements. The other charges and benefits from the annual review are largely offsetting. The most significant items were a $108 million charge in Gibraltar Life primarily to strengthen reserves on a block of business that came to us in the Star and Edison acquisitions, driven mainly by observed benefit utilization and also a $45 million benefit in Group Insurance reflecting updates of both life and disability claims reserves based on experience studies. Slide four shows the remainder of this quarter's list of market driven and discrete items included in our results and it is short. In the Annuities business, the performance of our separate account funds reflecting the equity market increase in the quarter caused us to release a portion of our reserve for guaranteed minimum death and income benefits and led to a favorable DAC unlocking resulting in a benefit of $0.21 per share. Going the other way, charges for integration costs in the quarter totaled $0.04 per share. In total, the items I just mentioned, including the impact of the annual actuarial review, had a favorable impact of $0.55 per share on Third Quarter results. Slide five presents two views of our ROE trend. The blue bars are as reported, based on adjusted operating income and equity excluding AOCI. This view reflects the variability in results from market driven and discrete items including the impact of our actuarial reviews in the Third Quarter of each year as well as the impact on ROE from fluctuations in the denominator due to foreign currency remeasurement. The gold bars provide a view of our ROE trend that is more indicative of our underlying performance by removing the impact of market driven and discrete items and removing the impact of the foreign currency remeasurement that affects our book value through net income. On this basis annualized ROE was 15.4% for the first nine months of this year, compared to 11.6% a year ago. On a GAAP basis, our net income of $981 million for the Financial Services Businesses in the Third Quarter includes amounts characterized as net realized investment losses of $556 million pre-tax comprised of the items you see on slide 6. The $1.7 billion loss from product related embedded derivatives and hedging was largely driven by reducing our assumed level of lapses on variable annuity contracts based on our annual actuarial review. While lower assumed lapses contributed to a positive unlocking for our AOI results, they produced a charge here because of the capital market's assumptions we are required to use for embedded derivatives under GAAP. Stepping away from the accounting treatment, greater persistency increases the present value of expected cash flows for the book of business under our base capital market assumptions, which include a 6% blended long-term annual rate of return as we showed on our Investor Day because the higher fees we collect outweigh the greater cost of the benefits. However, for product embedded derivatives, GAAP provides guidelines for capital markets assumptions to be used, both to project account value growth and to discount benefit payments, extending out decades into the future. For example, under this quarter's GAAP calculation, the assumed blended annual long-term rate of return for account value growth is about 1.5%, with equities growing at about 0.75% annually. These market inputs, when applied together with a greater persistency assumption, were the main drivers of a $1.5 billion increase in the embedded derivative liability producing most of the $1.7 billion loss. Foreign currency remeasurement was a positive item for our GAAP income statement this quarter. This remeasurement primarily represents changes in the value of non-yen liabilities relating to products denominated in US dollars and other currencies on the books of our Japanese companies whose functional currency is the yen. Strengthening of the yen produced a gain in the income statement because it would take less yen to pay off these liabilities. We consider this non-economic because the liabilities are matched with assets in the currencies in which they will be settled. As I mentioned, the offsetting change in the yen value of the assets is in AOCI rather than net income. Impairments and credit losses on investments were small in the quarter. Moving now to our business results and slide 7. I'll start with our

US Retirement Solutions and Investment Management businesses. Slide seven shows a view of the results of these businesses and the adjustments we make for market driven and discrete items to get a view of underlying performance relative to a year ago. Slide eight highlights the Annuity business. After adjusting for unlocking and experienced true-ups, Annuity results were $370 million for the quarter, an increase of $115 million from a year ago. Stripping out the impact of the unlockings and other one-off items we've disclosed, as we've done on slide nine in the gold bars, the trend of earnings for the Annuity businesses outpaced our account value growth over the past year. Account values amounted to $147 billion at the end of the quarter, up 11% from a year ago. This increase was driven by market appreciation together with about $4 billion of net flows which mainly occurred late last year and in the First Quarter of this year. Our base policy charges on variable annuities are linked to daily account values and with average separate account balances up 16% from the year-ago quarter, exceeding the point-to-point growth you see here, policy charges and fees were up 15% from a year ago. Our results also benefited from a reduced drag from distribution and other costs which rose less rapidly than revenues and also benefited from a more favorable DAC amortization rate as our gross profits have improved. Turning to slide 10. Our gross annuity sales for the quarter were $2.4 billion, in line with this year's Second Quarter, but down from $5.9 billion a year ago. We regard our level of sales as an outcome rather than a target and the current level of sales reflects actions we've taken over the past year to adapt our products to the current environment in order to maintain appropriate return prospects and improve our risk profile. While leaving rider fees unchanged for our living benefit guarantees, we reduced the income payout rate at various age bands and eliminated the guaranteed doubling of protected withdrawal value after 12 years when we introduced last February our current living benefit feature called Highest Daily Income, or HDI 2.1. In addition, over the past year we've withdrawn our X shares, or bonus product, we have suspended acceptance of subsequent premiums and generations of products offered before 2011 and we implemented a cap on subsequent purchase payments on more recent HDI products. In addition, to maintain an appropriate balance between the value proposition to customers and compensation to our distribution partners, early this year we also reduced the commission rates that we pay. Slide 11 highlights the Retirement business. After stripping out market driven and discrete items, which include the impact of our annual actuarial reviews in each year and a charge in the year-ago quarter to write off intangible assets relating to a business we acquired in 2008, earnings for the Retirement business amounted to $241 million for the current quarter, up $89 million from a year ago. Current quarter results benefited by about $80 million from a greater contribution from net investment results, driven largely by spread earnings from the two major pension risk transfer transactions that we closed late last year. The benefit from higher fees driven by account value growth was partly offset by higher expenses. Total retirement gross deposits and sales, shown on slide 12, were $10.5 billion for the current quarter compared to $6.4 billion a year ago. Standalone institutional gross sales amounted to $5 billion in the current quarter, compared to $3 billion a year ago. Current quarter sales included $4.1 billion of stable value wrap products sold to plan sponsors while the year-ago quarter included $2.5 billion of those sales. Full service gross deposits and sales were $5.5 billion for the quarter, including a major case win of $1.3 billion. This compares to a total of $3.5 billion a year ago. Net flows remained in the positive column for the third consecutive quarter with strong retention of existing cases. Total Retirement net flows for the current quarter amounted to $3.4 billion, and account values stood at a record high $312 billion at the end of the quarter up by more than $60 billion from a year ago, including about $32 billion from the pension risk transfer transactions late last year. Slide 13 highlights the

