# Q2 2015 Genworth Financial Inc Earnings Call - Final



FD (Fair Disclosure) Wire

August 5, 2015 Wednesday



**Length:** 11650 words

## Body

Corporate Participants

* Amy Corbin

Genworth Financial, Inc. - SVP of IR

* Tom McInerny

Genworth Financial, Inc. - President & CEO

* Marty Klein

Genworth Financial, Inc. - CFO

* Rohit Gupta

Genworth Financial, Inc. - President, US Mortgage Insurance

* Jerome Upton

Genworth Financial, Inc. - CFO, Global Mortgage Insurance

Conference Call Participants

* Nigel Dally

Morgan Stanley - Analyst

* Jimmy Bhullar

JPMorgan - Analyst

* Geoffrey Dunn

Dowling & Partners Securities - Analyst

Jefferies & Co. - Analyst

* Suneet Kamath

UBS - Analyst

* Sean Dargan

Macquarie Research Equities - Analyst

Presentation

OPERATOR: Good morning, ladies and gentlemen, and welcome to the Genworth Financial second-quarter 2015 earnings conference call. My name is Shelley, and I will be your coordinator today.

(Operator Instructions)

I would now like to turn the presentation over to Amy Corbin, Senior Vice President of Investor Relations. Ms. Corbin, you may proceed.

AMY CORBIN, SVP OF IR, GENWORTH FINANCIAL, INC.: Good morning, everyone, and thank you for joining Genworth's second quarter 2015 earnings call. Our press release and financial supplement were released last evening; and this morning, our earnings presentation was posted to our website and will be referenced during our call. We encourage you to review all of these materials.

Today you will hear from our President and Chief Executive Officer, Tom McInerney, followed by Marty Klein, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period. In addition to our speakers, Rohit Gupta, President of our US Mortgage Insurance segment, and Jerome Upton, CFO of our Global Mortgage Insurance division, will be available to take your questions.

During the call this morning, we may make various forward-looking statements. Our actual results may differ materially from such statements. We advise you to read the cautionary notes regarding forward-looking statements in our earnings release and related presentations, as well as the risk factors of our most recent annual report on Form 10-K and our quarterly Form 10-Qs as filed with the SEC.

This morning's discussion also includes non-GAAP financial measures that we believe may be meaningful to investors. In our financial supplement, earnings release and investor materials, non-GAAP measures have been reconciled to GAAP, where required, in accordance with SEC rules. Also, when we talk about the results of our international businesses, please note that all percentage changes exclude the impact of foreign exchange. And finally, references to statutory results are estimates, due to the timing of the filing of the statutory statements. And now I'll turn the call over to our CEO, Tom McInerney.

TOM MCINERNY, PRESIDENT & CEO, GENWORTH FINANCIAL, INC.: Thank you, Amy, and good morning, everyone. Today, I will provide a brief overview of the results for the second quarter, share progress against our three strategic objectives, and discuss the outcome of our strategic review.

Our second quarter operating income of $119 million reflects solid performance from each of our three primary mortgage insurance businesses. Compared to the first quarter, loss ratios in the US were flat and improved in Canada. Australia's loss ratio of 28% was higher than in the first quarter, but the first quarter's loss ratio benefited from the favorable impact of borrower recoveries. We still expect Australia's loss ratio to be within our annual expectations of 25% to 30% for the year. Long-term care earnings were negatively impacted by higher severity on new claims and lower terminations on existing claims; and life and annuity earnings were down sequentially, reflecting less favorable mortality than in the first quarter. Flow new insurance written was strong across our three strategic review. We are evaluating and implementing several new product and distribution strategies, but we expect sales to be modest near-term in this division. Additionally, we continue to focus on reducing operating expenses in US Life to bring them in line with our lower sales levels. Overall, we are encouraged with our second quarter results in our mortgage platforms and we remain focused on initiatives aimed at strengthening and improving US Life division results.

We continue to focus on achieving our three strategic objectives, which are to one, strengthen the mortgage insurance and long-term care businesses, two, simplify our businesses, and three, increase financial flexibility and strength. Progress against these objectives can be seen in our recently announced transactions that in the aggregate we expect will generate in excess of $600 million in net proceeds to the holding company, and in our implementation of two other actions that we expect will provide $500 million for PMIERs' capital benefit. The roughly $600 million of proceeds come from two transactions, the 14% sell down of our ownership stake in Genworth's mortgage insurance Australia, which generated net proceeds in excess of $220 million, and the planned sale of our lifestyle protection insurance business to AXA, which is expected to generate approximately $400 million of additional net proceeds.

In addition to these asset sales, required capital in our US mortgage insurance business, as measured under PMIERs, will significantly benefit from reinsurance and a reduction in affiliate asset holdings. In July, we executed two excess of loss reinsurance transactions that cover the 2009 to 2013 and the 2014 books of business at an attractive cost of capital in the mid-single digits. Terms, conditions and counterparties for the two treaties are similar; and we have received GSE approval on the first treaty and await their approval on the second.

Also in July, using primarily the proceeds from the recently completed selldown of Genworth's mortgage insurance Australia, the holding company purchased, for $200 million, GLIC preferred stock from US Mortgage Insurance. Combined, these three transactions generate an aggregate capital benefit of over $500 million. Taking credit for these transactions and a planned internal restructuring scheduled for later this year would put us in compliance with PMIERs as of the end of the second quarter. While we are pleased with our progress, we do expect to further supplement capital with additional reinsurance on our 2015 book of business and/or cash from the holding company to establish a prudent buffer for required PMIERs capital.

Turning to long-term care, achieving in force premium rate increases and benefit reductions continues to be our top priority for this business. As we said last quarter, we are providing three new LTC metrics going forward, which can be used to measure progress against expectations for additional annual incremental premiums or equivalent benefit reductions. Slide 12 in the second quarter earnings summary provides the following data for the quarters shown. One, approvals, including number of filings approved, associated in force premium, and the weighted average percentage approved. Two, the number of filings submitted and associated in force premium; and three, the estimated impact of the approved premium increases and reserve changes from benefit reductions on operating earnings. **We continue to believe our best course of action is to work with regulators**, distribution partners and policy holders to fix the long-term care business and we continue to make progress on this front. We have significantly stepped up regulatory discussions, including with some of the most influential state regulators in the National Association of Insurance Commissioners. I believe Genworth is leading the way on pursuing important regulatory reform, and we continue to urge regulators to consider moving to an annual rerating model for long-term care insurance, similar to the health insurance model.

