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GNW - Q2 2010 Genworth Financial, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to the Genworth Financial second-quarter earnings conference call. My name is Christy and I will be your coordinator today. At this time, all participants are in a listen-only mode. We will facilitate a question-and-answer session towards the end of this conference call. As a reminder, the conference is being recorded for replay purposes. (Operator Instructions). I would now like to turn the presentation over to Alicia Charity, Senior Vice President, Investor Relations. Ms. Charity, you may proceed.

Alicia Charity - Genworth Financial, Inc. - SVP, IR

Thank you and good morning. Thanks for joining us for Genworth Financial's second-quarter 2010 earnings conference call. Our press release and financial supplement were released last evening and are posted on our website. Again, this quarter, we will also post management's prepared comments following the call for your reference.

This morning, you will first hear from Mike Fraizer, our Chairman and CEO and then Pat Kelleher, our Chief Financial Officer. Following our prepared comments, we will open the call up for questions and answers. Kevin Schneider, President and CEO of US Mortgage Insurance; Pam Schutz, Executive Vice President of our Retirement and Protection segment; Jerome Upton, Chief Operating Officer of our International segment; and Ron Joelson, our Chief Investment Officer, will all be available to take questions.

With regard to forward-looking statements and the use of non-GAAP financial information, some of the statements we make during the call this morning may contain forward-looking statements. Our actual results may differ materially from such statements and we advise you to read the



cautionary note regarding forward-looking statements in our earnings release and the Risk Factors section of our most recent annual report Form 10-K filed with the SEC in February 2010.

This morning's discussion also includes non-GAAP financial measures that we believe may be meaningful to investors. In our supplements and earnings release, non-GAAP financial measures have been reconciled to GAAP where required in accordance with SEC rules.

And finally, when we talk about International segment results, please note that all percentage changes exclude the impact of foreign exchange. In addition, the results we will discuss today for the Canadian Mortgage Insurance business reflect total Company results, including the minority interest unless otherwise indicated. And now let me turn the call over to Mike Fraizer.

Mike Fraizer - *Genworth Financial, Inc. - Chairman & CEO*

Thanks, Alicia, and thanks, everyone, for your time today. We made important progress in the second quarter executing our strategy and delivering improved financial results. International earnings had nice growth supported by improving economic conditions in Canada and Australia and the success of our ongoing loss mitigation efforts.

US Mortgage Insurance made good strides towards profitability supported by loan modification and other loss mitigation efforts. Specifically, I am encouraged about the continued favorable trends in new delinquencies that we are seeing fueled by both seasonal patterns, as well as the burn-through of exposures associated with the 2005, 2006 and 2007 books. The size of the private mortgage insurance market and dynamics versus the FHA remains a challenge, which I will touch upon later.

We had mixed performance in Retirement and Protection. Sales were strong, particularly in life and long-term care insurance, along with positive net flows in Wealth Management. Earnings took a nice step forward in long-term care insurance and spread-based annuities, but fell in life insurance and fee-based annuities impacted by relative mortality performance, higher lapses on certain term policies and weak equity markets.

I am pleased to announce that we completed our excess cash redeployment plan, putting some \$3.5 billion back to work, hitting the high end of our targeted range.

In my mind, second quarter represented an inflection point for the investment portfolio where we clearly moved from playing defense to playing offense. Impairments were relatively low and are expected to remain low and we moved early to get cash to work using a variety of strategies to manage investments in the low interest rate environment.

We also looked closely at where it may be prudent to adjust product pricing in the event of a prolonged low interest rate environment. This morning, I want to focus on three areas. First, how we are investing for growth in targeted areas; second, developments on the regulatory front around the globe; and finally, on the size of the market for US Mortgage Insurance and what needs to change for future premium growth.

Let's turn to where we are investing in key growth areas that support earnings and return expansion. We see organic growth as our biggest opportunity with targeted complementary acquisition opportunities in selective entry into new markets. We focus on three fundamental agendas to grow organically -- introducing refreshed or innovative products, driving distribution penetration and expansion and improving value-added support services and capabilities.

On the product front, we continue to drive adoption of new products to support growth in life insurance. The more capital-efficient product suite introduced in the fourth quarter of 2009 has been one of our most successful new product launches and we will further refine our offerings.

Distribution feedback has been very positive given the attractive price point and flexibility the new products offer and this is apparent in our sales trends. Importantly, we see additional opportunities with new products in Long-term Care, Wealth Management and Lifestyle Protection.



Turning to distribution, a good example of our expansion drive is in Lifestyle Protection where we are focused on selling products in new ways. Rather than solely selling products at or near the time of a new lending transaction, we are broadening programs with our distributors to market protection to their clients with various types of outstanding financial obligations using appropriate coverage types.

In addition, we are broadening distribution channels to support sales with a larger dedicated team in place to do so.

Finally, a good example of where we are adding services and capabilities is in wealth management. Here, a key competitive advantage lies in service and technology differentiation. As a result, we are investing in sales coverage, technology and new products to position the business for additional growth longer term. In the near term, this will somewhat mute earnings growth, but should provide a good payback.

In sum, we are pursuing strong organic growth that supports our earnings and return targets. In addition, we will look at modestly sized acquisitions with a focus on Wealth Management and accretive life blocks, along with select opportunities to enter new markets on the international front that complement our existing business.

Turning to the regulatory environment, we saw a great deal of activity this quarter as regulators around the globe actively engage in financial reform discussions. In the US, the Dodd-Frank bill has targeted impacts on insurers that I would characterize as a net positive for our business. Importantly, it enables stronger discipline in mortgage origination practices that are a significant first step to overall housing reform, especially by granting statutory recognition to the importance of underwriting standards that are based on a borrower's ability to repay.

We are also encouraged that the law recognizes the important role of mortgage insurance by including MI as one of the features of a qualified residential mortgage. As you may know, qualified residential mortgages will be exempt from the new risk retention requirements that will be imposed on mortgage-backed securitizations, thereby encouraging prudent mortgage origination practices. This is an important step for the industry and we will carefully track how it evolves over the next several months as regulatory agencies implement the legislation.

In addition, there are many regulations and interpretations of the overall legislation to come, so we will remain appropriately engaged on these fronts.

Internationally, we are actively evaluating or engaging in dialogue around potential regulatory changes, which could aid mortgage insurance demand or expand opportunities for Lifestyle Protection, including ongoing Basel III discussions.

Finally, let's turn to the size of the US mortgage insurance market. We do feel the market is slowly starting to shift back towards private mortgage insurers and will continue to do so as the FHA reassesses its standards and reprices for appropriate risk management. We saw some progress in this respect with the FHA raising the upfront premium and requesting statutory authority to raise their annual premium.

