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Genworth Financial, Inc. (GNW)

Q4 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to the Genworth Financial's Fourth Quarter 2015 Earnings Conference Call. My name is Lauren, 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, this 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. Good morning, everyone, and thank you for joining Genworth's fourth quarter 2015 earnings call. Our press release and financial supplement were released last evening; and this morning, our earnings presentation was posted to our website and will be referenced during our c all. We encourage you to review all of these materials.

Today, you will hear from our President and Chief Executive Officer, Tom McInerney, followed by Kelly Groh, 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, Chief Operating Officer; and Dan Sheehan, Chief Investment Officer will be available to take your questions.

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

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

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

Thomas J. McInerney

President, Chief Executive Officer & Director

Thank you, Amy, and good morning, everyone. Today, I'd like to provide perspectives in three areas. First, progress against our 2015 goals; second, our strategic focus for 2016, and third, our fourth quarter financial results. I will then turn the call over to Kelly to provide more details on the results of the quarter, the annual assumption and margin analysis, and overall liquidity and capital management.

As we all know, markets continue to be volatile, driven by slowing global growth, low oil and commodity prices, the strengthening U.S. dollar and concerns about China. Despite the increasingly challenged macro environment and our mixed operating results in the quarter, we remain focused on our key priorities to maintain solid capital ratios, reduce debt levels, enhance holding company liquidity, and improve the operating performance of our businesses.

As shown on slide 2, we have accomplished a number of our most important 2015 goals, including achieving PMIERs compliance with a prudent capital buffer, completing the sale of our European lifestyle insurance protection business, and in January, using the majority of the proceeds to pay off the 2016 debt, executing a life block sale that is expected to result in over $200 million of cash payments to the holding company as well as utilize 100% of the life company NOLs.

Continuing to fix LTC legacy block issues by aggressively pursuing and achieving premium rate increases and benefit reductions, and announcing the sale of our remaining European-based business Genworth Mortgage Insurance Europe that is expected to provide approximately $55 million of net proceeds to U.S. MI. In aggregate, the transactions announced or executed in 2015 are expected to generate capital in excess of $1.3 billion across the organization by early 2016.

Looking into 2016, our overarching focus will remain on improving business performance and increasing financial and strategic flexibility across the organization. Underlying these efforts is an aggressive plan to fully restructure the U.S. Life business to address structural concerns driven by our legacy LTC business. We intend to do this through a series of internal actions that will separate, then isolate our LTC business from our other businesses.

There are three primary benefits of taking these actions. First, to isolate the LTC downside risk that is pressuring our holding company and subsidiary ratings. Second, to allow any future GLAIC dividends to be paid directly to the holding company. And third, to increase LTC transparency while reinforcing, with state regulators, the importance of future LTC rate actions to the sustainability of our LTC business.

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This will be a multiphase process, that in the end would generally align substantially all of our in-force, life and annuity business under GLAIC and all LTC business under GLIC. We plan to affect these moves through reinsurance and repatriation actions. Once these actions take place, we would then separate the GLAIC and GLIC ownership structure, so that both subsidiaries are 100% owned by the intermediate holding company. Also, GLICNY will become a wholly-owned subsidiary of GLIC. In connection with these actions, our primary Bermuda subsidiaries would be dissolved which would facilitate future cash movements from our international subsidiaries.

To further isolate our LTC business from our other businesses, and cause the LTC business to be excluded from our bondholder covenants, GLIC and GLICNY may ultimately reside in another part of our organizational structure. This last step would utilize the existing organizational structure created in 2013 that isolated U.S. MI, and we believe it will be credit positive to our bondholders. I want to emphasize that these proposed actions will require approval from various, different regulatory jurisdictions and may require other third-party approvals. While we had preliminary discussions with regulators, all or some of our proposals may not be approved and we remain open to other options.

We hope to complete these actions over the next 12 months to 18 months, and have committed $200 million of holding company cash to fund these actions. Because of the important impact the restructuring of the U.S. Life business can have and its benefit to our shareholders and all other stakeholders, we wanted to disclose our intentions even though the outcome will take an extended effort and is not assured.

As I have noted before, most of my personal time is devoted to assessing and developing the company's strategic options, implementing LTC premium rate actions, and working with regulators on various LTC restructuring proposals.

Given the complexity and time consuming nature of these efforts, we have promoted Kevin Schneider to the role of Genworth's Chief Operating Officer. He brings significant experience to this role and we believe that Kevin's oversight will be able to improve the operations of these businesses. In addition to Kevin's new role, Georgette Nicholas, who many of you know, was just promoted to CEO of our Australian business after serving as acting CEO for the past four months.

