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GNW - Q3 2012 Genworth Financial, Inc. Earnings Conference Call

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OVERVIEW:

GNW reported 3Q12 net income of $34m.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Genworth Financial's third-quarter 2012 earnings conference call. My name is Huey and I will be your coordinator for today. At this time all participants are in a listen-only mode. We will facilitate a question-and-answer session towards the end of the conference call.

As a reminder this conference is being recorded for replay purposes. Also we ask that you refrain from using cell phones, speakerphones, or headsets during the Q&A portion of the call.

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

Georgette Nicholas - *Genworth Financial, Inc. - SVP, IR*

Thank you, operator. Good morning, and thank you for joining us for Genworth's third-quarter earnings call. Our press release, financial supplement and third-quarter 2012 investor materials were released last evening.

Earlier this morning, additional information regarding our vision and strategy was posted to our website.

Today, you will hear from Marty Klein, acting Chief Executive Officer and Chief Financial Officer. Following our prepared comments we will open the call up for a question-and-answer period.

In addition to our speaker, Pat Kelleher, President and CEO of our Insurance and Wealth Management Division, Kevin Schneider, President and CEO of our Global Mortgage Insurance Division, Jerome Upton, Chief Financial Officer of our Global Mortgage Insurance Division and Buck Stinson, President Insurance Products for our U.S. Life Insurance segment will be available to take your questions.

With regard to forward-looking statements and the use of non-GAAP financial information, 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 note regarding forward-looking statements in our earnings release and the Risk Factors section of our most recent Annual Form 10-K and Quarterly Report on Form 10-Q each 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 and earnings release, non-GAAP measures have been reconciled to GAAP where required in accordance with SEC rules.

And finally, when we talk about International Protection and International Mortgage Insurance results, please note that all percentage changes exclude the impact of foreign exchange.

And now let me turn the call over to Marty Klein.

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

Thanks, Georgette, and good morning, everyone. Before we get started, I would like to say that we wish the best for all the people who are dealing with the aftermath of Sandy.

This morning we will provide an overview of our corporate strategy, give an update on the holding company including our credit rating situation and review third-quarter results in our businesses.

In developing this strategy, our highest priority has been to rebuild value for shareholders. Working with the Board of Directors, the management team has developed and begun executing specific plans to both safeguard and maximize the value of the Company for shareholders. We intend to accomplish that goal by achieving return on equity in each of our core offering businesses in excess of its related cost of capital; generating significant cash flow to the holding company from core business dividends; and realizing value from our non-core businesses; and enhancing financial flexibility by first managing the core businesses to enable them to be stand-alone on an operating and debt basis and, second, de-leveraging to enhance cash flow, reducing the burden on the holding company and placing the Company on better footing with rating agencies and the credit markets.

As part of this process, we have identified two core sets of businesses. The U.S. Life Insurance businesses, which includes life, long-term care, and fixed annuities, and Global Mortgage Insurance, which includes the U.S., Canada, Australia, and other markets. The businesses we have identified as non-core include international protection, wealth management, and of course the runoff segment which includes primarily variable annuities.

Each of these two core businesses, U.S. Life and Global Mortgage Insurance, has been evaluated on its potential to provide significant competitive advantages, deliver new business returns above its related cost of capital while covering its full expense base, and ultimately produce capital and deployable cash that covers the cost of its appropriate share of debt and supports its desired ratings.

Managing our core businesses with these goals will reduce interdependencies and subsidizations among businesses in order to improve financial performance and flexibility.

The performance of each business will be regularly evaluated against these criteria. For example, if a business is not delivering acceptable new business returns, we will evaluate available options to address this issue and ensure it does not continue.

As performance in the core businesses improves, we believe our financial strength and flexibility will improve as well. This flexibility should provide potential opportunities to take additional steps. For example, through the sale or spinoff of businesses if that would further increase shareholder value.

Our core businesses have significant opportunities to leverage their strengths to earn attractive returns, given the underserved middle market for life insurance, the growing consumer need for long-term care, the developing U.S. housing market recovery, and the continuing development of the housing markets in various international countries.

However, we also recognize that we are operating in an environment with macroeconomic headwinds and regulatory and rating agency challenges. We are also working to overcome underperforming in force portfolios, a relatively high cost of capital, and interdependencies among the individual businesses and with the holding company that impede flexibility.

In each core business, we have four key areas of focus. Rebalancing the business risk profile; writing profitable new business; improving returns on the in force portfolio; and supporting holding company liquidity and flexibility.

In Global Mortgage Insurance, we are working to rebalance the business risk through the partial sale of our Australia MI company, a narrower footprint in Europe, given the uncertain economic outlook and increased use of third-party reinsurance.

In the U.S., Australia, and Canada, we are prudently managing our capital and pursuing various ways to utilize that capital in the most efficient and productive way possible. In Europe, we are writing new mortgage insurance business in only four countries where business conditions enable us to achieve attractive returns.