Our long-term care premium rate action track record is very strong, as shown on slide 12 of the second quarter earnings summary. 10 additional filings in eight states were approved during the second quarter, bringing the total approvals in 2015 to 21 in 17 states. While it will take a number of years to move the older blocks closer to breakeven and newer blocks closer to original pricing, we these businesses, as well as the sales process with potential buyers. While there is strong interest in these businesses, we have determined that a large-scale sale of life and/or annuity, including a legal entity sale, is not in the best interest of our shareholders. In our evaluation, we considered a number of factors, including earnings per share, taxes, valuation and proceeds, in addition to ratings and commercial impacts. While there were a number of compelling positives, in our view, they were outweighed by potential adverse effects on ratings, which could negatively impact our collective businesses, given the interdependencies that exist both within certain agency methodologies and our own organization, among other things. That said, given the strong interest by potential buyers identified in this process, we may pursue a couple targeted smaller block transactions.

Given our life and annuity businesses are not where we'd like them to be with regards to sales, capital use and returns, our focus will be to streamline our life and annuity businesses and increase its value by writing accretive new business that addresses the financial challenges of aging. This will require first, more targeted product features and benefits; second, deeper relationships with those producers who are focused on these same challenges; and third, right-sizing and realigning the supporting cost structure. Given recent insights gained from our market assessment, we believe this is the best path forward.

As we've previously discussed, our US and Canadian mortgage insurance businesses offer the most attractive earnings growth and return profiles, and we are committed to position these businesses for growth by increasing the amount of profitable new insurance they write. With regard to our mortgage insurance business in Australia, we plan to continue to evaluate our ownership interest as we work to execute against our three strategic objectives.

While we made solid progress to date, we continue to seek ways to reduce our debt levels and improve the overall strength and financial flexibility of the Company. I assure you that we will continue to execute with urgency against our goals to improve long-term shareholder value. Now let me turn it over to Marty to cover the quarterly results in more depth.

MARTY KLEIN, CFO, GENWORTH FINANCIAL, INC.: Thanks, Tom. Good morning, everyone. Today, I will discuss our second quarter results and key performance metrics and provide an update on progress made on our 2015 goals. We reported net operating income of $119 million and a net loss of $193 million for the quarter, that included a $306 million loss of a planned sale of the lifestyle protection insurance business, or LPI. Overall, we saw good results in our Global Mortgage Insurance division that were more than offset by unfavorable mortality sequentially in the US Life Insurance division. Beginning in the second quarter, LPI is being reported as discontinued operations, and we expect to close the transaction by year end. The LPI team has done a great job in navigating a tough economic and business environment in Europe over the last several years, and we are pleased to be at this point in the sales process. Given where we are with PMIERs, we are likely to use the majority of those proceeds to reduce debt.

Looking at key performance metrics, sequential operating revenue results reflect three main drivers. First, earned premiums continued to be favorably impacted by the long-term care rate actions; second, investment income is up slightly from $13 million of higher gains related to limited partnership performance; and third, foreign exchange had an unfavorable impact of $8 million. Investment results were solid, with no impairments for the quarter. We remain disciplined in addressing risk in our portfolio. While recent events in Greece and Puerto Rico made headlines, it is important to note that we have no holdings in Greece and minimal exposure in Puerto Rico.

Our underwriting results were mixed. Sequentially, the loss ratio was lower in Canada, flat in the USMI, and up in Australia. The loss ratio in long-term care was up slightly from the prior quarter, as the seasonally strong first quarter claim terminations did not recur. Life Insurance results were impacted by unfavorable mortality.

full year 2015 and approximately $40 million to $50 million for 2016.

Turning to capital, we had generally good results in the quarter. A few points related to our capital positions. First, we maintained solid capital positions in our operating companies. Second, as Tom mentioned, USMI capital, as measured under PMIERs, is expected to benefit from both reinsurance and a reduction in affiliate asset holdings totaling approximately $500 million and helping to achieve a major goal of compliance with PMIERs. Third, we completed a $200 million Aussie dollar subordinated note offering in July and we anticipate receiving a special dividend of approximately $50 million in the third quarter. Fourth, for Canada, during the quarter, the business completed a normal-course issuer bid in which Genworth Financial participated to keep our overall ownership percentage at 57.3%. Additionally, this benefited holding company cash by $15 million. Fifth and finally, turning to US Life Insurance debt straight performance, unassigned surplus decreased approximately $38 million sequentially to $100 million from unfavorable long-term care and life insurance mortality. Risk-based capital levels in our Bermuda subsidiary, BLAIC, were approximately 335%, slightly down from the end of the first quarter. While repatriating the long-term care business in BLAIC remains a strategic priority, it is not now expected to be completed until after 2015.

Moving to the holding company, we continued to maintain significant liquidity. Our available cash and liquid assets were over $1.1 billion, up from the prior quarter primarily from $173 million in proceeds from the Australia selldown in May and dividends from operating subsidiaries, partially offset by debt service and holding company expenses. This represents a buffer of approximately $670 million in excess of 1.5 times debt service and restricted cash and well above our $350 million risk buffer. The dividends received from our international mortgage insurance business are $139 million halfway through the year, close to achieving the full-year goal of $150 million to $230 million. We should continue to receive ordinary dividends from Australia and Canada this year and, as previously mentioned, we also expect to receive a second special dividend from Australia.

Moving to business results, Global Mortgage Insurance had another good quarter, reporting net operating income of $110 million, although down $6 million versus prior quarter and down $26 million year-over-year, primarily from unfavorable foreign exchange, lower tax benefits and the impact of a larger minority interest.

Regarding Canada, operating earnings were $37 million for the quarter, down $3 million from the prior quarter. We saw a modest sequential increase in home prices, while the national unemployment rate remained flat, at 6.8%. Flow new insurance written was higher sequentially, primarily from seasonality. In June, we initiated a 15% price increase for mortgages with less than a 10% down payment, which should have a favorable impact in earned premiums over time. Canada's loss ratio decreased 5 points from the prior quarter, to 17%, reflecting a modest decrease in new delinquencies, note of cures, but was up 5 points versus the prior year from a modest increase in new delinquencies and a higher average reserve for delinquency from regional mix. Given Alberta's dependence on the energy industry, housing prices and unemployment in Alberta are starting to feel pressure from lower energy prices, although we've not seen an increase in delinquencies to date. We have taken actions to further strengthen the credit quality of new borrowers within that region. We continue to closely monitor performance within the province of Alberta, and while year-to-date performance has been strong, we could see pressure on the loss ratios in the second half of the year. We still anticipate ending the year within our previously communicated 20% to 30% range.

