REFINITIV STREETEVENTS

EDITED TRANSCRIPT

BHF.OQ - Q2 2023 Brighthouse Financial Inc Earnings Call

EVENT DATE/TIME: AUGUST 09, 2023 / 12:00PM GMT

OVERVIEW:

Company Summary

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

CORPORATE PARTICIPANTS

Dana Amante *Brighthouse Financial, Inc. - Head of IR*

David Alan Rosenbaum *Brighthouse Financial, Inc. - Head of Product Strategy and Pricing*

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

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

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

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

CONFERENCE CALL PARTICIPANTS

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

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

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

Suneet Laxman L. Kamath *Jefferies LLC, Research Division - Equity Analyst*

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

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

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

Zachary Ben Byer *Autonomous Research US LP - Equity Research Associate*

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to Brighthouse Financial's Second Quarter 2023 Earnings Conference Call. My name is Justin, and I will be your coordinator today. (Operator Instructions) As a reminder, the conference is being recorded for replay purposes.

I would now like to turn the presentation over to Dana Monte, Head of Investor Relations. Ms. Amante, you may proceed.

Dana Amante - *Brighthouse Financial, Inc. - Head of IR*

Thank you, Justin, and good morning. Welcome to Brighthouse Financial's Second Quarter 2023 Earnings Call. Materials for today's call were released last night and can be found on the Investor Relations section of our website. 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 remarks, 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, our Chief Distribution and Marketing Officer; David Rosenbaum, Head of Product and Underwriting; and John Rosenthal, our Chief Investment Officer.

Before we begin, I'd like to note that our discussion during this call may 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 SEC. Information discussed on today's call speaks only as of today, August 9, 2023. The company undertakes no obligation to update any information discussed on today's call.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

During this call, we will be discussing certain financial measures that are not based on generally accepted accounting principles, also known as non-GAAP measures. Reconciliations of these non-GAAP measures on a historical basis to the most directly comparable GAAP measures and related definitions may be found in our earnings release, slide presentation and 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, Dana, and good morning, everyone. Brighthouse Financial continues to deliver on its operational, strategic and financial management goals as demonstrated by the milestones and results we achieved through the first half of 2023. Our overall priorities are focused on: one, executing our growth strategy, which is centered around our complementary and competitive product offerings as well as our expansive distribution footprint; and two, maintaining our focus on prudent, financial management to protect our balance sheet through a variety of market conditions.

Reflecting the continued execution of our growth strategy in the first half of 2023, we further strengthened our annuity and life insurance product portfolio. In May, we announced enhancements to our Shield Level Annuities product suite, including the launch of Shield options with Step Rate Edge, a strategy that is designed to help clients keep their plans for retirement on track by providing additional growth opportunities in certain down markets.

Additionally, we have seen great success with our new Shield Level Pay Plus product, which we launched last August. Year-to-date, through June 30, our Shield annuity sales totaled $3.2 billion, a 5% increase compared with the first half of 2022. In addition to strong sales of our Shield annuities, we also delivered strong fixed deferred annuity sales, which totaled $1.5 billion through the first half of 2023, demonstrating the complementary nature of our annuity product portfolio. We intend to keep our annuity product portfolio refreshed, including by expanding our product offerings over time.

For example, we are currently working on a new fixed indexed annuity product, which we expect to launch later this year. Regarding our life insurance business, I am very pleased to share that in July, we launched a new life insurance product, Smart Guards, a registered index-linked universal life insurance policy that offers clients guaranteed distribution payments that can be used to supplement income and retirement as well as a guaranteed death benefit. We also continue our focus on maintaining the competitiveness of our life insurance products and recently repriced our SmartCare and Simply Select life products.

Through the first half of 2023, we have seen persistent growth in our total life insurance sales, which increased 23% compared with the first half of 2022 reflecting the strong progress we have made as we execute our life insurance strategy. Along with the success that we have seen in our sales results, we have also maintained our focus on effectively managing our expenses in order to further reduce our statutory expense ratio over time. The combination of continued sales growth, which adds high-quality new business to our in-force book and the outflows of our capital-intensive legacy variable annuities or VAs, is fundamental to shifting our business mix over time.

As of June 30, 2023, Shield and fixed annuities made up approximately 40% of our total annuity account value, an increase of 25 percentage points since year-end 2016 and a more than 10 percentage point increase since year-end 2021. Additionally, roughly 40% is represented by the less capital-intensive VAs with the higher capital-intensive VAs representing only approximately 20% of total annuity account value as of June 30, further reflecting the progress we have made toward evolving our business mix.

