THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

FG.N - Q2 2018 FGL Holdings Earnings Call

EVENT DATE/TIME: AUGUST 09, 2018 / 1:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Christopher James Littlefield *FGL Holdings - President, CEO & Director*

Dennis Robert Vigneau *FGL Holdings - CFO*

Diana J. Hickert-Hill *FGL Holdings - Chief IR Officer*

CONFERENCE CALL PARTICIPANTS

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

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

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

Kenneth S. Lee *RBC Capital Markets, LLC, Research Division - Analyst*

Pablo Augusto Serrano Singzon *JP Morgan Chase & Co, Research Division - Analyst*

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

PRESENTATION

Operator

Good morning and welcome to the FGL Holdings Second Quarter 2018 Earnings Conference Call and webcast. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Diana Hickert-Hill, Senior Vice President of Marketing, Investor Relations and Communications. Please go ahead.

Diana J. Hickert-Hill - *FGL Holdings - Chief IR Officer*

Thank you, operator, and good morning, everyone. We appreciate you joining our earnings call. Today, we will discuss our financial results for the second quarter of 2018 which ended on June 30. You can find the financial information for FGL Holdings on the Investors section of our website, fglife.bm. Today's presenters include Chris Littlefield, President and Chief Executive Officer; and Dennis Vigneau, Chief Financial Officer.

Some of the comments we make during this conference call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. We do not intend to update any comments on this call to reflect new information, subsequent events, or changes in strategy. A number of risks and uncertainties exist that could cause our actual results to differ materially from those expressed or implied. We discussed these factors in detail in the Form 10K that we filed with the SEC on March 15 of this year.

During this conference call, we may refer to non-GAAP financial measures that we believe may be meaningful to investors. Please refer to our second quarter earnings release, financial supplement and investor presentation that we posted to our website. These documents contain a reconciliation of non-GAAP financial measures to GAAP. And finally, all comparison comments today will be to the second quarter of 2017 unless we state otherwise.

Now I will turn the call over to Chris.

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

Thank you, Diana, and good morning, everyone. We delivered a strong performance in the second quarter and are continuing to gain traction in building our business to generate long-term value. As a reminder, there are a number of key components that we believe will facilitate enhanced growth and profitability over the quarters and years to come. First, we serve a market with very attractive demographic trends, and our products meet the growing consumer demand for safe money retirement products that offer principal protection with the opportunity for interest crediting upside based on market performance. We believe this combination of favorable demographics and index products provides a strong tailwind for our business.

Second, as we've discussed with you in the past, we are positioning the company for additional ratings upgrades, which we believe will accelerate sales growth of our existing business and give us greater strategic flexibility to enter new distribution channels and new businesses. Third, our strategic partnership with Blackstone will continue to allow us to reposition our investment portfolio to improve our investment yield and offer competitive new products. Our core annuity business is a simple net investment spread business and Blackstone's unique world-class investment expertise has delivered and will continue to deliver increased profitability and returns.

Fourth, we have a scalable platform that can accommodate significant growth, both organic and inorganic, without the need to add significant incremental base costs. We've previously disclosed that we believe we can add about another $10 billion of assets without a material increase in our fixed costs. And last, we benefit from the strength of our exceptional sponsorship and experienced board in leadership.

Turning to the results of this quarter, our second quarter total sales were $872 million, up 35% from last year. And our first half sales were $1.7 billion, up 17% from last year. Fixed indexed annuity or FIA sales totaled $549 million in the quarter, up 21% over last year and up 26% over first quarter. Year-to-date FIA sales were $985 million, up 10%. Our multi-year guaranteed annuity or MYGA sales were $220 million in the quarter, up 73% from last year and up 55% over the first quarter, excluding the $200 million FHLB funding agreement completed last quarter.

During our last earnings call, we noted that we expected a strong second quarter of annuity sales as we saw increasing momentum in each month of the year. This overall strong sales momentum is coming from several factors: attractive market demographics I mentioned earlier, strong long-tenured relationships we've developed with our distribution partners, our distribution partners increasing confidence in our company's future and anticipation of ratings upgrades, our comprehensive competitive product portfolio that reaps a range of consumer needs, the successful launch of a new performance-based income and accumulation product series in February, which contribute -- already contributed 12% of our FIA sales in the quarter. And last, the court ruling that vacated the Department of Labor rule and eliminated the distraction that have been impacting industry sales.

Turning to our indexed universal life or IUL business, we delivered $7 million of target premium in the quarter. And as we've mentioned in the past, we like the IUL business because it's renewal premiums provide a natural hedge for rising interest rates, it helps diversify our risks and provides us more duration for investment. We expect our IUL business to benefit from higher ratings which will allow us to expand distribution and attract new advisors.

