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Genworth Financial, Inc. (GNW)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Genworth Financial's Fourth Quarter 2014 Earnings Conference Call. My name is Christie, and I will be your coordinator today. At this time, all participants are in a listen-only mode. We will facilitate a question-and-answer session towards the end of this conference call. As a reminder, the conference is being recorded for replay purposes. Also, we ask that you refrain from using cell phones, speaker phones, or headsets during the Q&A portion of today's call.

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

Amy Corbin
Senior Vice President, Investor Relations

Thank you, operator, and good morning, everyone. Thank you for joining us for Genworth's fourth quarter 2014 earnings call. In addition to covering our fourth quarter results, we will discuss the long-term care active life margin review and provide an update on our strategic priorities.

Our press release and financial supplement were released last evening. Earlier this morning, our fourth quarter earnings summary presentation along with the investor materials covering the long-term care active life margin review and our strategic priorities were posted to our website. Both of these presentations will be referenced during our call this morning and we encourage you to review all of these materials.

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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, Kevin Schneider, President and CEO of our Global Mortgage Insurance Division, 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 related presentations as well as 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 references to statutory results are estimates for the quarter due to the timing of the filing of the statutory statements.

Given level of interest for today's call, we ask that analysts limit themselves to one question and one follow-up. Should you have additional questions, please re-enter the queue.

And now, I'll turn the call over to our CEO, Tom McInerney.

Thomas Joseph McInerney

President, Chief Executive Officer & Director

Thank you, Amy, and good morning, everyone. Our objectives for this call are to update you on fourth quarter 2014 results, provide a summary of the LTC ALR margin review and resulting outcome, and update you on steps taken as part of our strategic review process commenced over the last quarter as we explore options to maximize long-term stakeholder value. And in doing so, address questions that some of you have raised since our last call.

It is important to note that upfront that we are conducting a thorough review of a broad range of strategic options with the help of external financial and strategic advisors. In order to maintain flexibility with respect to our strategic options for all key stakeholders, we believe we need to pay down $1 billion to $2 billion of debt over time.

As you can imagine, there are benefits, challenges and trade-offs associated with each option, such as debt levels and terms, tax considerations, and the views of regulators and rating agencies. That said, we intended to continue to work through these issues and take the steps necessary to properly evaluate and implement the options that will best support our long-term strategic priorities.

We've also made decisions that resulted in certain charges in the fourth quarter that we felt were instrumental in moving forward to return the company to profitable growth as quickly as possible. The LTC margin is positive in the aggregate, but as we indicated might be the case in our past disclosures, the margin turned negative on the acquired LTC business, which resulted in an after-tax noncash GAAP charge of $478 million.

We also incurred a moderate 2014 statutory reserve charge in our New York subsidiary reflective of a higher claims severity and lower interest rates. Further, we also recorded net noncash charges related to the company's progress on plans to monetize the lifestyle protection insurance business, which we have previously identified as non-core.

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Marty will take you through this along with several other actions in more detail in a few minutes. We are also launching a very significant restructuring plan focused on supplier and cost rationalization, which we expect will generate in excess of $100 million in annual cash savings by the end of 2016. Moreover, capital and liquidity remain strong across all platforms and at the holding company. I also wanted to note that these charges overshadowed another solid quarter for the Global Mortgage Insurance and fixed annuity businesses.

There are a few important takeaways for our mortgage businesses. First, the Mortgage Insurance business continued to show progress from our turnaround efforts, which we laid out 18 months ago, benefiting from strong competitive positions, stable to improving markets and favorable loss ratio performance across all three primary platforms. Additionally, Canada and Australia remains strong cash generators and have been and are expected to continue to be reliable sources for future dividends to the holding company.

Second, our U.S. MI platform continued to show improved operating performance benefiting from a 19% drop in new flow delinquencies as compared to a year ago, reflecting the burn through of the order books as the new books now represent 56% of risk in-force. While this business has come a long way, we believe it will take a few more years to be a significant cash dividend contributor.

Third, the U.S. MI business made significant progress during the quarter, working with reinsurers toward our planned compliance with the new GSE capital requirements by the anticipated effective date. Lastly, we had a settlement in our European mortgage insurance business which significantly reduced risk in-force in Ireland with minimal earnings impact. In summary, the Global Mortgage Insurance business is executing well and we expect it to continue to be a strong driver of operating performance going forward.

Now, let me turn to the Life Division. The underlying fixed annuities performance was good and absent the reserve charge, Life Insurance showed modest improvement. LTC remains a significant challenge. We believe the updated assumptions for the DLR and ALR are reasonable and appropriate given the experience that has emerged and reviews undertaken.

We will continue to monitor experience, assumptions and the resulting reserves closely with support from outside actuarial advisors. We have made significant progress to date to re-rate the most problematic LTC blocks acquired or written over a decade ago. However, we expect to continue to feel pressure as these blocks reached their peak loss years as our policyholders age, and therefore, we will be pursuing additional in-force rate actions to recognize changes in experience.

We are encouraged, however, with the positive margins on the remaining blocks, and we'll actively monitor and address unfavorable experience as it evolves. On the rate action front, we have made good progress today in our 2012 rate actions, and based on current approvals and anticipated first quarter approvals, we now project approximately $240 million to $260 million of additional annual premiums against our $250 million to $300 million objective.

And now, I will turn the call over to Marty to go into more detail on the fourth quarter results and the outcome of the active life margin review.

Martin P. Klein

Chief Financial Officer & Executive Vice President

Thanks, Tom, and good morning, everyone. This morning, I will discuss our long-term care margin review and impacts related to it. But first, I will briefly review our fourth quarter results.

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As shown on slide 3 of the earnings summary, we reported a net operating loss of $416 million and a net loss of $760 million for the quarter. There were several factors impacting the operating loss, which overshadowed solid operating performance in several of our businesses particularly in our Global Mortgage Insurance Division. These items include after-tax charges of $478 million from long-term care blocks acquired over 20 years ago as a result of our annual review of active life margins, and unfavorable reserve adjustments totaling $48 million in our life and long-term care businesses.

In addition, reflecting our consideration of a variety of potential strategic options and current business realities, we recognized the following items in net income. First, we wrote off all remaining goodwill in both our life and long-term care businesses resulting in an after-tax charge of $274 million. Goodwill balances are highly dependent upon projected future sales levels, and with our assessment of current market realities in addition to our active consideration of potential business portfolio changes, projected sales levels could drop in some scenarios. We concluded it was appropriate to write off the associated goodwill balances.

Second, we recognized a tax charge of $174 million, reflecting a change in our intent to permanently reinvest earnings from Genworth Mortgage Insurance Australia Limited. While we have not made any decision with regard to this asset, we are evaluating it among several other available strategic options given its valuation and liquid state.

Also, we are progressing on the sales process of the lifestyle protection insurance business, which has been a noncore business for us. Related to that planned sale, we completed an internal debt restructuring resulting in a $108 million tax benefit. While I won't, of course, address valuation directly, we are seeing market interest for this business and are seeking to monetize it. Given current book value, we anticipate a significant loss on sale.

Global Mortgage Insurance had another good quarter as shown on slide 4, reporting net operating income of $83 million, down slightly versus the prior quarter and prior year when adding back the non-controlling interest impact of the Australia IPO in those periods.

Let's cover Canada on slide 5 first where operating earnings were $36 million for the quarter, down $10 million from the prior quarter. We saw lower unemployment and a modest sequential increase in home prices. Additionally, tax benefits were lower versus the prior quarter. The loss ratio increased five points from the prior quarter to 26% from seasonally higher new delinquencies, net of cures. The full year loss ratio was 20%, at the midpoint of our 2014 expectation. We expect the 2015 full year loss ratio to be between 20% and 30%.

Turning to Australia on slide 6, operating earnings were $33 million, down $15 million versus the prior quarter, primarily from less favorable tax benefits. Macroeconomic conditions were generally stable in the quarter as there was a slight decrease in the unemployment rate, and overall home prices experienced modest gains. The loss ratio remained very low at 15%. The full year loss ratio was 19%, slightly better than the low end of our 2014 expectation. We expect the 2015 full year loss ratio to be between 25% and 30%.

In other countries, we executed a lender settlement materially reducing risk in-force in Ireland from $700 million to $60 million with only a minimal financial impact in the quarter. Given the size of our international operations, foreign exchange rates do impact our earnings. While I can't predict where these rates would go, I can give you some perspective on sensitivities. For instance, if total year 2014 exchange rates were at current levels, our international earnings would have been approximately $30 million lower. Using this example, the rough rule of thumb would be a one-point move in either the Canada or Australian exchange rate would result in approximately $2 million change in earnings. I will stress that this is the only translation risk as our assets and liabilities in our

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international businesses are predominantly held in the respective local currency. However, we do hedge much of our foreign exchange risk associated with expected cash flows.