Asset Management business. The Asset Management business reported adjusted operating income of $200 million for the current quarter, an increase of $11 million from a year ago. This increase was driven by higher Asset Management fees, reflecting growth in assets under management net of expenses. The segment's assets under management amounted to $848 billion at the end of the quarter, up 9% from a year ago. While most of the segment's results come from Asset Management fees, the contribution from what we call other related revenues, which encompasses incentive transactions, strategic investing and commercial mortgage activities is variable in nature since it reflects changing valuations and timing of transactions. The contribution from these activities to current quarter results was $47 million, down by $24 million from a year ago which partly offset the growth in earnings that are driven by Asset Management fees. Slide 14 shows our US Life Insurance businesses including the adjustments for the updates driven by our annual actuarial reviews and the Hartford integration costs. Slide 15 highlights Individual Life. After adjusting for market driven and discrete items, Individual Life reported earnings of $145 million for the current quarter, up $6 million from a year ago. The in force block of business we acquired from Hartford contributed about $32 million. The business integration remains on track. We are building a unified distribution system, drawing on the Hartford's strength and financial institutions and our solid positioning in the brokerage general agency channel and are well into the process of integrating the product portfolios. Cost synergies are emerging in line with our expectations. The contribution from the acquired business was partly offset in the comparison of results by higher distribution costs, reflecting the expansion of our third party distribution system as well as higher current quarter sales. And also partially offset by a lower contribution from net investment results. Individual Life sales on slide 16, based on annualized new business premiums, amounted to $165 million for the current quarter, including $53 million from the third party distribution partners that came to us with the Hartford acquisition. This compares to total sales of $98 million a year ago. The current quarter sales increase was mainly driven by universal life products with guaranteed universal life accounting for just over half of our current quarter sales. Our guaranteed universal life products have had strong demand in third party distribution channels including the financial institution distributors that came to us with the Hartford acquisition. We've taken steps to limit concentration and maintain appropriate returns, which have driven the sequential quarter declines in overall Individual Life sales that you see this year. These actions have included a series of price increases, most recently in July and October of this year, and we are discontinuing the Hartford Legacy Guaranteed Universal Life product as part of our product portfolio transition. In addition we implemented a cap last May on the amount of premium a client can invest when purchasing a contract. Because of the time span of the application and underwriting process, typically up to four months, we would expect these actions to have an increasing impact on our reported sales going forward. Slide 17 highlights Group Insurance. After adjusting for the reserve refinements reflecting our annual actuarial reviews, Group Insurance earnings amounted to $23 million in the current quarter, compared to $28 million a year ago. The decrease reflected higher expenses and a lower contribution from investment results, which together more than offset improved claims experience in Group Life. Slide 18 presents the results of our International Insurance business. Once again, adjusting for the refinements reflecting our annual actuarial reviews, integration costs and the China Pacific sale gain that benefited Gibraltar Life's results in the year-ago quarter. Slide 19 highlights Life Planner Operations. After adjusting for market driven and discrete items, our Life Planner business reported earnings of $405 million for the quarter, up $32 million from a year ago. The increase was mainly driven by continued business growth. On a constant dollar basis insurance revenues including premiums, policy charges and fees, were up by 7% from a year ago. In addition foreign currency exchange rates, which reflect our hedging of yen income at JPY80 this year versus JPY85 last year contributed a benefit of $13 million to earnings in comparison to a year ago. Slide 20 highlights our Gibraltar and other international operations. After adjusting for the items I mentioned, Gibraltar Life reported earnings of $470 million for the current quarter, up $107 million from a year ago. The current quarter benefited from a contribution from investment results, about $50 million greater than a year ago. About half of this increase came from non-coupon investments mainly reflecting strong performance in Japanese real estate related investments. Third quarter results also reflected about $60 million of cost savings achieved thus far from the Star and Edison business integrations compared to about $40 million in the year-ago quarter. The remainder of the increase came mainly from continued business growth and from improved mortality, which was about $10 million more favorable than the average contribution of the past four quarters. Current quarter results in Gibraltar also benefited by $11 million in the comparison from foreign currency exchange rates. Turning now to the sales trend in International Insurance, shown on slide 21. International Insurance sales, on a constant dollar basis, were $726 million for the current quarter compared to $941 million a year ago. Our international sales pattern is affected by market developments, seasonality and actions we've taken such as repricings. The most dramatic impact on the sales pattern for the past five quarters is the surge in sales of Gibraltar's yen-based bank channel single premium whole life product that occurred during the third and Fourth Quarters of last year, reflecting competitor actions earlier in the year which limited the alternatives available to bank customers with substantial funds to invest in life insurance products. In order to limit our concentration in the product and maintain appropriate returns, we implemented crediting rate reductions and reduced commissions effective January 1 of this year. And we discontinued sales of the product at the end of September. A $280 million decline in sales of this product in the current quarter, compared to a year ago, more than offset an overall increase of $65 million, or 11%, for the remainder of our product portfolio. Our sales tend of to be seasonally strongest in the first and Second Quarters due to accelerated sales efforts toward the end of the fiscal year in Japan on March 31 and lump sum payouts to retiring teachers that become available for investment in life insurance products during the Second Quarter. This seasonality effect is the main driver of the sales decline from the Second Quarter of this year to the current quarter. Slide 22 breaks out Life Planner sales. Life planner sales were $265 million in the current quarter compared to $271 million a year ago. As you see in the gold portion of the bars, sales of our US Dollar Whole Life and Retirement Income products in Japan amounted to $37 million in the current quarter, down from $46 million a year ago. Changes in currency exchange rates have made products that are denominated in US dollars about 25% more expensive to Japanese consumers in yen terms during the current quarter than they were a year ago. This has dampened demand for these products. The decline in these sales essentially offset an increase of $10 million, or 8%, in other products sold by Prudential of Japan. Current quarter sales in our Life Planner operations outside of Japan were down $7 million from a year ago driven by lower sales in Korea. Slide 23 shows sales in Gibraltar Life. Sales in Gibraltar Life were $461 million in the current quarter compared to $670 million a year ago. Taking a look at the gold portions of the bars, you can see a $225 million decline in sales through the bank channel. This reflects the $280 million decrease in sales of the single premium yen-based product that I mentioned partly offset by $55 million greater sales of other products, mainly recurring premium death protection policies, good business. Sales by life consultants are flat with the year-ago quarter. Over the past year the life consultant count has declined by about 2,400 to roughly 9,300 at the end of the Third Quarter which is consistent with our expectations as we near completion of the process of implementing minimum production requirements and other Gibraltar standards for the sales force that came to us with the Star and Edison acquisitions. The impact on sales from the decline in headcount was essentially offset by an increase in productivity, both in terms of policies sold per life consultant per month and in terms of average premium per sale. Sales by independent agents, which are largely in the small business market, are up $17 million from a year ago. Slide 24 shows the results for corporate and other. Corporate and other operations reported a loss of $312 million for the current quarter. This compares to a $320 million loss a year ago after adjusting for market driven and discrete items. The decrease in the loss reflects lower expenses in the current quarter. And now I'll turn it over to Rob.