In addition, there is a clear opportunity for GSEs to review adverse market fees and loan level pricing that has steered new business to the FHA. These fees add to the cost of conventional loans that carry private mortgage insurance and this price difference influences originators and homebuyers when choosing a government-supported FHA loan or one from a private mortgage insurer.

Together, the combination of increased FHA pricing and potential changes in GSE market fees and loan level pricing should help shift demand back to the conventional purchase market, which is supported by private capital from mortgage insurers and Genworth is well-positioned to play its part in filling that role.

To wrap, I am pleased with our progress on several fronts, including new business trends, investment portfolio progress and improved fundamentals in housing markets in the US, Canada and Australia. And we will only intensify our execution focus in the second half of the year. With that, let me turn it over to Pat for a deeper look at the quarter. Pat?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Thanks, Mike. This morning, I will focus on four areas -- first, sales and earnings growth; second, risk management and loss mitigation actions; third, our capital management progress; and finally, how we think about earnings trends in the second half of the year based on experience to date.

Let me start with sales growth. We are seeing sales growth in several key areas, particularly in our leadership lines in Retirement and Protection and in Mortgage Insurance in Canada. This sets the stage for future revenue expansion. In life insurance, sales of our new, more capital efficient ColonyTerm UL and GenGuard UL products had strong sequential increases since their launch in late 2009. We remain number one in total life policies sold through the BGA channel and continued to make good progress expanding sales of larger face amount policies.

Turning to Long-term Care, individual long-term care sales increased 36% versus the prior year. Here, we are seeing a rebound following declines in industry sales in early 2009. We had good growth across sales channels led by the independent channel.

Wealth Management had its fifth straight quarter of positive net flows. Net flows were \$436 million, up considerably compared to a year ago and down slightly on a sequential basis. We view this as a very good result in the context of current investment market conditions.

We saw mixed sales growth in the International segment related to differences in market conditions in Canada, Australia and Europe. In Canada, flow new insurance written increased 61% year-over-year as overall mortgage market growth was robust. The market view is that originations have been loaded somewhat towards the first half of the year in anticipation of a rate increase and a sales tax increase, both of which occurred in July.

In addition, we saw the seasonal growth we expect on a sequential basis going from winter to spring. Accordingly, we would expect sales to slow moderately in the second half of the year.

In Australia, new flow insurance written declined 41% year-over-year driven by increasing mortgage rates and the reduction of government stimulus programs that fueled a strong origination market in 2009.

In Lifestyle Protection, the impact of lower consumer lending continues to pressure sales across Europe. Although consumer lending has stabilized at lower levels, many lenders remain capital-constrained and therefore are cautious in their lending activities. So we do not see conditions improving this year. At the same time, we are taking steps to improve sales, as Mike outlined.

Finally, in US Mortgage Insurance, we had incremental sequential growth in new insurance written. There are signs that business is gradually coming back to the private mortgage insurance market from the FHA, but at a slower rate than we would like to see.

Turning to earnings growth, a highlight in the quarter was growth in investment income in Retirement and Protection. We completed our planned cash redeployment that began in the fourth quarter of 2009 at the high end of the targeted range or \$3.5 billion. We reinvested the majority of funds in the fourth and first quarters ahead of declines in rates and yields. Cash reinvestment added about \$4 million after tax sequentially to R&P earnings. In addition, limited partnership investments generated \$6 million of earnings after tax compared with an \$8 million after-tax loss in the first quarter. However, lower earnings in our fee-based retirement income and life insurance businesses more than offset these improved investment results.

In fee retirement income, recent equity market declines resulted in valuation changes that reduced fee retirement income earnings for the quarter. In total, higher DAC amortization reduced earnings by \$11 million.

In our life insurance business, we experienced higher mortality and lapse-related costs than we have historically. The term insurance mortality ratio was 96% of original pricing levels compared to an average of 92% over the last eight quarters. This is normal statistical variation and reduced earnings by approximately \$10 million compared to the prior year and \$2 million compared with first quarter.

Term lapse-related costs increased \$11 million compared with prior year and \$4 million compared to the first quarter. This is primarily related to more lapses at the end of the level premium period on 10-year term insurance policies sold in 1999 and 2000.



International earnings growth was strong, aided by improved market conditions in Canada and Australia, plus tax legislation change in Australia that we had anticipated. The tax law change had a cumulative impact of \$16 million. \$6 million of this is attributable to second quarter 2010 and \$10 million is attributable to prior quarters. Going forward, the tax change will continue to provide benefits to earnings in Australia.

In Lifestyle Protection, earnings were flat on a sequential basis, underwriting results did improve marginally, reflecting lower new claim registrations and pricing and product changes. However, this was muted by some foreign exchange fluctuations. The US Mortgage Insurance loss increased moderately with favorable delinquency trends moderating slightly relative to the first-quarter result.

Looking next at risk management and loss mitigation, we continue to take a proactive approach to managing our risks through the market conditions, both that we currently see and what we might expect to see in the future. There are four examples I will touch on today.

First, in our housing-related businesses, we use loss mitigation to keep borrowers in their homes and ensure that we are paying only legitimate claims. In the US, this resulted in \$217 million of savings in the quarter, bringing the year-to-date amount to \$450 million.

Looking at the full year, we expect to approach the 2009 level. Savings could fluctuate depending on new delinquency trends, the success of modification programs and the impact of rescission experience as we work through the declining inventory of investigations. Given our experience over the past two quarters, we expect the benefits from rescissions to trail down and we expect the benefits from modifications to remain at or above what we saw this quarter driven by both HAMP and non-HAMP modifications.

Second, we are selectively reducing risk where appropriate by reaching contract settlements targeted for certain servicers, lenders or GSEs. This involves agreeing on terms that remove risk from our portfolios and achieve derisking targets. We have done this effectively over the past two years in Mortgage Insurance primarily in Spain, Australia and in the US.

As an example, in the second quarter, we reached a settlement with a US servicer relating to rescissions for a portion of our flow mortgage insurance portfolio. This is a mutually beneficial outcome. Settlement activity remains an additional tool for managing risk and positioning for stronger and more predictable earnings emergence going forward. I should note that this quarter settlement activity in our global Mortgage Insurance businesses reduced operating earnings by approximately \$18 million after tax.

Third, we completed pricing and product changes on new and in force business in Lifestyle Protection to improve earnings and decrease volatility. We have taken action in Western Europe and more recently in the Nordic region. In the second quarter, we achieved underwriting profit in nearly all of our European markets, although profitability remains below target levels due to lower lending and high unemployment throughout Europe.

