Genworth Financial Inc. Terminates Merger Agreement with China Oceanwide

(April 7, 2021)

On April 6, 2021 Genworth Financial Inc. (GNW) exercised its right to terminate its merger agreement with China Oceanwide Holdings Group Co. Ltd. (CO). This ends a nearly 4½ year process, characterized by 17 extensions, the receipt of numerous regulatory approvals in the U.S., and the sale of GNW's ownership interest in its Canadian mortgage insurance business.

In a press release, GNW's Board of Directors concluded that CO was not going to be able to close the transaction within a reasonable time frame, and that greater clarity was needed in regards to GNW's future. In addition, GNW stated that by terminating the agreement the company can pursue its revised strategic plan without restrictions, and without uncertainty regarding its future ownership.

This announcement was not entirely unexpected, as in early January GNW and CO elected to forego a fixed date of extension to the merger agreement, which was a change from the numerous previous extensions. Instead, beginning in January either GNW or CO could terminate the agreement at any time. At that time, GNW stated that CO was facing challenges in finalizing its financing for the proposed acquisition of GNW, which included both internal CO proceeds as well as third party financing. There was also the approval needed from the Chinese government for the conversion of currency.

Going forward, GNW will need to address upcoming holding company debt maturities and interest payments, as well as obligations related to GNW's legal settlement with AXA. In this review, we discuss the upcoming obligations for GNW, the actions GNW has taken or plans to take to address these, as well as the possible impacts to the GNW U.S. life insurers from the termination of the merger agreement between CO and GNW.

Effects of the Merger Termination on the GNW Organization

The merger termination between GNW and CO does not have substantial effects on the financial profile of the GNW U.S. life insurers, which we discuss later in this review. However, the GNW holding company, and especially its shareholders and bondholders, are significantly impacted by this termination.

From GNW shareholders' point of view, they will no longer receive the $5.43 per share CO agreed to pay as part of the merger/acquisition agreement. GNW's common shares last reached this level in 2015, and the current share price (as of market close, April 7, 2021) equaled $3.38. The share price only fell modestly since the announcement, indicating that stock investors had already "priced in" the probability that a merger between CO and GNW would not occur.

As regards GNW bondholders and the GNW organization, GNW will not receive the $1.5 billion of pledged commitments from CO (this does not include the $275 million of capital infusions CO pledged to contribute to GNW's U.S. life insurers). As GNW has considerable holding company debt outstanding, as well as payments due surrounding a settlement of litigation with AXA Financial (AXA), it will now find it more difficult to meet these obligations.

Beginning on the following page is a more detailed look at these two principal groups of GNW's obligations (senior debt and AXA settlement). Please note that GNW paid off $338 million of senior notes in February 2021, and thus these are no longer owed and not included in the list on the next page.

GNW Senior Debt

2021:	$659 million, matures in September
2021-2022:	$165 million of (annual) interest payments on senior unsecured debt
2023:	$400 million, matures in August 2023
2024:	$400 million, matures in February 2024
2025:	$750 million (issued by Genworth Mortgage Holdings, Ltd.)
2034 and after:	$895 million

AXA Settlement and Promissory Note

In 2015 GNW sold its lifestyle protection insurance business (and various subsidiaries) to AXA. These subsidiaries were accused of mis-selling payment protection insurance to U.K. citizens while they were owned by GNW. In 2020, GNW reached a settlement of litigation with AXA, and as part of this settlement GNW paid AXA $259 million in 2020.

The settlement also calls for GNW to make additional payments to AXA, which are comprised of the following:

2022:	$217 million, due in June 2022
	$256 million, due in September 2022
	$53 million in interest payments on GNW promissory note (see below)
2022 and future:	$108 million (estimated) for future claims

To secure this obligation, GNW issued a promissory note to AXA. This note covers the two installment payments in June and September 2022, and under this agreement, certain cash flows to GNW must be paid to AXA until the promissory note to AXA is fully repaid. These cash flows include any dividends received and/or capital raises, above defined thresholds.

Impact on GNW

The GNW financial obligations that are most critical include the $659 million of GNW senior notes that mature in September, the annual interest payments on GNW's debt, and the promissory note and interest due to AXA from the settlement agreement referenced above.