Looking to 2016, for our mortgage insurance businesses, we will focus on continuing to grow and strengthen each platforms by taking advantage of accretive market opportunities, balanced with continued capital optimization. In contrast, our U.S. Life business will be in full restructure mode, and tough decisions are being made around expenses, product offerings and market served. Unfortunately, we have concluded that our sales of traditional life and fixed-annuity products, are unlikely to recover from their current depressed levels. We believe our low sales are primarily the result of three realities: First, the negative ratings differential between Genworth and the top 20 traditional life and annuity insurers; second, distributor suspensions due to continuing concerns about our ratings and financial stability; and third, the lack of competitiveness of our traditional life and fixed-annuity products because of our smaller scale.

After careful and thorough analysis, we've made a difficult decision to suspend sales of traditional life and fixed-annuity products by the end of the first quarter of 2016. As a result of reduced sales activity, we expect to see additional cash expense reductions on a full year run rate basis of approximately $50 million in the second half of 2016.

Turning to fourth quarter 2015 and full year financial results, we are pleased with the underlying performance of our mortgage insurance businesses. For the full year, we experienced strong loss ratios of 21%, 23% and 37% for Canada, Australia and the U.S. respectively, all at or near the low end of our expectations.

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Both Canada and U.S. had solid annual NIW growth and all MI capital levels ended the year in excess of management targets. Our international businesses provided cash payments of $117 million in the fourth quarter, bringing year-to-date payments from all operating subsidiaries to approximately $400 million in 2015.

Additionally, in 2017 or later, we continue to expect U.S. MI to begin to pay dividends. While we continue to be challenged with disappointing LTC and Life results, our U.S. Life businesses benefited from significant LTC rate action progress with $255 million reflected in year-to-date earnings from a combination of incremental premiums and reserve releases.

In addition, future LTC earnings will benefit from the implementation of rate action approvals received in 2015 from 35 states that impact roughly $740 million of additional in-force premium with an average approval rate of 29%, in line with our 2014 margin assumptions.

We continue to expect to see a more meaningful benefit to LTC earnings from these actions in the second half of 2016 as the significant increases approved in 2015 are implemented on policy anniversary dates. While we are pleased with our rate action progress, there is still much work ahead of us to fully address the legacy LTC block issues. We continue to actively work with regulators and believe our efforts, coupled with the financial challenges of the broader LTC industry are making a difference. We have seen a marked change in the minds of the regulators over the last 6 months to 12 months, including a deeper appreciation by a broader set of regulators of the value that actuarially justified rate actions provide, not just to our company, but to the LTC industry in general.

Moreover, regulators now better understand the value to each state of private long-term care insurance relative to their costs for Medicaid. Despite these efforts and our work to restructure and reposition this business, we expect near-term LTC sales to remain at low levels.

Our commercial efforts will be primarily focused on individual and group LTC products, in addition to the launch of a new immediate annuity to address the over 80-year-old LTC market. Over time we expect to develop and offer products and services that complement these offerings and are geared towards addressing the financial challenges of aging.

Our U.S. Life Insurance business remains committed to servicing our existing 2.8 million in-force life and annuity policy and contract holders, continuing to address the LTC market needs and partnering with regulators to solve this growing need.

Now let me turn the call over to Kelly to provide a deeper overview of the quarterly financial results and the outcome of our annual reserve assumption reviews.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

Thanks, Tom, and good morning, everyone. Today, I will discuss our fourth quarter results and key performance metrics, provide an update on our annual assumption reviews in our U.S. Life businesses, provide information about our investment portfolio, recap progress against our 2015 goals and discuss our goals for 2016.

We reported a net operating loss of $82 million and a net loss available to Genworth shareholders of $292 million for the quarter. Both of these were impacted by $184 million of net unfavorable items, which were mostly in universal life insurance related to actuarial assumptions and modeling refinements. Overall, we continue to see

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solid earnings, capital and loss ratio performance in our U.S. Mortgage Insurance businesses. In U.S. Life, sequential results were higher in long-term care, stable in fixed annuities and lower in life insurance.

Looking at key performance metrics, sequential operating revenue reflects three main drivers; one, earned premiums continued to be favorably impacted by LTC rate actions. Two, investment income is down slightly sequentially. And three, foreign exchange had an unfavorable impact of $10 million pre-tax.

Moving to underwriting results. Performance in the quarter was mixed. Sequentially, the mortgage insurance loss ratios remained solid and loss ratios for the full year of 2015 in these businesses met or exceeded our expectations for the year. The loss ratio in long-term care insurance was down from the prior quarter to approximately 73%, as the current quarter included net favorable items that were partially offset by lower terminations on existing claims. The loss ratio was also impacted by less favorable experience, primarily related to policies not on claim in the acquired blocks.