On the international front, our international sales total of $54 million the quarter, up more than 60% over first quarter. We believe we have an opportunity to continue to grow our flow reinsurance business at F&G Re and are working on a couple of additional opportunities that could be in place later this year or in early 2019.

We've repeatedly emphasized that our first priority is driving profitable organic growth. At our Investor Day in March, we said we expected our total annuity sales to grow 10% to 12% in 2018. And with our strong sales performance through the first half, we're updating this guidance and believe our total annuity sales will grow 15% plus this year. And most importantly, we remain disciplined in our pricing and have continued to exceed our new business IRR targets while delivering this growth.

While we've delivered strong sales growth year-to-date, we expect to see additional upside once we're able to secure targeted ratings upgrades. We believe that we are already getting some of that lift now in anticipation of those upgrades, but we do expect some additional lift from new agents promoting our products because some agents cannot or will not sell products from companies without at least an A minus rating from A.M. Best.

Moreover, in addition to increased sales in existing channels, our ratings upgrade to A minus would also allow us to expand into new channels, in particular, regional banks and independent broker dealers, and we are in the process of building the foundation and leveraging existing relationships to access these new markets. While we're pleased with the progress we're making to expand our distribution footprint, we currently do not expect to generate sales to regional banks and independent broker dealers until sometime in the second half of next year.

With respect to M&A, we've been evaluating a robust pipeline of opportunities and are taking a disciplined approach to evaluating targets with a focus on areas we know well, life insurance and annuities and on deals, we believe we'll be accretive for our shareholders. Given the deep M&A experience of our board and management team, we're very confident in our ability to execute our acquisition strategy as accretive opportunities arise.

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

Dennis Robert Vigneau - *FGL Holdings - CFO*

Thanks, Chris, and good morning, everyone. Today I'll focus my comments on the following. Adjusted operating earnings including any areas where results were impacted by purchase accounting, the overall performance of the investment portfolio and progress on our reposition, an update on where we are with tax reform, and lastly I'll wrap up with some thoughts on capital liquidity and ratings.

Beginning with adjusted operating earnings on Page 13 of the presentation. I'll note that we have put all periods on a comparable basis to best demonstrate the trends across each period. First, adjusted operating income available to common shareholders in the quarter was $58 million or $0.27 per share compared to $42 million or $0.20 per share last year, a 38% increase year-over-year.

Although part of our overall core business performance, we had some notable items in the period within adjusted operating income that are worth pointing out. In the second quarter of 2018, we had $6 million net favorable earnings from 3 items. A $5 million net favorable adjustment from better actual to expected mortality in the single premium immediate annuity line. This product line by its very nature and given the average age of the policyholders will have variability quarter-to-quarter. We also had $4 million favorable earnings from bond prepayment income, which was partially offset by $3 million higher expenses for some project costs.

The $42 million of AOI available to common shareholders in the second quarter of last year was impacted by a net favorable $1 million from 2 items. First, $2 million favorable adjustment from better actual to expected SPIA mortality, which was partially offset by $1 million higher project cost. The trended details of these variable items can be found in our quarterly financial supplement.

Stepping back at the half year mark, we reported $119 million of adjusted operating income available to common shareholders or $0.55 per share year-to-date. This is up nearly 50% compared to $80 million or $0.37 per share in the first half of last year. Although we can't see quarterly fluctuations in earnings such as I described earlier, we are confirming our previously discussed AOI outlook of a $1.10 to a $1.15 earnings per share as we expect the second half of the year to benefit further from the portfolio reposition uplift.

One update regarding a technical accounting matter. In the quarter ended March 31, 2018, the company adopted the new accounting standard related to the classification of debt and equity securities which was effective 1/1/2018. Under this accounting standard, the change in fair value of equity securities is now recorded as net realized gains or losses on investments in the income statement, instead of prior inclusion as a direct adjustment to equity or AOCI.

In the current quarter, we identified 21 securities that required reclassification from fixed maturity to equity on the balance sheet and recorded an immaterial $21 million or $0.10 per share year-to-date unrealized loss, again, unrealized loss and GAAP net income. This reclassification had no impact on the $119 million of adjusted operating income available to common shareholders or $0.55 per share year-to-date. Importantly, the corrections did not result in a misstatement of any of the company's previously issued financial statements and all were -- and were adjusted for all periods and presented in our 10-Q to be filed later today.

I'll now turn to the investment portfolio performance for which we have provided additional information in the presentation. Overall, the portfolio is performing quite well. Average assets under management totaled $25.2 billion at June 30, reflecting an increase of $4.8 billion year-over-year, which included $1.4 billion of net asset flows over the last year. Average AUM also increased $1.2 billion from purchase accounting impacts and the inclusion of a combined $1.9 billion of assets for F&G Reinsurance and FGL Holdings.