We are encouraged by the continued improving trends in the U.S. housing market and we continue to expect that the U.S. mortgage insurance business will return to profitability during 2013. We remain focused on executing loss mitigation strategies, maintaining our distribution network and writing profitable new business through waivers, GRMAC, or potential NewCo type options.

At the same time, we are actively pursuing solutions to reduce linkages with and dependencies on the holding company. Our businesses in Canada and Australia continue to write profitable new business and deliver dividends to the holding company. While smaller books of new business are utilizing less capital in these platforms, we are working with the regulators as they evaluate capital levels more cautiously in this economic environment.

In our U.S. Life Insurance business, our primary focus is on improving the performance of the in force business through long-term care in force price actions, life block transactions and refinancing of life reserves.

We are also working to improve the new business profile of both life and long-term care by managing portfolio sales as well as redesigning products to reduce risk, improve profitability, and maximize capital efficiency. The goal is to provide regular ordinary dividends to the holding company beginning in 2013.

In our non-core businesses, we will manage new business to enhance the value that can be realized while generating cash and capital, for example, through an ultimate sale. Our priorities in managing our non-core businesses are as follows -- in International Protection, we will maximize the embedded value of the overall business through resizing the current European franchise while continuing to execute on growth opportunities in new markets. We are significantly narrowing the focus in Europe to key relationships and using appropriate pricing to protect margins during the prolonged financial crisis. This will enable us to reduce corresponding infrastructure costs.

These changes will add to the embedded value of the business while maintaining significant dividends to the holding company, enhancing our ability to realize increased value from the potential sale of the business in the next two to three years, and as economic and business conditions permit.

Wealth Management is an attractive business with a strong competitive position and continuing growth potential, and we believe it can also be a significant source of capital. We continue to invest in investment solutions and new capabilities to support the financial advisors we serve and to increase the value of the business. We'll also be evaluating opportunities to ultimately realize that value at the appropriate time.

All of these actions support our goals of building strength and flexibility at the holding company. We are positioning our core businesses to pay consistent dividends while generating cash and capital from our non-core businesses. While our current leverage ratio of 25% is appropriate for a diversified set of businesses, we are moving to a medium-term leverage target of 20% to 22%. This reduced leverage target is more appropriate for the core businesses on a stand-alone basis and will increase our financial and strategic flexibility and should also benefit our ratings over time.

As additional capital is generated, we will evaluate how best to deploy it. These options include first, strengthening the balance sheets and performance of our businesses where appropriate; second, reducing leverage to increase flexibility; and third, returning capital to shareholders such as through share repurchases. These options will be viewed through the lens of how best to increase shareholder value at the time.

Successful execution of this turnaround strategy should increase the earnings and ROE in our core insurance businesses while also generating cash and capital that will increase financial strength and flexibility.

I should also note that the Board continues to be actively in case in the CEO search process, working with Russell Reynolds, and has made good progress.

Let me now cover some topics at the holding company. We continue to generate and to maintain significant liquidity. At the end of the third quarter, cash and liquid securities at the holding company totaled about $1.4 billion. During the fourth quarter, we will pay out approximately $375 million to the operating companies related to tax sharing agreements with them. This includes the $230 million of temporary tax benefits being held at the holding company which we noted last quarter.

After reflecting those upcoming payments, the holding company has about $1 billion in cash and liquid securities, in line with our target of two times debt service coverage which is about $600 million, as well as an additional buffer of approximately $350 million for stress scenarios that might impact the dividend sources of the holding company over the next 18 months. We expect the year-end cash balance to also be in line with that target.

Regarding dividends to the holding company, the Insurance and Wealth Management Division remains on track with the 2012 goal of $300 million, having been paid $236 million through the end of the third quarter. In Global Mortgage Insurance, we continue to expect dividends from the International Mortgage platforms in the range of $50 million to $110 million for 2012, with $30 million paid year to date from the Canada ordinary dividend.

Also, the Company signed an agreement this month to sell its home equity access business for $22 million. This transaction is expected to close in early 2013 with no significant gain or loss on the sale impacting corporate or other activities.

Now I would like to touch on the actions of the rating agencies during the quarter. First, in our view, Moody's recent decision to extend the review of our holding company and of the U.S. mortgage insurance recognizes the plans that we have developed to increase our financial strength and flexibility. While S&P also acknowledged this, we were disappointed that they chose to take ratings actions before we had made further progress on our plans. We believe that as we execute our strategic plan, our financial strength and flexibility will improve, which should stabilize and ultimately improve our ratings.

However, in the meantime, we took steps to prepare for potentially adverse ratings actions. We do not believe the downgrade by S&P or the potential action by Moody's will have a material impact from a commercial, liquidity or financial perspective.