Shifting to Australia, operating earnings were $29 million, down $1 million versus the prior quarter. As in Canada, macro economic conditions were generally stable in the quarter, as the national unemployment rate was 6.0% at quarter end and overall home prices experienced modest gains sequentially. Like all markets we operate in, we evaluate the factors relating to the health of the market. Currently in this market, fundamentals remain solid overall, driven by supply constraints, vintages where we have taken actions to strengthen the credit profile of the business. While we may see pressure in the second half of the year, we still expect our full-year loss ratio to be in the previously provided range of 25% to 30%. Australia flow new insurance written was up 16% sequentially, reflecting typical seasonal improvement from the first quarter.

In USMI, net operating income was $49 million for the quarter, down $3 million from the prior quarter, as net investment income was lower and the loss ratio was flat to the prior quarter, at 33%. The dividends of $15 million per year which USMI had been receiving from its affiliate asset holding will move to the holding company going forward, since USMI exchanged it for cash in July of this year. Earnings will also be modestly impacted in the second half of this year from the reinsurance arrangements the business has executed.

Flow NIW increased from the prior quarter from a seasonally larger mortgage insurance market, even as the business intentionally decreased its single premium lender paid new insurance written, reflecting its selective participation in this market. At quarter end, 61% of the risk in force is composed of 2009 and forward books of business, at the low end of our anticipated range of between 60% and 70% by the end of 2015. We continued to make good progress in our capital goals and strategic priorities for our Global Mortgage Insurance division, and anticipate meeting or exceeding these goals in 2015.

Turning to the US Life Insurance division, net operating income was $57 million, down from both the prior quarter and prior year. The long-term care insurance net operating income in the quarter was $10 million. The results were impacted by unfavorable mortality on existing claims, which drove lower claim terminations; higher severity on new claims, where we had a higher mix of claims with higher daily benefit amounts; $5 million unfavorable impact, as we billed the profits followed by losses reserve; and $12 million of net favorable reserve items mostly identified during our material weakness remediation efforts. Although results in the quarter were impacted by higher claim costs, our claim reserve experience in the first half of the year in the aggregate was in line with the revised assumptions we developed last year. We will continue to monitor our experience, assumptions and resulting reserves closely. With regard to long-term care, as we said last quarter, near-term long-term care earnings are expected to remain at modest levels, with quarterly variability. The modest profitability is driven by two things. First, at this stage in our rate action implementations, the 2012 rate action benefits are starting to level off as we move closer to full implementation, and our next series of rate action filings are just beginning to ramp up. Second, we expect a gradual shift in the mix of policy holders on claim. As our in-force business ages, we expect to see more claims coming from products with higher daily benefits and inflation options. Given these dynamics, we anticipate long-term care earnings to remain at modest levels until the new rate actions, most of which have already been approved, are further along in their implementation next year, with the potential for some volatility where results could be better or worse than this quarter in the near term.

Moving to life insurance, operating earnings were $22 million for the quarter, down from $40 million in the prior quarter, primarily impacted by mortality experience in term life insurance from higher severity. For fixed annuities, earnings were $25 million, down from the prior quarter from unfavorable mortality in immediate annuities.

Sifting to the Corporate and Other division, the net operating loss for the quarter was $48 million. We took important steps in the last few months, with receipt of the irrevocable LPI offer, the further sell down of our holdings in Australia, and the progress USMI made on PMIERs compliance. As we move forward to advance our strategic objectives, I would note that our situation is complicated in part by the structures that had been established over the years within Genworth, including, for example, stacked entities and internal reinsurance for capital relationships. While these structures and interrelationships had benefit for a company which was in several businesses, such as tax efficiencies driving improvements in our businesses, including, in the US Life division, fix the long-term care business and increase the value of the life and annuity businesses through accretive targeted products and a focused and efficient cost structure; in the Global Mortgage Insurance division, drive earnings growth and capital improvements in USMI, which should benefit its dividend capacity and ratings over time; and continue to generate capital in our Canada and Australia platforms.

We believe growing USMI earnings and fixing long-term care are the two biggest drivers of value creation in our businesses and for our shareholders over time. In USMI, earnings are expected to grow significantly over the next few years, as we position this business to continue writing attractive new business, while the older vintages burn off, and to achieve a significant operating dividend potential once that capacity is restored. In LTC, we need to address the negative impacts of our legacy business, as we pursue our rate action goals and associated reduced benefits on the in-force over time, while writing profitable new business with more limited risk. While we have made good progress in several important areas this quarter, we have much work ahead, as we focus on these drivers and pursue our goals. With that, let's open it up for questions.

Questions and Answers

OPERATOR: (Operator Instructions)

Nigel Dally, Morgan Stanley.

NIGEL DALLY, ANALYST, MORGAN STANLEY: So your prior goal was to reduce debt by $1 billion to $2 billion. At least by my calculation, the only way to achieve that was from executing a sale of GLAIC. So just to start, can you clarify on whether that's still a reasonable goal.

TOM MCINERNY: So Nigel, we said that our goal would be to reduce debt by $1 billion to $2 billion over time. That's still our goal. With what we've done, the two transactions we did that we announced were at $600 million. So we clearly are making progress towards the lower end of the range. But that's still our goal and we continue to look at options. We decided, for a variety of reasons, not to pursue the large life and annuity transaction, but we are looking at potentially selling or reinsuring a couple of the blocks.

NIGEL DALLY: Okay. Thanks. And second question, just on BLAIC, the consolidation being pushed back. Can you provide some clarification as to what's driving that?

MARTY KLEIN: Hello, Nigel. It's Marty. It's still a goal. But obviously, as we were assessing a potential transaction, a larger transaction in US Life, it was going to come along with or perhaps following that. And as we work through that now, we do have the repatriation ahead of us. But we do think, as Tom had mentioned, we want to look at a couple of these Life blocks, and if we do pursue them, we'd maybe try to do them over the next several months or into next year. We'd want to probably do those first, if we do in fact decide to do them, and then do the repatriation.