The purchase accounting or PGAAP mark-to-market is a non-cash adjustment, which will amortize as a reduction to net investment income over the remaining asset life. GAAP earned yield on the investment portfolio was 4.4% for the second quarter and up 21 basis points sequentially. This level is approximately 60 basis points lower than the 5% pre-merger yield in the second quarter of 2017 and reflects the net impact of PGAAP partially offset by the year-to-date lift through reposition.

It's important to note that on a statutory basis which is not impacted by PGAAP, the economic yield remains above 5%. It's also important to note that this yield will continue to rise as we further reposition the portfolio to enhance investment income in earnings. I'll provide an update on that reposition in a moment.

Total asset purchases during the quarter totaled $1.5 billion at an average yield of 5.65%. Purchases were primarily in structured security such as CLOs, ADS, and mortgage-backed securities. Through the partnership with Blackstone, we are accessing attractive high-quality assets. On a year-to-date basis including the $2.7 billion block trade in Q1 and net new business asset flows, we have purchased $5.2 billion of assets at a weighted average NAIC rating of 1.7 and an average book yield of 5.2%. Overall, we're seeing meaningful benefits on new money flows and generating higher risk-adjusted yield than we have achieved historically.

Net investment income was $282 million in the quarter, up $25 million or 10%, growing from a higher net asset growth and bond prepayment income, partially offset by $18 million of premium amortization. The after-tax noncash impact of this amortization was $11 million or $0.05 per diluted share. Net investment income was up $19 million sequentially or 7% due to new business growth and $13 million from the block trade in February. The underlying quarterly net investment spread is stable for all products with recent period at 208 basis points which was adjusted from pre-merger levels of 250 basis points due to the PGAAP impacts I spoke of. Net investment spread for all products increased 20 basis points on a sequential basis due to the lift in that investment income.

For our core product FIA, we have historically achieved a steady net spread of 300 or better basis points, now reset to 254 basis point in the current quarter, again reflecting the impacts of purchase accounting. These impacts are noncash and spread will continue to rise back to historical level as we reposition the investment portfolio driving further earnings in ROE expansion.

To that end, I'm pleased to share some details on the progress we're making to boost the yield on the portfolio. As I mentioned, we expect the $2.7 billion block trade we executed in February to provide $40 million of annualized net investment income lift, with about $33 million of that to be realized in 2018. Secondly with respect to structured products, over the next few quarters, we will continue our rotation out of approximately $4 billion to $5 billion of relatively lower yielding public corporates, structured assets and munis and migrate into a higher yielding structured assets primarily CLOs, mortgage-backed securities and other asset-backed securities.

Overall, we expect this phase to deliver an additional annualized lift of about $60 million to $75 million of net investment income once completed, with a partial year $20 million uplift projected for the second half of 2018. We continue to favor structured assets as an alternative to public corporates. These assets provide attractive yields, enhanced credit protection and floating rate upside relative to corporate public bonds.

We have about 13% of the portfolio in floating rate assets today. And these assets are good for overall ALM and cash flow testing and also provide important flexibility to manage the portfolio irrespective of the rate environment. With a rising rate environment, it allows us to also pick up a little bit more spread on the in-force block. To put it in perspective on the floating rate portfolio, every 25 basis points increase is worth about $3 million of AOI. And this will grow as we shift a significant portion of the additional $4 billion reposition to this asset class.

Our CLO partner is GSO Capital, part of Blackstone, the credit business again within Blackstone. They have an excess of $100 billion in assets under management and one of the largest and most successful managers of CLOs globally. Our focus is on high-grade NAIC-1 and 2 rated CLO debt tranches which are generally floating rate in nature. GSO has a 20-year track record managing these types of assets and has outperformed the market with an average annual default rate of just 1/2 of 1% well below the 2.9% industry average. Likewise, GSO has a higher average recovery rate relative to the industry.

And lastly, we expect GSO to provide us with industry-leading scale and scope across this asset class and drive a tangible advantage going forward. Our partner on real estate and debt investing is Blackstone Real Estate Debt Strategies or BREDS. As you know, Blackstone is the largest real estate private equity firm in the world with real estate assets under management of a $120 billion. Within Blackstone, BREDS oversees $15 billion of investor capital and as part of their world-leading integrated real estate platform. BREDS has not had any realized losses since the strategy's inception in 2009. BREDS oversees our existing CMBS portfolio and as well as the execution of additional CMBS, RMBS, REIT and commercial mortgage loan trades for the portfolio repositioning.