From a commercial perspective, there has been no significant change in the ability to write new business or on the capacity or willingness of counterparties to enter into hedging transactions. The holding company does not have any long-term debt maturities until June of 2014 when $600 million of long-term debt matures. We plan to address this debt well in advance of its maturity date.

Along with the strategic plan discussed earlier, we continue to work with regulators and rating agencies to develop comprehensive solutions for U.S. MI. We are seeking to address rating agency concerns and to fulfill our commitment to pay all our valid claims, while safeguarding the liquidity, capital, and shareholder value of Genworth by first, increasing financial flexibility for Genworth and U.S. MI, by reducing U.S. MI's dependency on the holding company; second, preserving holding company liquidity buffers and other liquid assets; and third, sustaining U.S. MI's access to profitable NIW markets.

Alternatives under consideration include internal reorganizations and potential NewCo structures. These alternatives could require some form of capital contribution, none of which is expected to be material to holding company target liquidity or buffers. These alternatives also do not rely on our capital generation plans nor do they rely on additional contribution of MIC shares.

We believe that a runoff, spinoff, or sale of U.S. MI or the amendment of our bond indentures are not the most beneficial options for shareholders at this time. We will provide updates as we move forward further on these plans.

Now let's turn to third-quarter results where we reported operating income of $121 million for the quarter and net income of $34 million, which reflects the goodwill write-off in international protection.

In Global Mortgage Insurance, we saw continued progress in the division with reported net operating income of $56 million compared to income of $51 million in the prior quarter. There was stable performance in Canada, stronger results in Australia as the performance in the portfolio continues to improve, and consistent performance in U.S. mortgage insurance.

In Australia, operating earnings were $57 million. Unemployment was stable and home prices were up slightly from some continued regional variation. Lower interest rates have improved affordability and consumer sentiment. The loss ratio for the quarter was 47%, which is down 7 points sequentially. Overall delinquencies were down 10% with new delinquencies cures improving across all major states.

While paid claims are elevated, reserves remains largely in line with the trends we had anticipated following the first-quarter reserve strengthening. We continue to manage capital against the backdrop of increasing regulatory capital expectations, given the uncertain global environment. We are evaluating additional reinsurance treaties to manage the capital levels while balancing the increased cost and impact on overall returns.

Executing a partial sale of our Australia MI platform remains a key goal in reducing our exposure to mortgage insurance risk and generating capital. While the performance of the business is recovering, the increasing regulatory capital expectations and uncertain market conditions in Australia for initial public offerings can impact both valuation and timing. We remain committed to a partial sale, but given our liquidity at the holding company and the other leverage that we have to generate cash and capital, we will execute a transaction when it makes the most sense for shareholders. Execution of an IPO is subject to market valuation and regulatory considerations and we do not now expect an IPO to occur prior to late 2013.

Turning to Canada, operating earnings were $42 million for the quarter. Unemployment was stable sequentially and home prices were down slightly. The loss ratio decreased to 2 points sequentially to 30% as overall delinquencies were down 9% from the prior quarter. Improvement in the Alberta region continues, and changes to eligibility rules for government guarantee mortgages that went into effect in July this year are likely to reduce the size of the high loan-to-value mortgage insurance market. Our capital position remains solid in Canada.

The operating loss in other countries in the International Mortgage segment improved somewhat to $5 million sequentially, driven by a reduction in losses primarily in Ireland.

Moving now to U.S. MI, we had a net operating loss of $38 million in the quarter effectively flat sequentially after adjusting for a $12 million benefit from the termination of an external reinsurance contract in the second quarter. We are seeing a slow recovery in the housing market and the mortgage insurance market is improving and we have seen strong growth driven by a larger mortgage origination market and higher mortgage insurance purchase penetration in the quarter, the highest since 2008. Total losses were flat sequentially as a seasonal increase in new delinquencies and lower self cure activity was offset by loss mitigation and modest changes in aging.

Our total flow delinquencies fell by 19% from the prior year with new delinquencies up 5% sequentially from seasonality, but down 24% year over year reflecting the continued burn through of 2005 to 2008 books and the new better performing books becoming a larger portion of our overall portfolio. With the extension of the waivers, we anticipate continuing to write new business with risk to capital ratios above 25 to 1 in GEMICO.

Finally, during the quarter, the GSEs granted GRMAC an extension of the ability to write new business in nonwaiver states through 2013. Considering these improving macroeconomic fundamentals, the continuation of government programs, loan modifications, the continued burn through of the unprofitable books of business, and the growth of new books with a 20% plus ROE, we expect U.S. MI to return to profitability during 2013.

Moving to the Insurance and Wealth Management Division, reported operating earnings were $104 million. Life insurance earnings were $22 million for the quarter. We saw higher term life mortality experience in the quarter which is the third straight elevated quarter after three quarters of more favorable experience when compared to pricing assumptions. Fluctuations in mortality can occur, but we have not identified any systemic trends.