We are encouraged by the effectiveness of our repricing mechanisms and the strength of our distribution relationships as we pursue suitable loss mitigation actions. We continue to evaluate performance and will take incremental pricing or product actions as appropriate.

And finally, we have also taken additional steps in the investment portfolio. While the low interest rate environment is a challenge, our longer duration liabilities allowed us to invest in the 7 to 15-year part of the curve where we can take advantage of the higher yields. In addition, we invested in select asset classes whose spreads widened during the quarter, which helped to offset the lower interest rates.

Turning now to capital management, we are pleased with the sound capital ratios at our operating companies. We are successfully executing our plans to meet and provide for our obligations at the holding company. We currently have in excess of \$1.1 billion of holding company cash and short-term securities. We issued \$400 million of debt during the quarter and used \$200 million of the proceeds to repay a portion of our credit facilities.

In Canada, our majority-owned subsidiary issued CAD275 million of senior debt during the quarter and subsequently announced plans to repurchase common shares and return up to CAD325 million to shareholders. We expect net proceeds of approximately \$175 million to be received by the holding company in the second half of 2010. In total, we expect \$350 million to \$400 million in operating company dividends and return of capital in the second half of 2010 primarily from our international companies.

As we look to 2011, we expect the international companies, as well as the US life companies to pay dividends to the holding company. So in sum, our operating businesses remain well-positioned to support operating and parent holding company capital plans going forward.

Before closing, I would like to comment on earnings trends. In Retirement and Protection, we expect that revenue growth associated with the continuation of recent sales trends in our leadership line will provide meaningful earnings growth over time and we expect mortality and morbidity levels to remain within normal ranges. We do expect some level of continued volatility in equity markets and we would expect life insurance persistency to remain a manageable headwind.

In International, earnings trends have been favorable and stable in Canada and Australia with some choppiness in Lifestyle Protection and European Mortgage Insurance reflecting conditions in Europe.

In Canada and Australia, economic growth has been relatively strong; unemployment is declining; housing prices have rebounded strongly from the downturn and are now stabilizing; and governments have been withdrawing stimulus while central banks increase interest rates to control inflation. While these conditions persist, we can reasonably expect that loss ratios should remain in the current range with some normal quarterly fluctuations.

The decisive actions taken to improve earnings in Lifestyle Protection should result in overall earnings improvement if current market conditions persist with some choppiness in quarterly results. Given these actions, when markets start to recover and consumer lending returns in Europe, our Lifestyle Protection business will be well-positioned for further earnings improvement.

The Europe Mortgage Insurance business remains small and well-contained. It is worth noting that, at the end of the second quarter, total risk in force in Spain has been reduced significantly to approximately \$125 million as a result of the loss mitigation activities I described earlier. Given today's pricing and tight underwriting, combined with anticipated influences from the current regulatory environment, we do see targeted growth opportunities for this business in the years ahead.

Turning to US Mortgage Insurance, while current trends are favorable, we remain cautious in our outlook for the second half of 2010. Flow delinquencies decreased by 4% from first quarter to second, better than the 1% decline we have seen historically in the second quarter. We attribute the differential to the combination of burn-through of the 2005, 2006 and 2007 books and the favorable delinquency development in the 2009 and 2010 books.

Seasonal delinquency patterns are expected to continue in the second half of the year based on our average historical experience. Delinquencies generally trend up about 8% in both of the third and fourth quarters. However, the decreasing impact of poor performing books and favorable delinquency development relating to recent books will also influence second-half experience. Balancing these trends, we believe it is prudent to take a more conservative view of our US MI performance for the next two quarters and have a more favorable view as we look towards 2011.

To wrap, Genworth delivered good results this quarter, setting the stage for growth in sales and earnings and while we face some headwinds, we are encouraged by our progress. We remain focused on four levers to reach our return on equity targets -- profitable new business growth, optimizing investment performance, ongoing risk management, including loss mitigation, and finally, effective capital management. With that, I will open it up to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Ed Spehar, Bank of America.



Ed Spehar - *Bank of America-Merrill Lynch - Analyst*

Thank you. Good morning, everyone. I have a few questions. First, I would like to talk about the lapses in the life business. I have a hard time understanding the material negative earnings impact from 10-year level term coming out of the level premium period. Because I would have thought that this business would have been priced for almost 100% shock lapse at that point and I am wondering if you could give us a little more color on that. And then I have a follow-up.

Mike Fraizer - *Genworth Financial, Inc. - Chairman & CEO*

Go ahead, Pat.

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Okay. First, I'll talk about the 10-year term lapses generally and why it is they do not amortize fully over the level period. And I will do this from an accounting and an industry experience perspective. Accounting rules require amortization in proportion to premium revenue over the life of the policy. 10-year level term product with premiums that grade up on an ART basis following the level period will typically show some persistency beyond the period and continue to generate premium revenue. So it is normal in the industry that some portion of deferred acquisition cost remains to be amortized after the level term period.

Now ordinarily, you would expect that to be relatively minor fluctuations, and to understand what has happened versus prior year, we have to go back and start with our experience in the second quarter of last year and bring that forward to our experience in this quarter.

Back in the second quarter of 2009, amortization costs were relatively low for the term insurance portfolio at around 5% of premiums and that was due to unusually favorable lapse experience compared to what is more typical. A more typical run rate for amortization of acquisition costs on a portfolio like this I would say is in the range of 10% to 15% of premium.

Current year amortization costs are actually more in line with this more typical run rate, so the favorability we saw last year we are not seeing this year. So what is important is why. And as we looked at the emerging experience, we saw that most of the increase is attributable to an increase in amortization of acquisition costs as policies on the post-level period increased. We had the large book of 10-year term business sold in 1999 and 2000. We are seeing an increased rate of lapse because those are flowing into the level term period and we have seen the increase in amortization year-over-year that I described. Does that address your points?

Ed Spehar - *Bank of America-Merrill Lynch - Analyst*

Yes, I guess though the follow-up would be that if you're -- you are mentioning that -- I think that this is different than what you would have priced for, correct?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

I think to an extent that it is because when we priced this business and this was back in the 1998, 1999 timeframe, we did so based on the emerging experience for these types of products that we were seeing in the market. And as you can imagine, over time, we have continually adjusted our pricing and kind of kept up with the changes. I would say that, over the years, because the pricing of 10-year term products to consumers has improved, we have seen at least moderate increases in lapse rates relative to what had been the experience we saw back in the '90s.