We expect that this continued mix shift, along with the recent proactive derisking measures that we took to further improve the quality of our balance sheet, which we discussed on the first quarter earnings call, will help to produce more consistent cash flows through a variety of market scenarios and increase shareholder value over time.

In our effort to be a consistent returner of capital, we repurchased $152 million of common stock year-to-date through August 4, while we continue to operate with a cautious view on both the market and economic environment, as I've said in the past, we intend to maintain an active and

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

opportunistic share repurchase program. As we execute on our operational and strategic goals, we also remain disciplined in our financial and risk management, and we continue to conservatively manage our investments to maintain a high-quality and well-diversified portfolio.

As of the end of the second quarter, our combined risk-based capital or RBC ratio was estimated to be between 430% and 450%, which is at the upper end of our target range of 400% to 450% in normal markets. Our liquidity position remains robust with over $900 million of cash and liquid assets at the holding company as of the end of the second quarter. Our achievements and strong results through the first half of 2023 demonstrate our commitment to our shareholders and to supporting the growth of our franchise through a broad range of market scenarios.

I will now turn the call over to Ed to discuss our financial results in more detail.

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

Thank you, Eric, and good morning, everyone. Last night, Brighthouse Financial reported solid results for the second quarter of 2023. Starting with preliminary statutory results. As of June 30, our estimated combined statutory total adjusted capital, or TAC, was $7.6 billion, which compares with $8.2 billion as of March 31. Our estimated combined risk-based capital, or RBC, ratio was between 430% and 450%, down from a range of 460% to 480% at March 31 and is at the upper end of our target range of 400% to 450% in normal markets.

The decline in capital from March 31 was primarily driven by our annuity business. The largest portion of the annuity-related decline was the underlying performance of our variable annuity book of business, which was impacted by basis risk and normal volatility in the in-force liability. Basis risk refers to the difference between the performance of funds and the separate accounts and hedges linked to various market indices.

The other significant factor was related to the geography of our Shield book of business, which we plan to address by enhancing capital efficiency through reinsurance between Brighthouse Life Insurance Company, or BLIC, and our New York affiliate before year-end. We expect this reinsurance agreement will result in capital optimization benefits, including the reversal of approximately $200 million of the second quarter decline in TAC.

Moving to the holding company. Our cash position remains robust with holding company liquid assets of over $900 million as of June 30, which compares with $1.1 billion as of March 31. The decline in holding company cash is primarily related to the timing of interest expense and subsidiary dividends during the year and our ongoing share repurchase program. As a reminder, on an annual basis, nondividend flows to the holding company cover most of our fixed charges, and we do not have any debt maturities until 2027.

Finally, while we have not taken any subsidiary dividends in the year-to-date, we still expect approximately $300 million of ordinary subsidiary dividends to the holding company in 2023. Before turning to adjusted earnings results, I would like to take a moment to touch on the upcoming release of our long-term free cash flow projections or what we have previously referred to as distributable earnings. We are currently working through the later stages of the free cash flow projection process and expect to publish our updated scenarios in September. We will provide notice on our Investor Relations website approximately 1 week before we release the long-term free cash flow projections.

Now turning to adjusted earnings. In the second quarter, Brighthouse Financial reported adjusted earnings less notable items of $271 million, which compares with adjusted earnings on the same basis of $195 million in the first quarter of 2023 and $353 million in the second quarter of 2022. There were no notable items in the second quarter of 2023. The adjusted earnings results in the quarter were generally in line with our quarterly run rate expectation. This was a straightforward quarter on an adjusted earnings basis as alternative investment returns and mortality were both generally in line with expectations, and there are no market impacts on the amortization of deferred acquisition costs, or DAC, post the implementation of long-duration targeted improvements, or LDTI, as of January 1, 2023.

Turning to segment results. Annuity adjusted earnings were $291 million in the quarter. Sequentially, annuity results reflect higher reserves along with higher expenses, partially offset by higher fees and higher net investment income. Adjusted earnings in the Life segment were $15 million. Higher net investment income was the driver of the change sequentially. The Run-off segment reported an adjusted loss of $16 million. On a sequential basis, results were driven by higher net investment income and a higher underwriting margin. Corporate & Other had an adjusted loss of $19 million, reflecting higher expenses sequentially.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

To wrap up, through the second quarter of this year, we have continued to support growth in our franchise while delivering solid financial results with strong adjusted earnings and a continued robust capital and cash position. Since separation, we have taken actions to lower the risk profile of our company and optimize capital, and we continue to see opportunities to create long-term shareholder value.

