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GNW - Q3 2013 Genworth Financial, Inc. Earnings Conference Call

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GNW reported 3Q13 net income of $108m.

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PRESENTATION

Operator

Good morning, Ladies and Gentlemen, and welcome to the Genworth Financial Third-Quarter 2013 Earnings Conference Call. My name is Ashley, and I'll be your coordinator today.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. Also, we ask that you refrain from using cell phones, speaker phones, and headsets during the Q&A portion of today's call. I would now like to turn the presentation over to Georgette Nicholas, Senior Vice President of Investor Relations. Ms. Nicholas, you may begin.

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

Thank you, Operator, and good morning, everyone. Thank you for joining us for Genworth's third-quarter 2013 earnings call. Our press release and financial supplement were released last evening, and this morning our third-quarter earnings summary presentation was posted to our website. We encourage you to review all of these materials. Today, you will hear from our President and Chief Executive Officer, Tom McInerney; followed by Marty Klein, our Chief Financial Officer.

Following our prepared comments, we will open the call up for a question-and-answer period. In addition to our speakers, Pat Kelleher, President and CEO of our US life insurance division; Kevin Schneider, President and CEO of our global mortgage insurance division; Jerome Upton, Chief Financial Officer of our global mortgage insurance division; and Dan Sheehan, Chief Investment Officer 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 of our most recent Annual Report on Form 10-K and our Form 10-Qs as filed with the SEC. This morning's discussion also includes non-GAAP financial measures that we believe may be meaningful to investors.

In our financial supplement, earnings release and investor materials, non-GAAP measures have been reconciled to GAAP where required, in accordance with SEC rules. Also, when we talk about international protection and international mortgage insurance results, please note that all percentage changes exclude the impact of foreign exchange. And finally, references to statutory results are estimates for the quarter, due to the timing of the filing of the statutory statements. And now, I'll turn the call over to our CEO, Tom McInerney.

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Thanks, Georgette, and good morning, everyone. Thank you for joining us today for our third-quarter earnings call. Today, I would like to cover three areas. First, briefly discuss my view of the third-quarter earnings. Second, provide an update on our four-month review of our long-term care insurance business, and then wrap up with a few of the key milestones achieved this quarter.

We are implementing significant changes in our core businesses, and making progress on our four strategic priorities to improve shareholder value. To remind you, the four priorities are to improve the operating performance of the businesses; simplify the portfolio; generate capital; and increase the financial strength and flexibility of the Company. Before I get into my main topics for today, though, I wanted to make a few comments about Pat Kelleher, who we announced would be leaving the Company at the end of the year.

On behalf of the Board of Directors, our senior leadership team, and all Genworth employees, I would like to thank Pat for his years of dedication to Genworth and the many contributions he has made to our Company during his tenure here. Under Pat's leadership as CFO during the financial crisis, and more recently as Chief Executive Officer of the US Life Insurance Division, Genworth has made progress building financial flexibility, including the payment of an ordinary dividend from our life companies for the first time since 2008, improving capital ratios, and repositioning the long-term care insurance business.

As a result of the many contributions that Pat has made over the years, this is a good time to pass the baton to a new leader who can build on Pat's achievements to expand the business and focus on strengthening distribution and operations. Pat is here today, and will be available to respond to questions during the call. I will work closely with Pat to ensure a smooth transition of responsibilities, and will serve as Interim CEO of the US Life Division as a search is conducted for his replacement. We wish Pat all the best for the future.

Now let's look at Genworth's third-quarter results. Results in the third quarter of 2013 were solid, as we reported operating income of $119 million. Operating income was negatively impacted by two charges in the corporate segment, totaling $40 million, or $0.08 of earnings per share, relating to the make-whole expenses paid on the redemption of our 2015 debt in September and a deferred tax reversal related to expired or cancelled employee stock options. Those charges were partially offset by approximately $17 million of favorable adjustments in our US life business.

International mortgage insurance continues to have solid performance in Canada and Australia, with low loss ratios. However, our European mortgage insurance business was pressured again this quarter from delinquency development, primarily in Ireland. In US mortgage insurance, as we expected, seasonality increased new delinquencies and reduced cures, which resulted in a marginal net loss for the quarter, but we did see profitable growth in new business written. We continue to project that USMI is on a path to be modestly profitable in 2013, and we expect that its 2014 results will improve significantly over 2013.

The US Life Insurance Division's operating profit in the third quarter was up compared to the prior year, and benefited from favorable unlocking and other adjustments in the life product lines. And our long-term care insurance earnings are beginning to improve as a result of the premium rate increases we are achieving. Sales in the life insurance business were flat sequentially, as the business is transitioning to new term and universal life insurance product offerings.

We expect life sales will increase over time as we move to more permanent life insurance and hybrid product offerings. Long-term care insurance sales were modestly lower sequentially, given our changes in the retail channel and introduction of higher-priced products in more states. We would expect long-term care sales to trend down in the near term, given these changes, until the new product is established in the market and we expand our distribution reach.

We also will be looking at opportunities to increase consumer awareness of long-term care needs, and over time this could expand the demand for long-term care products. We would expect sales in our US Life Division to be two-thirds long-term care insurance and one-third life insurance in the near term. Over time, we would expect to achieve a more balanced mix of life and long-term care sales as our new products take hold in the market.

Let me now turn to other aspects of our long-term care insurance business. As the undisputed leader in the long-term care insurance industry, I am increasingly confident that there can be a significant opportunity for Genworth in the private market for long-term care insurance. Most consumers remain unaware that Medicare does not generally cover long-term care needs. And while Medicaid does cover long-term care, coverage does not begin until consumers have nearly exhausted their assets.

Today, 25% to 50% of state Medicaid budgets are already allocated to paying for long-term care for individuals. With the looming challenge of the 76 million baby boomers retiring at a pace of 10,000 per day, government entitlement programs will become even more strained than they are today.