Moving to slide 7, in U.S. MI, net operating income was $21 million for the quarter, up $23 million from the prior quarter. As a reminder, the prior quarter included $34 million of after-tax accruals recorded in connection with settlements, one with Bank of America which has now received GSE approval and another which has now been resolved.

The reported loss ratio for the year was 62%, including a nine-point unfavorable impact from third quarter of lender settlements. For 2014, U.S. MI net operating income of $91 million was significantly improved over 2013. Earnings and loss performance should continue to improve with the 2015 full year loss ratio expected to be between 40% and 50%.

NIW was seasonally down from the prior quarter but benefited as the business increased its single-premium lender paid new insurance written, reflecting a selective participation in this market. Future volumes of this product will vary depending on the evaluation of the risk return profile of these transactions. The company's estimate of U.S. MI and market share increased year-over-year to 15%. At year-end, 56% of the risk in-force is composed to 2009 and forward books of business. We anticipate this percentage will grow to between 60% and 70% by the end of 2015.

Turning to capital in the GMI Division on slide 8, the prescribed capital amount or PCA ratio in Australia is estimated at 159%, up from the prior quarter from continued strong statutory income. For Canada, the minimum capital test or MCT ratio is estimated at 225%, in line with the prior quarter. The U.S. MI at quarter end, the risk-to-capital ratio for GMICO was approximately 14.2:1, down from 14.8:1 in the prior quarter from an increase of $125 million in admitted deferred tax assets in GMICO, partially offset by changes in value of affiliate investments and increased risk in-force.

Our capital goals in the Global MI Division for 2015 include a PCA ratio of 132% to 144% in Australia; 220% or greater MCT in Canada; International MI dividends of $150 million to $230 million, and combined risk-to-capital ratio of less than 18 to 1 in U.S. MI. I would also note that Australia has declared a special dividend, our portion of which is approximately $40 million and will be received in the first quarter of 2015.

We have two strategic priorities for GMI in 2015. First, in Australia and Canada, we will continue to look for ways to optimize capital to improve ROE, provide for growth opportunities, and return capital to the respective shareholders. Second, in U.S. MI, it remains our priority to plan to comply with the new GSE eligibility requirements by the effective date. We still estimate the capital need to be between $500 million and $700 million. We continue to make progress in reinsurance transactions where the market appetite remains robust. However, we are waiting on finalization of PMIERs capital required standards and ultimate reinsurance terms are subject to modification. Turning to the U.S. Life Insurance Division as shown on slide 9, the operating loss was $482 million, reflecting the impact of the long-term care annual loss recognition review with the net loss of $750 million after the goodwill charges mentioned earlier.

Favorable mortality in life insurance was more than offset by reserve correction on a term life reinsurance treaty in the current quarter. Fixed annuity showed continued solid performance. The long-term care insurance net operating loss in the quarter was $506 million, driven primarily by the completion of the annual loss recognition testing review and associated charges on the acquired blocks of business as shown on slide 10. I'll provide greater detail on the review in just a few minutes.

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Although incurred loss results were primarily impacted by the loss recognition charge on acquired blocks and other adjustments, the claim reserve review from last quarter also had an impact as we set up higher claim reserves and new claims in the fourth quarter using the updated reserve assumptions, and also had lower reserve releases on existing claims. In addition, we had unfavorable adjustments to our claim reserves of $16 million including a $44 million claim reserve correction. This correction was identified in the fourth quarter as an operational process control efficiency and how we implemented one of the claim reserve assumption updates.

We are currently assessing the internal control environment around this issue as part of the year-end control assessment to determine whether we have a significant deficiency or a material weakness. While we've not yet completed this assessment, we believe this deficiency likely constitute a material weakness in our internal controls and we plan to complete our review process and reflect the results in our 10-K, as well as our plans for remediation if we do end up concluding on such a weakness. We are highly focused on addressing this issue and taking the appropriate actions to fix the issues.

Moving to slide 11, in-force rate actions continue to favorably impact earnings, benefiting results by $41 million, $7 million higher than the last year, but $3 million lower than the prior quarter. We also received additional approvals from our second round of filings from the 2012 in-force rate action that increased the incremental premium approved to $200 million to $210 million with another $40 million to $50 million expected in the first quarter 2015 against the total anticipated annual premium increase of $250 million to $300 million when fully implemented.

Moving to slide 12, operating earnings in Life Insurance were $1 million for the quarter, down from $13 million in the prior quarter, and include the reserve correction on reinsurance treaty of $32 million that I mentioned earlier. Mortality experience is favorable versus the prior quarter and unfavorable versus the prior year.

For fixed annuities on slide 13, earnings were $23 million, slightly lower than the prior quarter. Turning to U.S. Life statutory performance on slide 14, unassigned surplus decreased approximately $135 million and the RBC ratio decreased 18 points to approximately 430% in the quarter. There were several drivers to this decline.

First, as a result of our annual statutory cash flow testing review, we increased reserves by $39 million in our New York subsidiary to reflect an incremental $195 million negative margin on its long-term care insurance business, with the remaining $156 million to be recognized over the next four years. I'll provide more details on the review in a few minutes. Second, we increased reserves related to secondary guarantee UL products in our New York subsidiary, which is the second and final increase related to our discussions with the New York regulator on this matter.

Third, we reinsured a block of term universal life to a third-party reinsurer, providing approximately $80 million of unassigned surplus benefit. And finally, the completion of an internal debt restructuring in the lifestyle protection insurance business which provided overall tax benefits of $108 million on a GAAP basis, also resulted in changes to certain inter-company tax balances in U.S. Life and in the Bermuda entities.

The U.S. Life company has experienced the charge of $155 million, while BLAIC saw a tax benefit of $230 million. With the reflection of this benefit and other timing, BLAIC ended the quarter with an RBC ratio of approximately 345%, up from 245% in the prior quarter. We expect the RBC ratio in our U.S. Life companies to be greater than 400% at year-end 2015 and the repatriation of the long-term care business from BLAIC to U.S. Life companies remains strategic priority for 2015.

Shifting to slide 15 in the Corporate and Other Division, the net operating loss for the quarter was $17 million. International Protection reported a loss of $4 million in the current quarter that included approximately $4

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million of unfavorable items including higher claim reserves in certain contracts and unfavorable shift in the mix of contracts with profit share, higher expenses, and unfavorable foreign exchange. Runoff earnings were higher by $11 million compared to the prior quarter, primarily related to favorable taxes. We had favorable taxes in Corporate and Other related to timing with the full year operating tax rate of 34%.

Moving to investments on slide 16, our general account continues to perform well. The global portfolio of core yield was down slightly from the prior quarter at 4.38% due to the impact of lower rates and other factors and there were no impairments in the quarter.

As shown on slide 17, at the holding company, we continue to maintain significant liquidity with cash and liquid assets of approximately $1.1 billion, representing a buffer of approximately $685 million in excess of our target of 1.5 times debt service and well above our $350 million risk buffer. We anticipate maintaining this target and risk buffer in 2015. Unfortunately, our leverage ratio increased to 25.9% given the long-term care reserve increases, goodwill write-downs, and other impacts to equity this quarter.

Stepping back, in addition to our current excess liquidity at the holding company and the solid capital levels across our operating platforms, we have significant leverage benefiting our financial flexibility. These include monetization of our non-core businesses, additional life block sales or refinancings and reinsurance of MI business risks. We also have other sources of capital available that we could consider such as the additional sell-down of Australia MI business, among others. We currently believe these are more attractive sources of capital than an outright equity raise, and we have no current plan to do such a raise at this time.

Let me now turn to long-term care and discuss our annual margin testing. Please refer to the separate presentation of long-term care annual margin testing. In the third quarter, we made significant updates to our long-term claim reserves to reflect our updated view on our claim severity assumptions. After review of this experience, expected claim termination rates are expected to be lower and benefit utilization rates are expected to be higher than it had been assumed before the third quarter.

As a result of the updated assumptions, we expect claimants are staying on claim longer and using more of their available benefits. We made these updates to our claim reserve assumptions in the third quarter and they have informed the assumptions made in our margin analysis. With these updated claim severity assumptions, we have and we'll continue to pursue actuarially adjusted rate actions to attempt to offset the higher expected claims costs. These new claim cost views and associated rate actions represent the most significant updates for margin analysis last year.

Genworth's reviews of long-term care active life margins are substantially completed. We were assisted by two leading external actuarial firms with strong long-term care experience. One firm worked closely with our actuaries on the detailed assumptions and reserve changes, and the second firm conducted an independent peer review of our assumptions and approach. Both firms concluded that the assumptions and the aggregate were reasonable and supported by experience.