Quarterly fluctuations and terminations can impact the amount of active life reserves that are released. Life insurance results were impacted by the UL assumption updates and model refinements while fixed annuity mortality was slightly improved sequentially.

Total operating expenses of $433 million, included a $140 million pre-tax loss related to the pending sale of the European mortgage insurance business. Excluding that charge, operating expenses were lower sequentially, primarily related to higher legal accruals and expenses in the third quarter. As we've communicated in the past, our goal is to reduce cash expenses by $100 million or more in U.S. Life Insurance and headquarters. We made meaningful progress implementing expense reduction initiatives in 2015, absent our legal accruals and expenses achieving the low-end of our target with expected annualized run rate savings of approximately $90 million to $100 million.

While these cost savings could be partially offset by additional temporary transition expenses to build capabilities and close transactions currently underway, we expect to be on a run rate to exceed our goal in the first half of 2016.

Finally, as Tom mentioned, we are expecting to see additional expense savings from suspending sales of our current portfolio of life and fixed annuity products.

Turning to liquidity and capital. We made good progress against our goals in the fourth quarter. Let me highlight examples of that progress and update you on capital levels. First, we maintain solid capital positions in our operating companies. Second, we are compliant with PMIERs with the sufficiency ratio of 109%, as measured by the available assets divided by required assets. Also, we've reduced our affiliate asset holdings in U.S. MI to 15% through the elimination of all outstanding intercompany surplus notes with no PMIERs impact, further facilitating the expected payment of dividends beginning in 2017 or later. Third, we received $117 million in dividends and payments in the quarter from the operating companies, including $55 million in proceeds from the Australia Mortgage Insurance share buyback completed in December.

Fourth, turning to the U.S. Life statutory performance, unassigned surplus is expected to decrease approximately $145 million sequentially to around a negative $70 million, in part from an update of variable annuity assumptions and additional LTC cash flow testing reserves based on our agreement with New York highlighted in last year's analysis. This is an estimate as our statutory cash flow testing and regulatory discussions are still in process.

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I will note that unassigned surplus will likely decrease in the first quarter as a result of the expected $230 million of taxes due to the holding company from the life transaction completed in January. Finally, our available cash and liquid assets at the holding company were approximately $1.4 billion and represent a buffer of approximately $900 million in excess of 1.5 times debt service and restricted cash, and well above our $350 million risk buffer. The cash balance includes $325 million of proceeds from the completed sale of our lifestyle protection insurance business in December. In January, we used $321 million of those proceeds to redeem the senior notes due in 2016.

In 2015, the holding company received dividends and payments of approximately $400 million that includes special dividends from Australia as well as share buyback proceeds from both Canada and Australia. As we look forward to 2016, we anticipate dividends will be between $100 million and $150 million, reflecting a lower amount of special dividends. However, with the completion of the life block sale in January, we have successfully created another source of holding company liquidity from the life companies through internal tax payments.

The initial impact of this transaction is an expected tax payment to the holding company of approximately $230 million that will be settled in July 2016. Future tax payments will be dependent on the level of taxable income. In 2017 or later, we also anticipate to start receiving dividends from U.S. MI.

In 2015, net holding company other items was about $195 million. We included the key drivers of the other items in our presentation. Of the $195 million, $70 million was from items that recur every year, including scheduled payments for the tax matters agreement with our former parent company, as well as other expenses in the holding company. We estimate the internal tax settlements, which have historically been net outflows from the holding company will have a modest positive impact on cash going forward, but will depend on the level and timing of future tax payments from the life companies.

Additionally with the redemption of the 2016 notes, our interest expense will decrease by about $25 million in 2016. With that as a backdrop, let me discuss our near term debt maturities, most notably the $598 million due in 2018. The high yield market has been deteriorating particularly since the end of the third quarter, with the concerns around the slowing global economy. If we were to refinance today given the state of the market and our bond yields which have significantly increased it would likely be very difficult and very expensive.

Therefore, we believe the separation of GLAIC and GLIC and the isolation of the LTC business increases our financial flexibility across many fronts and is key to our ongoing credit story. Setting this separation to the side for a moment, should these poor market dynamics persist for the next two years, as we move closer to the 2018 maturity, we would have other options to meet it, including utilizing excess cash at the holding company, ongoing subsidiary capital optimization efforts for amounts over solvency ratio targets, or pursuing additional asset sales of block transactions.