When I joined Genworth in January, I was focused on understanding the long-term care business and how it could be managed to take advantage of the opportunity before us. As we implemented our three-part strategy in long-term care, we began an intensive, very broad and deep review of all aspects of long-term care insurance business about 4 months ago.

As a reminder, Genworth's three-part strategy for long-term care is one, obtaining significant premium rate increases on the older generation of LTC blocks written before 2002 to begin to bring them closer to a breakeven point over time and reduce the strain on earnings and capital. Two, requesting smaller rate increases more proactively on newer blocks as needed, to bring them back to original pricing. And three, introducing new products that are more tightly underwritten, with appropriate price benefits, using more conservative assumptions.

In our review of the long-term care business, we have been considering all important aspects and how we are managing the business. The first area of focus for us was our reserving. Here we have been assessing our long-term care reserves under both GAAP and statutory reporting, and determining whether to make any changes. We then moved into the area of in-force actions. We reviewed our internal processes so we're able to initiate smaller rate actions more proactively.

Another area for review was our use of captives and reinsurance. We are assessing our use of captives and reinsurance to ensure prudent risk management and capital management, and provide increased transparency to investors. As we already disclosed in our second-quarter call, if we were to repatriate the LTC business, it would have a minimal impact on the US life company RBC ratios.

New products and their design is another key area. We are developing a product with a much-improved risk profile that has only a marginal interest rate risk and lapse risk, and with significantly less morbidity risk. Given our strategy and product changes, distribution is also a focus. We are reviewing our retail channel positioning and our new product distribution strategy.

And finally, we have been determining how to provide more information to our investors on our long-term care balance sheet and the corresponding assumptions, as well as information to better assess the performance in earnings of the business. We have reaffirmed our commitment to our three-part long-term care insurance strategy, and here are some preliminary conclusions and observations from the review of our long-term care insurance business.

First, as a result of our in-force actions review, we recently began filing 6% to 13% rate increases on long-term care products issued beginning in 2003 and written through 2012. Current premiums on these policies are in the range of $800 million.

These policies are still profitable, but there is a need for more moderate rate increases to bring them back to the original pricing assumptions and to potentially avoid the need for much larger rate increases in the future. We believe this is the right approach for both consumers and regulators.

With this aspect of rate increases, we are asking the regulators to reconsider how they look at approving rate actions, by focusing on the projected loss ratio versus the actual loss ratio based upon experience at the time of filing. Given this new approach, we are cautious about providing an outlook on the impact these rate increases will have on the business. We will provide updates on these rate requests as more information is available.

Also, the premium rate increase approvals on the three older generations or series of products, written from 1974 through 2001, and on one series of newer generation policies, written from 2001 through 2007, continue to be achieved. As of September 30, we have received approvals representing $155 million to $160 million of annual premium increases from 31 states, versus the targeted per annum premium increase of $200 million to $300 million expected when fully implemented.

We are seeing approximately 83% of our policyholders deciding to pay the approved rate increases, approximately 12% deciding to pay their current premium amounts and take reduced benefits, and 5% accepting the non-forfeiture option. All those policyholders who have paid premiums on policies will receive at least the non-forfeiture benefit. We believe the high acceptance of the full-rate increase illustrates the continued value of the product to these policyholders.

With respect to the new product review, our new flex 2.5 long-term care insurance product is expected to be filed in November. Based on the conservative assumptions on lapses, interest rates, and morbidity, we believe returns will be well north of 15% on the flex 2.5 product line, with an improved risk profile.

Regarding distribution, we will be refocusing our efforts to increase the size of long-term care market through consumer education, expansion of current distribution, and establishment of new distribution channels. Finally, after an extensive review, we are even more confident that GAAP and stat reserves are adequate, with a comfortable margin for future deterioration.

We understand some analysts and investors have suggested we may need to take a significant reserve charge. This perspective seems to be primarily based on charges other long-term care insurers have taken. I want to point out four significant differences between Genworth and some of the companies that have taken charges.

One, we have $1.4 billion in after-tax hedge gains that reside in accumulated other comprehensive income on the balance sheet, and this amount will be amortized into income over time. Genworth hedged interest rates starting in 2000. The $1.4 billion contributes margin to our long-term care reserves.

Number two, Genworth is achieving significant premium rate increases on the older policies, to bring the policies closer to breakeven. And the per annum increases on these policies also add significant margin on our reserve testing. Three, Genworth has written a significant amount of new business over the last several years, with better underwriting and higher prices, and profits from newer blocks of business more than offset losses or low returns on the older blocks.

And finally, over the years, Genworth has implemented tighter underwriting standards, which has benefited our risk profile. All these actions, and our new strategic approach, put us in a position to take advantage of the opportunity in long-term care insurance. We plan to provide more details regarding our long-term care business at an investor update on a special conference call in December. The presentation will cover the details and analysis of long-term care balance sheet, including our GAAP and stat reserve review.

Let me now turn to the progress made on other strategic objectives and goals. First, the sale of the wealth management business closed in the third quarter, with proceeds and other cash on hand now dedicated to paying down the 2014 debt maturity. Second, we issued $400 million in new debt and redeemed the outstanding 2015 maturities in September. As a result, we have addressed all our debt maturities until December 2016.

Third, we entered into a new three-year credit facility of $300 million, which will allow us to reduce the amount of cash we need to maintain at the holding company. Fourth, we are on track for achieving our 2013 subsidiary dividend goals, with payment of dividends to the holding company totaling approximately $330 million year-to-date, including $100 million from the US life companies and $173 million from international mortgage insurance.

Finally, as you know, we have an important strategic priority to execute an IPO of up to 40% of the Australia mortgage insurance business, subject to market conditions, valuation considerations, including business performance in Australia, and regulatory approvals. The planned IPO of Australia has several strategic benefits.