Rob Falzon {BIO 4770408 <GO>}

Thanks, Mark. I'd like to give you an update on some key items under the heading of financial strength and flexibility and then address guidance for 2014. Starting on slide 25. We continue to manage our insurance companies to levels consistent with what we believe are AA standards. For Prudential Insurance, we managed to a 400% RBC ratio which we believe gives us some cushion against our AA objective. We began the year with an RBC ratio above 450%. While we don't perform a quarterly bottoms-up RBC calculation, we estimate that our RBC ratio continues to be above 450% at Prudential Insurance after giving effect to the Hartford transaction and other activities in the first nine months of the year. Prudential of Japan and Gibraltar Life reported strong solvency margins of 728% and 899% respectively as of June 30. These are comfortably above our 600% to 700% targets. Looking at the overall capital position for the Financial Services businesses on slide 26, we calculate our on-balance sheet capital capacity by comparing the statutory capital position of Prudential Insurance to our 400% RBC ratio target and then add capital capacity held at the parent company and other subsidiaries. At the end of last year prior to funding the Hartford Life acquisition, our on-balance sheet capital capacity was roughly $3 billion, of which $1.5 billion to $2 billion was readily deployable. Through the first nine months of this year we funded the Hartford acquisition, declared three quarterly common stock dividends of $0.40 each for a total of about $560 million and repurchased $500 million of our common stock, totaling roughly $1.8 billion of capital deployment and returns of capital. These capital uses were more than offset by excess capital generated within our businesses resulting in available on-balance sheet capital capacity of about $3.5 billion at September 30, including about $1.5 billion that we consider readily deployable. As you know, we announced a new $1 billion repurchase authorization in June, which extends through June 30 of next year. We executed $250 million of share repurchases during the Third Quarter under this authorization. Turning to the cash position of the parent company. Cash and short-term investments, net of outstanding commercial paper, amounted to about $4.5 billion at the end of the Third Quarter. This reflects senior debt issuance of $1 billion as well as $500 million of senior debt that matured during the quarter. Our recent issuance pre-funded $350 million of debt that will mature in 2014. The cash, in excess of our targeted $1.3 billion liquidity cushion, is available to repay maturing debt, fund operating needs or redeploy over time. Now I'd like to talk about our earnings guidance for 2014. Let's start by reviewing the key assumptions and considerations that underpin our guidance as summarized on slide 27. First to level set. Through the first nine months of 2013, our earnings per share, excluding items that we identified as market driven and discrete, was $6.76. Recall that throughout the year as we discussed our results we called out additional items that tend to fluctuate and were in the aggregate tailwinds to results, including excess returns on our non-coupon investments and favorable mortality in relation to average expectations. Adjusting for these items, as if they were roughly in line with midpoint expectations or historical averages, provides a run rate of approximately $6.50 per share for the first nine months, or about $8.65 per share on an annualized basis. We believe this provides an appropriate starting point for our 2014 guidance. Our guidance assumes a 2013 ending S&P 500 level of 1,760, which is near to today's S&P, and then 6% growth for 2014. Our International Insurance business non-dollar earnings are hedged and therefore locked in at JPY82 and KRW1,150 to the US dollar. Interest rates are assumed to follow a yield curve based on current rates. Lastly, we expect an effective tax rate of approximately 28%. Pulling all this together, our 2014 earnings guidance range for our Financial Services businesses on an adjusted operating income basis is $8.75 to $9.25 per share. Now I'll turn it back to John.

John Strangfeld {BIO 14004907 <GO>}

Thank you, Rob. Thank you, Mark. And we'd now like to open it up to questions. Eric?

Questions And Answers

Operator

Thank you.