Life insurance sales were down sequentially and year over year, consistent with the pricing and product actions taken this year as we managed sales volume and improved statutory performance. We expect to complete our second life block transaction in the fourth quarter of 2012. The initial phases of the transaction began in the third quarter and we recorded an associated GAAP loss of $6 million this quarter. We expect the capital benefit to be in excess of $100 million in the fourth quarter when the transaction is completed.

On October 22, we announced changes to our life insurance portfolio, designed to update our product offerings and further adjust pricing to reflect the current low interest rate environment and regulatory changes. Under the new AG 38 guidelines, we have determined that approximately 7% of our Universal Life Insurance reserves are subject to the new regulations which require additional reserve adequacy testing.

While our analysis is not yet complete, we do not expect a significant financial impact related to the new reserving requirements on our in force reserves subject to the new guidance.

Long-term care earnings were up for the quarter at $45 million. We had $29 million of favorable reserve adjustments impacting results for both active life and disabled life reserves, primarily as a result of the continued multistage system conversion. As of the end of the third quarter, reserves for both GAAP and STAT were adequate. After adjusting for the reserve items, the loss ratio was approximately 74% which is flat to the prior quarter.

Our previously announced 18% premium rate increase on the majority of the older issued policies continues to take effect. With respect to the recently initiated in force price actions through October 26, we have met with 20 states and recently submitted filings in 18 states. We also have approval from two states to begin implementation in the fourth quarter of this year.

Fixed annuity earnings were $19 million and sales in this line were up from the second quarter even as we continue take actions to maintain margins.

International Protection earnings were $8 million for the quarter. The business continues to navigate the tough consumer lending environment.

New claim registrations in Europe decreased 18% versus the prior quarter and 6% year-over-year. Given the impact of the continued challenging economic environment in Europe on the goodwill analysis in the quarter, we recorded an after-tax goodwill impairment of $86 million, which was all of the goodwill related to this business. As part of the plans to increase value through growth and new markets, we commenced our relationship with MAPFRE, a leading insurer in Latin America to utilize their distribution to access markets in South America.

Wealth management earnings were $10 million and business continues to provide steady earnings and dividends, including dividends of $30 million year to date.

Turning to capital, the U.S. Life Company's risk-based capital ratio is estimated to be about 420%, up from the second quarter. RBC benefited from favorable taxes as well as positive statutory income in the quarter. The ratio also reflects the extraordinary $50 million dividend paid to the holding company in the quarter from the Medicare supplement sale.

At the end of third quarter, unassigned surplus was the approximately $180 million and statutory operating income was approximately $590 million year to date. We still expect to achieve the 2012 unassigned surplus target of $250 million to $300 million that we laid out in February. These goals are a high priority as we work to reestablish the regular ordinary dividend capacity for our life companies in 2013.

Finally in the Corporate and Runoff Division, results in our Runoff segment improved from the prior quarter and prior year from variable annuity results driven by favorable market conditions.

Shifting to investments, the global portfolio continues to perform well. We have updated the analysis we gave back on our February 3 investor call regarding the impact from an extended low-rate environment on our earnings per share. The updated analysis shows an additional impact of $0.01 to $0.02 per share in 2013 and 2014, primarily due to lower projected earnings in Australia, related to the rate cuts made throughout 2012.

Let me wrap up, so we can take some questions. The last few years have seen several challenges for Genworth. We are now tackling those challenges head-on and will put them behind us, and must turn our Company around and turn the page to the next stage for Genworth.

With our competitive strengths and with our talented team of employees who provide valuable products and services to our customers, we are working to realize the many opportunities that we have to rebuild shareholder value. In doing so, we will build a stronger company which will benefit all of our stakeholders. We are moving quickly and urgently on our action plans and look forward to updating you of our progress.

And now, let's turn it over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Sean Dargan, Macquarie.

Sean Dargan - *Macquarie Capital Research - Analyst*

I have a question about your targeted debt to total capital ratio. You mentioned a medium-term goal is 20% to 22%. That is a bit higher than, I think, the 18% to 20% you talked about last quarter.

What -- how long will it take to get to that medium-term goal and what steps will you take to get there?

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

As we look at how we project out our earnings and look at the debt ladder and how it matures, we think that we sort of move into the 21% to 22% range in about three years from now. That assumes that with the $600 million maturity in 2014 that we would only really refinance about $250 million of that at some point in time. And the rest of it really comes from the delevering that happens along the way, as well as with the retained earnings. So it is really going to take about three years to get to that 21% to 22% range.

Then obviously as we generate capital from some of the things that we have talked about earlier, that would obviously give us the opportunity to accelerate that.