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

QUESTIONS AND ANSWERS

Operator

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

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

Ed, my first question, you guys reaffirmed -- you reaffirmed that you guys are expecting to take that $300 million dividend from BLIC in the second half of the year. Any timing you can provide there or thoughts around Q3 versus Q4?

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

Elyse, yes, I think, we'll just stick with the plan to take it in the second half at this point.

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

Okay. That's what I thought you'd say. And then as we think about the timing, if you do take that dividend up to parent, because I know you said, right, nondividend sources of cash, right, can fund interest expense. Should we think about buybacks potentially increasing? Or would you look to maintain kind of the similar cadence of repurchases we've seen so far this year?

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

Yes. So I mean, first of all, there is some seasonality in the interest expense, which I think you're alluding to as we have about -- I think it's about $60 million more of interest expense in the second quarter and the fourth quarter than we have in the first quarter and the third quarter because of the debt that we have outstanding and the timing of the coupons. The question about buyback, I don't really think I would look at a linkage here between what we do with our repurchase and the timing of our dividends up to the holding company.

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

Okay. And then Eric, you provided some color just in terms of Shield sales and how they've trended on pretty well so far this year. Could you -- just looking for a little incremental color on how you think sales could trend in the back half of the year? And anything you guys are seeing just in terms of the competitive conditions in the market?

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

Well, I'll start, and Myles is probably going to want to jump in. Look, we're very pleased with sales in the first half, and I don't really think we're going to see much of a difference in the second half. It's a good environment, I believe. You didn't ask about fixed, but fixed has been coming down a

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

little bit. We'll see what happens with interest rates. We're very pleased with the sales we're getting now there as well. It depends on a couple of different factors. The economy does matter to some degree. But mostly, we're pleased across the Board with our Shield sales at all of our distributors.

So Myles, I don't know if you want to add anything?

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

Yes, absolutely, Eric. I guess what I would say is we do expect to see continued growth with our suite of Shield products in the second half of the year. I think there's a few reasons for that. I think we're starting to see a shift in the industry, where customers are going back to some of the other products like RILA products away from FRA. FRA was down in the industry a little bit in the second quarter. And then we continue to enhance our offering, right? We launched Shield Level Pay Plus last year, which is our income solution that is being well received in the market, and we launched Step Rate Edge, as Eric mentioned a few moments ago, earlier this year, which is also being well received in the market. But the landscape remains competitive out there, but we do believe we will be able to continue to grow sales in the second half of this year.

Operator

(Operator Instructions) And our next question comes from Ryan Krueger from KBW.

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

First question was on New York. Is the impact of the internal reinsurance transaction expected to be the $200 million reversal that occurred in the second quarter? Or are there additional impacts beyond that, that you'd expect as well?

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

Ryan. So just to give a little background on this. I think you've heard us say that the Shield book of business is a natural offset to the risk of our VA book and as a result, the combination creates capital efficiency for us. So the issue that we have with our New York affiliate now is that the balance sheet is primarily Shield exposure with very little exposure to VA. So as the Shield book has grown at the New York affiliate, our operating capital -- our operating subsidiary capital structure has become less efficient and has given us a chance to look for some ways to optimize that.

So this proposed reinsurance is going to benefit us from a capital standpoint. And I would say it's the $200 million that we saw in the second quarter as well as capital optimization beyond that. So I think at this point, $200 million reversal of what we saw the impact in the second quarter is as far as we would go. But certainly, we expect that this reinsurance arrangement will support future growth of Shield in our New York affiliate.

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

Okay. And then any color you can provide in terms of the format of the upcoming free cash flow projections and if it will be different than how you've gone about it in the past?

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

Well, I would just say every year that we do this, we try to put out something that provides the investment community with the best view of how we would think about the future cash flows that should feed into the intrinsic value assessment of our company over time. And so we always look for ways to improve the format to help you get to the ability to model out and think about what this company is worth. And so I'd leave it at that. But as we said it's not going to be long before you're going to see what the results are, and we will give you a little bit of notice on the IR website so that you're prepared for when that release occurs.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Operator

And our next question comes from Alex Scott from Goldman Sachs.

