Ohio National Financial Services®
Life changes. We'll be there.®

Ohio National's 2019 consolidated financial statement and change in net income

Core to Ohio National's Mission is providing the protection products that serve its individual and business markets' needs. 2019 was the first year the company executed a new strategic direction, built on its historic strengths in life insurance coupled with its disability income (DI) insurance line.

Building on our strong financial standing, prudent risk management and diversified investment strategy, we reshaped our risk profile and enhanced our capital position in 2019. We are well positioned to continue to meet the needs of our policyholders. 2019 financial highlights and results include:

- 3% increase in statutory total adjusted capital, reaching $1.14 billion
- 6% increase in GAAP equity (including mark to market), reaching $2.6 billion
- Assets under management grew by 3% to $40.5 billion
- Paid more than $1.2 billion[1] in benefits to policyholders and beneficiaries
- Paid dividends to eligible policyholders for the 96th consecutive year

See our 2019 Annual Report to Policyholders and 2019 year-end news release for additional information.

Changes in net income

The GAAP statements of income in the 2019 Annual Report to Policyholders show net loss of $67.6 million for 2019 compared to net income of $72.6 million for 2018 for a decrease in income of $140.2 million. This decrease primarily represents an income fluctuation that can occur within a life insurance company as a result of certain timing and valuation changes that accounting standards can introduce. These mismatches can be derived from differences in accounting for future mortality, interest rates and equity market performance, leading to significant volatility in earnings. Our variable annuity line is particularly sensitive to changes in these factors.

During periods of strong market appreciation and/or rising interest rates, the company has reported a loss before income taxes. For example in 2019, 2017 and 2013, losses in the amounts of $101.5 million, $178.9 million, and $76.8 million, respectively, were reported (see below). In contrast, during the continuing uncertain economic period of 2011, the company earned a record amount of income before income taxes of nearly $400 million. Why?

These counter-intuitive, short-term income fluctuations are the result of the reinsurance and hedging programs the company uses to mitigate the long-term economic risks associated with variable annuities. The income results of risk mitigation primarily move in the opposite direction of the economic risk itself. As seen in the table below, in 2011 and 2014, interest rates declined significantly. Ordinarily, this would have a negative impact on pre-tax income. However, the use of reinsurance and hedging protected the company and yielded positive results.

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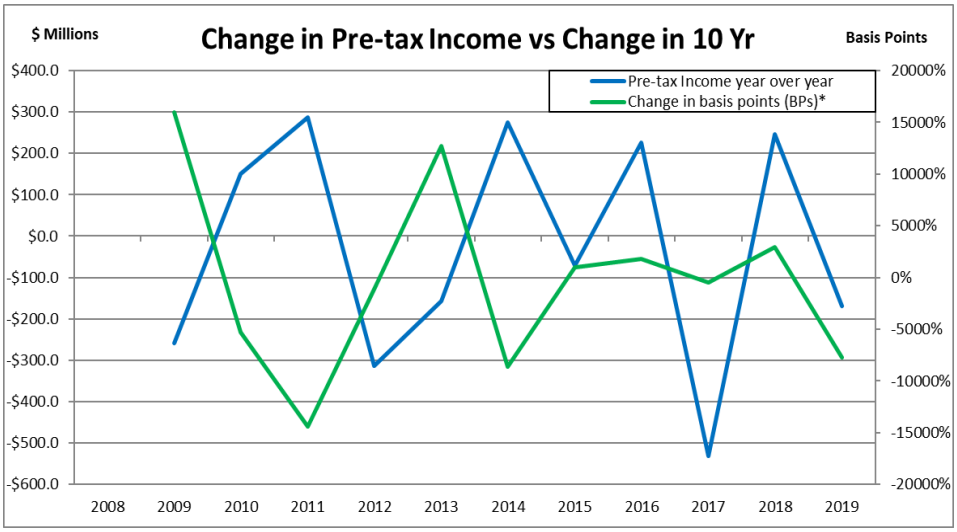
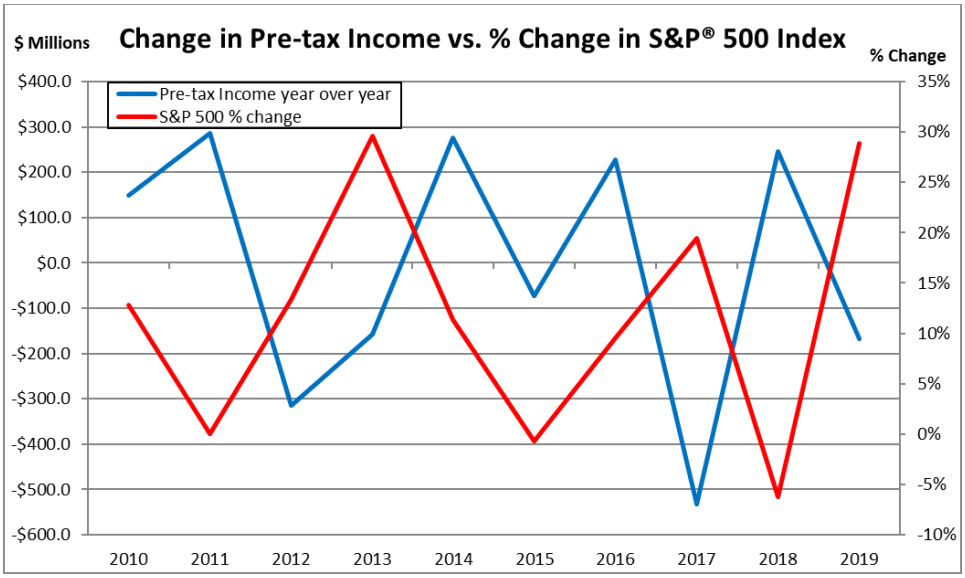
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Pre-tax income (millions)	$394.7	$81.0	-$76.8	$198.7	$126.4	$353.2	-$178.9	$66.6	-$101.5
Pre-tax income year-over-year	$286.1	-$313.7	-$157.8	$275.5	-$72.3	$226.8	-$532.1	$245.5	-$168.1
S&P 500® Index	1,257.6	1,426.2	1,848.4	2,058.9	2,043.9	2,238.8	2,673.6	2,506.9	3,230.8
% change	0%	13%	30%	11%	-1%	10%	19%	-6%	29%
10-year U.S. Treasury interest rate	1.87	1.76	3.03	2.17	2.27	2.45	2.40	2.69	1.92
Change in basis points (BPS)*	-144	-11	127	-86	10	18	-5	29	-77