Slide 2 summarizes our active life margin conclusions. First, GAAP loss recognition testing margins are positive in aggregate. However, we must test our acquired block, representing business acquired before 1996, separately from our other business. The margin on the acquired block, which, as we previously disclosed, has very thin margins, was a negative $735 million pre-tax as future in-force rate actions, either incremental premium rate actions or reduced benefits depending on policyholder behavior, have less impact given the higher age of the block. Net GAAP liabilities for this block had been approximately $2.6 billion before adjusting for the negative margin. The other, much larger block tested had a positive margin of $2.3 billion. Net GAAP liabilities for this block are approximately $15.7 billion.

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Second, statutory cash flow testing margins were positive in aggregate using our policies in-force as of September 30 and adjusting for year-end interest rates. As a reminder, we test each legal entity separately on a statutory basis governed by the specific rules of the regulator in the state of domicile.

The margins in our Genworth Life Insurance Company or GLIC and Brookfield Life and Annuity Assurance Company or BLAIC were a positive $4.3 billion in aggregate before adjusting downward for about $1.9 billion in provisions for adverse deviations or PADs. Given the requirements for cash flow testing in New York, we increased reserves by $39 million in our New York subsidiary to reflect a $195 million incremental negative margin on the long-term care insurance business in that entity with the remaining $156 million to be recognized over the next four years. Recall we have had negative margins in New York in the past for which we had previously held reserves of $80 million.

Our statutory capital levels remain solid with RBC ratio of approximately 430% at year-end reflecting these results. The components of the statutory and GAAP margins are laid out on slide 3. The present value of future premiums, claims and expenses are projected based on assumptions reflecting our own experience and actuarial judgment. As I mentioned, the most significant updates were to claim-related assumptions such as claim termination rates and benefit utilization rates, informed by assumptions which were updated in our third quarter claim reserve review, as well as the inclusion of additional assumed future premium increases and reduced benefits, which offset most of the expected increase in claims cost.

We developed a new series of anticipated in-force premium increase requests based on updated claim severity assumptions, and these premium increase assumptions were informed by our historical track record of what we have achieved in previous rate actions and reviewed with the relevant regulators as well as our third-party advisors. It is important to note that if actual claim incidence or severity in the future is different than expected, the projected in-force rate actions will change accordingly as these projected rate actions were developed to reflect claims costs being experienced.

Other significant impacts related to investment assumptions given the current low rate environment. As a reminder, Genworth began hedging interest rates starting in 2000 for long-term care. We have after-tax terminated hedge gains that resided in accumulated other comprehensive income on a GAAP balance sheet of approximately $1.7 billion, and this amount will amortize in the GAAP income over time. Similarly, we have approximately $830 million primarily from after-tax hedge gains on a statutory basis that reside in the interest maintenance reserve or the IMR on a statutory balance sheet, and the IMR amortizes into statutory income.

While our hedging program has dampened the effect of lower interest rates, during 2014, we revised our reinvestment strategy given that environment and adjusted our reinvestment strategy for long-term care business to pick up additional spread. This new reinvestment strategy is reflected in our cash flow testing analysis, and I'll provide additional perspectives on this revision in a few minutes.

In addition, we reviewed other assumptions and in some cases, made updates. In particular, we reviewed claim frequency, lapse rates, morbidity and mortality improvement, and expenses. The margin impact from updates in some of these items was modestly favorable. Slide 4 provides the summary of the key updates we made to both our assumptions concerning claim termination rates and benefit utilization rates.

As a reminder, from our third quarter earnings call, claim termination rates referred to the expected rates at which claims end, and benefit utilization rates refer to how much of the available policy benefits are expected to be used. Also, as you'll recall, there are numerous assumptions for claim termination and benefit utilization rates based on several characteristics such as type of policy as well as policyholder and claim characteristics.

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Assumptions developed in the third quarter claim reserve review informed our active life margin analysis, and we projected them forward over the 40-year plus projection period.

Subsequent to our third quarter claim reserve review, we continue to assess our assumptions concerning claim termination rates in connection with our active life margin review. After review and consultation with our third-party advisors, we increased the assumptions concerning claim termination rates slightly in the later durations given that the statistical credibility of our data for claims and duration 7 and beyond while much better is still limited. As we noted in our earnings release and commentary, we also updated our assumptions for this refined view in our disabled life reserves in the fourth quarter.

The combined impact of changes to the assumptions for claim termination rates and benefit utilization rates reduced GAAP margin by approximately $5.4 billion. As we discussed in the third quarter, we have developed management actions regarding premium rate increases that we expect loss that much or possibly most of the reduction in our margins from the updated assumptions.

Turning to slide 5, a key change from last year's margin testing is the inclusion of future rate actions in our GAAP loss recognition tests as well as in our GLIC and BLAIC legal entities. Inclusion of such premium increase and associated benefit reductions is consistent with actual guidelines, GAAP accounting and the regulatory framework in almost all states. In addition, we consulted with our regulators on these assumptions for our cash flow testing work.

Before discussing the future rate action assumptions, I want to give some context for our actions to date. First, we have a good history of achieving premium rate increases on our in-force blocks. In 2007, we filed for an approximate 10% rate increase and achieved about 90% of our requested filing that resulted in incremental premium of about $50 million to $60 million. In 2010, we filed for an approximately 18% rate action and achieved about 94% of our requested filing that resulted in incremental premium of about $40 million to $50 million.

Additionally, we have made good progress with the 2012 rate actions that represent about $200 million to $210 million of incremental premium when fully implemented by 2017, and have also received or expect to receive approvals in the first quarter reflecting $40 million to $50 million of additional premium increases. We still anticipate additional premium increases from the 2012 rate actions of $250 million to $300 million when fully implemented. Second, as part of our strategy beginning in 2013, we have filed through premium increases on our Choice II block. We have seen good progress today in our Choice II filings where we've heard back from 30 states and received approval from 22 states.

We believe the Choice II approvals received so far will add an incremental $20 million to $30 million in annual premium increases once fully implemented. We have also received or expect to receive approvals in the first quarter, reflecting $20 million to $30 million of Choice II premium increases. Also, we are going back to states that did not approve our Choice II filings to ask them to reconsider increases based on the new claim assumptions. We anticipate additional premium increases of $40 million to $60 million when fully implemented from the 2013 Choice II rate action. These actions we have been taking just since 2007 should result in additional expected premium of about $380 million to $470 million.

We have developed a plan for future premium rate increases for all older blocks up to and including PC Flex that we're informed by our historical track record reviewed with the regulators and consistent with projected future claim costs. These rate actions projected to be implemented over the next 15 years assume we achieve incremental annual premium which grows to $525 million to $625 million at the peak before declining significantly over the subsequent years as the number of active lives declines.

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The corresponding GAAP margin impacted these rate actions, reflecting both additional premiums as well as reduced benefits, is approximately $4.9 billion pre-tax. Before I move on to other assumptions and our margin analysis, let me provide some perspectives on future rate actions and corresponding potential reductions and benefits. We believe providing alternatives to policyholders so they can choose between accepting higher premiums or electing benefit reductions in these guaranteed renewal policies is important.

And we expect to see even more focus on, and receptivity of, reduced benefits as an alternative to higher premiums. We believe regulators and policyholders generally are more receptive to this approach and certainly prefer having choices. Such reduced benefits generally are expected to be actuarially equivalent to higher premiums, and so the margin impact should not be significantly different. However, with reduced benefits, our exposure to changes in future claims cost is lower. In other words, our tail risk is reduced.

In a low inflation world, some policyholders may find it more attractive to lower the benefit increase option or BIO riders on their policies in lieu of higher premiums. Choice I and II, representing our largest blocks, have a higher proportion of BIO features than do older product generations. Electing reduced benefits such as choosing a reduction in a BIO feature may be easier for those policyholders to accept than paying higher premiums, and regulators increasingly prefer that carriers provide such choices to policyholders.

Certainly, different people have different views on the subject of rate actions and the ability of Genworth and other long-term care providers to obtain them. We believe regulators are generally more receptive to acknowledging the need for such rate actions, and we've been working with them to gain approvals in forms that they think are more beneficial to policyholders through approaches such as staged increases or providing alternatives for reduced benefits. Our assumptions on future rate actions are in line with what would be actuarially justified while reflecting our own historical track record as a model of corresponding additional premium.

Now, let's shift to slide 6 and investment assumptions. Our cash flow testing projections assume a 10-year treasury rate of approximately 2.2% in line with levels at year-end, rising to approximately 4.7% in 2028 to 2030 before gradually declining over the remaining projection period to 4% to 4.2%.