Finally, with respect to alternative assets, this program is well underway as we grade towards a target funded allocation of 5% of the overall portfolio in 2020. This allocation will be across a wide range of assets including private equity, real estate, credit and multi-strategy type assets. Blackstone is the largest alternative manager in the world with a 30-plus year proven track record of deal flow and competitive risk-adjusted net returns throughout all economic cycles. At the half year mark, we are well into the sourcing of commitments for this alternative asset class with much more to come. By its very nature for this asset class, cash fundings will lag the investment commitments in the pipeline.

At this time, we have approximately $250 million of funded alternative assets and are building a robust pipeline of commitments to achieve $1.5 billion of cash fundings in 2020 or the 5% of AUM as I mentioned. Overall once completed, we believe the shift to alternative assets will add approximately $145 million of annualized net investment income left.

In summary, our partnership is progressing well and the opportunities thus far are exceeding our original yield expectations, and go beyond the enforced portfolio reposition opportunities. As I noted earlier, we are also seeing meaningful benefits on new money flows at higher risk-adjusted yields than we have achieved historically. Additionally, we are sourcing enhanced asset flows for our MYGA product line.

Let me provide a few comments now on where we are with tax reform. As I mentioned on the first quarter call, we expect our effective tax rate to be about 21% for 2018 and we are tracking close to that estimate at 20.7% on a reported AOI year-to-date basis. We continue to await clarification from tax and treasury authorities on the topic of the gross versus net for affiliated reinsurance issue. You will recall we made a tax planning election to have our Bermuda based affiliate company treated as a U.S. taxpayer. This election will maintain flexibility for our international platform to ensure no exposure to BEAT.

If the BEAT interpretation results in a gross calculation, we would recapture this affiliated business from Bermuda, and again, have no exposure to the BEAT tax. If BEAT ends up as a net calculation, then we would release the previously recognized expense at 21% and resume new business reinsurance. We expect to get guidance in the fourth quarter of 2018 and we'll update following that. Separate from BEAT, we are working on third-party strategies and opportunities to grow our international platform. These strategies should reduce our overall effective tax rate to 15% over time.

Let me wrap up with a few comments on capital. We finished the second quarter in a strong capital position with an estimated RBC ratio of about 485%. This includes the expected adjustments due to tax reform. The effective tax reform, as you know, only applies to the RBC calc as the rating agency proprietary capital models are pretax. Looking ahead, we are managing capital to fund new business, maintain RBC at greater than 450% and to secure ratings upgrades.

With regard to liquidity, you'll recall from our last earnings call that in April, we issued $550 million or 5.5% senior notes due in 2025. We used a portion of the proceeds to repay in full all of the outstanding combined debt between the senior notes and credit facility and contributed the remaining additional capital to our insurance subsidiaries to fund growth. Lastly, readily deployable capital is approximately $400 million comprised of insurance company surplus, available debt capacity and holding company assets.

In summary, since the merger closing, we have good momentum in executing on our strategy and delivered another very solid core. To recap the indicative outlook provided for 2018, we see top line annuity sales at, at or above 15% annual growth, while achieving our profitability and capital targets. Our AOI expectation remains in a range of $235 million to $245 million or EPS of $1.10 to a $1.15 per share and assumes a 21% AOI tax rate.

And as previously mentioned, we expect to maintain RBC at greater than 450%. We do view this as a transformational year following our merger transaction and are focused on achieving these objectives.

With that, I'll turn the call back to the operator to begin the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question will be from John Barnidge of Sandler O'Neill.

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

My first question ratings upgrades. I know you guys have talked about that. Do you have any update on the timing for that?

Dennis Robert Vigneau - *FGL Holdings - CFO*

This is Dennis. Yes, what I can say at this point is we've had very good ongoing dialogue with all of the rating agencies. We did have our annual updates with S&P and A.M. Best earlier in the quarter. We would expect them to go through their rating committee processes sometime in late third, early fourth quarter and we'll have an update -- specific update to provide after that. In terms of how we're feeling about it, we feel as though the business is very well-positioned for ratings upgrade. The capital levels, as I mentioned, are, we think, exceptional. With very strong operating performance, it has been well above the rating agency's expectations on what we have would have reported to them or shown them relative to our operating plans. And at this point, I think we are very well-positioned. So we'll see how it plays out and we'll report back once we hear.

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

Great. And then I know you have a small long-term care block that was non-core when the first reacquisition closed. You talked about disposing of it. Any update on that or kind of what the market looks like for such a transaction? It was a transaction announced last week. So I thought maybe the market had been unlocked a little bit.