The IPO will allow us to reduce risk and re-balance capital among the three major mortgage insurance platforms. Because Australia has a narrower economy than the US, it has a significant amount of exposure to mining and commodities, and has exposure to a potential slowing of growth in China. As a result, we believe it is prudent to modestly reduce our exposure to the Australian economy.

In addition, in Australia, there is a concentration among a small group of banks that write most of the mortgages. We have contracts with the banks, which are renegotiated on an ongoing basis. However, in connection with the implementation in Australia of the bank capital standards introduced by the Basal Committee, large banks in Australia continue to evaluate the utilization of lender's mortgage insurance, which could impact both the size of the private mortgage insurance market and our share of that market. The outcome of these issues with the large banks could impact how successful an IPO of our Australian mortgage insurance business is.

While the actions of the banks from the new capital standards will develop over time, we believe there will be more clarity on their impact in the coming months, and so we believe it is more likely that there will be better execution opportunities in 2014. Our capital and liquidity plans have not, and do not, depend on the execution of an Australian IPO, and given the financial flexibility we have created at the holding company this year, we have the choice of executing the IPO when it makes the most sense for shareholders.

We feel we've made headway on our turnaround. As we continue to focus on long-term care insurance, and the positive role it can have for Genworth, we expect to have a call devoted to long-term care in early December, where we can demonstrate our views on a quantitative basis so our investors can assess for themselves the adequacy of our reserves and outlook.

In February, in conjunction with the release of our fourth-quarter results, we would expect to provide you with our 2014 goals across Genworth. And now, I will turn the call over to Marty to talk about the quarter results in more detail.

Marty Klein - *Genworth Holdings Inc - CFO*

Thanks, Tom, and good morning, everyone. Today, I'll provide an overview of results for the quarter and discuss some early perspectives on our 2014 outlook. Let's begin with third-quarter results. We reported operating income of $119 million for the quarter and net income of $108 million.

In global mortgage insurance, reported net operating income was $87 million, down $15 million from the prior quarter and up $30 million over the prior year. Let's cover Canada results first, where operating earnings were $41 million for the quarter. Unemployment in Canada at the end of September was 6.9%, down from 7.1% in the prior quarter, and there was a modest sequential increase in home prices.

Premiums were down slightly from the maturing of the larger 2007 and 2008 books of business. Flow NIW in the quarter was up 30% sequentially, with a seasonal larger origination market and stable MI penetration. NIW is lower than last year, given the changes in eligibility rules for government-guaranteed mortgages.

We completed several bulk transactions in the quarter of approximately $3.9 billion. The loss ratio of 22% improved by 3 points sequentially, and by 8 points from the prior year, from a favorable shift in the geographic mix of delinquencies, resulting in lower severities.

For Australia, operating earnings were $61 million. Unemployment in Australia fell slightly to 5.6%, and home prices rose modestly from the prior quarter. Unfavorable foreign exchange impacted the business by approximately $7 million versus the prior quarter and $8 million versus the prior year. Excluding the impact of foreign exchange, premiums were up from the prior year, as the larger, more recent books mature and more premium is recognized.

The continued low interest rate environment helped keep the origination market in line with the prior quarter, with flow NIW up modestly. The loss ratio for the quarter decreased to 31%, down 4 points sequentially and 16 points year over year. The year-to-date loss ratio was 38%, slightly below the low end of our expected range of 40% to 50%. Regarding other countries in the international mortgage insurance segment, the operating loss was up sequentially to $12 million, primarily from higher losses in Ireland.

Moving to USMI, the business had a quarter in line with our expectations, with a net operating loss of $3 million. We are seeing strong NIW growth over the prior year from an increase in refinance, although that is slowing, as well as from purchased private MI penetration and stable market share.

Our total flow delinquencies fell by 24% from the prior year, with new delinquencies up 8% sequentially from normal seasonal variation and down 19% year over year, reflecting the continued burn-through of the 2005 to 2008 books, as well as the new, better performing books becoming a larger portion of the overall portfolio, now at 41% of risk in force. Year-to-date loss mitigation savings are at $439 million, well above our full-year target of $250 million to $350 million, as flow modifications remain strong.

Turning to capital in the division, the MCT in Canada was approximately 218% compared to our minimum target of 190%. In addition to paying an ordinary dividend in the quarter, the business generated proceeds to us related to its share repurchase program, in which Genworth Financial participated to maintain our ownership in 57.4%. The business continues to evaluate opportunities to optimize capital.

For Australia, the prescribed capital amount, or PCA, was 135%, in line with our target and above regulatory requirements. In USMI, at quarter end, the combined risk-to-capital ratio was approximately 22.4 to 1, and the risk to capital for GMICO was approximately 23.2 to 1. GMICO's risk to capital improved from the prior quarter, reflecting positive statutory earnings and a higher valuation of certain assets. We expect risk to capital to decline during 2014 as the business results continue to improve.

In June, the FHFA announced strategic priorities for the GSEs, and indicated there could be changes to the GSE eligibility standards. These changes could increase capital or asset requirements for mortgage insurers, although the details and timing of the standards have yet to be released. We believe the opportunities in the private MI market in the US are very attractive, and depending on the specific GSE requirements, there are a number of ways we could meet them.

We've made significant improvements in our financial flexibility, and we believe that we have several options to provide capital, if desired, to meet the potential new GSE requirements. We continue to evaluate these options, which include organic growth in earnings of the business and the potential utilization of part of the over $900 million of deferred tax assets; reinsurance; proceeds from the Australia IPO, should we execute it; convertibles; and debt, among other options to raise capital.

Turning to the US Life Insurance Division, operating earnings were $111 million. Earnings in life insurance were $54 million for the quarter. During the quarter, we reported adjustments and a correction, which, when taken together, favorably impacted results by $17 million.

Sales were flat sequentially, and down significantly year over year, as sales in our new products are not yet at levels previously seen in our term UL product, which was discontinued in the fourth quarter of last year. An important priority for the business is refining and developing life products in order to increase sales levels, while still meeting our return threshold.