Ed Spehar - *Bank of America-Merrill Lynch - Analyst*

Okay. But then I guess just thinking about this issue going forward, I mean this is maybe a gross oversimplification, but if we are just figuring out that the shock lapse assumption was incorrect 10 years after the product is sold, why isn't this going to be a multiyear issue depressing earnings?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

We are not saying that we are just figuring that out now. We are saying that we have adjusted over time and because term life insurance is a FAS 60 product, the amortization that is scheduled for GAAP reporting purposes is locked in as of when you set the assumptions at issue. We are saying that we saw the relatively favorable experience grade back to more typical in the current quarter. And we are also saying that the blocks of business experiencing the higher lapse were relatively big blocks in the 1999 and 2000 timeframe. And we wrote smaller blocks of this business in the 2001, 2002, 2003 timeframe after the advent of the XXX reserve regulations.

Ed Spehar - *Bank of America-Merrill Lynch - Analyst*

Okay. Thanks. That's helpful. Just two really quick ones. First of all, Pat, was the corporate and other loss this quarter elevated or should we think about this as kind of a run rate? And then on the US MI loss, should we be thinking about the second half of the year, the loss going up at a similar rate or greater rate than whatever the seasonal delinquency trend would likely be in those quarters?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Yes, I will handle the corporate run rate and turn over to Kevin for your other question. From a corporate run rate perspective, what I would say is that we have seen the impact of absorbing the institutional markets business in the Corporate segment, which has made earnings a little bit more volatile than it used to be, as well the tax differentials associated with APB 28, our calculations and the effective tax rate for the entire year are absorbed in Corporate. I would think of the run rate in Corporate as a little bit lower than what we are showing in the second quarter and then I will turn it over to Kevin.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

Good morning, Ed. How are you? This is Kevin. Think about the second half of the year, I think the most important thing to focus on or to think about is what happens with overall delinquency development. We have seen favorable again new delinquency development. We have seen first half of the year change in overall delinquencies that has been actually somewhat favorable to historical trends. Typically, as I think we mentioned, you would expect a higher rate of delinquency growth in the back half of the year. And as we look at it right now, I think the ultimate outcome in the year is going to be based on -- are we going to continue to see this favorable -- some favorable new delinquency development that would somewhat mute the traditional seasonality experience?

Do we continue and I think we have continued to see the burn-through of the bad books of business, the '05 through '07 type books. So I think that may provide a little bit of tailwind. But ultimately, we need to see how the thing plays out in the back half of the year. But as you think about overall income, I think the delinquency development is really the key thing you should think about in terms of the drivers.

Lastly, as we had this quarter, delinquencies have continued to come down now for a few quarters. We like the overall trends and where that is going going forward. The remaining offset to that though, as it was in this quarter, is a little bit of the aging of the existing inventory.

So as that new inventory comes down, we do have less new delq's, which is a very favorable trend. We do continue to have older delq's that stay in the pipeline now that continue to age forward. I think the encouraging thing there is, even with that smaller delinquency population, the overall delinquency or reserve level has continued to trend favorably. So while we do have some aging, it is being offset by that new delinquency reduction.

Ed Spehar - *Bank of America-Merrill Lynch - Analyst*

Okay, thank you very much.

Operator

Andrew Kligerman, UBS.

Andrew Kligerman - *UBS - Analyst*

Hey, good morning. Just as long as we had Kevin there, maybe I will just start on the US MI and then I have one or two quick follow-ups. So loss mitigation savings were a bit lower in the quarter at \$217 million and I think you stated that they reflected \$160 million in loan modification savings. And then the HAMP pipeline came down significantly from 28,000 to 16,000, and you cited a shift in modification starts from HAMP to alternative programs.

So I was kind of wondering what some of these alternative programs are relative to HAMP and how you think they are going to affect the default rate going forward?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

Good morning, Andrew. As you mentioned, our savings in the quarter came in at about \$217 million. Still encouraged by the fact that for the first half of the year, we are at \$450 million in total savings. You compare that to sort of last year, and we like that outcome at this point.

HAMP starts or HAMP inventory, to your point, were down, but what I continue to be encouraged by is that we continue to have strong HAMP closings. So our HAMP closings on the quarter that resulted in favorable modifications or cures came in about 5300. That was up from the last quarter on the 3400 range. So you still had some nice favorability there.

New trial starts continued at a reasonable level, and I think as you think about HAMP going forward based upon the changes in documentation requirements, those things that do get into a HAMP trial now should continue to have a higher throughput in terms of ultimate modification or cure, because those folks have a higher bar to meet in terms of their documentation requirements.

So although the overall HAMP inventory levels are down in terms of the top-line level, we are going to continue to see favorable HAMP benefit throughout the back half of the year.

Now your second question is what about the alternative programs, and as I believe I have shared with you before, industrywide if you step back from HAMP, the overall mortgage industry is doing about 2X alternative HAMP modifications to HAMP modifications. We have got a tremendous amount of focus around HAMP because the government stepped in at a time when the market was sort of locked up and introduced this program. But then ultimately what happened is the private sector stepped in and started doing what we do well, and that is introducing some alternative programs that at the end of the day may be more effective and more efficient for the consumer.

So I think that is nationally what has happened out there. What we are seeing is those alternative programs continue to tick up. We are up probably over 1000 alternative modifications outside of HAMP over what we were in the first quarter. That continues to trend favorably.

Those programs, I would say just think of them as number one, GSE alternative programs that had similar type approaches. They reduced the borrowers' overall payment, helping them cash flow so they can make their loan payment. Maybe a little bit of move towards some type of principal reduction, but still hasn't been a big thing.



And then you have a significant amount of lender proprietary type programs, or servicer proprietary programs. Those will continue as well. So as I think about it, we are seeing HAMP be kind of consistent. Maybe overall trials down from where they were at the end of the first quarter, but comfortable with the progress there.

And then those that are failing HAMP are falling out of HAMP, most of those are getting a shot or -- over 50% or are about 50% of those are getting a shot at one of these alternative programs. So they are getting another chance in the modification cycle to have something done to them. And I think that is really why we are getting the pickup and the lift in the non-HAMP modifications.

Andrew Kligerman - UBS - Analyst

Very helpful. And then just on the -- I guess Pat, maybe even Mike on this one -- core interest rate yield, that was 5.16% in the quarter. It improved. I guess that was partly due to the \$3.5 billion of cash redeployment. So given that Genworth is one of the more interest-sensitive companies, could you give us a little sense of where you expect -- a couple of companies have given us a sense of what they think the impact on earnings would be in each of the next several years if interest rates in general were to remain constant with where they are today.