During 2014, our investment risk and asset liability management team modified our reinvestment strategy for long-term care. In order to increase spread in a lower interest rate environment, we've made changes to our reinvestment allocations which will lower the overall credit quality one notch to BBB+ over time. Also, historically, we have invested very little in alternative investments, but we do plan to build up an allocation above the 5% over time. We've reflected these changes in reinvestment strategy in our cash flow testing analysis.

For GAAP loss-recognition testing, we utilize a static discount rate that is in line with our current portfolio yield as has been our practice for many years. As a result of the reserve increases in the third quarter and the fourth quarter, the assets required to back the liabilities increased as we needed to contribute assets so that assets equal liabilities.

In this low rate environment, these additional assets were lower yielding and decreased the PGAAP and HGAAP discount rates by 35 basis points and 23 basis points respectively. This impact on GAAP margins of the year-end discount rates was an unfavorable $1.5 billion. Long-term care is a long duration product and movements in any number of assumptions can impact performance over time. With that as a backdrop, we've provided selected sensitivities on illustrative assumptions on slide 7, but actual experience may differ.

The claims cost sensitivity or sensitivity A further increases the claim severity or claim frequency above what we have included in our updated assumptions. This sensitivity does not include future rate action or benefit

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reductions that we would likely put in place to offset much of this impact. Given the potential impact of interest rates on margins, we are providing two sensitivities.

The first interest rate sensitivity or sensitivity B assumes that that the 10-year treasury rates are 2.5% on a statutory basis for the entire projection period. The second interest rate sensitivity or sensitivity C assumes the discount rates impacting P GAAP, H GAAP, and statutory cash flow testing are reduced by 25 basis points.

Finally, the in-force rate action sensitivity or sensitivity D assumes that we only achieve 90% of the planned future rate actions that we have modeled. Next, I will cover two GAAP accounting implications that emerged as result of our margin testing and are summarized on slide 8. First, given the negative margin on our acquired block, GAAP reserve assumptions were unlocked and reset so that the expected margin is zero. With zero margin, this block has a higher likelihood of a future unlocking.

Second, as I discussed earlier, the loss recognition testing margin on our other block, the H GAAP block, was $2.3 billion on a GAAP basis. However, given a new claim severity and in-force rate actions assumptions, the earnings over the projection period display a pattern of profits for the next 15 years or so followed by losses thereafter. The profit period has a present value of approximately $3.5 billion, while the present value of the losses is the negative $1.2 billion netting to the $2.3 billion margin. This is a result of the active life reserve assumptions being locked in under GAAP and the increased premium or associated reduced benefits falling to the bottom line in the analysis, while the higher claim severity assumptions contribute to losses in later years.

This expected pattern has emerged for the first time during this year's margin testing given our updated view on claims severity. Therefore, we will use a portion of the expected benefit from future in-force rate actions to fund the expected future losses during the expected profit periods rather than being fully recognized in the period received. This change should help limit loss recognition testing margin deterioration in the future as we accrue an additional reserve liability for the future loss periods.

We've provided a lot of information this morning so let me sum up in our margin results. Our GAAP and statutory margins are lower than last year, but remain positive in aggregate. We must, however, recognize a GAAP charge on our block of policies acquired before 1996 as that block must be tested separately. We also have reserve increases in our New York subsidiary due to its incremental negative margin which excludes future rate actions. Finally, our U.S. Life capital and RBC levels remain solid even after reflecting our new claim cost assumptions in our claim and our active life reserve processes.

With that, I'll turn the call back over to Tom.

Thomas Joseph McInerney

President, Chief Executive Officer & Director

Now, let me take a minute to discuss in a bit more detail our strategic review and priorities. As discussed already, we have and continue to analyze a range of strategic options to maximize shareholder value. Working with our board, we have engaged external financial and strategic advisors to assist us in our reviews. We have made candid appraisals of our businesses' strengths and weaknesses and are taking proactive measures to rationalize our overall portfolio.

We believe that our mortgage insurance businesses are our strongest businesses, and we expect them to continue to perform well in 2015 and beyond. We must continue to take steps to mitigate LTC risks given the pressures on the older LTC blocks and the impacts we are seeing on sales given rating pressures. To that end, we continue to

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capitalize on our industry leadership in order to derive regulatory and market changes that are necessary to sustain this business over the long-term.

By far, the most important action we can take to make LTC a viable business is to continue to work with all state regulators to seek significant actuarially justified premium rate increases and benefit reductions on the existing in-force LTC blocks. Receiving future premium increases or benefit reductions on the older blocks of business is critical to maintaining positive ALR margins.

In addition to securing future premium increases or benefit reductions, we will continue to develop higher return, lower risk, new LTC and combo products to address the growing LTC needs and increasing size of the aging U.S. population. And we will impress on regulators the need to consider more frequent and smaller premium increases on current and future business as experience dictates.

We believe that the results of the cost and portfolio rationalization efforts we are pursuing will improve our ability to reduce debt levels, increase capital buffers, improve operating earnings and ROE in the life businesses, and grow profitable mortgage business. We remain actively engaged with our board, key stakeholders, and external advisors to ensure appropriate evaluation of growth opportunities, capital structure, regulatory actions, and rating considerations. We will provide investors with regular progress updates.

And now, Marty, Kevin Schneider, and I are happy to answer your questions.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we will begin the Q&A portion of the call. As a reminder, please refrain from using cell phones, speaker phones, or headsets. [Operator Instructions] Jimmy Bhullar from JPMorgan, your line is open.

Jamminder Singh Bhullar
JPMorgan Securities LLC

Q

Hi. Good morning. I just had a couple of questions. First, you mentioned the plan to reduce debt by $1 billion or $2 billion. Wondering if you could discuss the sources of cash through the HoldCo in 2015. Obviously, you're going to get dividends from the Australia and Canadian MI businesses. But what are you going to get at the HoldCo other than that? I'm assuming that you might not be able to get much dividends from lifestyle, but maybe – that's my first question.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

So, let me just take the first part and say that working with our board and our external financial and strategic advisors, we determined that when we're looking at all of the options that we might consider to raise shareholder value, we don't have as much flexibility as we'd like because of the level of debt at the holding company. And so, based on working with rating agencies, regulators and our feedback from external advisors, we believe that a target of $1 billion to $2 billion of debt reduction at the HoldCo frees up a lot of additional options to consider. And so, as we look at strategic options, we are looking at those that will allow us over time to reduce that debt.

I'll turn it over to Marty, I guess, to give you a little bit of specifics in terms of the 2015 operating dividends that we're expecting.

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Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Hey, Jimmy. It's Marty. I think what we have in our cash plans are really the planned dividends that we have coming from Australia and Canada. As you know, we expect that to be in the range of $150 million to $230 million. I'll remind you our annual debt services order of magnitude around $280 million. We're also obviously going into the year here with significant liquidity at the holding company probably close $350 million to $400 million kind of over our cash buffer, so that obviously provides some lift there. So, we do anticipate holding company balances to be relatively stable with the dividends we're getting.

Obviously, the other thing that we're working on as we mentioned in the remarks is we are launching our sales process of lifestyle protection. We're not managing our holding company cash, reflecting that but obviously, if we execute that, that will create some upside.

Jamminder Singh Bhullar
JPMorgan Securities LLC

Q

And the $1 billion to $2 billion that you're planning on doing that this year or is it more of a longer-term target?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

No. It's more of a longer-term target. And we're looking at things, as Marty said, like selling LPI or as we said last quarter, we're looking at selling blocks of life annuity. We are looking at our Australia business. And should we sell further down there that was part of the reason for that PRI tax charge. And now, obviously, there are other options, but all of those we're looking at in conjunction with our board and external advisors to do over the longer-term.

Jamminder Singh Bhullar
JPMorgan Securities LLC

Q

Yeah. But it's sort of a reasonable assumption that you do any debt pay-down, you would need to sell assets to the insured businesses because from the operation, the cash flows are somewhat limited.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Yeah. That's right, yeah.

Jamminder Singh Bhullar
JPMorgan Securities LLC

Q

Yeah. And then another question just related to that is, are there any implication if you do determine that there is a weakness in internal controls and your ability to do asset sales or do anything else in the short-term?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Hey, Jimmy. I think this came up really in the third quarter related to our long-term care, disabled life reserve...

Jamminder Singh Bhullar
JPMorgan Securities LLC

Q

Yeah.

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Martin P. Klein
Chief Financial Officer & Executive Vice President
A

...charge and we had a manual process they're going to introduce for the first time with that adjustment. And that's really where the issue is. We have to say we've been working on addressing that. When we have our 10-K, we'll provide more details on that error if it is in fact a material weakness, we're still assessing that. And then if it is a material weakness, we'll provide remediation plan.