Long-term care earnings of $41 million were up from $26 million in the prior quarter. Results this quarter reflected higher premiums and reduced benefits from the in-force rate actions, benefiting by $26 million versus last year and $14 million versus the prior quarter. The reported loss ratio for the quarter was approximately 64%, down from 67% in the prior quarter and up from 63% in the prior year.

The refinements we had in the current quarter impacted the loss ratio favorably by 1 point, while the reserve adjustments in the prior year impacted the loss ratio favorably by 7 points. With the same current quarter refinement, the new generation product loss ratio improved 3 points from the prior quarter to 52%, while the old generation product loss ratio was 4 points higher for the quarter to 99%.

Individual long-term care sales were down sequentially. Sales were expected to trend down in the near term, as we no longer sell AARP-branded products, and as we have introduced higher-priced products in most states. We are making good progress on the recently initiated in-force rate actions, with approvals representing approximately $155 million to $160 million, against the total anticipated annual premium increase of $200 million to $300 million when fully implemented.

We have seen an incremental $22 million of premium year to date from this rate action, compared to our full-year expectation of $20 million to $30 million in additional premiums.

Fixed-annuity earnings were $16 million, which is more in line with our expectations for the business in the near term, as earnings in prior quarters reflected higher bond calls and prepayments.

SPIA mortality was unfavorable compared to the prior quarter, and the favorable bond call and limited partnership performance we saw in prior quarters did not recur. Sales were up from the second quarter from both the rise in interest rates and pricing changes, while still meeting or exceeding targeted return thresholds.

The risk-based capital ratio for the US life companies was up slightly during the quarter, to an estimated 450%. Unassigned surplus was approximately $260 million, up from the prior quarter, primarily from positive in-force earnings and the recapture of a reinsurance treaty related to fixed annuities, partially offset by new business funding and realized investment losses.

Shifting to the corporate and other division, the net operating loss for the quarter was $79 million. International protection earnings were $4 million for the quarter. The business continues to refocus its footprint in Europe, centered on key clients. It also has continued to take expense actions, which helped results sequentially.

The runoff segment experienced more favorable equity markets and taxes versus the prior quarter and prior year, driving earnings to $25 million. In corporate and other activities, we had a $20 million make-whole expense from the previously announced redemption of our 2015 notes. Additionally, we had a $20-million non-deductible stock compensation expense as a result of cancellations. Approximately $2 million of the tax expense related to the current period, with the remainder representing a correction from prior quarters this year and in 2012.

Turning to investments, the global portfolio core yield was flat at 4.5%, while total impairments of $3 million net of tax were low. An increase in interest rates from the depressed levels we've seen is a positive for us, as it is for most other insurers, but the rising rates did decrease the earnings impact from prepayment speeds on structured securities.

Let me now cover some topics at the holding company, where we took several steps to improve our financial flexibility this quarter. We've entered into a three-year, $300-million multi-currency revolving credit facility, with a $100-million sub-limit for letters of credit. The credit facility is a source of contingent liquidity for us, and we do not expect to draw upon it.

We continue to generate and maintain significant liquidity, with cash and liquid assets of approximately $1.3 billion at the holding company. During the quarter, we achieved an important milestone by closing the sale of the wealth management business. The net proceeds from the sale, along with cash already held in the holding company, will be used to address the remaining $485 million of 2014 debt maturity.

Also this quarter, we issued $400 million of 10-year senior notes, with a coupon of 4.90%, and used a majority of the proceeds to redeem our 2015 debt maturity. With the redemption of our 2015 debt, and by setting aside cash at the holding company for our remaining 2014 debt, we have addressed all of our debt maturities until December of 2016.

With the work done to address near-term debt maturities, and with the credit facility in place, we are adjusting our cash and liquid assets target from 2 times to 1.5 times debt service. And we will continue to hold the buffer of another $350 million for stress scenarios. After deducting for the $485 million being held at the holding company for the 2014 debt maturity, we hold approximately $830 million of cash and liquid assets, modestly above our updated target. We anticipate maintaining cash and liquid assets in excess of this new target.

I now want to provide some perspectives on our goodwill testing, which we perform at least annually and which we completed at the end of the third quarter. As of the end of the quarter, we had goodwill of $867 million, mostly in the US life insurance division. The life insurance business had a goodwill balance of $495 million, and the long-term care business had a goodwill balance of $354 million.

The results of our goodwill testing did not result in impairment of any goodwill balances. In our goodwill testing for the long-term care business, the in-force estimated value does not contribute significant value to support goodwill. This means that goodwill for long-term care must be supported primarily from the valuation of new business. Therefore, the key assumptions impacting our evaluation of long-term care goodwill relate primarily to how we value new business and to the discount rate used.

I'll now discuss each of these two drivers. The valuation of new business is determined by utilizing several inputs, such as expected new business production, as well as the expected profitability of the new business, which primarily depends on mortality, lapse, and morbidity assumptions, expected investment returns, and targeted capital levels. We assume 10 years of new business production, which is based on our experience with actuarial appraisals for life insurance businesses and consistent with industry practice.

Regarding the discount rate, as part of the deep long-term care review that Tom discussed, this year we decided to change the discount rate from 11% to 14%, which we believe is appropriate, given our views on the market cost of capital for the product, given its duration and perceived risk profile. Given that goodwill for LTC is essentially supported by the value of new business, significant changes in production levels or in a discount rate, could result in a future impairment of goodwill.

To give you a sense of the impacts of these two drivers on goodwill margin, a 21% discount rate would push the margin to the breakeven point, while sales levels at about 65% of the projected level would push the margin to the breakeven point.

Let's now turn to goodwill for our life insurance business. In our goodwill assessment of our life insurance business, we used a discount rate of 10%, given that life insurance is a more stable business with a more predictable set of cash flows than is true for long-term care.