Sean Dargan - *Macquarie Capital Research - Analyst*

Thanks. And one follow-up about the Australian partial IPO. What has changed to push it back another back half of the year, I guess? What has changed in the Australian market that's led you to push back the timeframe?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

This is Kevin. As you think about our performance down there, we feel good about our return to profitability and the stability that we have seen, for now, a couple of quarters in our results. I think what continues not so much to change, but to evolve down there is some of the capital pressure from a regulatory capital standpoint. And basically the regulator in this environment, as Marty mentioned in his opening remarks, the regulators are cautious in these markets right now.

The other thing that I think we all need to be cognizant of is there -- just what's going on the overall market for IPOs in Australia. There's simply been no material IPOs of any size done in that market this year. And so, I think there remains some uncertainty in that market regarding just ability to tap into the market from that standpoint. We do remain committed to a partial sale.

I think the thing that is most changed for us though as we think about it is, we are going to do it when it makes the most sense for our shareholders. In our view at this point in time is that our valuations should improve in that market as we move towards the end of the year. Improving performance, subsequent quarters of improving performance will continue to help that. We are going to continue to help the valuation improvement and again that is when we are targeting it at this point, because we think it will be the one that will generate the best outcome for our shareholders.

Sean Dargan - *Macquarie Capital Research - Analyst*

Thank you.

Operator

Jeff Schuman, KBW.

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

Thanks. Good morning. I was wondering if you could help us just tick and tie a little bit on the holding company cash number. I think you said pro forma for the $375 million that goes through the Op Co's, I would hope it would have about $1 billion. Then I think you said you would end the year around that level, but there would also be some dividends this quarter. So I wasn't sure if there were some uses for those dividends or how we true up that arithmetic.

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

Yes, thanks for the question, Jeff. We are at right around our liquidity targets at the end of the quarter, maybe just barely in excess of them, once you adjust for that $375 million that would go down to the operating companies mostly the life companies during the fourth quarter. But in the fourth quarter, we have a few different things moving. We do have some dividends coming in, but we also have debt service that is going out the other way.

So with our projections, we assume that will all land at around $1 billion by the end of the year.

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

That's helpful. Just one other thing, if I may. Long-term care continues to have some issues around performance of the legacy block. But there was a reserve release this quarter which I guess you may have been for technical reasons, but it seems counterintuitive. Can you help us understand the nature of the reserve that we see?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

This is Pat Kelleher. I would be happy to that. We are nearing the completion of our implementation multistage update of the reserving system. What we did complete in the third quarter was claim reserve updates. And we actually had some reserve adjustments, some components of the reserve increase like on certain facility claims. Other components of the reserve decreased because we found out that the reserves were redundant.

So the first thing that is important there is in that component of the changes, we found that our reserves were approximately right in aggregate and our total claims reserve was sufficient. So it didn't change materially. We did have on the -- about $15 billion of active life reserves we?re holding on that business. A set of minor adjustments, which resulted in a favorable impact to earnings of $29 million after-tax. And we do not expect material impacts as the remaining work is completed.

We also did some work updating our GAAP loss recognition testing and our STAT reserved adequacy analysis. And consistent with earlier periods we have concluded, our reserves are adequate and appropriate. So it made sense to make the technical adjustments. Does that help?

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

That helps a lot. Thanks.

Operator

Geoffrey Dunn, Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

I have a question on the MI side and then Ryan has one on Life. On the MI side, can you update us where we stand with respect to the IBNR cushion from the previous reserve charge? And then in the quarter, when you talk about the sequential decline in the reserve for loan in defaults, was there a mix shift occurring in the payouts and cures, or any detail behind that?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

Yes, when you -- this is Kevin. I would just tell you, our overall view of the reserve that we put up in the second quarter of last year that included that additional provision you are talking for with an expectation of additional losses, it is a long way away from looking at the delqs. That those reserves were put up with to tell you where we are at in terms of the consumption of that total provision. I will tell you our reserves continue to hold up quite well. In the aggregate we think will remain on track as any pressure we continue to experience from aging has been offset from the severity improvement we've been seeing in our actual claims.

So, we basically think we are on track with it and that our reserves are adequate at this point in time.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Was there any notable benefit from releases related to other curtailment activity over the last several quarters?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

Nothing significant. It is just the ongoing curtailment benefit we are actually achieving on the individual loans as we perfect those claims and as we process those claims. So no big release or something like that if that was your reference.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

And then Ryan has a question on the life side.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

Good morning. I have a couple of quick ones. What is the expected earnings impact going forward from the life block transactions?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

This is Pat. The impact that we would expect going forward would be that life earnings would be lower on an annual basis by about $5 million a year, it is about $1 million a quarter. And that is on a transaction that generates in excess of $100 million of capital when completed.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

Thanks. And then what is the regulatory capital that is held in the International Protection entity?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

We will look that up. My estimate would be in the $800 million to $900 million range. And we can confirm that later as we look that up.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

And then just one clarification. The comment on cash flow testing reserves to long-term care being adequate, does that also incorporate your expectations for year end statutory cash flow testing?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

At this point in time, we have done the work relating to third quarter and we will update you on the fourth quarter analysis when that work is completed. And to your point on the statutory capital as of the end of the third quarter, it is about $770 million of statutory capital in the International Protection entity.

