Jackson National Life Insurance Company Update: ***De-Merger from Prudential Plc About to Occur*** (August 31, 2021)

In August 2021, Prudential Plc (PRUplc), parent company of Jackson Financial Inc. (JXN) and primary life insurance company subsidiaries Jackson National Life Insurance Company (JNLIC) and Jackson National Life Insurance Company of New York (JNLNY), announced its plan and timing for its planned "de-merger" of JXN.

Details as to the plan and timing of the "de-merger" include the following:

- JXN stated in early August 2021 that its "Form 10" Registration Statement with the Securities and Exchange Commission was declared effective in early August 2021. This was a necessary step toward the listing of JXN stock on the New York Stock Exchange (NYSE).
- PRUplc shareholders of record on September 2, 2021 will receive one share of JXN Class A Common Stock for every 40 "ordinary" shares of PRUplc stock owned
- Trading of JXN shares will begin on September 1, 2021
- The "De-Merger" will be completed on September 13, 2021
- "Regular-Way" trading of JXN stock will begin on September 20, 2021

The "de-merger" transaction received PRUplc shareholder approval on August 27, 2021, which was a necessary condition toward completing the de-merger.

Under the terms of the transaction, PRUplc plans to distribute a little more than 69% of the total economic interest in JXN. When added to the 11.1% economic interest sold to Athene in June 2020, PRUplc will retain just under a 20% economic interest (and similar share of voting interest) in JXN after the completion of the de-merger. This is similar to the spin-offs of Brighthouse Financial (by MetLife) and Equitable (by AXA), whereby a majority of shares were initially distributed (to MetLife and AXA shareholders respectively), with secondary sales following soon after to reduce the ownership share of these firms.

Management for JXN stated that PRUplc plans to sell a portion of its retained shares over the 12 months subsequent to the demerger, and PRUplc expects to own less than 10% of JXN (as measured by voting power and economic interest) within 12 months of the demerger. This is also similar to other spin-offs of U.S. life insurance groups, including Brighthouse and Equitable noted above, as well as Genworth, VOYA, and others.

In related news, JXN executed a term loan agreement in February 2021 with a consortium of major banks, for a total $2.7 billion. The term loan agreement is comprised of a one-year loan not to exceed $1.7 billion, and a two year loan not to exceed $1.0 billion. In its Six Month 2021 investor call, PRUplc stated that JXN drew down proceeds from these term loan agreements and management further stated that JXN will infuse at least some of the proceeds from these loans into JNLIC to bolster capitalization.

PRUplc management stated that it expects that JXN will initiate its own independent long-term financing (i.e. issue long-term debt) subsequent to the de-merger. JXN had planned to issue $1.6 billion of holding company debt in March 2021 but delayed this issuance due to claims against JXN from two former executives. It appears (based upon filings with the SEC) that these claims were successfully settled over the last several months.

Jackson National Life Insurance Company

The planned de-merger of JXN (ultimate parent of Jackson National Life Insurance Company (JNLIC) and Jackson National Life Insurance Company of New York (JNLNY)) does not have any direct effects on the financial or operational profile of JNLIC or JLNY. However, as public rating agency ratings are heavily driven by the rating agency view of the overall organization, the planned separation of JXN from PRUplc leaves a smaller and less diversified (business line and geography) parent company as owner of the life insurers.