Based on our annual goodwill impairment testing, the estimated fair value of the life business exceeded its book value by approximately 15%, including a goodwill balance of $495 million. Since the life insurance business has an estimated fair value that is relatively close to the book value, this means that modest decreases to our estimates for in-force value or for the value of new business could impact goodwill levels, and therefore are closely monitored.

Shifting now to our 2013 goals, we remain on track to achieve or exceed them, particularly regarding our dividend, capital, and liquidity targets, as detailed in the earnings slides we released this morning. As we head into the final quarter of the year, I'd like to provide some early and preliminary perspectives on our expectations for our businesses in 2014. These expectations assume that continued slow recovery in the US economy and housing markets, continuing challenged economies in Europe, and generally stable economies and housing markets in Canada and Australia.

In the US Life Insurance Division, we currently expect GAAP earnings to be higher than in 2013 by approximately 10% to 15%. The growth in earnings for the division should come primarily in long-term care, as the rate actions begin to more significantly reduce the losses and lower terms in the older books of business. And we expect earnings in that business for 2014 to be much improved over 2013.

Life insurance earnings should be in the same range as 2013, after adjusting for the favorable net adjustments we saw this third quarter, and will fluctuate with mortality experience, while fixed-annuity results may decline modestly from overall 2013 levels, as we expect lower benefits from bond prepayments. In Global Mortgage Insurance, we also expect improved GAAP earnings in 2014 over 2013. USMI should be the driver of this growth, with earnings significantly better than in 2013.

Adjusting for the impact of foreign exchange, earnings in our international mortgage insurance segment are expected to be lower than 2013 by about 10% to 15%. In both Australia and Canada, we expect continued solid loss performance, but earnings are expected to be pressured by lower US tax benefits and lower earned premiums in Canada from the smaller, more recent books. Finally, we expect results in other countries to be consistent with 2013 results.

Moving to businesses in our corporate and other division, we expect international protection earnings to be at levels comparable to the last couple of quarters, as the business works through a continued slow European economy. Finally, our runoff business will depend on the strength and direction of the US equity and credit markets. Against this overall expected continued improvement in Genworth earnings, we expect to maintain ample liquidity at the holding company, in line with our updated targets.

Longer term, we would seek to be able to return capital to shareholders, such as to re-instituting a dividend, but we first need to make further headway in improving financial strength and flexibility, as well as in dividend flows from our operating businesses, particularly the US Life Insurance Division. We'll provide an update and more details on our 2014 perspectives on our fourth-quarter call in February.

Let me wrap up. We continue to make good headway in executing our strategy and achieving our 2013 goals, and expect to see continued improvement in our results next year. But we have much work ahead of us to achieve those results, deliver on our strategic plan, and rebuild shareholder value. With that, I'd like to turn it over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is from Sean Dargan of Macquarie. Your line is open.

Sean Dargan - *Macquarie Research - Analyst*

Thank you, and good morning. My first question is around USMI. I realize that the third quarter results were within your expectations, but I think some investors looked at what MGIC did last week. They experienced favorable development and released reserves.

I think you are thought of as having conservative reserve assumptions. Can you maybe just tell us what you're seeing, and why maybe you did not release reserves? And maybe what your expectations of new delinquencies going to claim is, and whether that's changed?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes. Glad to, Sean, this is Kevin. Good morning. We continue to evaluate our reserve adequacy every single quarter, reviewing both our cure and our claim performance relative to our existing reserve factors.

We further get our own views of it supplemented by some third party inputs. And really the results of our Third Quarter basically came back that we were -- our loss experience, both on cures and claims, is generally in line with our overall reserve factors, so we feel good about that. One could call that conservative, but we feel good about it.

What we are seeing is some improvement in the emerging frequency indications. Really it's particularly related to new delinquencies over the past couple of quarters, but I -- at this point, I think we need to see a little bit more experience before we make any changes in that.

Where -- we -- if you think about our role rates or our frequency assumptions from a reserve standpoint, we're generally, you could say, between one and four or one and five loans going to claim. And I would see that come down over time, as we continue to see the reduction in new delinquencies going forward, the burn off of the older books, the new books which are very profitable and aren't throwing off a lot of new delinquencies.

So as that trend continues forward, and we see those cure rates start to come in, and hopefully with continued support from the economy, I think we would see more -- give us more confidence in terms of our ability to release some reserves going forward. Historically, we probably operated at sort of 50% of those role rate assumption levels. So we get back into a normal economy, we get back and through these old books of business, and I think that's the type of opportunity that's available for us going forward.

Sean Dargan - *Macquarie Research - Analyst*

Thank you. And just to switch gears, I have a question about the timing of long term care reserve analysis. So you're going to have a call in early December, and in Fourth Quarter results, we'll see the results of your review of best estimates from a GAAP reserve standpoint? And will we have the results of your statutory cash flow testing at Fourth Quarter results?

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Sean, it's Tom. Good question. We have largely completed our review, and what we would expect to do in that December call is to give you much more detail around how we do our GAAP reserve testing. The assumptions, best estimates and also a detailed review of our statutory reserves and how we do the cash flow testing, what the assumptions are. But we'll also give investors, analysts, some sensitivity to the key drivers of long term care, which are -- were interest rates, lapse rates and morbidity factors.

So I think it's going to be a complete overall review of the balance sheet and the reserves. In addition to that, we'll walk you through the new product and what its assumptions are, and why we think it's well designed product, both from a consumer perspective as well as from our perspective. So it will be a fairly broad, deep review of the long term care business. I think Marty wants to make a few comments as well.

Marty Klein - *Genworth Holdings Inc - CFO*

Sean, the only thing I'd add to Tom's comments are, we did do, as we do every quarter, but particularly the third quarter, we did do a deep dive on loss recognition for GAAP reporting. We also did our annual goodwill testing, as I talked about in my remarks.