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

First one I had is actually on the net income performance this quarter. I had been under the understanding that the market risk benefits was a little more aligned with market neutral and in a quarter where rates increased, I think historically, in every quarter, you've reported under LDTI, net income relative to adjusted would sort of follow the direction of rates. And this quarter, it went the opposite direction. So pretty big magnitude difference from what we would have expected. So I just wanted to find out if -- what has changed there? I mean, is the notional of interest rate hedges significantly moved up from what was in the 1Q statutory filings? And maybe if you could just help us think through your interest rate hedging program and your approach to it in general.

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

Alex. So first of all, I would say we did have a benefit from rates going up in the market risk benefit. So there was a benefit from rates, but there are a lot of other factors as well. We did put on a lot more rate hedges last year. And so that will certainly impact the relative sensitivity versus what you had seen from the restated historical GAAP numbers for LDTI. One thing I think might be helpful here is to step back and think about our hedge target and how that relates to LDTI. So it's fair to say that new GAAP accounting is a significant improvement over old GAAP because now we have both assets and liabilities mark-to-market under the market risk benefit framework.

However, we hedge to stat, and there are key differences between stat and statutory and the market risk benefit. And just to give you a few of those, I think you probably know this, but the MRB is based on a mean expected return versus statutory is a tail metric. The MRB assumes risk-free rate is the driver of returns across all asset classes versus statutory is a real-world return framework.

And finally, the market risk benefit is rider fees only versus the statutory calculation includes all fees and expenses. And just on that last point, using that to illustrate some of these differences and drivers for this quarter, when you are hedging on stat and you have a liability where it's taking into account all fees, that would suggest that you might have more equity hedging for a statutory framework than you would if you were just targeting GAAP.

And so that was a driver of this loss in the quarter that we were shorter equities from the standpoint of the GAAP framework because of managing to the stat framework. And then I'd also add, I mentioned basis risk. Now obviously, basis risk is a factor for both GAAP and stat. So that's another contributor as well. So there's no change in how we think about our interest rate hedges. I think there was a question that came up last night, I believe, about are you amortizing hedging results? We do not avail ourselves of the, what is it, SSAP 108, I believe. So we do not amortize any gains or losses associated with our variable annuity hedges. Just to clarify on that.

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

Appreciate all that color. Next one I had is on normalized stat earnings. They've been a little weaker so far through the year ex the impact of the mean reversion point change earlier in 1Q. Could you help us think through what is a good run rate here? I know a lot of things can move around, so probably not great to just look at the year-to-date numbers. So any way you can help us think through like what we should expect over the next 12 months out of norm stat earnings?

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

Yes, I think it's very difficult to talk about a run rate for norm stat earnings. We've said in the past that we can have a couple hundred million dollar movement in that number in a quarter in either direction that is outside of what you might anticipate given equity and interest rate movements

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

in the quarter. I think that looking at metrics like norm stat earnings, it's better to do that over time. I think when we give you our free cash flow disclosures next month, you can think about those numbers. And there is a linkage between norm stat and free cash flow because norm stat is supposed to measure the excess capital generation over time. So I think when you see those free cash flow numbers and you think about multiyear periods, it's best to think about it in that fashion because I just don't see how you can give a run rate for this metric in a short time period.

Operator

And our next question comes from Tracy Benguigui from Barclays.

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

Are you seeing basis risk since you're using more customized indices? Is there a simple way to put it like a percentage of hedging breakage?

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

Tracy. We are always looking for ways to improve the effectiveness of our VA risk management strategy, which obviously includes hedging. We look for ways, and we have had success, I would say, in terms of reducing basis risk by introducing more indices into our hedging program. But I don't think I would go beyond that other than to say, if you look at the $200 million norm stat loss this quarter, the biggest driver of that was basis risk. So that was a key factor this quarter. We've had basis risk in other quarters, but there have been offsetting items. And in this quarter, I think it stood out more than what we have seen on a net basis than what we've talked about in the past.

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

Okay. One of your competitors also completed an internal reinsurance transaction from New York to a non-New York entity, but they had to pay a ceding commission. So I just want to be sure, when you're talking about $200 million reversal, is that a net figure where you're taking into account any ceding commission to New York? And I'm also just wondering, just by moving those Shield reserves to like Delaware, does that leave RBC more compressed at your New York entity? It will be helpful just to understand how well capitalized New York will be post transaction.

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

Sure. So the first thing is, remember, BLIC New York is a wholly owned subsidiary of BLIC. So the net impact of the ceding commission is not an issue. And then secondly, the expectation is the capital metrics for BLIC New York will improve as a result of this meaningfully.

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

Okay. So they both improve in a way?

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

Correct.