In particular, the AXA settlement agreement and promissory notes greatly limit GNW's financial flexibility in meeting its maturing debt obligations, as any shareholder dividends paid by GNW's mortgage insurers in excess of $50 million, as well as a segment of any funds (dividends or sale proceeds) GNW may receive from its Australian mortgage insurance operations, must be applied to prepayment of the AXA promissory note and cannot be used to pay down GNW senior notes. Thus, even though the promissory note to AXA becomes due after the $659 million of holding company debt maturing this coming September, the promissory note may be the most critical item in the near term.

Current and Future Actions for GNW

GNW management began to pursue an alternate strategy to meet its holding company obligations in 2020, which perhaps reflected the growing unlikelihood that GNW would complete a transaction with CO and thus need to find other ways to meet near term obligations.

Among the steps GNW executed were the following:

- Sale of GNW's ownership interest in its Canadian mortgage insurance business
- Issuance in 2020 of $750 million senior debt by the U.S. mortgage insurance operations
- Repayment of maturing GNW debt, $338 million paid in February 2021 and $397 million in 2020
- Settlement of litigation with AXA (discussed on the prior page)

However, these steps have been insufficient to bolster GNW's liquidity and cash resources sufficiently to meet its upcoming debt maturities and legal settlement costs and as GNW management recognized in its Year End 2020 "10-K" report, the company will have to take additional steps to fund these obligations.

The additional steps include:

Sale of the Remainder of GNW's ownership in Australian Mortgage Insurance Obligations

On February 28, 2021, GNW sold its entire ownership position in Genworth Mortgage Insurance Australia Limited. This transaction raised approximately $360 million and GNW management stated that $247 million of the proceeds will be paid to AXA to reduce the outstanding promissory note, with the remaining proceeds of $123 million available to GNW. This transaction also removes as an obligation for GNW the $146 million of floating rate junior subordinated notes issued by the Australian mortgage operations.

Subsequent to the repayment of $338 million of GNW senior notes in February 2021, GNW had cash and liquid assets at the holding company of approximately $700 million. The proceeds attributable to GNW from the sale of the Australian mortgage insurance business would bring this estimated amount to over $800 million, which would certainly help to meet GNW's remaining 2021 debt maturities of $659 million and at least some of this year's debt interest costs. The allocation of the $247 million of proceeds to the AXA settlement also significantly reduces that obligation for GNW.

However, the company would still have a sizable remaining obligation to AXA, as well as next year's debt interest payments, and holding company debt maturities that are due in 2023, 2024, and 2025. Thus, GNW will need to execute additional steps to address these obligations.

Expense Reductions

GNW stated in both January and April 2021 that it plans to reduce expenses by bringing its expense structure in line with its current business activities. Management states that it expects these reductions to be concentrated in its life insurance and annuity business, as a result of the run-off status of these operations. Management stated in its Year End 2020 "10-K" report that, based upon its expense reductions to date, annual savings would be approximately $50 million.

In addition, as the merger of CO and GNW will not occur, it is much less likely that the GNW life insurers will recommence offering new products which could lead to additional expense reductions above and beyond what was disclosed in the "10-K" report.

Partial IPO of GNW's U.S. Mortgage Insurance Operations

GNW management reaffirmed in its "10-K' report that it is preparing for a possible partial initial public offering (IPO) of shares in GNW's U.S. mortgage insurance operations. There has been no formal announcement yet as to the timing or terms of any transaction, which includes but is not limited to the percentage ownership that GNW would offer in any transaction.

GNW's U.S. mortgage insurance operations (conducted by mortgage insurance companies, which are legally separate from any GNW's U.S. life insurers or any other GNW affiliate) were consistently profitable in recent years, with annual GAAP net income that averaged $363 million over the six years 2015-2020 (2020 net income was $378 million). The consistent recent profitability of this business, the relatively small number of U.S. mortgage insurance companies, and the general requirement that prospective homeowners that lack a 20% cash down payment must carry such insurance may make this an attractive stock offering. This could lead to considerable proceeds for GNW, which could in turn be used to pay down the group's aforementioned obligations.