Could you give a little color on that? How do you think earnings will be impacted next year in '12 and maybe '13?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

This is Pat; I will do that. I will have to give you a little bit of background because you are right, a lot of the work that we have done over the last several quarters is going to impact that. I will start with our International and our Mortgage Insurance businesses. There are generally short-duration products in those businesses, so they don't have the interest rate risk or earnings fluctuations caused by interest rate movements that our US life insurance or our long-term care business might.

So what I do to respond would be I'll step back and talk a little bit about the potential impacts of interest rates across our domestic life insurance business where we are relatively more interest-sensitive than in international, and what we have been doing to mitigate these impacts as well as what they would be.

And I would say in general, low interest rates and movements in interest rates impact returns in our annuities, Long-Term Care and in our Universal Life products. In our annuity blocks, over the past three to four quarters as we have been actively putting cash back to work, we have been lengthening in asset durations and matching asset and liability durations to lock in spread. Actually we went a little bit long on the SPDA portfolio anticipating that with a low interest rate environment, you might see better persistency and that was prior to the unlocking that we did in the current quarter.

I would say, currently, we have a tight matching of asset and liability durations through our fixed annuity business, which does help to minimize interest rate risk. So we might see some residual leakage associated with nonparallel shifts of the interest rate curve as it flattens. But generally speaking, the spreads should maintain at the current levels going forward or within about 10 basis points or so of current levels.

In the longer duration liability products like long-term care, we have similarly put back cash to work and we have lengthened asset durations. But we also employ hedging strategies that lock in yields for cash flows yet to be received.

In general, I would say we have got interest rate protection for about 70% of the expected cash flows over the next 10 years. And to give you an idea of the scope of those strategies and programs, these strategies provide downside interest rate protection and effectively they are currently worth about \$1.8 billion, and they reside in the balance sheet in accumulated other comprehensive income after adjustments for tax.

In the current quarter, due to declines in interest rates, these hedges increased in value by approximately \$575 million. So again, in long-term care, over the next several years, we would have about 30% of our cash flows exposed to reductions in rates. But because of the impact of these rather significant hedging strategies, we feel like the earnings volatility associated with at least a decline in interest rates over a few years would be limited.



And then finally in Universal Life, that is currently a small piece of our in force and our secondary guarantee account balances only make up about 30% to 35% of the total UL block. And here, we are employing the duration matching strategies similar to those described for the annuity block. And I would say you would have similar types of leakage from the spreads on the account values and the difference between earned and credited interest rates. Does that address your question?

Andrew Kligerman - UBS - Analyst

That was excellent, Pat. So it sounds to me that I shouldn't be looking for any major impact from the low interest rate environment, that the impact would be somewhat modest. Is that a fair assessment?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

That is what we have designed our strategies to achieve, yes.

Andrew Kligerman - UBS - Analyst

Excellent. Thanks a lot.

Operator

Steven Schwartz, Raymond James & Associates.

Steven Schwartz - Raymond James & Associates - Analyst

Hey, good morning, everybody. Pat, can I just follow up on a statement that you just made to Andrew. I'm not sure I understood it. You said for the SGUL you were practicing the duration matching that you were doing in the annuity, particularly SPDA. But of course the SPDA is an SPDA, it is a single premium. The UL, my understanding is it is not. So I guess I don't understand how those two match up. I would imagine that what you would be doing at SGUL would be the same thing that you were doing in LTC?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

Well, where we are looking at -- the toughest matching strategy to accomplish with UL is with respect to the secondary guarantees. And because those reserves are the ones that you hold the fund future benefits that you might have to fund that can't be funded from the buildup in the policy. So we do extend the duration of our liabilities because we sell products that are not highly oriented to upfront premiums, but the assets backing the liabilities and the assets backing the surplus associated with that line are all available to lengthen duration and employ the strategy that I described.

So it is not going to be perfect and as I indicated to Andrew, there should be or you could reasonably expect that if interest rates remain low or if the curve twists, there will be leakage there. But we feel pretty good about it. And in particular, the UL block of business is a small exposure. The secondary guarantee is like between \$1 billion and \$2 billion of the general account portfolio in total.

Steven Schwartz - Raymond James & Associates - Analyst

Okay. And then if I may, one more follow-up and another question. Just the message to Ed on the lapses with regards to the LTL product, you simply -- the experience is not necessarily worse than we are looking for. Experience a couple years ago was probably better. This experience is in line and what we are seeing is really a mix shift as the big firesale blocks come off. Is that an accurate statement?



Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Generally, that is accurate. The only qualification that I would make is that it is true that the lapse experience that we are seeing now is moderately elevated relative to our original pricing in the '90s. And we are working with that as part of our business plan and our strategy for managing profitability on the line.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. And then if I may, just looking at a couple of regulatory things, on both the MI side and the LTC side. Just wondering if you all have any new insights into what may happen with the GSEs and how that may all work out and as well any recent thoughts on class?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

Steve, this is Kevin. I will start with new insights on the GSEs. I think the answer is no. (technical difficulty). That is an issue that is going to continue to be debated I think throughout the fall and throughout 2011 as we move forward.

I think the one new insight or observation I will make that we do feel good about is the inclusion again of mortgage insurance in the statutory definition of a qualified residential mortgage. I think that is encouraging and we should feel good about that going forward. The regulators have a lot of work to do in terms of writing all the regs to match up with that law. However, it is the first time you have seen outside of the GSE charter, the statutory reference to mortgage insurance and I think that is simply due to the recognition of the soundness of the overall model and the support it has to low down payment lending.

Steven Schwartz - *Raymond James & Associates - Analyst*

Kevin, does that mean that whatever happens to the GSEs, the GSEs become less important for the demand for your product?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

The way I think about it is this risk retention provision in the bill was designed to make sure good-quality business was underwritten out there. And the inclusion of mortgage insurance potentially in that regulatory outcome gets you to what I think is potentially another channel for Mortgage Insurance. So outside of the GSE charter requirement, now you have the potential for additional channels; you have the potential for I think an additional leg of value proposition for the product, which is based around further capital relief for the lenders. And that should be positive.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, great. Thank you.

Mike Fraizer - *Genworth Financial, Inc. - Chairman & CEO*

Let me hand it off to Buck Stinson on the CLASS question. Buck?



Buck Stinson - *Genworth Financial, Inc. - President, Long-Term Care Insurance*

Yes, Steven, on CLASS, the implementation process for class has been turned over to Secretary Sibelius and the Department of Health and Human Services and we continue to monitor that very closely. To date, not a lot of activity. Most of their emphasis right now is on implementing the major medical healthcare reform initiatives. So to date, not much of an update in terms of any other progress on implementation.