Chris Giovanni, Goldman Sachs.

Q - Chris Giovanni {BIO 16655447 <GO>}

Good morning. Thanks so much. I guess first question just on in the quarter maybe the below the line charge, the $1.7 billion, you talked about it primarily related to lapses. I think back at the Investor Day in June when you walked through all the cash flows and MCV scenarios you talked about lowering the lapse assumptions for those that were outside of the surrender charge period from 10% in 2012 to 9%. So I'm wondering if that's what this charge is related to or if you've done something else in terms of refining assumptions maybe inside surrender charge period?

A - Rob Falzon {BIO 4770408 <GO>}

Chris, it's Rob Falzon. No, that's on point. What we did is we further updated that base lapse assumption. We brought it down from -- brought it from 9% down to 7%. We also tinkered with the dynamic lapse assumption and the sensitivity of customer behavior to the in the moneyness of their policy. And the combination of those two are the primary drivers to the $1.7 billion that you're looking at.

Q - Chris Giovanni {BIO 16655447 <GO>}

Okay. And then the dynamic lapse assumption, that moved from 5.4 [ph] to about where?

A - Rob Falzon {BIO 4770408 <GO>}

Well, that's a very difficult thing to calibrate because it's a slope. So it sort of depends on where the curve you are. But the order of magnitude of change would be sort of in the same range as what you're looking at on the days lapse assumption.

Q - Chris Giovanni {BIO 16655447 <GO>}

Okay. And then I guess regarding variable annuities, you've sort of stabilized here the $2.4 billion, $2.5 billion range. We did see a competitor do a reinsurance arrangement. Just wondering your thoughts, given the distribution and how strong of distribution channel you guys have, if that's something you would consider given the demand still appears to be there kind of across the industry for VA products?

A - Charlie Lowrey {BIO 3976922 <GO>}

Sure, Chris, this is Charlie. We think that those kind of transactions are all about diversifying risk. And we review our risk management strategies for our living benefit guarantees on an ongoing basis. And while we've looked at reinsurance, and will continue to look at potential reinsurance transactions, up until this point they haven't been as compelling to us. So we approached the issues in a slightly different way. First, we lowered sales to an appropriate level relative to our overall business mix, so we're down about 60% from year-over-year. Second, we lowered the risk profile of our existing VA product, as Mark described. And third, we diversified and are continuing to diversify a product range into other products with different or complementary risk profiles. So for an example, we launched our PDI product earlier this year, which has no equity risk because it's based on fixed income. So we'll continue to look for ways to add products to diversify risk further as well as continue to look at reinsurance where it might make sense, both to our existing book and on a prospective basis.

Q - Chris Giovanni {BIO 16655447 <GO>}

Okay, thanks. One last quick one. Then I'll get back in the queue. Mark, you accepted the non-bank SIFI designation. Wondering if you could give us any kind of additional comments in terms of maybe the decision, why not to move ahead with legal action and then any other kind of updated thoughts or developments here over the past couple months?

A - Mark Grier {BIO 1391186 <GO>}

Yes. The decision not to pursue this issue in court was a business judgment that was made by management and the board and we believe it's the best decision for the Company. We, by the way, I would say have a fundamental difference of opinion with respect to the liquidity basis for designation. However, we also believe that moving on is the right thing for us to do and that we will now continue to play a constructive role in the development of things like capital standards and the supervisory framework. And so we're moving on with it. In terms of where we stand, our supervisory, regulatory and capital regimes are all evolving. We'll be fully cooperative and responsive with respect to the supervision by the Federal Reserve and we'll seek opportunities to provide constructive input on issues that are important, like capital standards.

Q - Chris Giovanni {BIO 16655447 <GO>}

Okay. Thanks so much.

Operator

Steven Schwartz, Raymond James & Associates.

Q - Steven Schwartz {BIO 1500083 <GO>}

Good morning, everybody. A couple of things. First, I wanted to again follow up on the lapse assumption change in the discussion of GAAP versus economics. The returns that were assumed under GAAP, that's what came out of your stochastic modeling?

A - Rob Falzon {BIO 4770408 <GO>}

Steven, it's Rob Falzon. No, our -- unless we're talking about the GMWB, to be clear. Our GMWB falls under FAS 157, 133. Under that accounting, we used risk-neutral accounting for it. So it's not stochastic modeling. It's actually a market-neutral view of that liability that uses market rates for returns as opposed to best estimates for returns. So by way of example, Mark highlighted them in his talking points up front, that's the calculation that has equities earning 75 basis points, fixed income earning 2.25 over the life for a blended return on the account values of 1.5%. So it's not a stochastic modeling of expected account values, but rather the risk neutral view of that.

Q - Steven Schwartz {BIO 1500083 <GO>}

I'll take this up with Neil and where those numbers come from, I guess. Quickly just looking at the guidance, just a couple of questions. Share repurchase assumed in this?

A - Rob Falzon {BIO 4770408 <GO>}

We don't provide guidance on share repurchases specifically, Steven. I think as you know, our board authorized $1 billion of stock buybacks in June of this year. That extends through June of next year. And out of that $1 billion we implemented $0.25 billion in the Third Quarter.

Q - Steven Schwartz {BIO 1500083 <GO>}

One more if I may. The Japanese consumption tax, how much do you think that's going to affect earnings for 2014?

A - Ed Baird {BIO 15922078 <GO>}

This is Ed Baird responding. Not by a lot. Because the consumption tax is applicable to third party. And third party's a smaller portion of our distribution than it is for some other companies that you may be monitoring on this. So we don't anticipate any material impact next year.

Q - Steven Schwartz {BIO 1500083 <GO>}

Okay. Interesting. Thank you.

Operator

Nigel Dally, Morgan Stanley.