So as of the Third Quarter, we're comfortable with those margins, as Tom said. Also, with respect to statutory, while cash flow testing for regulatory purposes is an annual exercise, as of year-end, we have is we've done this deep review. Looked at it in much more recent time frame, as of June 30, and again, we'll go through those details in our December call.

Sean Dargan - *Macquarie Research - Analyst*

Thank you.

Operator

Thank you. Our next question is from Geoffrey Dunn of Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Thank you. I've got a couple, and then Ryan has one on the Life side. Just to be clear, so your new incidents provision on domestic MI, you said, is 1 in 4 to 1 in 5. Do you think that the longer term is more like 1 in 7, like one of your competitors has said? Or closer to 1 in 10, like another competitor had indicated?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

I'll just go back to what I said, Geoff. I think ultimately, we'll get back to more historical run rate on this, and it's about half of where we are today. So whether that's 7, 8, or 10, it's going to be in that range, I would say, between those two. And I can't give you more specificity on it.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, and then Australia, you continue to see positive development on the delinquency inventory there. Can you provide a little bit more color on what is occurring, and what is that shake up from Queensland? Or if there's anything lost there versus underlying core economic improvement?

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Yes, I think in the quarter, we saw our losses and our loss ratios continue down. You got a low interest rate environment down there that's continuing to support the housing market. I -- you've got the 2007 and 2008 books that are continuing to season. We're getting those behind us. We're getting -- we've essentially moved through all of the build up that we had in 2012 in a claims pipeline, so that's behind us.

So our claims on hand are very low. The quality and performance of the books since 2008 has really been very, very solid. Like in the other markets, when we went and made the same type changes. We're getting the full benefit -- or we will be, going forward, start to get the overall benefit of the price increase that we implemented this year. That's fully implemented now, and we should see that on all of our business going forward. So the market is holding up pretty well. Unemployment is stable, in the high five range. That could drift up a little bit on us, and so we're cognizant of that.

Overall, even with the concerns in China, mining has been holding up relatively well. What we have seen is some reduction in future capital investments for mining. But the mining pricing and the export levels are holding up nicely. And we're just seeing recovery generally across all of the regions. A little less quickly coming out of Queensland, but in all of the other regions down there, we're seeing across-the-board reduction in our delinquency. So I think going forward, my view is, we're going to continue to have solid loss performance in the near term, certainly in line with our pricing expectation.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, and then Ryan has been on the life side.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

Thanks, it's Ryan. I had a question about the 10% to 15% growth outlook in US life earnings in 2014. Should I -- is that going to be -- is that based on the reported GAAP expectation for 2013? Or should I be applying that growth rate excluding the life items this quarter?

Marty Klein - *Genworth Holdings Inc - CFO*

Let me just kick -- I think that our expectations for 2014 at 10% to15% increase is kind of the increase over we expect to land for the full year 2013. In the life insurance line of business itself, there were a number of items impacting this quarter. So if you -- I would recommend excluding that, as you think about 2014 versus 2013.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

Okay, thanks. And then within that outlook, how much of the long term care premium increases would you expect to flow through the 2014 results?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of US Life Insurance*

This is Pat. I'll take that. In the third quarter, we did see the impact of the most recent rate actions on the older books increase by about $14 million versus prior quarter to about $26 million overall.

And I'd say this is the result of the implementation of rate increase approvals that we've seen ramp up over the last several months. So as we continue to implement the rate actions, we do expect this earnings impact in 2014 to continue to build from the current level around $26 million in the current quarter, but at a more moderate pace.

And this is a significant driver in the US Life Division's expected earnings improvements, a range of 10% to 15% overall for 2014. I would say that, that said, that the earnings impact is going to depend on the level and speed of additional regulatory approvals, as well as a mix of policy holders electing premium increases versus reduced benefits. And we'll provide more details on this outlook in our Fourth Quarter call.

Ryan Krueger - *Dowling & Partners Securities - Analyst*

Okay, thank you.

Operator

Thank you. Our next question is from Joanne Smith of Scotia Capital.

Joanne Smith - *Scotia Capital - Analyst*

Yes, good morning. I just wanted to go to the Canadian MI business for a minute. The loss ratio was quite low in that business. And I know that, historically, its been somewhere in the mid 30s. And I'm wondering how sustainable you think that the current loss ratios are?

And I understand that, in the initial comments that you made, that you're expecting somewhat of a decline in earnings next year. But I'm trying to figure out if the historical level of around mid 30s is where we should be looking for it to go over time, or is it going to be said aloud at something lower than that? And then I have a follow-up.

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Okay, Joanne, this is Kevin. I -- you've got a lot -- some of the similar type behavior going on in Canada that we've seen in Australia. And again, it's the old book seasoning through the profitability of a new book, so we're very encouraged with the level of the loss ratios we've seen.

I think you've got a great question, is it sustainable? And I think some of the biggest drivers we're seeing right now has really been in the recent experience attributable to fewer reported delinquencies coming out of Alberta, in the 2007 and 2008 books in Alberta. The severity on those claims has typically been higher than the experience across the rest of the country. And as those come down, it's really helped drive down the loss ratio in the recent couple of quarters.

Overall, I think, again, we're going to have solid loss performance in Canada going forward. Traditionally, you're right. We've been -- I think we guided you this year to 35% to 40% loss ratio range. I would expect us to be under that, finishing out the year. A little bit of pressure from some fourth-quarter seasonality, but we should be below that range as we exit 2013.

And I think we should be well within our pricing going forward. Whether it's below that or not, we'll try and give you some more color on that again at our update of the fourth quarter call.

Joanne Smith - *Scotia Capital - Analyst*

Great, thanks very much, Kevin. And also on -- just for Marty or Tom. You've met a lot of your milestones this year, in terms of the life company dividends, in terms of your leverage ratio, in terms of the USMI business, et cetera. I'm wondering -- maybe I'm getting a little bit ahead of myself, but I'm wondering when we can start thinking about reinstatement of the dividend.