Operator

Suneet Kamath, UBS.

Suneet Kamath - *UBS - Analyst*

Good morning. I had a couple of questions. First just to follow up on Sean's line of questioning on the debt to capital. Does the three years that it takes to get to the 21% to 22%, does that incorporate any of those strategic transactions that you are talking about? Be it Australia IPO or any of these other additional life block transactions?

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

No, Suneet, it does not. I was attempting to clarify that, but maybe I was not successful. So we would get down to that 21% to 22% range in about three years with just the natural progression of our debt ladder and retain earnings and assuming that with that $600 million of debt that comes due in 2014, that we would refinance just about $250 million of that. All of that excludes the impacts of any capital generation actions which would give us the opportunity to accelerate that de-leveraging if we chose to.

Suneet Kamath - *UBS - Analyst*

Got it. Yes, you might have clarified it, I just -- maybe I missed it. And then I guess a follow-on to that can we assume given the priority set that you established that we are probably not going to see anything material that comes of share repurchase until that leverage ratio gets to your target level?

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

Good question. I think that we are going to look at it at the time. Obviously creating financial flexibility is a very important objective of ours and de-leveraging is certainly one of the ways we are going to do that. But we're also very mindful of where our shares are trading and will be trading and we will look at that as well and we will make the assessment at that time.

Suneet Kamath - *UBS - Analyst*

And then my second question is on your presentation you had mentioned a couple of times, one of the challenges is the interdependence of your businesses. Can you just talk about some of the key aspects of that comment and what actions you can take to reduce those interdependencies?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

Sure. We do think it is very important as we improve our business performance as well as our financial flexibility that we manage the businesses on that kind of stand-alone basis that we talked about. And I think there are a few different things that we want to look at. We want to make sure that, as we have goals for the businesses with respect to their returns, return on equity, particularly as we are writing new business, for example, that we look at that expected ROE when we are pricing, and developing products.

And we want that to be in excess of the appropriate cost of capital for that particular business line. As you can imagine, different businesses at different risk profiles, different tenors, so obviously, their cost of capital should vary or the return on equity should vary along with that.

But also, different businesses have different amounts of debt, different amounts of leverage that they can carry. For example, a stable portfolio of life insurance businesses could really have a leverage of 22% to 25%, maybe 26%. For mortgage insurance platforms, that's a lower type of range. You are looking at probably typically around 15%, maybe as high as 18% and as low as 12% so you get different amounts of leverage. So we want to make sure that each of our operating businesses is being run in a way that can support its specific debt leverage as well as an appropriate target for it.

And then finally, we want to make sure that we are covering all the expense loads in our pricing and that there's not any kind of reliance and support from other businesses or from the holding company to do some things that aren't priced in into our products.

Suneet Kamath - *UBS - Analyst*

But from a capital perspective is there any sort of cross subsidization of these businesses that needs to be unwound or anything like that? I guess the whole stand-alone profitability and cost equity, I can't think of a good one, but just in terms of cross subsidization of capital, is there anything that we need to think about there?

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

Well, I just think for example that as we are managing our debt, we are going to be looking at it and managing our individual businesses so they are carrying our appropriate share of debt load.

So for example, as we are pricing mortgage insurance we are going to assume that we are able to lever it at a 15% number instead of an overall 25% number which has been what we've been doing. We have been operating at a combined leverage ratio of 24% to 26% which, for a diversified set of businesses, we think, is entirely appropriate. But we want to make sure for pricing and those types of returns that we are really looking at the businesses to be priced for their particular debt load that's appropriate.

So in case of MIs, for example, we would be looking to price more of the 15% leverage or something as opposed to a 24% or 25% leverage assumption.

Similarly, we want to look at -- on the other side of the coin we look at, for example, long-term care returns and while an overall diversified set of life businesses might you might want to have a cost of capital look at it at 11% to 12%. We realize that for long-term care, particularly, it is a higher number. It has been a riskier product although we are working to change that risk profile through underwriting and pricing and product design, but we think long-term care, for example, as a cost of equity is probably 13% to 15% to maybe even at 16%. So we need to make sure that we are pricing it and that it carries or covers that particular cost of equity.

Does that help you?

Suneet Kamath - *UBS - Analyst*

It does. Thanks.

Operator

Mark Palmer, BTIG.

Mark Palmer - *BTIG - Analyst*

Thanks. Good morning. You mentioned during the strategy overview that there was the potential for NewCo type options for the U.S. mortgage insurance unit. Could you provide some more color on what you are thinking along those lines?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

Sure, Mark, this is Kevin. I will provide the extent of the color that I can, given where we are in these discussions with the various stakeholders. Going -- I think the way you should -- we think about U.S. MI and what we are really trying to drive there is, number 1, we are going to continue to write as much of that profitable business as we can under the waivers that have currently been granted to us by our home domiciliary state regulator as well as the other state regulators across the country.