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

It's Chris. So yes, we continue to explore our options with respect to that business. Again, we do have parties that are interested and continue to work towards seeing if there is a transaction that would allow us to exit that business in a way that isn't in the shareholders' long-term best interest. So we continue evaluated, there definitely are parties that are interested in the block, and we hope to have more update on that in the back half of this year.

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

Great. And my last question. Growth in the quarter, is there any way to size the driver -- I mean improving operating environment for the industry versus ownership overhang going away versus increased partnership on the distribution side?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

Well, yes, John, I think your question is where do we see growth coming from. I think you're going to see record FIA sales in the second quarter. I think across the industry it's up pretty significantly. So we're definitely seeing an increased momentum in the sale of the product. I think the product continues to win in the marketplace with a principal protection and the upside crediting versus the VAs and other savings product alternatives and then just general -- just confidence in the overall story of the company. So I think people are back to recruiting. They know that the future is no longer uncertain. They understand the story. They understand the financial strength and the growing momentum that we're having, and so they're building and recruiting behind our company. So I think we're seeing a lot of real positive momentum there.

Operator

And the next question will be from John Nadel of UBS.

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

I'm looking at Slide 6 and I'm thinking about operating income and operating EPS first half versus the outlook for the full year. I just wanted to make sure, should we be looking at that on a core basis ex notable items to judge your achievement of the full year? Or should we be looking at that on a reported basis?

Dennis Robert Vigneau - *FGL Holdings - CFO*

It's Dennis. As I mentioned in my prepared remarks, we do have a few of our legacy lines of business that have variability quarter-to-quarter. We review the reported earnings as all-inclusive. There is that variability quarter-to-quarter. We don't typically plan for SPIA mortality in any particular quarter. We know we'll have some and you should view it on a reported basis going forward.

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

Okay. And then also just a quick question on the bond prepayment income. Is that -- when you call that out, Dennis, is that the actual amount received in the quarter or is that just the amount above what you believe is the more some -- more normalized level?

Dennis Robert Vigneau - *FGL Holdings - CFO*

That's the absolute dollar amount of what we have received. And again, some of that is really just driven by the quality of the assets that we buy. And again that tends to be lumpy and variable quarter-to-quarter. But it's reflective and it's a part of the operating performance.

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

Understood. No, everybody is generating them. Last question. On statutory capital, your statutory book value declined a little bit quarter-over-quarter versus 1Q. I guess I was a little surprised by that given I think you injected some of the debt proceeds into the Iowa company. I think that was $125 million. So can you talk about the moving parts in statutory capital this quarter?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, we did put $125 million into the Iowa operating company quarter-over-quarter. I'll check that number and get back to you. I will validate that number got into the QFS. I'll follow up.

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

Okay. And then if I could just sneak one more in, just for Chris. One of the things we continue to hear is that competition for deals or transactions is much greater for smaller transaction size. There's a lot of capital chasing after deals, a lot of firms chasing after deals. A little bit less so with larger, more complicated transactions. Are you seeing that? And how do you respond to that in terms of thinking about the outlook for M&A for FG?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

Yes, I mean I think it really depends on the particular liabilities that are being offered and the blocks of business that are being offered. We've seen decent sized blocks of business without a lot of competition. We've seen some with much more competition. So it's really varied by the block that's being offered. I think we are very confident in our ability to be able to leverage both the offshore structure that we have with F&G Re as well as the investment expertise we have to bring value to deals. But we're going to be disciplined and we're not going to be chasing things that aren't supportive of us delivering a 15% ROE to our shareholders over time. So that's how we think about it. There's definitely competition, but we're going to continue to be disciplined. We do think that we're going to be in position to be able to execute on some transactions over the course of the next year or 2, but that still remains to be seen and that's how -- that's probably how I would describe it at this point.

Operator

The next question will be from Kenneth Lee of RBC Capital Markets.

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

Just one. On the fixed index annuity sales and how they could be potentially helped by a potential ratings upgrade. Maybe I wonder if you could outline how quickly potential benefit sales might be felt? Presumably, they could be an instant boost to sales within existing independent agent channel, but wondering how long it would take to establish new relationships, expand the distribution reach within the independent channel. And it sounds as if the time frame for expanding to regional banks is probably not going to happen until the second half of next year. I'm wondering if that's going to be contingent on any kind of ratings upgrade as well?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

So, yes, with respect to the ratings upgrade, I do think we're getting some of that volume now. I do think people are beginning to be comfortable selling and recruiting to FG based on the positive outlook for ratings enhancements. Once the actual ratings upgrade occurs and if occurs, it's probably going to be felt late in the quarter following the upgrade. So you get the upgrade and then if people get attracted, you train them on the story, and then they begin to market and sell the product. So it's probably a couple of months after you actually get the upgrade that you'll see some additional boost in the overall sales. With respect to the regional banks, absolutely regional bank and the IBD channel is dependent on a ratings upgrade. So that's the first thing that has to happen as we need to get the ratings enhancement at least to an A minus from A.M. Best before we'd be able to access those channels.