However, in light of the economic difficulties brought on Covid-19 and the associated government edicts and lockdowns, mortgage insurance earnings may deteriorate going forward, and indeed this occurred in the second quarter 2020 when GNW reported a modest GAAP loss in its mortgage insurance operations. In the event mortgage insurance operating performance deteriorates this could lead to a lower potential valuation for a partial IPO, and/or more difficulty in executing such a transaction to begin with. This could be especially if credit and equity market conditions deteriorate generally.

However, ALIRT notes the very strong performance the housing market has exhibited for the last decade, and perhaps especially since the onset of the Covid-19 pandemic last year and the considerable changes in economic activity, which may have aided mortgage insurers such as GNW.

Further, even without an IPO of GNW's mortgage insurance operations, the mortgage insurers can still provide proceeds to GNW in the form of shareholder dividends. GNW's largest mortgage insurer, Genworth Mortgage Insurance Corporation, can pay $197 million of shareholder dividends in 2021 without the prior approval of the North Carolina Commissioner of Insurance, while two other much smaller GNW mortgage insurers could pay another $2 million of dividends without prior insurance department approval (dividends from GNW subsidiaries that exceed $50 million are required to be used to pay down the AXA promissory note).

Other Options

Other possible options could include sales of existing blocks of business, issuance of additional debt by the GNW holding company and/or affiliates, or other asset sales. It is not possible to predict what (if any) of these options GNW may pursue, or the possible success of any of these options or any specifics in terms or conditions.

Note that none of GNW's three major U.S. life insurers have the legal ability to pay any shareholder dividends at this time, given large historical operating losses for each company, and thus the life insurers will not be a source of funds to meet GNW holding company obligations, absent a sale of one of the companies or some other unforeseen transaction.

Effects on GNW's U.S. Life Insurers and Current ALIRT Model Results

GNW's insurance companies (life insurers or mortgage insurers) are legally separate entities from their ultimate parent company GNW, as well as from any other insurer or any other affiliate within GNW. As a result, the GNW insurers are not legally responsible for any of the financial obligations of the GNW organization described earlier in this review.

As mentioned earlier, the termination of the merger agreement between GNW and CO does not materially change the current or going forward financial profile for the three GNW life insurers. Genworth Life Insurance Company (GLIC) and Genworth Life Insurance Company of New York (GLNY) will not receive the capital infusions ($175 million and $100 million respectively) that CO had agreed to upon the closing of the merger of CO and GNW, but these infusions were relatively modest and one-time in nature, and CO had stated publicly that it would not contribute any additional capital to the GNW life insurers (GLIC, GLNY, and Genworth Life & Annuity Insurance Company (GLAIC)) after these initial infusions.

GNW management has stated that it will not infuse any additional capital into its three life insurers, and thus the life insurers will need to continue to manage the blocks of business in a mostly run-off status. As discussed, GNW further stated that its strategic plan is to reduce expenses to reflect its current business activities, and that these expenses have been and will be concentrated in the group's life insurers. Absent the CO acquisition, the likelihood of the GNW life insurers restarting new business is very low and this could result in a faster and more significant reduction in expenses for the life insurers, which could in turn lead to improved earnings (or at least reduced operating losses) for the insurers going forward.

In addition, GLIC and GLNY can solicit additional rate increases from state insurance regulators for traditional long-term care insurance. GLIC has received numerous rate increase approvals from state regulators over the last several years, though GLNY has received only two rate increase approvals from the New York Department of Financial Services, New York state's insurance regulator.

As is the case for any life insurer, there is the possibility of heightened investment losses in light of the weak economic conditions owing to the Covid-19 pandemic and related government edicts. Such losses could reduce surplus and/or earnings for the GNW life insurers, however these possible risks are not unique to GNW or its insurers.

The table below shows the Total ALIRT Scores for the three major Genworth U.S. life insurers for the last five years, with commentary on each insurer following thereafter. A sharp decline (25%) in surplus for GLAIC in 2020, as well as the reversal to operating losses (from strong earnings in 2019) were the primary reasons for the sharply lower ALIRT Score, while improved operating performance and capitalization produced a higher ALIRT Score for GLIC. GLNY incurred large operating losses, though this was offset by a higher surplus position and the company's ALIRT Score rose two points in 2020.