Secondly, we have the additional potential to write business through another subsidiary that we talked about, our GRMAC subsidiary and we are only writing in a very narrow handful of states there right now that haven't provided the waiver. So the next possibility you could do there is just think of that as it has got enough capital in it to write 50-state type production for about six to 12 months. So that is another opportunity.

Then, you start getting to, I think, your real question which is what are some of these other structural alternatives. And I will just say that we are in ongoing discussions with our regulators, with the GSEs to consider various alternatives that we could -- really when we -- they're really in confidential and discussion right now, but as we get closer to the point that we can bring back and talk with you about them, we'll be glad to do that. One example could be an alternate use of GRMAC entity and doing something with that structurally.

So all on track, these are good potential structural alternatives for us. But really, I would say where we start with is where with our current waivers we are good shape and be able to continue right in the places we are writing.

The last thing I will just add on to that is when we think about some of these NewCo structures or alternative structures, one of the things they might give us the ability to do is to prevent an avenue to bring in some external capital outside of Genworth in the event that that's the alternative that we needed to be able to write the new business. And it wouldn't be reliant then; at that point, on our own internal capital.

Mark Palmer - *BTIG - Analyst*

Very good. One other question with regard to Moody's. As you mentioned, they extended their review. Could you give us a better sense of where things stand with regard to Moody's? Were they waiting for a release of your strategic plan? Are they holding off until they see what happens with regard to execution in that plan? Just a general sense of where things are.

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

It's Marty. Let me take that one. Obviously with the rating indices it is a different type relationship. So we had the opportunity to give them a lot of detail that is not publicly available. So, spent a lot of time with the agencies, Moody's and S&P, for example, talking to them well in advance of this call about the strategic plan as well as some of the alternatives that we are looking at in U.S. MI that Kevin was just talking about. So they've had a chance to see that.

We do think that if we are making very good headway in the strategic plan and also able to implement a number of these alternatives with regard to the U.S. MI, that it will be very, very helpful to the Moody's process. So we are working very urgently and diligently to move these things along.

Mark Palmer - *BTIG - Analyst*

Thank you.

Operator

Geoffrey Dunn, Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

For Kevin. Can you provide some of the key macro and operational assumptions behind your projection for return to profitability in domestic MI next year?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

Yes, I will -- I hit some macro assumptions as well as just, I guess, point to some of the trends that we are seeing right now and how we feel about those. Back in -- when we gave our expectation that we had a path to profitability back in February, we said we were going to have a burnout of the 2005 to 2008 books.

Well, we are seeing that. We thought we were going to have -- that was all based upon an adequacy of our reserves. We are seeing that. It was based upon eventually the RIF and performance of the new books of business starting to outweigh the bad books of business. And we are seeing that happen today. We are -- the markets that we are seeing for mortgage insurance that is coming back for us to be able to operate and participate in is in excess of what we had expected back in February at that time. Our share levels are generally holding up.

So our -- it's a combination of that improvement in purchase penetration that is creating the bigger mortgage insurance market, the good pricing we have and our share performance is helping us. We said we were going to continue to expect loss mitigation benefits at that point, I think, to the tune about $300 million and $400 million where we are coming through and we are going to be exceeding those targets. So we feel good there.

I think -- when you sort bring it back, all those things, and bring them together, we are just on the glide path towards hitting that profitability as we expected back in February. The last thing I think we said at the time is our overall delinquencies and new delinquencies were going to go down about 20%. We are on track, year to date. It is down 23%. So, all those trends are heading in the right direction.

Getting back to your macro question, we are still expecting we are going to have -- unemployment is not going to change materially from here on out. We are still going to be operating, not much help from the growing employment base. Anything that accelerates that right now from the current level could be a good tailwind for us.

But we are not expecting any material improvement in unemployment. And in fact, we expect to be sort of elevated throughout 2014.

On the HPA basis, we think we have sort of troughed and we've hit the bottom at about a total 20% downturn from the high in the FHFA index. And we will expect that to have slow and gradual growth going forward from here. And we are starting to read more about that and hear about it more in the press today as it materializes out there.

So just directionally, all our trends are really heading in the right direction. We feel good about it. Our -- the new books are about to get to that inflection point when they start to tip over the experience on the old legacy books and we are encouraged by what we are seeing.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

That's all very helpful. Thanks.

Operator

Jeff Schuman, KBW.

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

Can you help me better understand the nature of the Australian regulatory concern? I mean, it seems like if you do an IPO and transfer some of your shares to the public market, that doesn't directly impact the balance sheet or capital of the Australian entity. And in fact, it gives that entity sort of a new avenue to access the capital.

So what is the reason for their pushback on the IPO?