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

Got you. And then in terms of the -- wondering what sort of like the level of sales -- annuity sales that the company could support based on internally generated cash and still keep RBC ratios relatively unchanged?

Dennis Robert Vigneau - *FGL Holdings - CFO*

I'm sorry? Could you repeat that question?

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

Just wondering what's the level of sales that FG could generate on annual basis and still keep RBC ratios relatively intact?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes. I would say we could comfortably -- and we'll come back with a more refined answer. But we could comfortably generate another $1 billion-plus sales and remain very comfortable within our capital availability.

Operator

The next question will be from Pablo Singzon of JP Morgan.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

So I had a couple of questions about FG's non-FIA liabilities. The first one is the cost of crediting on non-FIA liabilities is higher than FIA liabilities. So I'm just wondering, can you please give us some color on what products are driving that gap? And do you expect that difference to narrow overtime whether you did a block for natural one-off or any other actions you might take?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, Pablo, can you repeat your question?

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Sorry about that. So the first one is just the cost of crediting is higher on non-FIA liabilities than FIA liabilities. So I...

Dennis Robert Vigneau - *FGL Holdings - CFO*

I got it, yes.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Yes. So just some color on what products are driving the gap? And yes.

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, we've got a blended group of historical products in there. We've got -- first of all, we've got MYGA. We've got SPIA blocks as well. We've got some traditional life ROP and that all gets blended into those crediting rates. They just tend to -- those aren't rates they sort of get set when you put that business on the books, whereas FIA, you are continually managing credit rates on the in-force book as well as repricing new business. So the historical book is just a more static crediting rate than what we have on the FIA by their very nature.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. And are there any significant runoff to think off in the next couple of years? I think your MYGAs might be beginning to run off in both in '19 or '20. I just wanted to check if that's the case?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Sure. Great question. So as we think about the -- I'll take MYGA first. As we think about MYGA, the last big tranche that we had, that came in sort of a lumpy fashion. As you recall, we had -- at one point, we're a little more episodic in terms of putting MYGA business on the books. We did have a tranche back in the December fourth quarter time frame of 2013 probably about $700 million-ish somewhere in that range that was brought on at that time. That's a 5-year product that will be coming up for renewal here in December. What I will say is we have a very good track record and very stable policyholder behavior of being able to manage those renewal events quite successfully and retain the majority of those assets. Often times, we not only renew assets for one area, but we also get a percentage of those MYGA assets reuped for a second renewal at the 10-year mark. So it's not at a level where it's anything that we are concerned about. We've got very stable policyholder trends in just -- and given the middle market focus that we have across our customer base, they tend to just be stable and not rotate out as much as other customer bases do. So we feel good there and really since then, we've had much smaller and more predictable quarterly MYGA sales volume come on more in the 1 to $250 million range in any given quarter. So that's not certainly anything that, as we look forward, we'd be expecting a big chunks of AUM to run off in any particular quarter. On the other blocks of business, the biggest one is single premium immediate annuities. We do have this sort of a bifurcation within that block of liabilities. We've got a slice of a couple or $300 million of impaired risk higher aged annuitants. That's where some of the quarterly volatility comes from. The average age on that block of business is over 90 years. And again, that's about $300 million. So there's some lumpiness there, but again, it's $300 million in total reserves. So as that runs off, that typically generates income as we go forward. So again, I look out in the future and things look pretty manageable and pretty steady as she goes in terms of those other blocks and their runoff.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Okay, thanks. So my second question is also MYGA related. So you suggested that you expect MYGA sales to pick up this year basically support higher operating rates in better yielding assets. How should we think of spread margins in MYGAs compared to FIA? Also just in terms of their overall profitability, are the 2 products comparable or is one really meant to subsidize the other?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Sure. So the way to think about MYGA versus FIA is you have -- in nominal dollars, you have a lower spread, but you invest about half the capital behind the MYGA product that you do in FIA or even slightly less than half. So the more important metric to be that we focus on is the relative return per dollar of capital. And historically and as we look ahead, we are at least putting MYGA business on the books at equivalent lifetime returns for as FIA. And in most years, we're putting it on at higher IRR than our FIAs which we tend to target in that unlevered 13-plus range, and we've been historically outperforming those unlevered IRR targets over the last 3, 4 years, which puts us up over fifth -- over mid-teens on a levered basis.