The other thing I'd point out is that the repatriation process does take a while. And part of it is in the process. There's a polling recess where you have to file your pro forma financials, which has been difficult because we've been working through what that pro forma is going to look like. And now that we've got that somewhat determined, although we have to think about these life blocks, we'll play that through. But still a goal, but I think it's going to come into next year, at the soonest.

NIGEL DALLY: Great. Thanks.

OPERATOR: Jimmy Bhullar, JPMorgan.

JIMMY BHULLAR, ANALYST, JPMORGAN: I had a couple of questions. The first is just if you could talk about the financial impact of the reinsurance deals that you've done in the USMI business. You're the CFO of the Global Mortgage Insurance business. So I'd ask Rohit to handle that question.

ROHIT GUPTA, PRESIDENT, US MORTGAGE INSURANCE, GENWORTH FINANCIAL, INC.: Good morning, Jimmy. This is Rohit. So the cost of reinsurance transaction, both for 2009 to 2013 book, as well as 2014 transaction, as Tom stated, is in the mid-single digits. Just to ground you, these are amortizing transactions. So over a period of time, the cost of the transaction will drop. But just to give you a ballpark, for calendar year 2015, we would expect the ceded premiums to be in the range of $10 million to $15 million. So you can use that as a calculation point.

JIMMY BHULLAR: Okay. And then on your sales outlook for the US Life division. I understand in LTC, you're making a lot of product changes. But your sales were weak across the board. So just wondering if you can talk about your outlook and how much of the weakness is being caused by ratings issues versus just your intention to preserve capital?

TOM MCINERNY: So I think, Jimmy, that first of all I would say that in long-term care, we did relaunch, refresh in a product this year and just launched it. So I think that will help sales in LTC. In annuity, fixed annuities, clearly the low interest rate environment has made getting the appropriate spreads for us a challenge. But in addition to that, I think as we're going through the strategic review of life and annuity, that clearly had a significant impact on sales. And so with that now behind us, we would hope to improve somewhat. And obviously the ratings decline, while an A- at A.M. Best is acceptable in the BGA channel, where our principal sales, are the S&P and Moody's ratings has had an impact on our sales through financial institutions.

So as both Marty and I commented, we expect, given the low interest rate environments and our ratings, for sales to be modest for some time. We are looking at a number of product changes and focusing on specific BGAs and distribution outlets to improve sales. We also brought in a new leader for -- a commercial leader, Chief Commercial Officer for the business. So we hope all those things will help. But I do think sales will be challenged for a period of time, although working on a number of product changes and distribution strategies to improve it.

JIMMY BHULLAR: And then lastly, if I could ask one more, on the Canadian and Australian MI businesses, if you could just talk about what your views are on those markets. There's been a lot of concern about low commodity prices or frothy housing markets in those regions. So how do you view your business and the margins in Canada and Australia? I think Australia, you mentioned you expect a decline in margins. But what's your view of the market overall?

TOM MCINERNY: Jimmy, I would just say that we're pleased with the results across the US, Canada and Australia. I think our loss ratios continue to be in our range, probably at the low end of the range that we forecasted. So we're comfortable with all three of the businesses. Clearly, as you stated, there are macro economic challenges that impact the markets, particularly in Canada and Australia. And I'll ask Jerome just to make a few comments on that.

JEROME UPTON, CFO, GLOBAL MORTGAGE INSURANCE, GENWORTH FINANCIAL, INC.: Jimmy, good morning. It's Jerome Upton. I think one of the things -- I would start with Canada and just give you a broad perspective on economic conditions. We all have seen that GDP has contracted in Canada early in the year. But when you dive in deeper on that, it's primarily driven by oil price decline and sort of the contraction there. We saw the Bank of Canada lower rates around 50 basis points, or down to 50 basis points. But I think in the second half, most economists, including the Bank of Canada, would expect GDP to grow. And they're expecting 1.1% growth, when you look at it year-over-year. Employment outside of the oil-producing areas are holding up very well. And our business performance, as Tom indicated, has been strong. You also have seen the loony, or the Canadian dollar, lower, which is going to help exports in that economy.

market.

The credit quality in the business remains very good. We've taken actions, if you just think about Alberta, Alberta is a pressure point. Alberta is a buyer's market. And while we haven't seen the performance deteriorate all in Alberta, we do expect that we're going to see some pressure in the second half. Home prices have gone down some. There could be further degradation there in home prices, 5% to 10%. But overall, the credit quality that we have on the recent vintages, because we took action in that area early, the credit quality is good. And the older vintages have home price appreciation behind them. So that's sort of a macro perspective on Canada.

In Australia, GDP is continuing to grow. It's growing below trend. It's about 2%. The trend's normally been higher than that. In Australia, the RBA cut cash rates down to 2%. But you probably noticed yesterday, they held rates flat at 2%. They did not take another cut on rates.

And employment is doing okay overall, down to 6%. It actually went down a tick to 6%. We're just simply seeing pressure in the mining-related areas, in Queensland, where they extract a lot of coal from the ground, and in Western Australia, where there's significant iron ore extraction. So we're seeing pressure there, because prices have come off over the past couple of years.

We took actions, starting in 2013, in both of those areas to cut loan balances down and LTVs. So that should help us. And it's the older vintages that are pressuring us and there's likely some embedded HPA or embedded equity that will help us there.

With respect to the Sydney market, you have seen Sydney grow, from a home price perspective, consequentially year-over-year. But when we dive into that, it's a concern when you see home prices go up that large. But when we dive in, you have to put this in a longer term context. The Sydney market has had periods of below home price trends in 2004 and 2008, and they actually had declines in home prices in 2011 through 2013. So if you look at this over a longer term trend, you see 5% growth over a 10-year period.

We are watching carefully the investor lending concentration in that market. But I would tell you that one thing we feel good about is the regulatory action that's being taken, as well as the lender action that's being taken to strengthen the underwriting in that Sydney market on investor lending. So we applaud that action that's being taken and we think it's a good thing.

So those are the assessment of the markets. I think overall, we still feel good. But we acknowledge we're going to feel some pressure in energy-related and mining-related areas.