Q - Nigel Dally {BIO 1512203 <GO>}

Thanks. On the annuity lapses, I understand this is a GAAP charge, but any implications for your statutory results either for this quarter or for year-end, cash flow testing?

A - Rob Falzon {BIO 4770408 <GO>}

Nigel, it's Rob. Good question. There is a statutory impact as a result of the charge that we took. However, that impact is entirely offset within our PrucoRe entity, where these riders reside, by the gains that we have from the macro interest rate hedge we have within that entity. As a result of that, there will be no capital capacity impact as a result of this assumption update.

Q - Nigel Dally {BIO 1512203 <GO>}

Okay. Got it. Second, just in looking at the results, hopefully one of the key areas of the outside with the non-coupon investments at Gibraltar. Just hoping to get some color surrounding the size of the equity and real estate portfolio housed in Japan. If we go back longer over the time frame, just beyond the last four quarters, what's sort of like a normalized return you would expect to generate from those investments?

A - Eric Durant {BIO 3932339 <GO>}

Nigel, it's Eric. Let me deal with the normalized return aspect of your question. The truth is we don't know what a normal return there is. So let me give you some numbers. In all of last year, the contribution of income on non-coupon investments at Gibraltar was $97 million. For the year-to-date through September, and in the Third Quarter by the way, it was $71 million. For the year-to-date through September it was $176 million. I think you're on your own in coming up with what you would consider a normal level of income from those investments to be. As for the size of the portfolio, basically are three different pieces here. There are equities that we own that generate dividend income, but the equities themselves are not mark-to-market. There is directly owned real estate and then there are fund investments, generally in the form of a limited partnership. And the vast majority of the growth from 2012 to so far in 2013 has come from the fund investments and reflects very favorable market conditions both equities and real estate in Japan.

Q - Nigel Dally {BIO 1512203 <GO>}

And if you were to put those three buckets together what would be -- can you provide the aggregate size? Or is that something you haven't disclosed?

A - Eric Durant {BIO 3932339 <GO>}

The aggregate size at Gibraltar, I don't think it's a very meaningful number, frankly, but I'll answer the question. It's about $3 million.

Q - Nigel Dally {BIO 1512203 <GO>}

Okay. Great. Thanks a lot.

Operator

Jimmy Bhullar, JPMorgan.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Hi. So just another question on first the VHR. Just wondering how you think of the charges? Is it more because you've underestimated the economic liability or it seems like it's more just because of very conservative market assumptions embedded in US GAAP? And then if the market does perform better than what is embedded in the charge, would some of that charge reverse over time? That's the first question. Secondly, for Charlie on the disability. The loss issue, if we adjust for the actuarial assumption change I think was around 96%, which is worse than where it was before. So maybe just talk about what you're seeing in the disability business, what drove the deterioration there and just progress on your repricing initiatives?

A - Rob Falzon {BIO 4770408 <GO>}

So Jimmy, it's Rob. I'll answer the first question and turn it over to Charlie. In terms of our view of assumption updates, there was an accounting outcome and that's programmatic and I think we've described for you how that math is done and you can place your own judgments as to how conservative that is. We gave you the reinvestment rates. They result in particularly large claims way out in the future when the account values grow at those very modest levels. And then those claims are discounted back at a LIBOR curve, or the swap curve, so at a very low rate which reflects today's rate. When we look at our own expected case modeling for purposes of our anticipated cash flows, as a result of the assumption update we believe there's been a significant increase in the present value of our cash flows associated with this book of business. And so that's kind of our economic lens on that. In terms of the second part of your question, which is the reversion, yes, to the extent that through the 133, it's going to always be marked at market, through the swap curve. To the extent that we actually realize better returns than are forecasted will result in reversions going toward us at points in the future. So just to be clear, the economics are better when lapses go down but the accounting is worse. It's a point we made on Investor Day and your question is right on point.

Operator

Thank you.

A - Charlie Lowrey {BIO 3976922 <GO>}

Let me answer Jimmy's second question which has to do with disability and the benefit ratios. So the disability ratio this quarter was on a normalized basis was 96% versus a year ago of 96.5%. So we've come down slightly. It is worse than it was last quarter, which was 93.2%. Now we said the process wasn't going to be linear and we're kind of going to grind the ratio back down is the words we've been using. That's exactly what we're doing. But if you look at incident severity and termination for a moment, Third Quarter to Third Quarter where we did see improvement, incidents decreased, severity was slightly higher but terminations increased and I'll come back to terminations in a second because that's an important part of the equation. Third quarter to Second Quarter we had both incidents and severity both increase somewhat, severity more than incidents, which more than offset the increase in terminations. So you did have a little bit of a back step there. But I think the issue, and the important issue, is we've been working really hard on claims management. And the terminations in both cases have gone up. So we're dealing with a problem. We're about a third of the way through it at this point. We're repricing certain cases. We're letting others lapse and we're working on the terminations themselves, which are showing material improvement. We'll get there, but it isn't going to be linear. But if you look on a sort of four-quarter rolling average I think you'll see improvement as we go forward.

Q - Jimmy Bhullar {BIO 4278955 <GO>}

Thank you.

Operator

Erik Bass, Citigroup.

Q - Erik Bass {BIO 19920101 <GO>}

Hi. Thank you. Question on the international business. If you can talk a little bit about your outlook for sales? And are you expecting growth to reaccelerate in 2014 as some of the noise from the tough comps in the single premium sales subsides?