Operator

The next question will be from Andrew Kligerman of Credit Suisse.

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

Just following on that MYGA question. And of course, you mentioned on the call and in the press release that you were able to get enhanced asset sourcing capabilities from Blackstone. Curious what are the crediting rates that are -- that you're offering out there on the product today?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Sure. So we on our most current offering, and it's been this for probably the last 90 days, is 375. We do have a substantial number one share in the independent space. We are not currently the highest rate. I think the highest rate out there today is about a 4% crediting rate. And we're getting nice volume flow -- differential between our 375 and 4 is not -- and that's on a 5-year product just to be clear, that we're not seeing any tangible slowdown on the volume we're getting. So we've been keeping our rate steady at that 375. We adjusted monthly as needed and based on the volume that we're looking to get. But most importantly, it is all about achieving the target margin. So at any given point, and you've seen this in various quarters, we'll adjust pricing if we can't get the margin and we'll just take -- we'll adjust pricing downward and take less volume to get that margin back up. So we're pretty disciplined. But currently, the environment looks pretty good and volume has been fairly steady.

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

Makes a lot of sense. And then, Chris, I think I heard you mentioned that in the M&A area, you are interested in life insurance as well as annuities. Any particular type of product area that you're more focused on? Are they the more UL interest sensitive stuff? Is it term?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

No, I mean there is a -- there has been a number of different life blocks that have been offered. We're probably interested in things that are probably not more term and on the other areas of life where we think we can bring some advantage to the block, whether that's coldly or boldly or other different blocks that that may be offered. So that's kind of the things that we're looking out. We wouldn't be particularly interested in a large term block unless we really thought that there was an opportunity for us to achieve the targeted returns and get to help us demonstrate and deliver our 15% ROE and I'm -- we're just not seeing term as a way to get there at this point.

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

And you're seeing a lot of opportunity out there in that area?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

I would say there's a decent amount of opportunity. I think there's much more opportunity on annuity blocks, but there have been definitely some life opportunities available as well.

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

Got it. And then just lastly, on your targeted 15% tax rate over time, could you kind of give us -- and I know there's a lot of negotiation and just work with regulators to get to a tax rate. But when would you logically think you could get to a 15% tax rate without being held to it because things change over time, but when do you think you could get there?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, I think the -- this is Dennis. I think the way to envision our path to a 15% is I dimension it in 2 ways. First, in terms of organically getting there, the types of things that are going to be supportive of that are the flow reinsurance deals that Chris mentioned in building volume there. We do have a some nice opportunities in the pipeline. If it were just left to the organic growth, I think that's a multi-year effort to get down to the 15%. But what we are pairing that with are opportunities to do block reinsurance, M&A-type transactions from -- into our offshore platform, whether that is Cayman or Bermuda, both of which are 0 tax rate jurisdiction. So as we think about our M&A pipeline and how we would structure those block reinsurance deals, that's the way we're thinking about it. And that effort will accelerate meaningfully as we close those opportunities. And we are confident as we work through the pipeline that we will lend transactions. I can't predict when, but as we bring those transactions on, it will probably take just to size it roughly, given the size of our balance sheet today at about $25 billion. We're sitting here at a 21% tax rate. To reduce that by 5 or 6 points, you'd have to put somewhere between $5 billion and $7 billion or $6 billion to $8 billion of assets in a transaction in one of those offshore -- or combination of transactions in one of those offshore platforms. So there is a pretty steady pipeline across a variety of potential deals out there that could readily get you to that level of assets if we were to successfully close one. So that will take time. I can't predict when the transactions will close. But we are actively working and we'll update you as those transactions develop.

Operator

The next question will be from Ryan Krueger of KBW.

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

First I wanted to follow up on taxes. In terms of moving assets offshore potentially, is the primary method going to be potential M&A transactions? Are you still also considering more of a kind of trade with other counterparties as a way to get assets offshore?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, we are considering -- again depending upon where tax reform goes and the opportunities that recapturing the currently Modco business offshore and then doing additional reinsurance transactions with other third parties. Those activities are still under exploration. I don't have anything to report that's nearing completion, but the sort of a combination of that, the block M&A that I talked about and the organic flow deals that we already have in the pipeline. It will be a combination of all 3 that come together to get that tax rate down.

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

And then...

Dennis Robert Vigneau - *FGL Holdings - CFO*

As well, I know there are a number of other strategies as it relates to dealing with the -- should it end up in a gross calculation, we are exploring those. Again, I don't have anything specific to report on, but there are a number of strategies out there. You've heard others in the industry refer to them. We're evaluating those very same strategies and there is potential for a fourth leg of this strategy to come to fruition and allow us to accelerate the reduction of the tax rate. But I'm very confident that the combination or any combination of these 3 or 4 ideas will over time drive down that tax rate and start leveraging to a greater degree that offshore platform.