JIMMY BHULLAR: Thank you.

OPERATOR: Geoffrey Dunn, Dowling and Partners.

GEOFFREY DUNN, ANALYST, DOWLING & PARTNERS SECURITIES: I wanted to follow up on the previous question about the XOL transactions, see if you can provide a little bit more color with respect to, is it all of the 2009 through 2013 and 2014 books that's being covered? Any detail on the attachment points of the XOL. And as far as the incremental 2015 XOL, can you give us an idea of what you think the incremental capital benefit will be from that?

ROHIT GUPTA: Geoff, this is Rohit. Good morning. Let me give you some color on the XOL transactions. As Tom and Marty stated, the total capital credit from these transactions at the end of the year is expected to be around $300 million. We would basically say that the XOL tiers are within the credit tiers that PMIERs have subscribed, because that was the intent of these transactions, to get capital credit under the PMIERs framework. At this point, we are not providing any more detail on attachment and detachment points. But on cost of capital, I did provide some color on cost of capital being in mid-single digits, and 2016 impact being $10 million to $15 million for the first two big milestone with PMIERs. We believe we will be compliant, given the effect of these three transactions, the two reinsurance transactions, plus the GLIC asset exchange, as of second quarter. But we still believe that we actually need financial flexibility, both for the required asset side, which could actually have variations from forecast, just based on items like interest rate, higher NIW, or different policy lapse than our expectation, as well as in our asset base, as Marty stated, we have Canada ownership, 16% of Canada ownership. So based on the volatility on the stock price, as well as foreign exchange, we believe it's prudent for us to actually have a financial buffer, financial flexibility against our PMIERs compliance.

GEOFFREY DUNN: Okay. With respect to the ceded $10 million to $15 million, is there ceding commission and/or profit commission consideration beyond that, or are you giving us a net impact?

ROHIT GUPTA: Geoff, this is net and gross. It's an excess of loss transaction. There's no profit commission and no ceding commission. So this is actual amount of ceded premium. I would reiterate that these are amortizing transactions. So as you transition from 2015 second half to 2016 to 2017, you will see absolute dollars of premium ceded go down. But there's no concept of profit commission or ceding commission back. The cost of capital is based on the ceded premium and the capital credit we provided.

GEOFFREY DUNN: Okay. In terms of thinking about a cushion against PMIERs, how are you approaching that? I know most of the industry said last quarter, you're still evaluating it. Now, as you put plans into place to take additional capital actions, how are you thinking about it? Is it a 5% or 10% buffer? Is there a dollar buffer? How do we try to anticipate what additional capital needs you might have about that?

ROHIT GUPTA: So Geoff, just two things. First thing, we've always had a consideration for a buffer, right from the range, first range we provided in July of 2014, when draft PMIERs came out, and we provided the range to the marketplace. And including of our final range, when final PMIERs came out on April 20, we actually included a financial flexibility buffer or cushion in that range, also.

And the two items, without going into any specific dollar numbers, the two items we consider when calculating our buffer is on our required asset side, just the volatility we could end up facing against our forecast, based on items like interest rate, new insurance written, losses, as well as lapse. And then secondly, on the available asset side, given our MIC ownership, just volatility in foreign exchange, volatility in the actual stock price. We have looked at those trends historically and actually created an appetite, a risk appetite and a financial flexibility appetite framework that we use. The buffer is dynamic in nature, and at this point of time, that's what we're building our capital towards.

MARTY KLEIN: Geoff, it's Marty. I would just also note that as the team looks at the potential for 2015 transaction, at this point, we think it's quite possible that we'd be able to not only remain in compliance with PMIERs, given the other progress we've made, but also hit that buffer, largely through that type of transaction. Obviously, we have to get such a transaction done. But we do think that the size of that book of business and the appetite we've seen so far is probably going to give us a decent shot to build in that financial buffer that Rohit talked about with that transaction. If that's the case -- and again, that's an if, we have to work through what that deal would look like -- but if that is the case, then I think that as far as the LPI transaction, we think that, as I said earlier, the majority of the proceeds, if not almost all those proceeds, would go towards debt pay down. But obviously, we have to play through on the 2015 potential transaction.

GEOFFREY DUNN: Okay. And then last question, if I may. Once you repatriate the LTC risk next year, is there any strategic reason to upstream the Canadian ownership from BLAIC to the holding company?

TOM MCINERNY: I'm sorry. Could you repeat that? Upstream what to the holding company again?

relationship. So we'll assess what we want to do as we're doing the repatriation, which obviously involves BLAIC, we'll assess what we want to do with Brookfield.

There have been some tax advantages in the past for their overall structure. But as things move around, as we continue to assess Australia and do some other things, we'll have to assess what we want to do with Brookfield and what we want to with some of those ownerships. So it's a little premature to say what we would do in that regard.

GEOFFREY DUNN: Okay. Thank you.

OPERATOR: Ryan Krueger, KBW.

RYAN KRUEGER, ANALYST, KEEFE, BRUYETTE & WOODS: I was hoping to go back to the decision not to sell the entire life and annuity business. Can you talk a little bit more about that decision and specifically, how meaningful of a role did the expected proceeds that would actually make it to the holding company play in the decision not to go forward?

TOM MCINERNY: So Ryan, we looked at a number of different criteria. Obviously, we had our outside financial advisors also working very closely with us. And there were a number of factors. I would say probably the most important ones were earnings per share and accretion dilution, taxes and tax impact on the actual valuations that we received from the bidders and also the proceeds.

In regard to the proceeds, we did talk with our key regulators, which are the regulators for our three legal entities. I think all three were open to allowing us to take some proceeds out of the companies, and particularly the GLAIC, because while obviously they want us to maintain appropriate RBC levels, and I think they're comfortable with where we are today, they also clearly get the importance of reducing debt at the holding company by the $1 billion to $2 billion. So I would say they were fairly open-minded on that.

We ultimately decided, while there were a lot of positives for doing the deal, including our ability to reduce debt, in the end, our view was they were outweighed by potential adverse effects in the ratings and the loss of earnings diversification. So in the end, those were the two drivers that outweighed the positives and led us to decide not to do the larger sale, the sale of GLAIC, but to focus on a couple of the blocks that we think make sense to do something with.