A - Ed Baird {BIO 15922078 <GO>}

Yes, let me explain a little bit about what happened in this quarter and that might lay a foundation from which you can draw some of your own extrapolations. So the overall drop was driven, as Mark pointed out, primarily by what happened in the bank. And that was a targeted reduction. The single premium product which dominated last year, much of the bank distribution of the roughly $1.4 billion last year, about $900 million of it was the single premium. That product can work pretty well in a flat or rising interest rate environment, but in a dropping interest rate environment it's not a product we want to be in. And that's why, as you'll recall over the earlier quarters of the year, we put in a series of constraints which culminated in ultimately our shutting the product down. So that's a big number that has dropped out of the overall production. If you then switch over to the -- and I think by the way, within bank channel you will see growth over time, but it will take time for that recurring premium growth to make up for the loss in the single premium. So that drop was precipitous and intended whereas the growth equally intended will be more gradual. If you look over on the life consultant side, the flat sales is actually extremely good news for the reason that Mark pointed out. We were able to achieve essentially the same sales in this quarter as we did this time last year through life consultant, but with 2,400 fewer sales people which allows us to reduce agencies, real estate, et cetera. That's about a

20% reduction in the headcount which was fully made up for about equally between productivity measured in number of sales and the average premium. Those two are very healthy signs for this business going forward. I anticipate that the headcount, the reduction rate will slow down, gradually stabilize and as a result will follow precisely the pattern we followed a decade ago when we took Kyoei away. Now Gibraltar through the same pattern. If you look at the life planner, that was down a little bit, but I'm not so much concerned about that because of where the drop came from. As you well know, three factors drive sales. The headcount, which in the case here continues to be pretty healthy at around 4%. That's probably as good as we can continue that in light of the emphasis on quality. The productivity actually rose slightly. So the only place where there was a drop, which produced the overall drop in life planner sales, was in the average premium. And that dropped relatively substantially by about 8%. Not too concerned about that. I view that as episodic, not in any way indicative. And the reason I say that is if you look back over the last four or five years, a lot of our sales growth was driven by on average about a 4% to 5% increase year by year in the average premium. So typically what we have had, and what I anticipate recurring again in the future, is you get about a 4% growth in headcount, you get maybe a 4% or 5% growth in the average premium, you get a smidgen out of productivity and that gets you to the double-digit, which is characterized the historic pattern and I would expect us to return to that in the future. I hope that's somewhat helpful.

Q - Erik Bass {BIO 19920101 <GO>}

That's helpful. Thank you. And then you mentioned some of the sales of US dollar products have declined a bit, given the movements in the currency. Are you seeing customers shift to yen denominated products? And then can you just talk about how your positioned in the yen denominated market and whether you earn the same margins on yen denominated products as you do on the dollar denominated?

A - Ed Baird {BIO 15922078 <GO>}

The yen denominated product, at least on the Retirement Income side, is very common product in the small business market, which is a significant market for our life planners, particularly some of our more experienced and successful life planners. The dollar denominated one is used more traditionally in the individual market for the purpose as evidenced by its name, Retirement Income. You get a number of factors here. Part of it is the currency factor, but it's difficult to isolate that because there has also been rate increases on both currency-based products over the last year, year and-a-half. So it's a little hard to know precisely what might be driving it. But I will point out that the dollar denominated Retirement Income has been the lead product in life planners, specifically in POJ, for, oh, problem probably five, six years now. And over that period of time you will have seen that the currency rate has fluctuated rather dramatically. So I wouldn't attribute too much significance to just a single quarter's movement in the currency. I suspect you will see this retain its position as a lead product for POJ regardless of currency movements.

Q - Erik Bass {BIO 19920101 <GO>}

Okay. And any comment just on the relative margin between yen dollar denominated?

A - Ed Baird {BIO 15922078 <GO>}

They tend not to, over time, over a cycle of movement on the interest rates, they tend to be priced in relatively the same region. So it has a lot more to do with what's going on at any one particular time in the capital market than it does necessarily what we're targeting in our pricing.

Q - Erik Bass {BIO 19920101 <GO>}

Okay. That's helpful. Thank you.

Operator

Mark Finkelstein, Evercore.

Q - Mark Finkelstein {BIO 6253120 <GO>}

Good morning. Rob, you talked in your presentation about spending $1.8 billion between Hartford buybacks, dividends, et cetera. And total available capital grew by about $500 million. So that gets you to kind of $2.3 billion, if you will, of implied capital generation which annualizes to somewhere around $3 billion. And I guess my first question is, is that the right way to think about capital generation going forward? Were there things in this particular first nine months that kind of would influence that one way or the other? What is your outlook on 2014?

A - Rob Falzon {BIO 4770408 <GO>}

Well, Mark, let me try to answer your question without giving an outlook on 2014 and tell you how I sort of think about the framework for capital capacity and capital generation. Start with the net income of the business. If you look through -- and adjust that for the non-economic things. So we start with our capacity that we had at the end of last year. That was around $3 billion. We had net income before FX remeasurement and NPR of about $2.2 billion, if you did that calculation. And then deduct from that the capital deployment things that I called out to you. Which was the combination of dividends, the stock repurchases and the Hartford acquisition. As a result of that you have the difference between those two is about $0.5 billion worth of positive capital net generation. There are a number of other things that run through for the first nine months of the year. However, all those other things wash each other out. When you look at where we were at the end of last year and where we are as of September, it's about that $0.5 billion difference between what we generated in earnings and what we redeployed in the three ways that I described. There are times where we have other things moving through capital capacity, but that's not creating a lot of noise in this particular year.

Q - Mark Finkelstein {BIO 6253120 <GO>}

Okay. Maybe just moving to guidance a little bit. You kind of framed out $8.65 as a reasonable starting point. The low end of the range is $8.75. And I guess what I'm interested in is there -- are there any businesses that as we look out to 2014 where if you kind of eliminate the non-coupon investments or favorable mortality or kind of some of the non-trendable stuff. Putting that to the side, are there any other businesses that you're expecting kind of pressured earnings relative to what we've seen in 2013? In a sense earnings to go down, if you will?