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

That's helpful, thanks. And then when we look at the ultimate investment income uplift that you expect versus the 2018 uplift which was helpful, how should we think about the DAC amortization offset that would come through just trying to dimension how that would actually impact your bottom line?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes. So as we uplift the portfolio and as part of our annual DAC reviews and assumption reviews which we undertake like most in the third quarter, as that yield begins to come through, we'll take the resulting new future yield in the portfolio, and we'll factor that into our unlocking of -- to the extent there is any of the DAC impacts. In general, as that portfolio uplift is realized and all other things being equal across the various and numerous assumptions that we review each year, uplift in yield will generally have a favorable impact on DAC amortization as it drives enhanced future expected gross profits and therefore your DAC is amortized over a broader base of expected future income. So it would be a positive and again we undertake that in the third quarter. That work is already underway and we'll have a full report of at least what the current year's impact is on next quarter's call.

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

So would there be like a rough K factor type of offset as well just normally as you generate more income that that would come through separate from what you are talking about?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, that's where the positive -- yes, exactly, that's where the positive comes from. The K factor would adjust and -- would adjust down, so, therefore, every dollar of revenue that's coming in, you're amortizing a lower percentage K factor. So that's where the lift comes in and in the third quarter, we'll go through the annual assumption setting as natural part of that. There is always -- to the extent, there is a current period catch up for previously recognized to sort of catch the book up, that comes through in the third quarter. We'll talk more about what that impact is once our analysis is complete. And then we can give some insight as to what we view that K factor in the profitability going forward next quarter.

Operator

The next question will be a follow up from John Barnidge of Sandler O'Neill.

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

There is a large public writer of annuities on the market. Given improvement in your share price over the last couple of months, did that change the economics or make it easier to make acquisitions this size or kind of change your thinking around your M&A strategy?

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

Yes, John. I think we're probably not going to comment on any specific opportunities that are out there. Obviously, we look at valuations pretty closely and deciding whether or not to execute on a transaction. And that's probably all I would probably be willing to say on and other than, we're going to remain disciplined and pay only what we think an asset is worth and make sure that it's accretive to our shareholders support of over 15% ROE.

Operator

And the next question will be a follow up from Pablo Singzon of JP Morgan.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

I just wanted to follow up on expenses this quarter. It seems like there was a sequential uptick. So would you consider the amortization normal this quarter? Also the same question for just general operating expenses?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Well, in terms of the operating expenses, I did note we absorbed about $3 million after-tax expenses related to various strategic projects. So that went through the bottom line. In terms of amortization, there's always a bit of fluctuation from quarter-to-quarter depending upon the margins that come through across the various product lines. So nothing out of the ordinary that I would note and I would just consider it normal quarterly fluctuation.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. And then my next question was about your offshore reinsurance. I believe they are currently not created now. Do you think there will an impediment in growing your business there and using those vehicles to bring down your effective tax rate? And are you working to get those entities rated?

Dennis Robert Vigneau - *FGL Holdings - CFO*

Yes, great question. We are in the active process of working with the rating agencies to get those entities rated. The benefits of that are -- I think are pretty clear. It makes us -- as we grow those businesses, it will make us a more attractive partner to do business with. We have had some success even though those companies are not yet rated, not only in the flow business that we are bringing on the books each quarter but also in building the pipeline. But we are actively working on that and I would expect coming out of this year's annual rating agency review cycle at various points as they complete their process and go through committee, you'll start to see those ratings for those offshore companies come online.

Operator

And ladies and gentlemen, this will conclude our question and answer session. I will now turn the conference back over to CEO Chris Littlefield for closing remarks.

Christopher James Littlefield - *FGL Holdings - President, CEO & Director*

Yes. Thank you very much. To conclude, we're very pleased with our second quarter results and how we're executing to position F&G for the future. We're making substantial progress on the strategy we set forth at our Investor Day in March. We've delivered strong sales growth buoyed by the robust demographic tailwinds, which we think will continue. We secured ratings enhancements and believe we're well-positioned for future additional enhancements. We're moving forward with our portfolio repositioning and generating increased investment yields. Our profits in our ROE have increased significantly and we're on track to exceed our sales plan while achieving our new business profitability targets. So we appreciate your interest in investment in our company and look forward to updating you again on our progress on our third quarter call. Thank you.

Operator

Thank you, sir. Ladies and gentlemen, the conference has concluded. Thank you for attending today's presentation. You may now disconnect.