RYAN KRUEGER: And in terms of the block sales now, or block reinsurance that you're looking at now, do you think the proceeds freed up from those would be free then to the holding company and help meet your debt reduction targets? Would they most likely be retained and used to bolster RBC?

TOM MCINERNY: I think one, we have to negotiate those deals with the counter party or the reinsurer. There is a capital benefit, and I would expect that when we talk to the regulators, they would be open-minded in terms of allowing us to take that out. But we'll have to one, get the deals done and then talk to the regulators. But as I said, I think while they understand our need to reduce parent company debt, I think they're pretty open-minded on that. They know that's a significant objective and will, I think, work with us to get there. Obviously, they also want to make sure that there's enough capital in the operating entities to allow us to pay the policyholder obligations going forward.

MARTY KLEIN: But Ryan, I would say that while I think these couple life blocks are interesting economically and would have some capital benefits, I don't think they're all that overall significant as far as the amount of proceeds we'd get out and pay down debt. I think they're definitely helpful for the business and the capital within the business, but I don't think overall they're going to have much of an impact on our ability to get money out and pay down debt from those transactions, just to manage those expectations. We think there's other benefits, from capital standpoint and economic standpoint. That's why we're taking a look at them.

business sales are likely necessary. I know you've mentioned you're still evaluating Australia. Is that something we should still -- is that really the most likely additional use would be a further sale of Australia?

TOM MCINERNY: So there are a number of potential sources of proceeds to help us focus on the debt reduction. Clearly, both Australia and Canada are meaningful payers of dividends and special dividends. And so they will clearly be an important source, as they have been. In addition as USMI makes its progress, it is significantly improving its earnings and it's working on their negative unassigned surplus, but that is because we're making progress there and we would expect USMI to also, at some point, 2017, maybe later, to be able to pay a dividend. And then we?ll also look at asset sales.

And so we've always said the goal is reducing debt by $1 billion to $2 billion. And the reason for that range is it gives us more optionality in terms of the options we can consider for the Company, including potentially splitting the Company. And so that's an important point. But we always believed that we would be doing this over time, and so we'll continue to look at the opportunities that we have both in the Life division, as well as in the MI side.

RYAN KRUEGER: Okay. Great. Thank you.

OPERATOR: Colin Devine, Jefferies.

COLIN DEVINE, ANALYST, JEFFERIES & CO.: A couple questions. First, Marty, I think it would be very helpful if you can just go a little bit deeper on to what some of the issues are with the interconnected capital structure in Genworth. Because what I think I heard today is a big reason why you can't do a larger life sale is because of that. And that's an issue there, because of the interconnection. So we can hit that one first?

Second, to give you a break and catch your breath, can we flip over to Genworth Canada? I'm talking about Alberta. If arrears got back to where they were, say during the financial crisis, at that level, just to size maybe how bad things could go, how much of an issue would that be for Genworth Canada?

And then lastly, if you can provide a little bit more color on what are the remaining issues with respect to selling Australia. Thanks.

MARTY KLEIN: Hello, Colin. I'll start out and then I'll kick it to Jerome for your question on Canada. And then Tom can take the last question.

On the interconnectivity, that is something we've obviously known about for a while and want to continue to work through. I think over many, many years, Genworth, like a lot of companies that are in a lot of different businesses, set up these interrelationships that certainly had benefits, tax benefits. We have tax sharing arrangements, which can be very helpful. Certainly, capital relationships and reinsurance relationships.

I think specifically to us, ratings -- and this is also true for other companies that are in multiple businesses -- obviously our overall ratings are impacted by the mix of business we have, as well as obviously, the level of debt that we have. And as different rating entities look at these differently, to be clear, certain things matter to them a lot. Earnings diversification, how many different businesses you're in, and what's their view of the volatility or variability of those businesses. Also, some agencies have a concept of core businesses and then they notch other ratings off of what they view as the core business. So those are all things that we have to be mindful of.

I think the biggest driver of why we did not pursue a transaction life in annuity is we felt like the ratings repercussions would not only potentially hurt the US Life division, given the loss of potential address that.

There are a number of very specific things to us. Obviously, the relationship between BLAIC and GLIC without long-term care reinsurance is certainly one pretty major connecting point. And actually, speaking of GLIC, the fact that we have stacked entities, GLIC is the parent and then it owns GLAIC, the Virginia company, which has a lot of life and annuity business. And they both, in turn, have an ownership of GLICNE, so you have that kind of stacked structure, while it provides some overall capital benefits, it does impede dividend flows, for example, from GLAIC. So that's a consideration that we have to work through, see what we want to do about that.

Obviously, we've had the GLIC preferred stock that was in USMI that did not get any credit at all under PMIERs. Similarly, the other part of USMI's capital structure is Canada, which while we think it's a very good business, it does, under the way PMIERs is constructed, have a lot of volatility. So that creates the need for a bit of a buffer more than maybe the business would ordinarily have if they had a consistently stable part of its capital structure in there. So we have to kind of work through that.

So there's a lot of those types of things. Some of them would make some sense to look at very closely. Others, I think would not be economic. So we have to sort through what we can do to change those interconnected things and improve our financial flexibility over time. In the meantime, it's very important that we make our businesses perform better. In Life and Annuity in particular, now that we're going to be in that business, we need to work on how to grow it efficiently and effectively and profitably. And obviously, fixed long-term care business, which is going to be a major, not only earnings driver, but I think overall shareholder value type of proposition, given the way the market's long-term care right now.

COLIN DEVINE: Marty, just following up on that, you mentioned Genworth Canada's ownership structure. Two quick ones. One, why not get it up to the holding company, since you freed up some other capital? And two, why not sell it down to 51%, 52%, like you did for Australia?

MARTY KLEIN: Yes, I think that, Colin, looking at those things, they make a lot of sense, but they also involve cash and things like that. So we have to look at the cash and capital needs that we have and what's the best way to use it. And certainly, there are some benefits to getting Canada out of USMI, absolutely, but we have to also think about what we want to do with our cash and our capital.

I think also, Canada is -- while USMI has been working to comply with PMIERs -- the dividends that Canada has been paying not only go to the holding company, but also go to USMI. So USMI, which to this point has been in need of capital, has benefited by its relationship historically with owning Canada, because of the dividend flows which USMI has been able to capture. But obviously, with the compliance with PMIERs, and that also included, frankly, a contribution from the holding company -- or not really a contribution, an exchange of the GLIC preferred for cash -- we're in a different situation now, so we'll have to assess a lot of those things.