I do think that we're still going through our overall control assessment. So, I don't want to make too many conclusions right here, but at this point I anticipate that if it is a material weakness, it's pretty isolated to that particular situation. And if that is the case, I wouldn't anticipate any broader issues as you described.

Jamminder Singh Bhullar
JPMorgan Securities LLC
Q

Okay. Thanks. And then just one last one, you did change the permanent reinvestment assertion for Australia that sort of gives you some flexibility to sell down your stake. I'm wondering why you did not do that for the Canadian business and is that something you would consider?

Thomas Joseph McInerney
President, Chief Executive Officer & Director
A

Yeah. I mean, the first thing I would say on all three MIs is that we think all three are performing well and they're our strongest businesses. I'm looking at Australia and Canada and our holdings of those – yeah, we looked at the percentage of ownership that we have of those. We look at whether the banks in those markets received explicit or implicit credit for the mortgage insurance. We looked at our market share versus competitors in the overall competitive environment.

We do think in Canada, there is a potential based on what the housing regulator has said that they may look to reduce the housing authority, corporations guarantees and therefore, the tax credit exposure. So, we think that's a potential in the Canadian market to grow. And then, obviously, for management oversight and synergies between Canada and Australia are different, so all of those went in. And so, our conclusion was we haven't made any decisions yet on Australia, but we are looking at options to sell down further. Right at this point, we are not currently looking to sell down in Canada. So that's the difference in the tax treatment.

Jamminder Singh Bhullar
JPMorgan Securities LLC
Q

Okay. Thank you.

Operator: And next, we have Suneet Kamath from UBS. Your line is open.

Suneet L. Kamath
UBS Securities LLC
Q

Great. Thanks. Good morning. Marty, I was hoping you could help us reconcile the statutory active life margin in terms of what you showed us in the last presentation and what you're showing us today, just in terms of the pieces. So, you start with the – whatever it was, the $2.6 billion, I think. What was the impact of the revised claims assumptions? And then separately, what was the impact of the future rate increase benefit that ultimately gets you to, I think, what the comparable number is this quarter of $2.1 billion.

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Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah, you're right. Your beginning and ending balances are right, Suneet. And we called out in my prepared remarks the pieces on a GAAP basis, and those assumptions are really the same on a cash flow testing basis with one slight change or maybe not-so-slight change I'll speak to in a moment. I don't want to get into specific amounts, but the assumptions are the same. The discounting rates, a little bit different. So those amounts are roughly the same. I'll mention those again on a GAAP basis. About $5.4 billion negative impact to margins on an updated claims termination rates and utilization assumptions; about $1.5 billion for interest rates as a decrease to margin. Then on the positive side, about $4.9 billion pre-tax of a premium in-force rate actions in the future; and then about – we didn't really call it out, but roughly $500 million to $600 million of sort of other adjustments and those kind of really gets you on a GAAP walk.

On the statutory side, it's really the same items. The present values are a little bit different. I think the difference in stat is that with the interest rate approach that we used which is different in statutory testing where we used a variety of randomly generated interest rates and take the average of that, and we described in the presentation what that average gets to. That's obviously a different approach than what we do in GAAP where we just use our current portfolio rate and use that to discount back the cash flows.

Then the other adjustment in statutory, which is not reflected in the GAAP margin testing is that new reinvestment strategy, I articulated, where we're over time and really takes a long period of time as we're reinvesting – we're reinvesting in bonds such as the average credit quality and the reinvestment strategies BBB+. That takes probably 15 years to almost 20 years in the model to get fully into that BBB+ category in average.

And then similarly, we built in a small allocation alternatives that builds up over time. I think it takes 10 years to 12 years to get up to the, I think, 5% allocation. So, those are really the differences on stat. Really kind of if you think about that $1.5 billion interest rate hit in margin or in GAAP, it's a bit less on statutory basis for those reasons.

Suneet L. Kamath
UBS Securities LLC

Q

And frankly, I think a lot of us are more focused on statutory. So, at some point, if you could give us a clear reconciliation of how that ALR, on a stat basis, change that would be very helpful. The second question I have is on the anticipated rate increases. I guess, that's slide 5 of your LTC presentation. So, it looks like you have a prior approved or anticipated rate actions of $380 million to $470 million. But when we think about the $525 million to $625 million of anticipated peak incremental annual premiums, is that in addition to the $380 million to $470 million? Or does that include some of the $380 million to $470 million?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Yeah. That is an addition to the $380 million and $470 million. So, those are future premium increases or benefit reductions that we'll seek over the next 15 years or so. I do want to make a comment there. I've been here for two years and I think there has been a significant change from a regulatory perspective in terms of where the states are. I think, two years ago, I think, a number of the regulators were still working through what was actuarially justified. I think now there's a recognition based on our recent experience, our experience in competitors that there is a need for significant increases on the old business for us and other companies. Long-term care is a guaranteed renewable policy and so regulators are required to approve appropriate actuarially justified increases. So, I think there has been a change over the last two years in terms of how regulators in all the states look at it.

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Suneet L. Kamath
UBS Securities LLC
Q

Right. And when you say in your prepared remarks that you've run these price increases by the regulators, who specifically is that? Is that just your main insurance regulator or have you sort of discussed this with all of them that you have to go back to and ask for price increases?

Martin P. Klein
Chief Financial Officer & Executive Vice President
A

Yeah. Suneet, it's really with the domiciliary regulators for our U.S. Life companies. We do anticipate having a call with all the insurance departments here shortly to go over this type of information. That's really in conjunction with consultation with the regulatory domicile – the regulators of our domiciliary states. I would just point out by the way that one of the things that's in our future rate actions, which is a part of the overall block that we haven't had historically as much rate actions are in Choice I and Choice II, which really represent about $1.4 billion – a little over $1.4 billion of the overall $2.4 billion of in-force. And as we think about the new claim termination rate and utilization assumptions, or updated assumptions that we have, that's an area where really I think a big chunk of the future rate actions comes into play. Historically, we haven't had as much focus on that. If you think about the 2007 and 2010 rate actions, they were really contained to the much older blocks.

Suneet L. Kamath
UBS Securities LLC
Q

Got it. It makes sense. And then just the last quick one, just on long-term care. If we back out the charges and then we back out the benefits from the rate actions of, I think, $41 million, it looks like the normalized earnings excluding rate actions for LTC in the quarter was a negative $53 million, which is, as far as I've been tracking this, the worst quarter we've seen. So what – just any color in terms of what you're seeing in the core business, why we saw some significant deterioration relative to what we saw in the third quarter. I would have expected maybe the DLR charge would have improved earnings because you're sort of front-loading some benefits, but maybe that's not right.

Martin P. Klein
Chief Financial Officer & Executive Vice President
A

Yes. Suneet, let me just – I think the core is really – we could maybe talk about this a little bit offline, but the core is a little bit higher number. But you're right. It is negative. It's the first time we've seen it negative. There are a number of kind of nonrecurring things between the reserve – the margin impact this time, the adjustment that we're having and the reserves that we talked about earlier. The error is worth about $44 million. So we do have those things. But you back all that out, it still is a negative P&L number.

I think a couple of things are driving that. Really part of it is really related to the new claim reserve assumptions that we put in place at the end of the third quarter. And there was a couple aspects to that. One is as new claims come on to the books, we're now setting up a significantly higher reserve than we did in the past. So that's a pretty big difference that we're seeing this quarter. And then along the same lines with the new claim reserve approach that we have, we had less in the way of reserve releases on existing claims. Again, you recall that we updated our claim termination rates. We think people will stay on claim longer.

So, those dynamics this quarter had a pretty big impact on the quarter. I think that obviously has a current period impact. Presumably, if we have the claim reserve right, that means there'll be a lot less drag in future periods or hopefully no drag in future periods from the claims that go in the books. Then the final thing I'd say is this

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quarter, we have a fair amount left in reinsurance benefits. I want to say after tax probably about $15 million less in reinsurance benefits quarter-over-quarter, if that's helpful.

Suneet L. Kamath
UBS Securities LLC

Q

Got it, yeah. My core number just backed out the benefit of the rate actions. That's how I got from your minus 12 to my number. But thanks again, we'll follow up.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Yeah. But the only thing I would say on that is I think you have to count the premium increases, the benefit reductions we're getting and there's no question that going forward, we will, based on the new claim termination rates and benefit utilization, we do need to go back to the states on those old blocks and take that into account. And so that's part of why you need the premium increases to benefit reductions going forward that we've laid down on slide 5.

So to me, that's a critical part of it and we obviously would expect and these are all the numbers that are shown on page 5, or the annual incremental premiums and so, it's a lot of incremental premiums. Or going forward, we think there may be more benefit reductions and premium increases depending on what policyholders decide. And I think those are very important to restore the profitability of the in-force long-term care business.

Suneet L. Kamath
UBS Securities LLC

Q

Understood. Thanks for the time.