A - Rob Falzon {BIO 4770408 <GO>}

In our guidance we're not providing anything specific at a business level, Mark. So I actually can't respond to your question directly. Just to be clear, in the starting number that I gave you we did eliminate the excess non-coupon and the excess mortality. And so that's out of the numbers on an enterprise level basis. The guidance we're providing is at an enterprise level without bringing it down any further.

Q - Mark Finkelstein {BIO 6253120 <GO>}

Okay. One more if I just may. What was the actual statutory charge on lapse? I think you alluded to it, saying it was offset by the macro hedge, but what was the actual impact?

A - Rob Falzon {BIO 4770408 <GO>}

So if you look at the -- recall that our account statutory accounting for this particular product follows what we call a modified gap. So it's not traditional stat. And so if you look at the change in the hedge target, that would have been about $1.4 billion.

Q - Mark Finkelstein {BIO 6253120 <GO>}

That was fully offset by a macro?

A - Rob Falzon {BIO 4770408 <GO>}

I'm sorry?

Q - Mark Finkelstein {BIO 6253120 <GO>}

And that was fully offset by that macro hedge?

A - Rob Falzon {BIO 4770408 <GO>}

That's the reserve charge. When you look at the capital implications of that you have to tax affect it and then we have to add to that some additional risk capital that we had to put in. The net capital number, absent that reserve charge, that's what ran through the P&L and the statutory books, would have been about roughly $1 billion. And yes, it was $1.1 billion, and it was entirely offset by the gains that we had on the macro hedge.

Q - Mark Finkelstein {BIO 6253120 <GO>}

In a rising equity and interest rate environment? I'm confused about how the macro hedge would have offset that?

A - Rob Falzon {BIO 4770408 <GO>}

It's a cumulative gain in the macro hedge, not just a quarter's gain. So it was the gain that we had in there that we'd never count as part of our capital capacity and generally it's a protection against rising interest rates. So it gains as rates rise.

Q - Mark Finkelstein {BIO 6253120 <GO>}

Okay. All right. Thank you.

A - Mark Grier {BIO 1391186 <GO>}

It's the famous under-hedge.

Q - Mark Finkelstein {BIO 6253120 <GO>}

Got it.

Operator

Ryan Krueger, Dowling & Partners.

Q - Ryan Krueger {BIO 15132646 <GO>}

Thanks. Good morning. The individual annuities core ROA was up to about 102 basis points in the quarter. If the equity market kind of follows the past in your 2014 guidance assumptions, should we think about that as a sustainable type of margin going forward?

A - Charlie Lowrey {BIO 3976922 <GO>}

I think so. Because if you look -- this is Charlie, by the way. If you look at the drivers of that, it was really an increased margin from increasing fees and less increasing expenses. And so that drove the ROA along with a lower K factor. So the combination of that, if you extrapolate out our assumptions, should be that that's a sustainable margin going forward.

Q - Ryan Krueger {BIO 15132646 <GO>}

Okay. Thanks. On statutory cash flow testing, as we head into the end of the year. Last year you added a pretty substantial amount for your long-term care business relative to its modest size. With interest rates up in 2013, could we see some reversal of that reserve add from last year?

A - Rob Falzon {BIO 4770408 <GO>}

Ryan, it's Rob. I'm not going to speculate on what interest rates will do in the future. What I will tell you is that when you look at the -- I think I can give you the rates that we set our AAT at last year. And then you can make your own forecast as to what that may do in the future. Just got to give me one second to run that down. I would say the rates on -- that we said at the time that we set up the reserve for long-term care were significantly below today's rates. I'll have to, rather than scamper around now I'm trying to find it, I can follow up with you and give you that number.

Q - Ryan Krueger {BIO 15132646 <GO>}

Okay. I'll follow up. Thanks.

Operator

Thank you. Our next question --

A - Rob Falzon {BIO 4770408 <GO>}

Actually, let me just follow up. Ryan, when we set the rates -- as of September where we set the rates a year ago versus today, we're about 56 basis points higher than when the LOR was established last year. Specific answer to your question.

A - Mark Grier {BIO 1391186 <GO>}

There are a lot of moving parts in this. But the gist of your point is that the directional impact of higher rates is good. But again, there are a lot of moving parts.

Operator

Seth Weiss, Bank of America Merrill Lynch.

Q - Seth Weiss {BIO 16689254 <GO>}

Hi. Thanks a lot. And just a follow-up on the run rate and annuities. Understanding that you don't give sales targets in annuities. Just thinking about that ROA sustainable, it's fair to say that we're assuming that today's level of sales is a good base level. Is that correct?

A - Charlie Lowrey {BIO 3976922 <GO>}

I think what we'd say there is that we're comfortable with the level of sales we have today and sort of leave it at that. We wanted to reduce the level of sales and we did because we think about a number of different aspects when we think about level of sales. One is the product and making sure it's profitable, and we've taken steps in that direction. Second is to ensure that it still fulfills a customer need, and it appears to be doing so. And the third is the overall percentage of business mix. And Mark and John talked a lot about business mix overall. And that can be a governing factor. So between those three variables we come up with what we like to think of as a level of sales which we would be comfortable with. And we think we're comfortable with the level of sales we have now.

Q - Seth Weiss {BIO 16689254 <GO>}

Okay. Great. Thanks. And just a follow-up question in terms of the share repurchase authorization and understanding that you're not going to give any specific buyback guidance. With you no longer formally challenging the SIFI designation, from a process standpoint is there anything different this quarter from last quarter, in terms of being able to go into the market and repurchase shares?

A - Mark Grier {BIO 1391186 <GO>}

Well, capital planning broadly will be part of the supervision process with the Federal Reserve, yes.

Q - Seth Weiss {BIO 16689254 <GO>}

And in terms of this quarter, even though there's no formal restriction yet, any action will need to have a discussion with the Fed? Is that correct?