COLIN DEVINE: And maybe just, why don't you clarify for everybody, what is the cost to capital for USMI by owning the Canadian stock? If you swapped it for cash, what would be the benefit?

ROHIT GUPTA: Colin, do you mean under PMIERs context?

COLIN DEVINE: Yes.

ROHIT GUPTA: Under PMIERs, the prescribed discount for publicly traded securities is 25%. So whatever the market value is multiplied by the foreign exchange rate gives you the market value of Canada that's in USMI. And at quarter end points, we adjust that down by 25% to calculate our PMIERs available assets, and then whatever volatility that's baked in, that's basically part of our financial flexibility buffer we talked about.

that our risk to capital is like 13.5 in Genworth co these days. And so that's what we have to drive to and manage to now. Why don't we kick it to Jerome for your question on Canada?

COLIN DEVINE: I think you just reinforced why the ownership structure is still the way it is. But let's go to Alberta.

JEROME UPTON: Colin, good morning. It's Jerome. I would say that we did feel pressure coming out of the GSC and from Alberta, as you point out. But I would say that we feel better positioned at this point in time in that market, acknowledging that we are going to feel pressure. We have taken some underwriting actions in that area, number one, to strengthen the recent vintages. And those actions would've improved our credit scores in the region, as well as to just an overall much more conservative approach to collateral valuation and underwriting in general. So we do feel better positioned. And also would note that coming out of the GFC, home prices were at pretty elevated levels in Alberta. What we're underwriting now and underwrote post the GFC, the housing market was down some, so we feel better positioned at this point in time.

I really can't give you a number, Colin, with respect to pressure on the business, and link it back to the global financial crisis. Because we're going to have to wait and see what's going to happen with oil prices and the extent and the duration and how long they stay down before we can give you any type of estimate on that. We're telling you in 2015 that we're going to stay within our guidance of 20%, 30% in Canada. And as we move into 2016, we'll give you an update based on what we see in the market, the home price declines that are there, and the unemployment increases.

COLIN DEVINE: Okay. Thank you.

TOM MCINERNY: And Colin, just to take your last point quickly, so we can go on to some other questioners. We continue to evaluate our ownership position in Australia. As we've said before, there is a benefit to majority ownership, including that we retain a majority on the Board. And also, because Australia has been such an important payer of dividends over time to help us manage the annual debt service, Australian ownership and dividends there are important. If we did decide, at some point down the road, to sell Australia ownership, we'd likely use the large portion of those proceeds to reduce debt.

COLIN DEVINE: Thank you.

OPERATOR: Suneet Kamath, UBS.

SUNEET KAMATH, ANALYST, UBS: I wanted to start with long-term care. I don't know if you talked about it on this call, but in the past, Marty, you'd talked about wanting to maintain a buffer for long-term care volatility. Have you done any more work in terms of sizing that?

MARTY KLEIN: Hello, Suneet. Actually, we've been doing a lot of work on what we want to do in life and annuity and some other things. I would say it's still something we want to look at. I think that part of that is going to be a function of what other businesses are in the US Life division, and that was not all that certain for a while. I think that the way that the risk-based capital rules under NAIC rules are such that we would want to manage over time long-term care to a higher level. It does not necessarily mean now that we're going to be in the life and annuity businesses. We'd also do that for the life and annuity.

So I think what we're working through now that we've got life and annuity businesses and earnings stream and diversification, it provides some capital and risk buffer. We have to assess that longer term goal. I do think it'd be along the lines of holding up a higher RBC number behind long-term care, probably more in line with what we think its economic risk and economic capital would be. But we'd have to weigh that with a balancer of what we're doing in life and annuities, now that we have those businesses. Also want to be mindful of overall cash flows and surplus growth in business and strategic review and not going to do a transaction in life annuity, we can turn our attention to what exactly do we want to do in long-term care. I think historically, we've looked at US Life, the division, and wanted to manage long-term care in excess of 400. I would imagine that minimum 400 is probably going to go up a bit, once we work through that. But we'll have more details later on this year, hopefully.

SUNEET KAMATH: Okay. And my second question is just in terms of the strategy, I think a lot of us heading into this call were maybe anticipating that you might announce something pretty big that would move you much closer along your way to delevering and then ultimately breaking up. But based on how you're characterizing your situation today, it seems to me that what we should be thinking about is perhaps a larger number of smaller items as opposed to any one big thing, in terms of sending cash up to the holding company and reducing debt. So I guess my question, is that a fair characterization of how you're thinking about things on a go forward basis?

TOM MCINERNY: I think, Suneet, that that's fair. We continue to evaluate and look at and will continue to do that, various options. But I do think that the large life and annuity transaction, for the reasons we talked about, I think we looked at that, looked at it hard, and decided in the end not to go forward with that. But we'll continue to work over time on reducing the debt in the range that we've talked about.

SUNEET KAMATH: And is there a timeframe for that debt reduction? I can't remember if you gave us something in the past.

TOM MCINERNY: We said $1 billion to $2 billion over time. And again, it is a high priority to reduce the debt. We have other priorities. We've got to balance all of them. And so I think that we'll leave it at that.

SUNEET KAMATH: Okay. Then last one, just for Marty, on LTC earnings. If we think about the 2012 rate actions, I think it took a couple years to get the real earnings benefit from that. So now that you have most of that baked in the cake and you're going back for additional rounds of rate increases, why should LTC earnings improve dramatically as we get into 2016? I get they'll probably improve a little bit. But are we talking about a dramatic increase or more of a gradual grind higher?

MARTY KLEIN: I'd say it's a decent increase, assuming the business continues to perform as it has been, and as we would expect. There is a lot of variability in long-term care earnings, as I pointed out. But I think that a lot of the 2012 rate actions, if you think about it, they come in two pieces. One is the additional premium we get, and that's fairly steady and that will continue on. But then the other part of it is those benefit reductions -- which I know you know this, but just for everybody else that's listening -- those benefit reductions, there's an immediate reserve release in the current period. So when we're implementing the rate actions, there's a lot of additional earnings benefits you get for that reserve release component. And as the round of rate actions begins to get through the implementation period, those earnings benefits from reduced benefits and that reserve release begin to ebb away.