Operator: And next, we'll take Sean Dargan with Macquarie. Your line is open.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Thank you and good morning. I just want to follow up on the present value of future premiums embedded in your margins. As far as I'm aware, you're the only company assuming future rate increases that have not been either filed or approved. And on Tom's commentary that that getting these rate increases are critical. I think it puts a seed in some investors' mind that you may have to walk away from the estimates of the benefit that you're going to be getting from these in your margins. So, just to be clear, this methodology was signed off by the Delaware regulator and two separate actuarial firms?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Hey, Sean. It's Marty. Actually and I don't want to speak to individual companies, but I think actually there's a number of companies, actually more than a few that do include future rate actions in their GAAP analysis. And increasingly, as we've done the research, it looks to be in the statutory basis as well. And I don't want to talk about specific companies on this call, but I certainly can follow up and give you some direction on that offline.

I'd also say that on statutory basis, with the exception of New York that if you look at the guidelines in cash flow testing, they typically point to actuarial guidelines. Then you go to the actuarial guidelines, and they, in fact, allow for cash flow testing on businesses such as long-term care, which are guaranteed renewable. So, then beyond that, we did speak with the regulators on our domiciliary states specifically about this. They agreed that it's appropriate

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to include it, again, with the exception of New York, which does not allow for it. And then after we developed the plan, we then spoke again with them and reviewed it. If that's helpful.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Sure. And the actuarial firms that you mentioned are also okay with this methodology?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. They have reviewed all of our assumptions including this, and they believe the margin tests in aggregate or margin results in aggregate are appropriate given the assumptions we used including these.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Great. And one follow-up. So, you wrote down all goodwill associated with LTC and life. But you did not write down DAC or take a DAC charge. Can you just remind us what's the difference in accounting is in which you have to impair DAC versus goodwill?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Certainly. It is a different approach for us as we test goodwill. It's really kind of a two-pronged test. One is the test that looks at the overall value including the in-force and projected sales, and actually for a while now, both for our life insurance and long-term care lines have failed that particular test. So, then you segue to another test that really is very much focused on the value of new sales. In both life and long-term care, as you recall, we didn't partially impair or write off some of the goodwill balances in life insurance and long-term care. As we now look at where we are this quarter with potentially reduced sales from where we are given rating agency issues and some of the other things that we may do and dialing back sales to preserve capital along with some strategic options, we decided to write down all the remaining goodwill.

Shifting to DAC, it is a different analysis. That really frankly is part of the overall margin testing. So, when you do your GAAP margin testing, if the margins are negative, you then first write off the DAC and then after the DAC is written down, you're going to the reserves and reset those. So, our margins as you saw on the historical GAAP block are still quite positive and so we aren't in a situation where we're writing down DAC.

Obviously, in the future, if we decide to report parts of the long-term care business separately from a GAAP accounting standpoint and certain investors have different opinions on that, if it makes sense it takes some of the older business and put it in a different block and report separately, there would be – it would be tested separately and there would be DAC write-offs in that scenario.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Okay. Thank you.

Operator: And our next question comes from Ryan Krueger with KBW. Your line is open.

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Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Hey. Thanks. Good morning. On the sensitivities you've provided to the active life margins, I had a couple of questions there. First, how should we think about the interplay between the impact of the lower interest rates and a lower discount rate? In other words, if interest rates were lower than your assumption, would that also likely lead to a discount rate reduction on top of that as well?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. The discount rate is really a function of interest rates and spreads. Basically, it's effectively the portfolio rate. For GAAP, it's the current portfolio rate, and we just use that all the way through. And for stat, it's whatever the portfolio rate is year-by-year depending on the test or the scenario that's being used in the cash flow testing. But it is effectively the portfolio rate, and obviously the portfolio rate does depend on interest rates as well as the spreads you're getting on your portfolio.

Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay, I see. So if interest rates are lower as your portfolio yield comes down, you also lower your discount rate, so there's essentially two impacts?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Right.

Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay. And then can you – you show the sensitivities relative to the $4.3 billion statutory margin that's before PADs.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Right.

Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Can you help us think about what the sensitivities would be to the number that's already after the PADs? Because the sensitivities would be lower because you're already assuming some of this, I think, in the PADs.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

No. I think it's a very good point. And again, after PADs, I think our margins are right around $2.1 billion. The PADs this year are largely for a couple of reasons. One is for future rate actions, and the other is really for what we expect to have in the asset side or return side. So, I think you make a good point that close to $2 billion in PADs that we have, or actually $2.2 billion of PADs that we have, those really go sort of directly to interest rate-related aspects and conservatism there as well as rate action PADs.

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Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Got it. Okay. And then, if the BLAIC – can you give us an update on how much the statutory capital and RBC ratios are at the end of the year in BLAIC, and what the anticipated impact of repatriating that will be?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Sure. BLAIC's RBC did go up just about 100 basis points during the quarter to about 345% at year-end. The biggest part of that had to do with this tax benefit we got from this LPI kind of restructuring, and that really contributed most significantly to BLAIC's RBC increase this quarter. In addition, there was a smaller timing impact related to a repatriation of some small block of term business that was in there. So, BLAIC's RBC is now at 345%. The overall capital level in BLAIC is just over $800 million.

Ryan J. Krueger
Keefe, Bruyette & Woods, Inc.

Q

Thank you.

Operator: And our next question comes from Colin Devine with Jefferies. Your line is open.

Colin Devine
Jefferies LLC

Q

Good morning. I guess a couple of questions. First, Marty, you intimated the possibility you are considering a closed block. And based on your comments that there would be a DAC impairment, is it fair to conclude if we do look at what you define as the old block here, it would fail the margin testing? And so, there is a deficiency on that. That's the first question.

The second and perhaps you have Dan Sheehan there who can talk to this, when you're looking at changing the investment strategy, how much is that impacting the margin testing you've done here? And what I'm getting at is how dependent on it – how dependent is the testing on the success of that strategy? So, if we can clarify that.

And then for Tom, I guess, Tom, I'm scratching my head here because you're telling me the MI businesses are getting better, and yet I'm looking at your guidance for next year, and you're guiding for lower loss – for weaker loss ratios in both Australia and Canada versus what they had in 2014. So, maybe you can reconcile that since, frankly, I think you're forecasting some fairly significant increases on the loss ratios for both of them.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Well, Colin, let me start off, and on your first question, the historical GAAP block really, except for the acquired block, it's business really acquired 1996 and before, really represents a lot of the older generations as well as the newer generations. It's everything modeled in aggregate. I think it is very fair to say that the older blocks are performing much less well, in fact, losing money versus the newer blocks. So, in the overall margin that we have on GAAP, clearly that's – well, maybe not that clearly, it is a function of some of the newer business that has very, very positive margin. And that offsets to some extent what would be presumably negative margin in the older blocks. So, if we did at some point, and I noticed this was in your note, take some part of the old long-term care business and report it separately and manage it differently, that would likely create a DAC loss. Again, we're

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looking at a lot of different things right now, as Tom mentioned. And certainly that would be something that could happen. We're still assessing that along with a variety of other things.

With respect to your second question, I'd say that the reinvestment strategy and cash flow testing, it's a reinvestment strategy that is pretty typical with insurance companies. We've had a very high credit quality portfolio in long-term care particularly given the long duration nature of it. In fact, in the new reinvestment strategy, the credit quality in the very long duration stuff is still very high but as we are looking to, like many other insurance companies, get a little bit more spread, we'd intend to reinvest in just a little bit lower credit quality things such as the average portfolio would be BBB+.

Similarly, we also have had historically, at Genworth, next to nothing in alternative investments and thinking about a number of other insurance companies have 3%, 4%, 5%, 6%, 7% in equities or alternatives. We've had historically close to zero. So we'd build that up to about 5%. I think those things in the model because it's a reinvestment strategy and it's a very long duration portfolio, it takes quite a long time in the models to kind of build up to really make a bigger impact. As in the case of the bond portfolio credit quality, I think it takes 15 years to 20 years and on the case of alternatives, it probably takes about a dozen years or so to kind of build up to that 5% allocation. Clearly, alternative investments have a higher return in them than do fixed income bonds these days. But that was what was in our model.

Now, I'll turn it over to Tom for your last question.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Yes, Colin, I would say that first of all, we were pleased with the performance of all three of the MIs in 2014. If you look at that one slide that Marty showed in terms of how they performed against the targets we said at the beginning of the year, that's all green on that page. I would say we think they're good businesses. They're performing well. The loss ratios in 2014 were well below what our targets were. And so I think my feeling, I'll let Kevin talk specifically about 2015 in the guidance that they were very low. We think over time based on the historical performance in those markets that those loss ratios in 2014 were so good that they're probably not sustainable at that level. We still think 2015, the loss ratios will be good but I'll turn it over to Kevin to give you some more specifics on 2015.