**One basis point is equal to one hundredth of one percent (0.01%) and is used in this case to express the changes in U.S. Treasury interest rates.*

Inverse relationship between pre-tax income and U.S. Treasury interest rate.





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Importance of core earnings

The income effects of changes in reinsurance and hedging are shown in net other income (loss) including realized gains and (losses), benefits paid or credited to policyholders or beneficiaries, and other expenses in the statements of income. Because these income effects are relatively short-term in nature and we are in a long-term business, we operate the company using core earnings. See the appendix for further discussion of core earnings.

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Core earnings (millions)	$205.6	$204.8	$205.7	$197.4	$190.7	$176.7	$181.5	$192.7	$171.1

Additional comments regarding the soundness of Ohio National: Generally accepted accounting principles ("GAAP") equity, excluding mark-to-market related effects on bonds, remained a strong $2.3 billion at the end of 2019. Assets under management, a non-GAAP measure, were $40.5 billion, a 4.3% 10-year compound annual growth rate. Separate account assets were $19.9 billion, a 7.7% 10-year compound annual growth rate. Also, The Ohio National Life Insurance Company's (which is the primary operating insurance company) statutory Total Adjusted Capital ("TAC") at Dec. 31, 2019 was $1,137.0 million, increasing 3.2% from year-end 2018.

Appendix – Detailed accounting discussion

Income (loss) before income taxes decreased $168.1 million, from income of $66.6 million in 2018 to a loss of $101.5 million for 2019. The following table summarizes the significant components effecting the changes in the consolidated Income (loss) before income taxes for the periods indicated:

	2019	2018	$ 2019 vs. 2018	% 2019 vs. 2018
	(in millions)		(in millions)	
All other items of income before income taxes	$ 184.4	180.2	4.2	2.3%
Changes in value of certain reinsurance contracts and hedges, and related reserves and claims on our variable annuity contracts	(222.0)	(15.0)	(207.0)	N/M
Net realized investment (losses) gains, net of related DAC amortization excluding other-than-temporary losses on securities	210.4	3.1	207.3	N/M
Gain (loss) on debt retirement	(10.3)	-	(10.3)	N/M
Market effects on DAC amortization	(12.5)	8.0	(20.5)	N/M
Base DAC and UFEL true-ups and unlockings	(107.8)	(12.6)	(95.2)	N/M
GLWB/GPP related reserves, hedges, and DAC	12.1	(14.1)	26.2	N/M
Impact from systems conversion	1.3	(10.9)	12.2	N/M
Non-recurring corporate expenses	(21.3)	(17.3)	(4.0)	(23.1%)
Annuity inforce management	(114.9)	(57.7)	(57.2)	(99.1%)
DAC & UFEL write-off related to RGA transaction	(17.8)	-	(17.8)	N/M
Financial statement corrections related to prior years	(3.1)	2.9	(6.0)	N/M
Income (loss) before income taxes	$ (101.5)	66.6	(168.1)	N/M