A - Mark Grier {BIO 1391186 <GO>}

I would characterize it more the way I just said it, which is pretty general, and that is that capital planning is one of the issues that will be part of our supervisory process. I don't want to be more specific than that.

Q - Seth Weiss {BIO 16689254 <GO>}

Okay. Understood. Thank you.

Operator

Eric Berg, RBC Capital Markets.

Q - Kenneth Lee {BIO 4390566 <GO>}

Hi. This is Kenneth Lee filling in for Eric Berg. Just have a question on pension transfers. We're seeing an (inaudible) of environment rising interest rates, equity markets is presumably helping out pension funding levels for corporations. Just curious if on balance you guys are seeing more or less interest among corporate clients for pension transfers?

A - Charlie Lowrey {BIO 3976922 <GO>}

Sure. It's Charlie. Clearly the funding ratios have gotten better. If you look at the latest Mercer study you see that the average funding ratio is probably around 91% or so with interest rates and equity markets rising. But I think it's fair to break the market down into three different segments. And the first is what we call zero to $1 billion, maybe zero to $2 billion. And that's mainly a cash market. And there's always a certain number of these transactions that are done year in and year out. And we have seen a slight uptick in activity here, but this is pretty much business as usual. There are lots of competitors in this space, especially in the zero to $1 billion range. So I'd say little bit more here, but more or less business as usual. You get to the $2 billion to $4 billion range, there's definitely more activity in this range. There are more conversations taking place with clients and there's a lot more consultant activity here as well. And this is either a cash, or at the upper end of the range, kind of an in kind market so there are less competitors here. But we're definitely having more conversations in this range. Finally you get to the jumbo range, which is what we characterize as $4 billion and above. Here we're -- what I would say is that we're having the same number of conversations, but the intensity of those conversations and specificity of those conversations has increased. Now, as we've always said, these will be episodic and they have very long lead times, but conversations are absolutely happening. And here there are far few players in the market. I think you can segment it into three different areas, but in general I think there are more conversations taking place and at the upper end of the market the intensity is increased.

Q - Kenneth Lee {BIO 4390566 <GO>}

Great. Thanks.

Operator

Joanne Smith, Scotia Capital.

Q - Joanne Smith {BIO 16931590 <GO>}

Good afternoon. I guess it is now. Two questions. The first one is on the full service retirement business. I notice that you had a large case win during the quarter and I do recall you expressing some disinterest in this business going forward, given the competition and the pressure on fees. So I'm wondering if you've had either a change of heart or if conditions have gotten better?

A - Charlie Lowrey {BIO 3976922 <GO>}

Okay. We have not had a change of heart in terms of profitability. I think the conditions have gotten better. I think your -- and you recall -- your recollection is correct in that two or three years ago we expressed some concern over the pricing in the industry and we pulled back and in fact had negative lows for a number of quarters. That I think reflects the discipline we've showed. But what we're seeing in this market, it's interesting, is more RFP activity. In part because we think some of the HR departments are less focused on healthcare going forward. They've kind of looked at that and now are refocused on their plans. So we see more RFP activity, which is we think real. In other words, not as many checked bids in the marketplace. And so there's a little more plan turnover. What I'd also say is that we've seen some price stability in the marketplace. Pricing was going down for a period of time. It seems to have stopped as plan sponsors realize they can only squeeze so much out of a rock before they start losing in service. So we have -- what we've seen is that we are not necessarily the low bid and we are still winning some plans because they've gone back to looking at service and quality. Now, you can't be way out of line, but you can -- you don't have to necessarily be the lowest price in order to win the business. Service and quality are absolutely factors that are coming back into play. So we're not going to win every case. We still have our price discipline, but there are cases that we are winning and the pipeline looks pretty good going forward.

Q - Joanne Smith {BIO 16931590 <GO>}

And are you talking about the large case market?

A - Charlie Lowrey {BIO 3976922 <GO>}

Large and mid-case market.

Q - Joanne Smith {BIO 16931590 <GO>}

Large and mid-case. Thank you for that. And then just for Mark, I've been reading a little about the language coming out of Washington concerning the Volcker Rule. And it sounds like it's going to be a lot more tougher than maybe some Wall Street executives think. I'm wondering, have you been able to assess what you've been hearing in Washington about how the Volcker Rule could potentially impact life insurers, especially with respect to the hedging activity?

A - Mark Grier {BIO 1391186 <GO>}

Well the short answer to that is no. This is still very much evolving and there's a lot of input flying toward Washington about the consequences of a number of aspects of the Volcker Rule. And we don't have a very good picture at this point of what that might mean for us. However, hedging activities are core to our business and these are not proprietary trading type activities that would be the target at least of the spirit of the Volcker Rule. We use derivatives to reduce risk, not to increase risk.

Q - Joanne Smith {BIO 16931590 <GO>}

Mark, do they understand the whole issue of the derivatives liability? It seems to me that the feds don't understand the life insurance business and the whole complexity that we've been discussing on this call about the VA charge. I think it would really confuse the feds.

A - Mark Grier {BIO 1391186 <GO>}

Well, certainly the complexity and lack of transparency combined with volatility and size of the embedded derivative liability in the annuity business is important. I would say that we have opportunities to work hard on explaining this and focusing on the economics versus the accounting and working with the regulators to get pointed in the right direction around a sensible economic solution to thinking about risk and capital.

Q - Joanne Smith {BIO 16931590 <GO>}

Okay. Thank you.

Operator

Thank you. Today's conference call will be available for replay after 2 PM today until midnight November 14. You may access the AT&T teleconference replay system by dialing 800-475-6701 and entering the access code of 272227. International participants may dial 320-365-3844. And those numbers once again, 800-475-6701 or 320-365-3844 and enter the access code of 272227. That does conclude your conference call for today. Thank you for your participation and for using AT&T executive teleconference service. You may now disconnect.