Kevin Schneider - *Genworth Financial, Inc. - SVP, U.S. MI President and CEO*

It is not really a regulator pushback on the IPO. If you just think about our regulatory capital levels that we are holding to, as you saw in the quarter, our MCR levels came down a bit from where they were in the previous quarter. We told you that that was going to happen after our second-quarter call, largely as the result of the elevation of some reinsurance -- affiliate reassurance that we had in the system that was being provided by the U.S. MI business.

So one of the things we are working through is rebuilding and building that NCR back up into a level that we think will be more appropriate in that regulatory environment. And so think of that in the low 140s to high maybe 150 MCR type level. So we are doing that through the continued improvement in our business performance. We are doing it through looking at other ways of managing the capital perhaps by the usage of some reinsurance. And so you have got to -- we are working through those things with the business right now.

They have implications to ultimately the ROE of the business. How much capital you hold is really driving what?s the ROE of that business. What is the ROE of that business over a forecasted period of time that you could disclose when you are doing in some type of public -- some type of IPO type process and that all drives valuation. So at the end of the day it all comes back to valuation, and we just think, as I mentioned earlier, that those valuations will improve as we get deeper into 2013, allowing us to hit a higher valuation and deliver more value to our shareholder.

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

That's very helpful. Thanks, Kevin.

And I was wondering if I could ask about long-term care. That is, I think you mentioned possibly looking at reinsurance, maybe of in-force long-term care. I was wondering if you could comment on market capacity there. I know there are some reinsurers who publicly said they are interested in reinsuring new business, but not so much legacy books.

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

Yes, we certainly have a market and we do reinsure our new business and we are benefiting on our capital plan and our risk management plan from that. With respect to the existing business, I really think that the path to building value is proceeding with the announced rate increases and rating changes, particularly on the older book. Because if you were to look at the reinsurance support, it potentially would be a lot better after we complete those rerating processes rather than before.

So, while right now our existing business plan is looking at the rerating process as a means of mitigating the losses on the older book and thereby improving profitability of the book overall, as we finish that we will, of course, look at reinsurance markets and support and how we are using capital to support that business and as well how to produce the best valuation of the business over time for shareholders.

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

Great. Thanks a lot.

Operator

Suneet Kamath, UBS.

Suneet Kamath - *UBS - Analyst*

Just a question on interest rates. Last week, we saw a couple of companies take some pretty sizable charges related to reducing long-term interest rate assumptions in their DAC models that I guess they are in their reserving. And I know you had a modest adjustment in 3Q, but just curious if you are seeing any pressure in terms of having to take an action like we have seen in some other companies at some point down the road if rates remain low and if there is any way you could help dimension sizes of that potential action. Thanks.

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

This is Pat. I'll take that. The characteristics of our portfolio are important here. If you look at our life insurance business overall, our total liabilities on UL products are only in the neighborhood of around $7 billion. A relatively -- relative to a much larger and general account balance with reserves on FAS 60 type products like long-term care and also like term life insurance.

And when you look at the secondary guarantee universal life portfolio where you would probably be most concerned about that, those reserves are only 7% of our total UL reserves. So we did take a close look at our emerging yields. They are actually consistent with prior periods. So, while there is exposure to low interest rates, we haven't really seen that impacting our core yields to date.

We did make some changes in assumptions, making the projected interest rates for reserving purposes more conservative and that is what resulted in the change. But that is why perhaps it is different for us than you have seen, for some other companies in the space with much larger UL portfolios.

Suneet Kamath - *UBS - Analyst*

So it you are not anticipating anything if rates stay low, I guess over the next year or so in terms of the --?

Pat Kelleher - *Genworth Financial, Inc. - President and CEO - Insurance and Wealth Management*

If rates stay low and consistent with our forward-looking assumptions, we think we'll be fine. If rates stay low and get worse than those assumptions, then we will reevaluate every quarter. But again, that is a relatively small proportion of our overall portfolio from a reserving perspective.

Suneet Kamath - *UBS - Analyst*

Thanks.

Marty Klein - *Genworth Financial, Inc. - Acting CEO and CFO*

And I would just add that as I mentioned in the script that we do expect next year and year after rates -- and really for us more important is our investment yields stay at the current levels that we would expect, maybe $0.01 or $0.02 of pressure over the next year or two. Some of that over the course of, really, we are seeing a bit of it this year and next year really comes from what is happening in Australia which is largely a floating-rate market. So as rates there have dropped really about 1.25% roughly now from where they were at the beginning of the year, that sort of changed some of that forecast.

That chart that we sent out in February so just relate, though, $0.01 or $0.02 to that chart. And what we can do in the fourth quarter is really provide an updated view of where we are at that point in time going forward.

Suneet Kamath - *UBS - Analyst*

Thank you.

Operator

That does conclude Genworth's financials third-quarter earnings conference call. Thank you for your participation. At this time, this will end the call.