Our view continues to be the same on class in terms of its impact on the private insurance industry. We think at the end of the day, private insurance is still going to have a very competitive offer, vis-a-vis whatever the implementation process would come out maybe 2012, 2013. But very limited activity to date.

Steven Schwartz - *Raymond James & Associates - Analyst*

Buck, did I see something recently in the trade press that there is a group of congressmen trying to overturn class?

Buck Stinson - *Genworth Financial, Inc. - President, Long-Term Care Insurance*

One bill from Congressman Charles Boustany has been introduced, basically a watchdog bill that would engage both the House and Senate in monitoring the actuarial soundness of the assumptions coming out. So there is a level of activity I think both in the House and Senate making sure that there is fiscal responsibility over the top of any form of CLASS implementation.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, thank you.

Operator

Connie Deboever, Boston Company.

Connie Deboever - *The Boston Company - Analyst*

Hi, thank you for taking my questions. Just to focus back on the US MI, think you mentioned that you are seeing more later-stage delinquencies in the pipeline. I am thinking about reserve per delinquency, which has ticked up. Should I think about that continuing to tick up? And then also along similar lines, if I am looking at the reserve methodology, I don't think you have taken into account the HAMP and other modification benefits in terms of reserves. So wondering if that might be an offset?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

Yes, Connie, good morning. Let me start with sort of your second question. You are correct. We have not altered our reserving approach or methodology to include any future benefits for loan modifications. So far, we have only incorporated observed experience to this point in time. HAMP potentially has the opportunity to help you down the road; I guess too soon to tell yet on that.

Going back to your first question, we just have, as a country and as an industry, we have older stage delinquencies that continue to languish in the pipeline, as well as those that are continuing to move forward through foreclosure. If you think about our overall delinquencies that are aged over 12 months or greater, I think the total number has probably moved since the end of the last year from about 16% of total inventories to 25% of total inventories. So a little bit of aging there.

That has pressured the benefit we are getting from the lower overall delinquency levels, but the real driver there, if you think about it, is your reserve per delinquency is moving up because you have less delinquencies, but the overall reserve levels are still trending favorably. And I think that is the way you should continue to think about our expectations.

Connie Deboever - *The Boston Company - Analyst*

Okay, great. And then if I am also thinking about paid claims, they look like they have stabilized between first and second quarter. I guess just to your second-half outlook, as you work through the '05 to '07 book, which is seasoned and then I guess the offset would just be potentially higher claims too in terms of delinquencies seasonally, I mean how should we think about paid claims in the back half of the year?

Mike Fraizer - *Genworth Financial, Inc. - Chairman & CEO*

Paid claims should continue. Right now, we haven't seen any particular tick-up in paid claims, but we do have -- even though we have had stabilization and peaking of those older books of business, they still have not rolled all the way through to claims. So there is more paid claim exposure going forward. The delinquencies have certainly peaked, but I would expect that trend probably to trend up a little bit going forward.

Connie Deboever - *The Boston Company - Analyst*

Great, thank you. Those are all my questions.

Operator

Mark Finkelstein, Macquarie.

Mark Finkelstein - *Macquarie Research - Analyst*

Good morning. I have a few follow-ups in a couple areas. Firstly, just on the DAC issue. I guess it costs something around \$11 million this quarter from the elevated lapses on the 10-year level premium term. Is that the kind of number we should be expecting through 2010 and then when you get into 2011, you talk about a smaller book. How much would we expect that to moderate by?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

In 2010, the way that I would look at the amortization trends in total is that it did increase to a normal range of 10% to 15% of premium in the second quarter. And in the near term, I would expect that to continue because of the way that the business rolls off the books once you reach the end of the level premium period and because the new book years are smaller, I would say that it would trend down. But it would do so gradually over a period of a couple of years and we will be monitoring experience. I mean we could see trends improve and we could see trends moderate or -- I'm sorry -- improve or they could deteriorate some. But at this point in time, that would be my best answer.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay. And then on the interest rate question, I think that was a very helpful answer and the 70% hedged on the long-term care. I guess the question is, if you have that degree of kind of hedging, but we are still hearing the 3% 10 year range, is the hedge enough to avoid any asset adequacy testing issues as we get towards year-end at these levels?



Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Well, we feel that we are well-protected in our Companies through that hedging strategy and as well, we have some smaller, non-qualifying hedging positions, which provide downside protection associated with potential declines in the interest rates over the balance of the year. So between those two strategies, we feel like we are certainly adequately reserved given a statutory valuation rate of about 4%, which is much lower than the current portfolio yield.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay. And then just finally, the tax benefits in Australia, I think you said that the current quarter impact is \$6 million. How should we think about the benefit going forward? Is that the right number? Will it moderate?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

At this point in time, I would expect that is the right number.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, so \$6 million going forward? Okay. Thank you.

Operator

Jeff Schuman, KBW.

Jeff Schuman - *Keefe, Bruyette & Woods - Analyst*

Good morning. Thank you. A couple follow-ups, Pat, back on the life insurance. First of all, I was wondering if it would be possible now or at some future point to give us a little more detailed picture of kind of the 10-year term cohorts I guess by quarter. Because I am thinking -- you said that there was kind of a big sales impact in early 2000 and then it goes down from here. But I am thinking if we could sort of see how that -- the size of the various cohorts could probably anticipate the impact a little better. So that is -- I guess that is the first item.

The second question, I am wondering about the interplay of persistency and mortality. To the extent that there is somewhat higher lapses than were anticipated at pricing, I would tend to think that the people who are lapsing are choosing to reenter. And that would I guess imply maybe some anti-selection and some different mortality going forward. And then lastly, I am wondering if, in the future, we should anticipate kind of similar issues as kind of the 15 and 20-year level term policies written from that year kind of bubble up. That's it. Thanks.

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

Okay. First one is with respect to cohort detail. The way that I would look at it is I would look at the life insurance amortization and in comparison to -- that is in the supplement -- in comparison to the revenue stream associated with the business. Because if you break it down into a lot of detail, you see a fair amount of fluctuation between cohorts and it is difficult to observe trends. So I would suggest that use the information in the supplement, take a look at the way the amortization is changing as the revenue trends and that should give you a pretty good picture. And where things happen from quarter to quarter, which are out of line with the usual quarterly trends, you can count on the fact that we will provide additional clarity on that.