Kevin D. Schneider
Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Yeah, Colin. As the guidance says as stated in Marty's remarks, in Canada, we're expecting it to be between 20% and 30% next year. Had great experience this year. I think the thing, and to Tom's point, I don't think it's sustainable. It's still even in our guidance, it's well within the range on our pricing expectations on Canada where we price the business. I think we just need – we're a little cautious right now as we observe the impact as we play through 2015 on what the oil price is going to do to the country. And that's something we're watching very closely. We think that's probably going to tap down the overall home price appreciation experience in Canada and might have some pressure relative to that oil price effect on overall unemployment. So I think we're a little bit more cautious on it but still a solid loss ratio performance.

In Australia, we're targeting a 25% to 30% range in Australia. I think it's a lot of the same type dynamics. The Australia economy is holding up pretty well but obviously the RBA is concerned with the strength of that economic growth. They've reduced cash rates as a result of that and cut their rates. So I think they're expecting some challenges to the economy. We think there's absolutely going to be a moderation in home rates down there. We've benefited significantly in 2014 from cure rates in Australia where we've sold houses and not even

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experienced any losses associated with it because of the high home price appreciation level. So I think that's going to tap down. So still very solid performance, well within our pricing expectations. But it is going to moderate, I think, off of what have been two very, very favorable years from a loss ratio perspective. And then the U.S. business is going to grow. It's going to continue to grow and experience, I think, a decent year in line with Tom's comments.

Colin Devine
Jefferies LLC

Q

Thank you. One follow-up for Marty. Marty, lifestyle protection, I think you acknowledged there's going to be a significant loss, I think that was the adjective you used if you're able to sell it. Given that, why wasn't the DAC impaired at a minimum? It seems to me effectively you acknowledged that $248 million has gone, so why not just clear the deck at this quarter?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. In a sense, it would be kind of nice to clear the decks and some of the stuff, but we do have to follow GAAP accounting rules. I would say that where we're launching a process, the GAAP accounting for this really means that to do what you described would really entail calling it discontinued operations. And I think to do a lot of it, so if you have to have a pretty tangible plan where you feel extremely confident that you actually would execute it, sell within about a year of timeframe. And so while we're launching the sale, and hopefully we'll be in a position where later on in the year we'll be able to actually execute a sale, I think we're not quite to that point where we can get to that GAAP accounting threshold and do that.

I would say that it's certainly our intent to sell it hopefully later this later. We've launched that process. I don't really want to comment on the valuation we expect to get from LPI, but we do want to make sure you and our investors and analysts all understand that. I think it's quite likely to be below and probably well below the current GAAP book value, but we're not really quite at the point yet from a GAAP accounting standpoint where we're able to make that change in our accounting.

Colin Devine
Jefferies LLC

Q

Okay. Well, I hope you can get there in the next quarter. Thanks.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Well, the further along we get, the better for us, so we hope we move it along as well, too. Thanks, Colin. By the way, just to be definitive on your question on some of the cash flow testing, yes, we absolutely would pass cash flow testing without this reinvestment strategy handily. So, it didn't have so much of an impact that would have negative margins.

Colin Devine
Jefferies LLC

Q

But it is fairly dependent on the assumptions on the new business and it's still early days for those to be fair too, right?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

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Yeah. To be fair, absolutely. Yeah. We called out and think the impact on a GAAP basis $4.9 billion is pretty similar on stats, so you can certainly wind it in and we wanted people know what was in that assumption and the amount of premium that's in that assumption, absolutely.

Colin Devine
Jefferies LLC — Q

Okay. Thanks.

Operator: And our next question comes from Geoffrey Dunn with Dowling & Partners. Your line is open.

Geoffrey M. Dunn
Dowling & Partners Securities LLC — Q

Thanks. Good morning. Just a little change in questioning. I'm a little confused on domestic MI for this quarter. Was there or was there not an additional loss accrual this quarter?

Kevin D. Schneider
Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division — A

Geoff, there was not an additional loss accrual. I think what we've seen in the U.S. business is we're continuing to see positive emergence of our early term delinquencies. But we need no adjustment to our factors associated with that. We're going to continue to watch for sustained performance before we make those adjustments. But we're probably reserved at sort of 1 and 6 times from the frequency standpoint trending more towards 1 and 7. But we need to see more sustained performance on that.

And on the other side of it – but we still got to be prudent, I think, as we watch severity, because severity has been kind of sticky. The older delqs continue to age. When you look at that all together, our reserves are performing – or our business is performing consistent with our reserve expectations but we had no adjustment this quarter.

Geoffrey M. Dunn
Dowling & Partners Securities LLC — Q

Okay. And then you also alluded to discussions with reinsurers. Are there any new reinsurance agreements this quarter? And are you still looking at XOL?

Kevin D. Schneider
Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division — A

We put no reinsurance agreements in place this quarter. We did make some nice progress working in the U.S. business, if that's your question, with reinsurers and consistent with our plans to be compliant from a PMIER standpoint. So, we've made a lot of progress with the reinsurers. Where we stand though is we still don't have the PMIER standards are not final. Until they are final, we won't know exactly how they're going to gauge the insurance. So, we're working on that and good review right now with the GSEs as well as with our state regulator.

Geoffrey M. Dunn
Dowling & Partners Securities LLC — Q

Okay. But at this point, you're still going down the XOL versus quota?

Kevin D. Schneider
Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division — A

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At this point in time, that would be our approach, yeah.

Geoffrey M. Dunn
Dowling & Partners Securities LLC

Q

All right, great. Thank you.

Operator: And our next question comes from Steven Schwartz with Raymond James. Your line is open.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Hey. Good morning, everybody. A lot have already been answered already. Marty, your description of the profit pattern for GAAP on LTC, are you basically referencing SOP 03-1? Is that how this is going to work?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Not exactly and I was wondering when this question would come up because it is a new phenomenon for us. And again, what we're seeing here in our margin testing for GAAP is the kind of expected pattern of earnings is over the next 15 years or 16 years. We have positive earnings, and then it becomes negative after that, kind of under the way we'd been reporting and that as those losses kick in after about year 2015 or 2016, the present value of those losses is about $1.2 billion. You take the $3.5 billion of positive and $1.2 billion negative, you still have positive margin at $2.3 billion.

But GAAP accounting, under GAAP accounting, when you have a period in the future where there are losses, you do need to accrue a liability for that. Beyond that, though, there's not really any clear GAAP accounting guidance on exactly how to do that. So, we're working with our accounting teams and our auditors to develop the approach. And again, I think there could be a variety of approaches depending on how we decide to do it and working in conjunction with our auditors. I think what we'd anticipate doing is that – what we'd anticipate doing is taking on – given that we now have a different view of severity on existing book, we will probably take some of the future rate actions on those existing book that we're tending to get. And rather than having the normal course as we would do, have that all hit the bottom-line as we get those additional premiums or as we get reserve releases. We'd rather take some of that benefit and fund liability for those future losses.

Again, I'd remind you that this really relates to the block of business we have at the point in time we did the cash flow – I'm sorry, the margin testing, so it says at year end. So any new business that we would write is really not part of this. It's really reflective of the block that we have on the books right now. But basically what we'll take is part of the benefit we'd get from future rate actions rather than hitting the bottom-line, we'll take some of that and build up an incremental liability to fund those losses so that $1.2 billion of present value losses would be effectively zero with that liability we build up.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. So, the use of benefit factors and what have you that you might do for GMIB or SG, well, is not necessarily – that's not necessarily where it's going to work?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

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No, no, not at all. This is all within the existing block that we have of long-term care and basically, as we're projecting forward, we would take our new view of claims which creates some losses in future years along with our new view of future rate actions and kind of change the accounting recognition for those future rate actions, so some of that would be building up as a liability or a reserve, if you will, against those $1.2 billion of losses, but it's all within the long-term care line of business.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Right. Yeah. I understood that. Now, I guess my question, it goes back to – I don't have a page number on here – page 3 of the long-term care insurance annual margin testing. The present value of future claims and expenses is $40.7 million. The present value of future premiums is $27.3 million on the HGAAP block.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Does that mean I'm going to have a benefit ratio, benefits divided by premium of, I think, that's 150%?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. I'm not sure I'd look at it quite like that. I think what – in fact, this doesn't really change the margin testing. What it does is that it changes the pattern of GAAP earnings recognition for the future rate actions. And I think that's maybe a way to think about it where if we did nothing, we'd get this future – let's go into status quo where would change nothing. What we'd see is over the next 15 years or 16 years, we'd get these additional premiums or reserve releases under these benefits. And that would hit the bottom-line. And that would help benefit the next 15 years or 16 years. But then you get into those later periods beyond 15 years or 16 years, and a lot of that benefit would already have been recognized in our GAAP P&L.