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Hey, Joanne. This is Tom. I would say that we're pleased with the milestones that we've achieved. We have a lot more to do. And as we said, I think we still have a priority, Marty and I, to look at the leverage and also the fixed charge coverage ratio, which is important.

And we like to see improvement there. As we continue to make progress in the turnaround, we'll look for -- in generating more capital, we'll look for opportunities to return capital to shareholders, including reinstating the dividend and/or share buybacks over time.

Joanne Smith - *Scotia Capital - Analyst*

Okay, thanks.

Operator

(Operator Instructions)

Our next question comes from Ed Shields of Sandler O'Neill. Your line is open.

Ed Shields - *Sandler O'Neill & Partners - Analyst*

Good morning, everybody. I think this is a question for Pat. Annuity deposits were rather strong in the quarter at around $714 million. I guess I'm trying to get at how much was due to the opportunistic performance with the interest rate environment in the quarter, and how much was due to gaining traction in the fixed index annuities? I'm just trying to get a sense of what may continue out of the deposit growth in the quarter, and what will drop off?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of US Life Insurance*

Yes, thanks for the question, Sean. I would say it's a combination of both. We did see that with interest rates and yields up in the quarter. We saw good opportunities on traditional fixed annuities to increase sales while maintaining margins.

We also saw that, over the course of the quarter, we continue to make further traction on sales of fixed index annuities. That's becoming a more important, I think in the range of about 30% of the fixed annuity sales overall. So looking at it all-in from a mix of products sold and from a margin perspective, we feel good about the sales in the third quarter and the momentum, as well, into the fourth quarter.

Ed Shields - *Sandler O'Neill & Partners - Analyst*

Okay, great, thank you.

Operator

Thank you. Our next question comes from Suneet Kamath of UBS.

Suneet Kamath - *UBS - Analyst*

Thanks, and good morning. Had a couple questions about the long term care business. Just in terms of the price -- the impact of the price increases, does that pretty much fall to the bottom line right away, once they actually start to collect the premium?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of US Life Insurance*

This is Pat. I'll take that. Following from the observations that both Tom and Marty made in their prepared remarks, as we look at our reserve adequacy testing and on a statutory basis and on a GAAP basis, with adequate reserves, we continue to build active life reserves on a locked and original assumption basis. And therefore, particularly on the older blocks, where we're seeing these significant premium rate increases, those premiums are coming through. And they're directly mitigating the losses that we're seeing, moving the loss ratios down and moving the results closer to the breakeven that we're targeting. Does that help?

Suneet Kamath - *UBS - Analyst*

Yes, I think maybe the answer is that it's -- a lot of it is falling to the bottom line.

Marty Klein - *Genworth Holdings Inc - CFO*

Suneet, I'd just add, I guess, as we think about it, it comes into the bottom line in a couple different ways. One is that, for the policy holders that elect to take the higher premium, which is the big majority of folks, as Tom mentioned, it comes to the bottom line by virtue of getting at higher premium. And then after taxes and stuff like that, it ultimately hits the bottom line.

The other way it hits the bottom line is through, in the situations where some policy holders elect to take reduced benefits. And in that case, for those reduced benefits, there's a reserve release, which impacts -- or affects results very currently. So you saw a combination of that this quarter as well as last quarter. That reserve release phenomenon will kind of occur over the next few years, while we're implementing the rate actions. But then once they're fully implemented, that would go away. Then obviously, the premium part of it will continue on.

Suneet Kamath - *UBS - Analyst*

Got it. Okay. And then, I think, Pat, you had mentioned earlier, with respect to the $26 million of additional premium that you reported in the quarter from the price increases -- that I think the -- I think your comment was that that increase was expected to moderate going forward. I just want to make sure that's right. And then maybe get color around why? And then at what point would you expect the full $155 million to $160 million of rate increases that have been approved to be flowing through the system?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of US Life Insurance*

Thanks, Suneet. I appreciate the question. The $26 million was actually the bottom line earnings impact, which included both the premium and the benefit provision changes that Marty just described. And what we saw as the rate increase approvals came in, in rather large amounts over the last several months. We're implementing those and making those changes to the system and to individual policies.

And therefore, the rate of increase on that bottom line impact from zero to the current level of $26 million has been relatively high, as we work on implementing the balance of those rate increases, given that we've made very substantial progress already in obtaining approvals towards our

$200 million to $300 million of target. We would expect that to grow from the $26 million, but at a slower rate, and of course, depending upon the policy holder elections, the pay premiums, and/or to reduce benefits.

As I look at it, the $155 million to $160 million of already approved premium rate increases, a large -- very large percentage of that is going to come in over the course of the next year, 15 months, as we receive approvals. However, I would also say that some of those rate increases are phased in over a period of years. So the way to look at it is, we've achieved some degree of momentum and critical mass, with respect to implementation of the rate increases. And it's really going to play out over the next several years.

At the end of that point in time, we would expect to be seeing all of the individual policyholder decisions around level of benefits to be made, and the continuing impact will be the $200 million to $300 million of annual premium rate increases, which will have been achieved over that 2, 3, maybe 4 year time frame. Does that help?

Suneet Kamath - *UBS - Analyst*

Yes, no, that's helpful. My last question is either for Tom or Pat. Tom, in your comments about the reserve adequacy, I think you'd said that you're even more confident, based on this most recent review, than you had been previously. So just curious, where did the incremental benefit, in your mind, come from, to give you the greater level of confidence?

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Suneet, as I said, we did, over the last four months a very thorough, deep, broad review of the long term care business, looking at everything. Marty and I have been working with Pat and his team to look at every aspect, both new business reserves, the old book, and looking at the old book by policy year. So we've done an extensive review. And while we have been saying for some time that we believe the reserves were adequate with a margin. We're now saying, or I said today, that after this four month extensive review, we're more confident than we've ever been that the reserves are adequate, with a comfortable margin.