To your second point, the interplay of mortality and persistency, logically, you are right, but we do price -- we do also price the product, recognizing that interplay and in particular as I look at the mortality that is emerging quarter over quarter, we haven't seen that anti-selection. In fact, I described the mortality as being within the normal range, but high.

To give you a little bit more color on what actually happened, our number of claims in the current quarter actually declined from first quarter, but it just so happened that the severity increased because the people who happened to die this quarter owned larger policies. So it really is fluctuating randomly within a range and we haven't seen anything associated with the interplay that you describe. Although that certainly exists. And then --.

Jeff Schuman - *Keefe, Bruyette & Woods - Analyst*

The last part was whether, as the 15 and 20-year products sort of, from that era, sort of matured, should we expect sort of another little bubble in terms of persistency impact?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

I believe that there is that risk, but I think the risk is highest on the 10-year product because this particular design does have a good amount of persistency beyond the 10-year period because of the ART design. If you go to the other extreme, say with a 30-year product, the ART premium that comes out the back end is so high relative to the level premium that the policyholder has been paying that almost all, like or all of the policyholders are expected to lapse. So the higher the expected lapse rate gets in the shock period, which does happen on the longer duration product, the less exposure you have to this. But certainly, there is going to be residual exposure on the long duration products. I believe we are dealing with the tough issue now.

Jeff Schuman - *Keefe, Bruyette & Woods - Analyst*

Okay, that's helpful. Thanks a lot.

Operator

Darin Arita, Deutsche Bank.

Darin Arita - *Deutsche Bank - Analyst*

Thank you. Could you give a little color on the change in the RBC ratio from the first quarter to the second quarter in terms of what caused it?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

This is Pat. I would be happy to do that. I actually expected, based on the strong production and the declining investment results, that we would have a 5 point decline in the RBC ratio. We had a 10 point decline. The balance is really attributable to some restructuring we did associated with the XXX reserving facilities we have. And in effect, we recaptured a small block of XXX business, which increased the strain in the business and in addition to what you would normally see associated with the new business. That costs four to five points and that was a conscious decision. It facilitated the transaction and we are still within our target RBC ranges.



Darin Arita - *Deutsche Bank - Analyst*

So assuming that we continue to have very favorable life insurance and long-term sales growth, should we expect 5 point declines per quarter here?

Pat Kelleher - *Genworth Financial, Inc. - SVP & CFO*

I would expect that there will be some volatility from quarter to quarter, but we see steady declines in our investment losses and impairments. Particularly from the perspective of the structured securities, we are starting to see delinquencies decline there and impairments, for example, in the subprime have been close to zero in the current quarter, maybe \$3 million to \$5 million.

So given that we are incurring the strain on the new business now, we will expect earnings in future periods associated with that as investment losses decline, we will see some declines in the near term in the RBC ratio, maybe in that 5% range. But then it should start to naturally build given the engineering of the growth and the declining investment losses.

Darin Arita - *Deutsche Bank - Analyst*

Okay, that makes sense. And then turning to the Lifestyle Protection business, you had significant changes made over the past year. Can you talk about how that business might perform differently this time around if it goes through another shock experience if unemployment starts to increase again in Europe?

Mike Fraizer - *Genworth Financial, Inc. - Chairman & CEO*

Darin, it's Mike. I guess I would think about it this way. First is we took all the actions that we thought were appropriate to deal with the in force that we have had as far as -- about half of the book was monthly premium, so it was subject to price change. So we moved on that, as you know and really put all those price moves in place. But we remain actively monitoring those areas for performance to see if there is any additional pricing actions required.

I will remind you that as part of -- when I use the term pricing actions, it is not just premium. You may change how you handle a profit and loss share with a distributor. You may change a commission structure that also helps you get back some margin along with that.

The second thing we did though is we looked at our experience and incorporated that back into product design as we go forward. In other words, did you have to adjust the nature of any liabilities or therefore coverages so that it could handle a more strained period like we just have gone through. So that has been built into the new products that we are selling now.

Finally, surrounding both of those, whether it is old or new, we do have active loss mitigation efforts. In other words, following up on claims, making sure we are paying valid claims, but let's say you have an accident and sickness claim, someone should get better and like for example go back to work and you have to have active follow-up on those.

So I think we have designed the business model to handle a more stressed environment going forward, and we have used the same types of back-testing disciplines that we did in the US Mortgage Insurance business in Europe to make sure that that is a data-driven and analytic exercise, not a theoretical one. So we are quite comfortable with that model going forward.

Darin Arita - *Deutsche Bank - Analyst*

All right. That's very helpful. Thank you.



Operator

Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - Philadelphia Financial - Analyst

Thanks for taking my call. Two questions. One, when is the earliest you think the Senate will pass the FHA bill enabling them to raise the annual premiums similar to the one that the House passed?

Kevin Schneider - Genworth Financial, Inc. - President & CEO, US Mortgage Insurance

Jordan, I think the earliest possibility would be before they go out for the fall election. That is probably the earliest. Whether it gets down there or not or is later on in the year as part of appropriations has yet to be determined. But the earliest would be before the election this fall.

Jordan Hymowitz - Philadelphia Financial - Analyst

Okay. Second, there was a Senate hearing -- sorry -- a House hearing yesterday and it seemed to kind of be a lovefest for the MIs in general. I mean there wasn't a single consumer advocate that was anti-MI. Do you see a general shift towards your product in general from regulators, consumer groups and things of that nature?

Kevin Schneider - Genworth Financial, Inc. - President & CEO, US Mortgage Insurance

I haven't been to one of those lovefests in a while and I missed yesterday, so I wish I could've been there based upon the coverage that you have just described. But I think that what we are seeing is an understanding of MI and candidly, the value of the regulatory capital framework through this cycle. And it is not just a US issue. I think it is a global type recognition overall for the framework that mortgage insurance provides to low down payment lending.

So I mean you raised the issue, so I am going to summarize what they said. Number one, they said this is an industry that got no federal support through the cycle. This is an industry that, at the end of the day, the capital, the regulatory capital frame-up held up amazingly well through this cycle. It is well-reserved. We are required to hold reserves for these tough cycles like we are going through. It is a countercyclical reserving approach and potentially, I think most importantly, they said it is a model for regulatory reform of the GSEs going forward that needs to be considered.

So the answer to your question is it was a good meeting, it was a good hearing. Whether it is a shift or not, I think it is actually a recognition of how we have held up and how this industry has held up through this cycle.