As a result, public rating agency ratings were downgraded for JNLIC and JLNY in 2020 when the transaction was announced:

- Moody's: Downgraded one notch from A1 (5^{th} highest) to A2 (6^{th} highest)
- S&P: Downgraded two notches from AA- (4^{th} highest) to A (6^{th} highest)
- Fitch: Downgraded two notches from AA- (4^{th} highest) to A (6^{th} highest)
- A.M. Best: Downgraded one notch from A+ (2^{nd} highest) to A (3^{rd} highest)

However, JNLIC's financial profile did change significantly in 2020, as the company sold (via reinsurance) its in force fixed and fixed indexed annuities to units of Athene, a publicly-traded insurance organization with a major presence in annuities (both directly written business and reinsurance). This resulted in a significant change in JNLIC's business profile, which included the following:

Sale of Fixed and Fixed Indexed Annuity Business

- Cession of $27.6 billion of fixed and fixed indexed annuities policy reserves, and $28.2 billion of investments
- ATH purchased an 11% economic and voting interest in JXN, which equaled $500 million
- The $500 million from ATH was infused into JNLIC
- The reduction of risks and capital infusion produced an improvement in JNLIC's risk-based capital ratio, equal to approximately 80 basis points.

The transaction with ATH (and its Bermuda reinsurers) was executed via funds withheld reinsurance, whereby JNLIC retains legal control of the policy contracts and the investments that support the business, and the assets and liabilities remain on JNLIC's balance sheet. However, the economic risk of the business is transferred to ATH. In addition, the capital related to the business is held by ATH's reinsurers.

This leads to much higher levels of reported assets and much lower reported capitalization measures for JNLIC than would be the case if the reinsurance were executed via coinsurance. As the policy contracts and investments related to the business ceded to ATH totaled 42% of total general account policy reserves and 37% of total general account invested assets, the effects on JNLIC's financial ratios and by extension ALIRT Score could be substantial.

Though the sale of the fixed and fixed indexed annuity business to ATH resulted in a reduction in aggregate risks for JNLIC and an improved risk-based capital ratio, the transaction significantly reduces JNLIC's business diversity. The company's group annuity and individual life insurance businesses were not part of the transaction with ATH, and thus they do provide JNLIC some diversity in its business. However, the growth in JNLIC's fixed and fixed indexed annuity business significantly reduced the skew of JNLIC's policy liabilities and overall business to variable annuities with guarantees, and it will take quite a bit of time for the company to rebuild its product and business diversification.

Capital Infusions

Despite the capital relief related to the sale of the fixed and fixed indexed annuity business to ATH, JNLIC's risk-based capital (RBC) ratio declined in 2020, equaling 347% at year end 2020, down from 366% at year end 2019. The decline in the risk-based capital ratio in 2020 was due the following:

- Market movements (falling interest rates, elevated stock market volatility): Reduced RBC Ratio by 108 basis points
- Adoption of changes to variable annuity reserve and risk-based capital methodology: Reduced RBC ratio by 80 basis points
- Additional reserves and capital requirements due to new business: Reduced RBC ratio by 23 basis points.

This was partially offset by the ATH transactions (sale of the fixed and fixed indexed annuity business, and capital infusion) and capital generation from existing business.

The change in methodology as regards guaranteed variable annuities related to JNLIC's early adoption of VM-21. VM-21 was developed with the goal of reducing the "non-economic" volatility related to variable annuities with guarantees. VM-21 affects both the policy reserve for variable annuities, as well as the required risk-based capital to be held for such contracts.

The change in methodology provides a greater cushioning for the required risk-based capital related to guaranteed variable annuities, which should lead to less volatility in insurer RBC ratios. However, the policy reserve component for variable annuities will become somewhat more volatile.

Management for JXN stated that in their adoption of VM-21 at year end 2020, the initial modeling assumption was not consistent with their intent. Management further stated that the adjustment resulting from this correction and related modeling changes reduced JNLIC's RBC ratio by 80 percentage points. This adjustment turned out to be the principal reason for the reduction in the company's RBC ratio, despite the sale of business to ATH.

In their Six Month 2021 Investor Call, PRUplc management stated that, subsequent to the aforementioned capital infusions tied to the JXN's term loan agreement from a consortium of banks, JNLIC's RBC ratio would equal between 500-525% as of 6/30/21 on a "pro-forma" basis. However, JNLIC's Six Month 2021 statutory financial statement did not reflect any capital infusions, and as a result this capital infusion (and related improvement in JNLIC's capitalization measures) will likely not be reflected until the Nine Month 2021 financial statements are filed on November 15, 2021. Note that risk-based capital information is only provided in the annual financial statements, so that information will not be officially available until the Year End 2021 financial statements are filed in March 2022.