Suneet Kamath - *UBS - Analyst*

Okay, thanks very much.

Operator

Thank you. Our next question is from Geoffrey Dunn of Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Thanks. Just to follow up. I was curious as to your thoughts on domestic MI pricing. We've seen everybody settling into the various tiers of pricing, but last week, you obviously saw Radian make an across-the-board reduction. MGIC followed, I think, Monday.

What are your thoughts in terms of how pricing is going to shake out? Are we heading into a more competitive environment, especially with new entrants? Or do you think it is a scenario where you can hold pricing?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes, I -- thanks for the question, Geoff. When I look at the opportunities in the market right now, even though the -- and let me just take it up a little -- a level. Even with total originations coming down on the quarter, primarily from the reduction and re-financings, the MI penetration is up. We're close to 13% on an MI penetration level, driven by purchase penetration, which is up to 22%, very high for us, and something I feel good about.

So the overall MI market continued to grow. So our NIW is up because of the growth in that broader MI market, and I think that is going to continue as we work through some of the challenges that the FHA has. Our share, really for several quarters, has been sort of flat. And I think we've been pressured a little bit by some of the pricing moves in the marketplace.

We will be announcing today, to more directly answer your question, that we plan to decrease rates for our monthly premium product consistent with the moves you saw earlier in the week by some of our competition. I'm comfortable doing that at this point, because as we look at the conditions in the marketplace, and the way our production has been performing, it's still above our targeted return thresholds.

So I think we're getting to a point where there's some opportunity to be a little bit more competitive. We feel more comfortable with our capital flexibility. We're more comfortable with the direction the market is going. I don't think the move has any material impact on our type of risk we'll be bringing on. So it's -- the guidelines are very immaterial in terms of the changes made there. But it will be somewhat more price competitive, and I think that will just probably, hopefully, where it's going to settle out for the time being.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, great. Thank you.

Operator

Thank you. Ladies and Gentlemen, we have time for one final question from Craig Perry of Panning Capital.

Craig Perry - *Panning Capital - Analyst*

Hey, guys. Thanks so much for taking the call, and congratulations on the great results and improving performance. I just had one quick technical question, and then another broader question, which you may or may not be able to answer.

The first is, with regards to the $1.4 billion of realized hedge gains that are in AOCI but not in the ex-AOCI book value, what's the right way to think about the timing of that getting pulled into book value as an asset or realized through the P&L statement? And then the second question is, more broadly, if you think about each of the businesses, it sounds like you're underwriting to -- call it a mid-teens IRR, really across all of your business units, give or take a few hundred basis points.

So you -- given the trajectory of premium rate increases in the long term care business, which is obviously the biggest component that has fallen behind those IRR hurdles. What's the right time frame to be thinking about normalized earnings power for the business in aggregate? Because by my math, it looks like 2015, 2016, 2017, we should be approaching aggregate ROEs for the business north of 10%. I'm just trying to see if that foots with how you guys are thinking about it? Thanks so much.

Marty Klein - *Genworth Holdings Inc - CFO*

Craig, it's Marty. It works a little bit differently for GAAP or for stat, but the punch line is that those gains amortize into income over a period of time. It's, I think, a relatively modest impact for the next few years, but then it builds over time. These are hedges against what is a very long duration product, so it really comes more in the medium term, if you will.

However, we would expect to see a bigger impact, but it has begun to amortize a little bit into income for GAAP purposes. For statutory purposes, it actually amortizes a little bit more quickly -- or it starts a little bit more quickly, and over a longer period of time. And again, as well for stat, there's a little bit of benefit that we're seeing in the near term, and then that will continue to build in the medium term.

Craig Perry - *Panning Capital - Analyst*

Got it. Okay, that's very helpful. And then on the second question, I don't know if Tom wants to try to address that, in terms of how you are thinking about achieving a more normalized earnings profile for all of the aggregate businesses?

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Yes, I would say, Craig that this is a turnaround that's going to occur over a 2 or 3 year time frame. I think we're accelerating the turnaround. And we're pleased so far with how things are going. Still a lot more work to do. I would say that, both in USMI and the long term care business, for USMI, what we're underwriting today, and really what we've been underwriting for several years now, has very good business, which we think has returns in excess of 15%.

The same for long term care. The current product we're selling, we think it has good returns. This new product, which we call Flex 2.5, I'm sure we'll come up with a jazzier marketing name for it. But that product, we think, is -- the benefits and the pricing are very good. We will have less interest rate risk and lapse risk, and less morbidity risk. So we do think that, as I said in my comments, that return -- the returns on that will be well north of 15%.

Going to the other lines of business, we have, in life, in fixed annuities, I think the industry average over time is in the 10% to 11% range. And I think those products have less risk, certainly, than long term care. And so we think that's still an acceptable return. And then I think we're seeing, in Australia and Canada, very good returns, double digit, and we expect those to continue over time.

But coming back to the overall ROE for Genworth Financial is low. It's certainly improving, but we've got quite a bit of work to do to continue in the turnaround. I would -- since we're in the world series time frame, I would say that we're probably in the second or third inning of the turnaround. And so more to come, but I think we're on a good track.

Craig Perry - *Panning Capital - Analyst*

Great, thanks so much, guys.

Operator

Thank you. Ladies and Gentlemen, I will now turn the call back over to Mr. McInerney for closing remarks.

Tom McInerney - *Genworth Holdings Inc - President & CEO*

Thank you, Ashley. And thanks to all of you for your time and questions today. I think Genworth is changing through all of the actions and the execution of our priorities and objectives. We are committed to moving forward with products, customers, distributors and employees in an effort to help families become more financially secure, self-reliant and prepare for their future needs. We look forward to our December call, where we will review our long term care business with investors and analysts.

Operator

Ladies and Gentlemen, this concludes Genworth Financial's Third Quarter Earnings Conference Call. Thank you for your participation. At this time, the call will end.