Total ALIRT Scores for the Genworth life insurers

	2016	2017	2018	2019	2020
Genworth Life Insurance Company	38	34	31	35	39
Genworth Life & Annuity Ins. Co.	37	33	35	46	37
Genworth Life Ins. Co. of New York	31	22	21	33	35
ALIRT Life Composite	49	50	47	52	47

Genworth Life Insurance Company

- Genworth Life Insurance Company (GLIC) primarily offers long-term care insurance. GNW's life insurers (including GLIC) ceased sales of life insurance and fixed annuities in early 2016.
- GLIC's ALIRT Score declined from 2015-2018 due to ongoing operating losses in each year, which largely reflected losses and reserve strengthening for GLIC's long-term care insurance business. The operating losses, coupled with net capital losses in 2014, 2015, 2017, and 2018, contributed to a steep decline in GLIC's surplus position, which fell 32% from 2013 to 2018. Most of this reduction occurred in 2018, as total surplus fell 24% on large operating losses and net capital losses.

- The lower surplus boosted GLIC's leverage measures and the company's investment risk to surplus measures and led to a significant reduction in the company's risk-based capital ratio to a low level.
- As mentioned earlier, GNW continues to receive and seek state regulatory approval for rate increases for long-term care insurance, which may help ameliorate losses in GLIC's long-term care insurance.
- The Total ALIRT Score for GLIC was a low 39 at 12/31/20, which was up four points from year end 2019 but was still considerably below the ALIRT Life Industry Composite Score of 47.
- GLIC benefitted from improved operating performance (earnings and returns on equity and assets) in 2020, which may have been due to reduced claims due to Covid-19 pandemic (lower utilization due to fear of entering nursing homes among insureds, as well as higher mortality for policyholders already on claim). This may be a temporary benefit, if utilization and claim trends return to historical norms in 2021 or beyond.
- However, this was largely offset by sizeable unrealized capital losses, which reflected to a significant degree the reduced surplus positions of GLIC subsidiaries GLAIC and GLNY. Reductions in the surplus of GLAIC and GLNY also contributed to GLIC's capital losses in 2014, 2015, 2017, and 2018.
- GLIC benefited from a sharp increase in its Interest Maintenance Reserve (IMR), which likely related to the sale of existing bond holdings given the sharply lower interest rates), which in turn contributed to an 14% increase in GLIC's total surplus in 2020.
- The rise in surplus led to reduced asset leverage, operating leverage, and investment risk to surplus measures for GLIC in 2020. However, GLIC remains impacted by high health (long-term care) insurance exposure, while its asset and operating leverage though improved still remain above industry average, as do its exposures to BBB rated, below investment grade, and Level 3 (difficult to value) bonds.
- **GLIC remains below ALIRT's minimum qualitative credit rating standards.**

Genworth Life and Annuity Insurance Company

- Genworth Life and Annuity Insurance Company (GLAIC) has minimal new business, as the company ceased writing new life insurance and annuities in March 2016 (it began selling small amounts of fixed and indexed annuities again in 2018), though the company continues to service this business. GLAIC also has variable life insurance and variable annuities in force though it has not been active in either business for quite some time.
- GLAIC incurred large operating losses in individual life insurance in each year 2015-2020, which reflected increases in policy reserves as a result of adverse mortality in GLAIC's universal life insurance business, as well as the impact of the decades-long low interest rate environment. GLAIC also incurred operating losses related to its term life insurance in 2019 and 2020.
- Earnings for individual annuities rebounded in 2019 from operating losses incurred in 2018, in part as the improved stock markets led to releases for reserves covering variable annuity secondary guarantees. Earnings continued (albeit at a lower level) for individual annuities in 2020.
- The Total ALIRT Score for GLAIC equaled 37 at 12/31/20, which was down nine points from the 12/31/19 ALIRT Score of 46. This decrease was mostly driven by aggregate operating losses incurred in 2020, which were a reversal from earnings reported in 2019. The worsening operating performance in 2020 was due to larger operating losses in individual life insurance and lower individual annuity earnings.
- GLAIC also reported a small net capital loss in 2020 and surplus declined 25% for the year. This led to a considerable increase in asset leverage and certain investment risk exposures (especially non-investment grade bonds, Class 2 (BBB rated) bonds, and mortgage loans).
- Additionally, GLAIC's score remains adversely impacted by negative cash flow, high reinsurance usage, above average operating leverage, and the narrow business focus.
- Offsetting this somewhat is GLAIC's above average net investment yield, high liquidity, lack of health (long-term care) insurance exposure, and solid risk-based capitalization.
- GLAIC's increased premiums written in 2020 stemmed almost entirely from deposit type contracts, which reflect increased borrowings from the Federal Home Loan Bank to boost liquidity.
- **GLAIC's ALIRT qualitative credit rating was lowered after a review of full year 2020 financial results, due to the large operating losses and substantial decline in surplus in 2020. As a result, the company no longer meets ALIRT's minimum qualitative rating standards.**