And then you got these higher claims given our new severity – updated severity assumptions and those higher severity expectations would lead to losses in future years. So, rather than doing that, what we need to do is set up a accrual for a liability to fund that period of time where those with future losses, and the way that we'll do that is we will not recognize the full benefit of those additional premiums or the full benefit of reserve releases but rather we'll recognize only part of that benefit and then set aside the remainder of that benefit and kind of accrue a reserve or a liability against those losses.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

All right. So, deferred profit liability is what you said. Okay. And then for Tom, I can't find the number here, but I thought I saw that the debt-to-total capital is currently 25.9%. Was that correct?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

That's correct.

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Steven D. Schwartz
Raymond James & Associates, Inc. Q

Yeah. That doesn't strike me as ridiculously high. I mean, a lot of companies are around 25%. I don't really understand why you think you really need some significant action here.

Thomas Joseph McInerney
President, Chief Executive Officer & Director A

So, again, I would say, Steven, that it's based on the options we're considering, including a number of investors and shareholders over time have talked about a split, and with $4.6 billion of debt at the holding company. Today, Australia and Canada being the primary sources of cash capital to service the debt, our feeling is to have a broader array of options that we could consider. And again, we have made no decisions on any of these. We believe we have more flexibility if the debt was $1 billion to $2 billion lower than what it is today.

We have talked to the rating agencies. We've talked to regulators and certainly we have heard from a number of investors over time. And I do think that given the level of debt and given today's payors, if you will, of the debt service, now U.S. MI, we think in a few years as it builds earnings in the unassigned surplus from the last year's goes away. It will also be a payor of dividends.

We don't think with long-term care, we are looking to improve the capital, RBC capital supporting long-term care. And therefore, we don't expect a lot of ability at least in the next few years to pay dividends. So, it's really to have flexibility to consider a broad array of options that are feasible, we believe. And our outside financial advisors have also confirmed that we'd have to reduce the debt around that range given the current cash capital generation of our operating subsidiaries.

Steven D. Schwartz
Raymond James & Associates, Inc. Q

Tom, you referenced a split. I assume you were referencing the potential of splitting MI from the Life Insurance operations. So that'd be correct?

Thomas Joseph McInerney
President, Chief Executive Officer & Director A

Right. A number of investors and others have talked about that.

Steven D. Schwartz
Raymond James & Associates, Inc. A

Sure.

Steven D. Schwartz
Raymond James & Associates, Inc. Q

Okay. Thank you.

Martin P. Klein
Chief Financial Officer & Executive Vice President A

Again, we haven't made any decisions and I think the debt pay-down Tom talked about would be designed to give us flexibility to do other options whatever they are. But I think with our current earnings streams, the mix of businesses, I think we – the debt lowered is quite manageable. What we would like to do is pay down a billion or a

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couple billion to have more strategic flexibility, if you will. But I think with the status quo, what we have, well, it's a little bit more down than we like. We certainly think it's very manageable with the flows that we'll be getting from Canada, Australia, U.S. MI come back over time and the U.S. Life, we're going to really sit tight on as far as dividends for next year or two and let that capital base build back up.

Steven D. Schwartz
Raymond James & Associates, Inc. Q

Okay. Thank you.

Operator: And ladies and gentlemen, we have time for one final question and it comes from Scott Frost from Bank of America. Your line is open.

Scott Frost
BofA Merrill Lynch Q

Hey. Thanks. Just wanted to make sure I understood this. On slide 3, you're talking about, for example, the $42.7 billion is the PV of future claims. You're saying that increased by $5.4 billion. Is that what you called out in the release? And then you're offsetting that by $4.9 billion of additional premium increases? And this leads us to the second question here. Is that the right way to – am I thinking about that the right way?

Martin P. Klein
Chief Financial Officer & Executive Vice President A

Right. The $5.4 billion is really represented in the present value future claims and expenses line, so that's...

Scott Frost
BofA Merrill Lynch Q

Okay.

Martin P. Klein
Chief Financial Officer & Executive Vice President A

...larger by that $5.4 billion. Again, there's one distinction on a GAAP versus stat, one is GAAP is pre-tax, that $5.4 billion is a pre-tax number. And then similarly the additional premiums, the $4.9 billion pre-tax of future premium benefits are really reflected in the present value future premiums row.

Scott Frost
BofA Merrill Lynch Q

Okay. Now, that's what I wanted to ask about. You talked about earlier the premium increases that you're going to get that have already been approved plus incremental expected additional premiums. It looks like about, if I look at sort of midpoint, it looks like $1 billion annually or whatever is what you're supposed to be getting. Am I assuming kind of a similar ratio in that $4.9 billion of rate increases you've already gotten versus rate increases you expect to get?

Martin P. Klein
Chief Financial Officer & Executive Vice President A

Yeah. To be clear and I'll refer folks to, I guess, it's slide 5. That $4.9 billion of benefit, pre-tax to margin reference is really associated just with the incremental premium that we would get in the future; at its peak that's $525 million to $625 million. What happens is as we implement that, you look at that in our modeling, it kind of builds

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up over time. It takes us about 15 years to really get that fully implemented. So, it ramps up pretty slowly and then actually it ramps down pretty quickly as the number of active lives paying their premium comes. It's really just about four years, five years, six years where we're getting additional premium in that neighborhood.

But the $4.9 billion is associated only with that, what we say there the anticipated peak actual additional premium. So, the other premium that we referenced that we've gotten to date, the $380 million to $470 million is really just trying to give a context for folks about what we've already achieved just in the last few years with these rate actions. That's already because it's approved that had already been built in to our margin testing.

Scott Frost
BofA Merrill Lynch — Q

Okay. Just – I should have asked more simply. Of the $4.9 billion of premiums you expect to get, how much of that has already been done?

Martin P. Klein
Chief Financial Officer & Executive Vice President — A

That's all in the future.

Scott Frost
BofA Merrill Lynch — Q

That's all in the future.

Martin P. Klein
Chief Financial Officer & Executive Vice President — A

That's all in the future.

Scott Frost
BofA Merrill Lynch — Q

That has to be requested from regulators and approved. That – I'm correct?

Martin P. Klein
Chief Financial Officer & Executive Vice President — A

That's right. Yeah, yeah. That is right.

Scott Frost
BofA Merrill Lynch — Q

Okay. For your debt reduction, what I count – it sounds like over time, and I'm looking at your debt maturity schedule, it looks like you've got $300 million doing 16; $600 million 18; $400 million 20. I mean, is that the time period I'm thinking about for your debt reduction plan? Is it normal amortization? Is that the time horizon we're talking about? And do you consider the 6.15% of 66 (sic) [166] to junior subs, is that contemplated as part of the plan in reduction?

Martin P. Klein
Chief Financial Officer & Executive Vice President — A

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There's different ways to pay down the debt. One is just with the passage of time really just pay off the maturities. And really the next few maturities we have are $300 million and $600 million respectively. That's certainly one way to do it.

I think what Tom described as we look at the strategy is what – is there anything we should be doing differently and our options we should be looking at that if we did choose those, those might accelerate those pay-downs if we sold the business or did something different or put something and run off for a variety of different things, will that create some capital that would give us the opportunity to do something quicker, if it made sense to do it in an economic scenario. So, obviously, how we think about the pay-down of debt is going to be a function of what we decide to do strategically and they're very intertwined.

Scott Frost
BofA Merrill Lynch

Q

So, again, that sounds like that implies tenders or open market purchases.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. If we did that approach, exactly right. If we – if, for example, we sold a business and had some capital we might then say, well, let's rather than waiting for maturity, we might then do a tender, and again, we have different obviously tenders with different maturities and different costs, and we'd look at all that in that particular market and decide if we wanted to do tenders, some open market purchases or what have you.

Scott Frost
BofA Merrill Lynch

Q

Okay, great. Thanks a lot. That's it for me.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Thank you for your question.

Operator: And ladies and gentlemen, I will now turn the call back over to Mr. McInerney for closing comments.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

Thank you, Christie. And again, thank you for all, everybody on the phone today for your time and your questions. And although we may not have answered every question about all of our future actions, we hope you have a sense of our focus and priorities and that you found today's discussion helpful. While our challenges are both complex and substantial, we are confident that our actions to date and the strategic review of future actions that we're now looking at will serve to continue to grow our mortgage insurance businesses, will rationalize our life insurance business while leveraging our leading position in long-term care to significantly improve in-force profitability and improve the way the LTC industry is regulated.

I can assure you that our management team is focused and determined to transform and build value in Genworth's businesses for the benefit of all of our stakeholders. Thank you very much.

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

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