Jordan Hymowitz - Philadelphia Financial - Analyst

Okay. And final question is no one has brought up your book value on the call. It increased to over \$28, which is almost two-thirds more -- or almost three times your stock price. I mean do you guys expect to lose money any time soon or is there any reason why that book value should substantially come down towards your current price?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

I think our sales trends are good, particularly in the leadership lines of Retirement and Protection. Our investment experience is improving in terms of increasing investment income in the portfolio. The businesses in the international jurisdictions, particularly Canada and Australia, are seeing the benefits of both effective loss mitigation and improving economic and housing markets. And I feel pretty optimistic that we are delivering on the plans that we have got in place. I guess I would have to say I will leave the valuation questions to someone else.



Jordan Hymowitz - Philadelphia Financial - Analyst

Okay. I'm sorry, it is half your current -- double your current stock price to book value -- I'm sorry, not three times. Sorry about that. Thank you very much.

Operator

Donna Halverstadt, Goldman Sachs.

Donna Halverstadt - Goldman Sachs - Analyst

Thank you. My questions were already asked.

Operator

Eric Berg, Barclays Capital.

Eric Berg - Barclays Capital - Analyst

Thanks very much. Can you hear me?

Mike Fraizer - Genworth Financial, Inc. - Chairman & CEO

Yes, Eric. How are you doing?

Eric Berg - Barclays Capital - Analyst

Good, thank you. Let me try to get of the speaker here. Hold on just a sec. Thanks very much. I am well, thank you. Pat, I was hoping we could build on some of your responses to the earlier questions.

First, in response to I think Jeff's question, are you saying that on the longer duration term policies, say 30-year term or 20-year term, that the rate of increase in premium that the customer suddenly -- maybe not suddenly -- but let's just say faces at the end of the level period is less pronounced than is the case in the 10-year and that therefore the 10-year policy is much more likely to lapse than the 20-year or 30-year term at the end of the level period? Is that what you were saying?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

No, that is not what I was trying to say, Eric. I was trying to say that we recognize that for the longer duration product, the premium increase will be much more pronounced. Therefore, the expected lapse is closer to 100% and there is, I will say, less room for margin of error in estimating the persistency beyond the end of the level premium period.



Eric Berg - Barclays Capital - Analyst

Okay, thank you. So it is the other way from what I have said. Very clear now. Why then should we -- since you didn't get it right on a certain -- to a certain degree on a certain cohort of policies, the 10-year level premium issued at the end of the prior decade, why should we -- why won't then these other policies likely face similar issues or pose similar challenges for you?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

I think they will pose the same challenges. I am just saying that for the longer duration policies, because you expect lapse rates closer to 100% because the premium increase is so dramatic, there shouldn't be much variation between the experience and the expected result. In the case of the 10-year term product, there was more margin for error, but we have adjusted as we have seen experience emerge.

Eric Berg - Barclays Capital - Analyst

Okay. And then just a couple of questions, one narrow, one broad for Kevin. I think somewhere in your prepared remarks, either Kevin or Mike was saying that you expect an 8 point -- something about 8 points in the second half of the year in delinquencies. I just want to make sure I understand exactly what you are referencing here. Is that an 8 percentage point increase in the loss ratio year over year, 8 percentage points, 8%? Are we talking sequentially year-over-year? I just want to make sure absolutely clear on what you mean.

And then third and finally, I would love to hear from Kevin on his observations on sort of what would be the main factors in his mind going forward that is going to drive business back to the private sector from the FHA. I know Mike provided an excellent introduction. I would love to hear some additional comments from Kevin. Thank you.

Kevin Schneider - Genworth Financial, Inc. - President & CEO, US Mortgage Insurance

Eric, first of all, to your question about the 8%, what we said there is our historical experience over time to include the recent experience over the last few years through this difficult environment is that historically we have generally had an 8% average increase in total delinquencies in the third quarter, followed by a subsequent increase in the fourth quarter.

Now the way I think about this going forward and had caveated that a bit before is we have had -- although we have had a return to more traditional seasonality where you have declines in the first half of the year and growth in the second half of the year in delinquencies, we are seeing that traditional seasonality somewhat favorably muted in the first half of the year. And there is the potential for that in the back half of the year, primarily driven by the fact that we think we have burned through some of these large, more troubling books of business. So that is the answer to your first question. Is that helpful?

Eric Berg - Barclays Capital - Analyst

Yes. So in other words, we are talking about number of delinquencies and we are saying that if you had 100 -- hello?

Pat Kelleher - Genworth Financial, Inc. - SVP & CFO

If you had 100, it would have gone up 8.

Eric Berg - Barclays Capital - Analyst

Very good. Yes, that's clear then.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, US Mortgage Insurance*

Turning to the other question, I really think there are four things we believe will bring back a healthy private mortgage insurance market and help us continue to shift business away from the FHA. The first of those is continued enhancement to the FHA's risk management and loss mitigation efforts. The second is increased FHA pricing. The third is a reduction in overall GSE adverse market delivery fees and loan level pricing, and then finally, and I think this is a little longer-term change, is a rollback in FHA loan limits to levels that are really more consistent with traditional government housing policy objectives.

So let me just roll through those really quickly. The first one, again, as it relates to FHA risk management and loss mitigation efforts, given the high level of delinquencies and defaults the FHA is experiencing -- I know they are committed and we are very supportive of applying additional resources and flexibility to their overall loss mitigation efforts. I mean they just need more capacity to work through some of these troubling loans.

As it relates to pricing, they have their upfront pricing increase that they have already implemented and now the bill has been passed out of -- has come out of the House side that needs Senate support that allowed them to reduce their annual pricing, it is currently I believe at about 55 basis points. This will allow it to significantly raise that annual pricing, which would make FHAs compared to a conventional mortgage very, very -- on much more of an even playing field.

Third, I think the GSEs in their pricing and the approach they took going into this period is worth a relook. It is time to revisit the market; it is time to revisit their pricing. The markets have stabilized materially. In particular, their adverse market delivery fees I think are worthy of a revisit and their loan level pricing. So if those repricing efforts are undertaken, it will do a lot to help bring back the market to the conventional space and to private capital.

And then, finally, the fourth I mentioned was loan limits and if you recall, the FHA's loan limits were raised along with the GSEs back at the beginning of the cycle. And not only were they raised, but in proportion to the GSE's loan limits, there is a lot of overlap in the two markets that historically didn't exist.

And so as I think about it, the government and the taxpayers are now supporting loans that are up to over \$700,000 and I don't think that is what the FHA was originally designed to do. I think they would like to find a way to start to walk back away from that and allow private capital that is waiting to support those type of loans and that type of insurance to do what private capital does best.

Eric Berg - *Barclays Capital - Analyst*

Very helpful. I look forward to following up with you, but a very, very, very helpful start. Thanks again.

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.



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