The company realized investment gains of $197.9 million as a result of a reinsurance transaction that commenced during the third quarter of 2019. This is the primary driver behind the $207.3 million increase in net realized investment (losses) gains, net of related DAC amortization.

During the year ended 2019, the company had $114.9 million in costs associated with the annuity inforce management programs. Beginning in 2018, the company offered certain variable annuity policyholders a guaranteed minimum income benefits (GMIB)/fixed income annuity (FIA) exchange. In addition to this exchange, the company offered a GMIB cash bonus offer program, in which the company offered the policyholder an additional cash offer exceeding current account value when the policyholder surrendered or exchanged an existing GMIB contract. For the year ended Dec. 31, 2018, a total of $1,087.5 million of GMIB retained business account value was surrendered, approximately $530.0 million of which was converted to the FIA product with the enhanced guaranteed lifetime withdrawal benefit (GLWB) rider value.

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In 2018, the cost of the cash bonus offer program totaled $57.7 million and accounted for approximately $370.0 million of the $1.1 billion surrendered. The cost of the variable annuity buyout program was $114.9 million and resulted in $735.1 million in account value surrendered for the twelve months ended Dec. 31, 2019.

The decrease was also driven by the effects of the components of the changes in value of certain reinsurance contracts and hedges, and related reserves and claims on our variable annuity contracts as detailed in the table below:

	2019	2018	$ 2019 vs. 2018	% 2019 vs. 2018
	(in millions)		(in millions)	
Fair value reinsurance contracts	$ (36.9)	93.0	(129.9)	N/M
Hedging	(184.1)	11.1	(195.2)	N/M
GMIB/GMDB/GLWB (non-fair value) reserves	(101.7)	(173.7)	72.0	41.5%
DAC amortization	100.7	54.6	46.1	84.4%
	$ (222.0)	(15.0)	(207.0)	N/M

Through our variable annuity contracts, we have exposure to guaranteed minimum income, death and withdrawal benefits. The future policy benefits and claim reserves associated with these benefits are determined under traditional GAAP accounting models with reserves accumulating over a long time. We mitigate a significant portion of the economic risks associated with these benefits through reinsurance and hedging. The reinsurance and hedging are accounted for using current market inputs, while the liabilities for future policy benefits and claims are accounted for using long-term inputs.

The changes in values of the reinsurance and hedging often have significantly greater volatility than the related book value reserves. These deviations can positively impact or negatively impact our publicly reported operating earnings. In response to the counter-intuitive effect of this volatility on GAAP earnings, in addition to income (loss) before income taxes, Ohio National measures core earnings, a company-defined non-GAAP measure, as a more meaningful measure of our long-term operating performance. It is calculated by adjusting income (loss) before income taxes for the impact of realized gains and losses, net of related policy deferred acquisition costs (DAC) amortization; change in value of trading securities, excluding Latin America activity; impairment of goodwill and intangible assets; loss on debt retirement and certain items that fluctuate from year to year in a manner unrelated to our core operations. These adjustments consist principally of non-economic and asymmetrical accounting items and certain non-recurring items including:

- Changes in the value of certain reinsurance contracts and hedges related to our variable annuity contracts, and related DAC amortization
- Market effects on DAC amortization on variable products
- Changes in GLWB/guaranteed principal protection (GPP)/guaranteed minimum accumulation benefit (GMAB) fair value reserves and related hedges and DAC amortization.

Effective Jan. 1, 2016, we began five-year averaging all DAC and unearned front end loads (UFEL) unlockings not accounted for within another management operating earnings (MOE) adjustment category as management believes these unlockings are not primarily related to current year core operations and this adjustment produces a more meaningful long-term view of our operating performance.

[1] Benefits paid in 2019 to policyholders and beneficiaries include cash payments for life insurance benefits, systematic withdrawal transactions on deferred annuity contracts, monthly disability income benefits, retirement plan benefits and annuity lump sum death claims and disbursements. Excludes Latin American operations.