We do have, though, a lot of rate actions that are in process, much of which that have been approved already, which is -- most of which have been approved, actually -- which will, I think, really begin to hit next year. So I think if the business performs like it does this year, and then also with these rate actions that we've got in the queue and much of which have been improved, we should be in decent shape.

One thing I'd remind folks is that as is in our earnings slides, and I think as Tom noted, this is on slide 12, we did just this quarter get 10 filings approved that impact premium of about $336 million. And the average rate increase on that is 37%. As we pointed out that the 2012 rate actions, it takes 2 to 3 years to get that in to earnings. But we are making steady progress. And I think what we're

SUNEET KAMATH: All right. That's fine. Thanks.

OPERATOR: Ladies and gentlemen, we have time for one final question. Sean Dargan, Macquarie.

SEAN DARGAN, ANALYST, MACQUARIE RESEARCH EQUITIES: I'm just wondering how you're thinking about returns on new MI business in 2016. On June 30, the PMIERs were amended and there was an added capital charge to be implemented in 2016 on lender placed mortgage insurance. You wrote a lot of that in the first quarter. I think the press release said that you wrote less of that in the second quarter. I'm just wondering if you could frame how much less of that and what you're thinking on writing that product is going forward, given that returns are probably mid-single digits?

ROHIT GUPTA: Good morning, Sean. This is Rohit. So you're absolutely right. we reduced our premium single concentration from first quarter to second quarter. As we have stated in the past, we try to manage the return and risk appetite for this product, because single -- LPMI, let's start with that. Lender paid mortgage insurance is primarily a single premium product. And under [HOPA] consideration, it is a non-cancellation policy unless the mortgage actually lapses. So we have seen increased duration of this product in the past in our own experience. And we think FHFA and GSE's multipliers in PMIER's context that rolled out on June 30 are in alignment with that.

As we think about our 2015 book returns, we have given guidance on mid- to low teen returns from a pricing perspective. And we have also stated that our books are performing, our new books since 2009, are performing better than those expectations. As far as 2016 book returns are concerned, we haven't given any guidance, at this point. And I think that will be in part driven by the mix of LPMI in the market at that place.

As you're aware, the new factors do not go into effect until January 1, 2016. And LPMI is a refi-based product. As refinance volume has declined, we would expect LPMI volume to decline with that. So once we have a better idea on where the volume is trending, we will give some guidance in terms of what we expect LPMI mix to be, as well as what would that do to our 2016 return expectations. I would state that if you look historically, our business has been historically under participating in single premium and LPMI. And on portfolio basis, our concentrations are lower than the average concentration you see in the industry.

SEAN DARGAN: Okay. Great. And if I could just ask one question about Australia. You announced a special dividend that was larger than what Macquarie was expecting. I'm just wondering what your thoughts are on capital deployment there and if you've given any thought to raising the common dividend, which would probably have a favorable impact on the share price, which would allow you to sell your ownership at a higher price later down the road?

JEROME UPTON: Yes, Sean. Good morning. It's Jerome Upton. So with respect to the special dividend you highlighted, I think you probably saw that we did issue a tier 2 subordinated note of roughly $200 million Aussie and did buy back $90 million of the prior tranche that was coming due in 2016. So that gave us the ability to issue the special dividend and probably helped us surpass expectations in the market.

On the ordinary dividend, I would say the Board's comfortable with where we are currently. As with any ordinary dividend, we want to make sure that we're comfortable that we can continue to pay that ordinary dividend, and the Board will evaluate whether any increases are prudent, given the overall environment and conditions that we have. We understand in that business that we have capital optimization opportunities, but they would start with looking at ways to grow organically and make sure that we feel like we're adequately covered organically. We've also got to take into consideration the mark to market. Because part of our prescribed capital amount and the large capital ratio you're seeing is driven by the mark to market on securities. And then we would look to other opportunities and ways to deploy capital at a return that is above our weighted average cost of capital. And then, if comments.

TOM MCINERNY: Thank you very much, Shelley. I would like to make just some brief closing comments. I want to thank all of the investors and analysts and other participants on the call today. We believe we are making progress on our outlined strategy to strengthen Genworth, simplify our businesses and increase financial flexibility. While we recognize that substantial challenges remain, we continue to invest in our strongest businesses and to manage each of our businesses to maximize returns while balancing capital needs. We very much appreciate the support of our investors and assure you that we're working very hard to justify that support. And now, let's end the call.

OPERATOR: Ladies and gentlemen, this concludes Genworth Financial's second quarter earnings conference call. Thank you for your participation. At this time, the call will end.



## Classification

**Language:** ENGLISH

**Publication-Type:** Transcript

**Transcript:** 080515a5764774.774

**Subject:** EXECUTIVES (94%); COMPANY EARNINGS (90%); PRESS RELEASES (90%); ANNUAL REPORTS (89%); FINANCIAL PERFORMANCE & REPORTS (89%); SECURITIES LAW (89%); BANKING & FINANCE REGULATION (78%); EQUITIES (78%); FINANCIAL RESULTS (78%); SECURITIES & OTHER INVESTMENTS (76%); MULTINATIONAL CORPORATIONS (72%); REPORTS, REVIEWS & SECTIONS (65%)

**Company:** GENWORTH FINANCIAL INC (94%); JEFFERIES LLC (71%); MORGAN STANLEY (58%); KEEFE BRUYETTE & WOODS INC (57%)

CARRIERS (94%); SIC6411 INSURANCE AGENTS, BROKERS, & SERVICE (94%); SIC6321 ACCIDENT & HEALTH INSURANCE (94%); SIC6311 LIFE INSURANCE (94%); NAICS523120 SECURITIES BROKERAGE (58%); SIC6211 SECURITY BROKERS, DEALERS, & FLOTATION COMPANIES (58%); NAICS523110 INVESTMENT BANKING & SECURITIES DEALING (57%); SIC6282 INVESTMENT ADVICE (57%); CONFERENCE CALLS (90%); ACCOUNTING (89%); SECURITIES LAW (89%); BANKING & FINANCE REGULATION (78%); EQUITIES (78%); INSURANCE (78%); INVESTOR RELATIONS (78%); SECURITIES & OTHER INVESTMENTS (76%)

**Person:** TOM MCINERNEY (92%)

**Load-Date:** September 6, 2015