Operator

And our next question comes from John Barnidge from Piper Sandler.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Can you maybe talk about the new fixed indexed annuity product you're talking about rolling out and how widely you anticipate it initially being rolled out through your distribution?

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

David, you're on mute.

David Alan Rosenbaum - *Brighthouse Financial, Inc. - Head of Product Strategy and Pricing*

Got it. Sorry about that. So as Eric mentioned, we are working on a new fixed and next annuity product to launch later this year. As you know, our footprint in fixed index annuities is relatively small, and that's been intentional. It is a big marketplace, however, sales last year were around $80 billion and sales so far this year, almost $50 billion. So a big market, and so we're looking to enter that in a more broad way. So what we're thinking about and what we're planning to really to target a handful of distribution partners where we have solid relationships to really start are really more of our entry into this market, and that's kind of how we're going to start it later this year. So more to come.

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

And then my follow-up question. You all have been reducing your office exposure for a number of years and it modestly fell again. What's the targeted level you'd like to get to?

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

John, it's John. Thanks for the question. I'm not sure we have a specific targeted level in mind. We're at 24% of the portfolio right now. And given that we're not going to be buying any more office or investing in any more office loans generally over the near term, we'd expect that figure to come down with portfolio roll off. But we don't have a specific target in mind.

Operator

And our next question comes from Zach Byer from Autonomous Research.

Zachary Ben Byer - *Autonomous Research US LP - Equity Research Associate*

I guess -- on the reinsurance transaction, I guess that optimizes your balance sheet. I was just curious, are there other opportunities you're considering to further optimize the balance sheet going forward?

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

Zach, it's Ed. I think we have done a pretty good job of taking advantage of opportunities to optimize the balance sheet. We're always looking for opportunities to do more, and when it makes sense, we will. But at this point, I don't see anything specifically that I would point out.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

Zachary Ben Byer - *Autonomous Research US LP - Equity Research Associate*

Got it. And then just kind of shifting to RILA. So as the market's evolved and expanded, and there's been more new entrants, how have you seen product design and competitive dynamics evolve as well? And just thinking about your market share, is there a difference between your products versus competitors? Or if not, what do you think has allowed the market leaders to retain their relative leading positions?

David Alan Rosenbaum - *Brighthouse Financial, Inc. - Head of Product Strategy and Pricing*

I'll start and then I'm sure Myles will probably want to jump in. I think from a product design perspective, one of the things that we've thought about from the beginning is that simplicity and transparency matter. And that's kind of how we have built our product design and the enhancements that we add. And with -- there are 20 or so players in the market, so it's competitive. When we think about the economics, we're comfortable with the economics that we are maintaining our pricing discipline.

We have been looking to enhance our product and really enable us to compete in a variety of market conditions. And you heard some of the enhancements that Eric talked about earlier in the prepared remarks, and we will continue to look to do that as well as addressing more client needs, and we did that thinking about supplementing income and retirement with the launch of Shield Level Pay Plus in August of last year.

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

Yes. So I guess I would add to what David said, I agree with what he said. Our focus continues to be on our top distributors, and I think that's been a real differentiator for us. And we continue to round out our suite of Shield offerings that David said a moment ago to address multiple customer needs as well as to make sure that the product can compete in a variety of market conditions. And that type of focus with that comprehensive approach has allowed us to continue to maintain share. And over time, the expectations are going to continue to grow share.

Operator

(Operator Instructions) And our next question comes from Tom Gallagher from Evercore ISI.

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

First, a question on the hedge performance. Is really all of that coming from legacy VA? Or is any of that breakage and basis risk coming from Shield?

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

Yes. I would -- we manage this overall as a block. So I don't know that I would be able to break that out for you specifically. I mean, remember, this is managed together. So I don't think there's a good answer to give you on that.

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

Ed, the reason I ask is, I was listening to what you were saying in the beginning about the mix shift, which sounds like there's been a meaningful change in AUM and underlying earnings power coming from, we'll call it, a higher multiple, more stable business. I just want to make sure as we roll the clock forward 2, 3, 4 more years. Are we still going to see the same level of net income volatility potentially coming from Shield? Or do you see them being meaningfully different when you think about hedging performance? My understanding has always been the buffer annuities are much, much tighter when you think about the [ALM] aspect of the hedging, and I just want to know, does the accounting represent a similar story? Or does it also have some high degree of volatility associated with the newer product on the Shield side?