Genworth Life Insurance Company of New York

- Genworth Life Insurance Company of New York (GLNY) largely writes long-term care insurance in New York. GNW (including GLNY) ceased new sales of life insurance and fixed annuities in early 2016.
- GNW increased policy reserves numerous times over the last several years, as a result of its internal analysis and agreements with the New York Dept. of Financial Services (NYDFS; GLNY's regulator).
- Management stated that a portion of the statutory reserve increases are the result of NYDFS' refusal to allow future rate increases to be included in the asset adequacy analysis until they are approved. In 2018, the NYDFS approved a long-term care insurance rate increase for GLNY, which was only the second increase approved by the NYDFS (the first was in 2014). As a result of the rate increase, GLNY did not have to post additional asset adequacy analysis reserves in 2018, though the company did increase overall long-term care insurance reserves substantially during 2018.
- The markedly lower surplus (down from $586 million in 2016 to $353 million in 2018) produced sharply higher asset and operating leverage measures, as well as much higher investment risk to surplus measures, and these are key factors in the very low total ALIRT Score.
- The ALIRT Score for GLNY remained low at 35 as of 12/31/20, which was much higher than the year end 2018 score of 21 but was still well below the ALIRT Life Industry Composite score of 47.
- GLNY's below average ALIRT Score reflected a sizeable operating loss incurred for the full year 2020, a reversal from strong operating earnings recorded in the full year 2019 and the first nine months of 2020. However, in the fourth quarter 2020 GLNY recorded a $100 million increase to reserves as the result of the company's asset adequacy analysis. Management notes the reserve increase was largely due to the company beginning to use New York specific assumptions for the testing of its long-term care insurance contracts, as the experience of its New York policyholders was worse than its nationwide policyholders.
- GLNY also reported a steep decline in the company's risk-based capital ratio in 2020, which equaled 200% at 12/31/20.
- Despite GLNY's operating losses in 2020, the company's total surplus position rose 24% for the year, which was mostly the result of a large increase in the Interest Maintenance Reserve (IMR), which reflected realized capital gains from the sale of bonds that related to the sharp decline in interest rates. These gains are transferred into the IMR and are amortized into statutory surplus over time.
- As ALIRT includes IMR in surplus, the increase in IMR for GLNY (or any other insurer) produces an increase in the company's total surplus.
- GLNY's ALIRT score continues to reflect significant use of unaffiliated reinsurance, high health insurance exposure (which represents the long-term care insurance business), negative cash flow and slowly declining premium volume, and above average investment risks as a percent of surplus (especially NAIC Class 2 (BBB rated) bonds, mortgage-backed and asset-backed securities, and level 3 bonds).
- **GLNY remains below ALIRT's minimum qualitative rating standards, due to the continued negative trends in surplus and operating results.**

This review is prepared by ALIRT Insurance Research, an independent insurance industry financial analysis firm. ALIRT provides its ALIRT (AnaLysis of InsuRer performance Trends) Services to institutional clients responsible for monitoring exposures to insurance company financial deterioration. This review is for the specific internal use of our clients, and may not be redistributed without the express written permission of ALIRT Insurance Research.

While this review is prepared for your personal use, it is not a substitute for an impartial and thorough investigation of insurance company relative financial strength, and does not satisfy federal and state mandated fiduciary due diligence. Financial information contained in this review is obtained from public sources we consider reliable, but we cannot guarantee as accurate. This review should not be considered complete, includes expressions of our opinion, and must be accepted without responsibility to ALIRT.

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