Based upon JNLIC's year end 2020 risk-based capital ratio, and information reviewed in JXN's Analyst Day presentation, ALIRT estimates that the capital infusion could be as much as $1.5-2.0 billion. An infusion of this size could lead to significant improvement in other capitalization and leverage measures, and could lead to a higher ALIRT Score, going forward.

ALIRT notes that several other life insurers that became part of smaller, less highly rated organizations often carry higher levels of capital under their new ownership structure, and the reverse is also true that insurers acquired by larger, more highly rated groups often begin reporting lower capitalization. Thus, it is possible that capitalization ratios for JNLIC could be higher going forward.

As mentioned earlier, JXN expects to complete a holding company debt issuance subsequent to the demerger. It is possible that some of the proceeds from the debt raise (given current credit market conditions it seems likely that JNLIC will be able to successfully raise debt) could be used to pay down amounts drawn down under the term loan agreement (which runs between 1-2 years).

Going Forward

JNLIC will become the principal entity of the soon to be publicly-traded JXN. JXN will be only minority-owned by PRUplc subsequent to the spin-off, with PRUplc planning to sell down its remaining ownership over time.

JXN and PRUplc management stated that JNLIC received a sizable capital infusion in recent weeks. These capital infusions, which will be reported in the company's 9 Month financial filings, will bring JNLIC's risk-based capital ratio to near or above the range for many of JNLIC's competitors and peer companies.

In all, JNLIC is in a somewhat similar position in terms of changing parent company, markets, business, and ratings to Brighthouse Life Insurance Company, Equitable Financial Life Insurance Company, the VOYA life insurers, and others in recent years. Many of these insurers enjoyed considerable success in terms of sales, distribution, and market breadth after their corporate changes, and JNLIC has strong relationships across most important annuity distribution channels (and the individual firms within each channel),

Prior to 2020, JNLIC enjoyed a diversified book of individual annuities, with the largest business in variable annuities with guarantees, but the company also had fixed annuities, fixed indexed annuities, non-guaranteed variable annuities. The sale of the fixed and fixed indexed annuity business to ATH substantially reduced the business diversity of JNLIC and increased the percentage share of the company devoted to variable annuities with guarantees. By extension, this increases the correlation of JNLIC's earnings and financial results to stock market returns and interest rates.

Though the transaction with ATH reduced risks in the aggregate for JNLIC (especially as regards general account investment risk), ALIRT believes that rebuilding business line diversification would be a credit positive. However, it will take some time to rebuild this business given the high level of competition in fixed indexed and registered index linked annuities, downgrades in JNLIC's public ratings last year, and the perceived loss of "backing" of a large international parent company.

In addition, as the primary entity within JXN, JNLIC will likely serve as the source of funds for JXN to meet holding company obligations such as debt principal and interest and operating costs, as well as for shareholder remuneration such as stockholder dividends and share repurchases. As JXN will be a publicly-traded company, it may face shareholder pressure for such remuneration, which could lead to shareholder dividend demands from JNLIC. However, large shareholder dividend payments would be nothing new for JNLIC, as shareholder dividends paid averaged over $500 million annually in 2012-2019.

We will monitor JNLIC for any additional changes, including the amount of the capital infusion referenced in this review and its effects on the company's financial measures. Please contact us if you would like to discuss JNLIC or if you have any questions.

ALIRT Insurance Research, 200 Day Hill Road, Ste. 220, Windsor, CT 06095

Phone: (860) 683-2070 Fax: (860) 683-4020 Email: info@alirtresearch.com Website: www.alirtresearch.com