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Okay. So first of all, I mean, remember that Shield is liquid indices, and so they don't -- it does not contribute to basis risk generally and as meaningful a way as VA, okay? So I would say that without giving -- getting any more specific on your first question. The second is, again, we're managing this together, right? So I think if you say -- if you were -- if you're saying, yes, I look at Shield and I buy a call spread and I write a put, right? Like it's pretty straightforward, right? I think that's what you're referring to as tighter hedging. I think you used the word tighter hedging, I don't know, but you're correct. But remember, we're not managing this separately. We are managing this together with our VA block.

So it is slightly different when you think about it in that fashion. The other thing that I would say is, again, going back to the answer I gave to Alex's question, we have chosen a hedge target that we think makes the most sense for us as a regulated entity that is looking to generate free cash flow as measured by cash to the holding company from our operating subsidiaries over time, while protecting the statutory balance sheet, which is critically important to our distribution franchise. And that, in our opinion, is the right target. When you pick that target, I think by definition, it means all our targets are secondary and what happens relative to those other targets is secondary.

If you try to manage to all of them, I would argue you managed to none of them. And we think we are managing to the appropriate one. So when you talk about net income, it's -- I anticipate it will be volatile, and it will be difficult to predict. And I think we can talk about some of the drivers of why it is, what it is. But at the end of the day, we're making decisions to try to generate a growing stream of free cash flow, a convergence of free cash flow across scenarios. So we have a more predictable overall free cash flow profile.

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

That makes sense. And just for a follow-up, can you talk a little bit about competitively, are you seeing the alternative backed insurers getting more aggressive in the buffer annuity space? I think I recall a couple of quarters ago, hearing that they're rolling out products, but they're kind of on the fringe, is that still generally true? Is it still the domain of the traditional insurers that you're really competing against there? So just any color, any further elaboration on who the competitors are in the buffer annuity space.

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

Yes, it's Myles. I'll go ahead and jump in on that one and any of my colleagues can contribute as well. I mean, the competitive landscape in the RILA category has become significant over the years, over the last decade or so. And you're competing with a variety of different competitors. So it's not just the insurers that are backed by some alternative investment shops. It's really across the board. And you're seeing, obviously, the product portfolio enhanced in a number of ways. Obviously, not only protected accumulation strategies, but custom indices. Now you're seeing the evolution of income and I think you'll continue to see a number of enhancements moving forward. So I personally expect to see that this category will become even more competitive over time. But it's not really focused on one particular type of insurer. I mean you got 19 carriers in the category now, and I think a couple of others have filed for products. So it's pretty much across the board.

Operator

And our next question comes from Suneet Kamath from Jefferies.

Suneet Laxman L. Kamath - *Jefferies LLC, Research Division - Equity Analyst*

Can you just give us an update on the sales strain that you expect from new business? I think in a recent quarter, Ed, you'd put it at maybe 5 RBC points, just given your sales expectations for the second half, are we still in that neighborhood? Or has it changed?

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV

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

Suneet. So I'll tell you that in the second quarter, it was in that neighborhood. So what I would consider to be the more normal, let's say, 5 a quarter, right? I pointed out on the first quarter call that growth was actually a contributor to RBC. I believe I pointed that out in the first quarter call -- in the first quarter because when you sell a lot of fixed annuity -- fixed rate annuities like we did in 2022, there's a big C4 capital charge, an upfront charge that you have to hold for the year and then you release it at the beginning of the subsequent year, right?

So we did see a benefit to RBC in the first quarter and now this quarter, we're back to the more normal type of impact. I would just say overall, with RBC, I mean, obviously feel very good about the fact that we are at the upper end of our target for normal markets. And if you take into account the benefit that we think we get on tack from this reinsurance topic that we discussed earlier, that's another 10-plus points to RBC. So we feel good about the RBC ratio. We feel like we are in a good position to fund growth. Obviously, funding growth for us is an important part of this story as we continue to shift our business mix toward higher cash flow, lower risk products.

Suneet Laxman L. Kamath - *Jefferies LLC, Research Division - Equity Analyst*

Got it. And then do you have an update on the unassigned surplus as of the end of the second quarter for BLIC?

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

Yes. Let me check on that. We might have to get back to you on that one.

Operator

And I am showing no further questions. I would now like to turn the call back over to Dana Amante for closing remarks.

Dana Amante - *Brighthouse Financial, Inc. - Head of IR*

Thank you, Justin, and thank you all for joining us today. Have a great day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2023, Refinitiv. All Rights Reserved.

©2023 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

REFINITIV