Next, I would like to cover our annual review of assumptions, focusing mainly on universal life and long term care. Let me start with universal life, where we updated assumptions and made model refinements, resulting in $194 million charge in the quarter. This review leveraged both our own experience and the expertise of third-party actuarial firms that provided, among other things, views on updated industry practices. These updated assumptions included, one, we updated assumptions for persistency for both term universal life and no-lapse guarantee UL. Given the lack of credible experience in term UL, as we haven't yet hit significant shock-lapse periods, we utilized our term life insurance experience, and ultimately brought forward by one-year the post-level premium period shock lapses. Additionally, we updated the premium persistency on no-lapse guarantee UL, which resulted in an overall reduction in anticipated premiums.

Two, we updated our views on long-term interest rates to include our latest view of the forward curve, asset mix, credit spreads and default rates. While our reinvestment assumptions vary based on portfolio strategy across the

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curve at different durations, to give you a feel for one of these points, this reflects a 10-year treasury yield, growing to approximately 3.9% over 30 years, which is down 35 basis points to 70 basis points across our projection horizon.

Three, we updated our mortality assumptions for term UL to reflect further anti-selection in the shock-lapse period. Four, we updated our model horizon, lengthening our universal life model from 30 years to 60 years consistent with cash flow testing and other long-tail products. And lastly, the charge in the quarter included $36 million of corrections related to yearly renewable term reinsurance rates used in our actuarial models.

In our assumption review, we looked at a number of other assumptions including older age mortality, for which we did not make any changes at this time. We will review mortality and other assumptions again in 2016 with the benefit of updated experience and comparisons to industry experience where appropriate.

In LTC, we've completed our GAAP active life margin testing. The results of our testing for the HGAAP block representing policies written since late 1995 was a positive margin of approximately $2.5 billion to $3 billion, which is above what we reported a year ago. We've decided to provide a range this year and going forward given the long tail leveraged nature of the product and that future assumption and modeling changes could lead to significant changes in margin.

Our analysis leveraged one additional year of experience as we reviewed our assumptions and methodologies. Morbidity and mortality assumption updates negatively impacted margin while updated projections for our in-force rate actions included related modeling refinements that positively impacted margins.

We currently believe our assumptions are reasonable and supported by experience, and we used two leading actuarial firms with significant experience in long term care insurance to assist in both our assumption development and to perform peer analysis on our calculations. Additionally, experience for the LTC block is still emerging, particularly on our Choice I and later products. We will continue to monitor our experience, assumptions and resulting reserves closely.

Turning to in-force rate actions on slide 13, we made significant progress on our current rate actions that cover our oldest blocks of business through our Choice II product, achieving between approximately, 70% and 80% of requested increases to-date. As we continue to file for additional rate increases, including 19 states that gave partial approval for rate actions, we expect that number will increase. All in, we anticipate our current set of rate actions will provide an incremental $410 million to $500 million in peak premiums in 2017.

As a reminder, approximately $230 million to $240 million of that has already been fully realized with an additional $130 million to $150 million that is approved and being implemented. The future rate actions projected to be implemented over the next 10 years to 15 years, assume we achieve incremental annual premium, which grows to $450 million to $600 million at the peak around 2025 before declining significantly over subsequent years as the number of active lives decline.

Last year, we disclosed a benefit to the GAAP margin of $4.9 billion pre-tax from future rate actions that offset much of the impact from our updated assumptions. In this year's analysis, the GAAP margin benefits from approximately $6 billion pre-tax from future multi-year rate actions. This increase reflects the following: one, updated mortality rate and claims frequency assumptions; two, refinement of the model for policyholder behavior; three, inclusion of additional filings in states that are expected to approve partial amounts to achieve actuarially justified rate increases, as well as reduce cross state subsidization; and lastly, a modest increase in the planned rate filing for one block.

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It is important to note that if actual claim incidence or severity in the future is different than expected, the projected in-force rate action will change accordingly, as projected rate actions were developed to reflect claim cost being experienced.

LTC is a long duration product and movements in any number of assumptions can significantly impact performance over time, so we've provided select sensitivities on illustrative assumptions on slide 14.

Turning to our acquired block, as a reminder last year this block had negative GAAP loss recognition testing margin, so the GAAP reserve assumptions were unlocked and reset, so that the expected margin was zero. In this year's analysis, we continue to separately test this block and the resulting margin was slightly positive. Therefore, we did not unlock our GAAP reserve assumptions in the fourth quarter. We will continue to review LTC assumptions going forward and further study additional elements of the block as experience emerges.

As we noted in our press release last night, our statutory margin work is underway. While not complete, we anticipate the statutory margins for our GLIC or Delaware entity to remain positive in aggregate. Discussions with our New York regulator are ongoing. We will update you when the testing is completed either at the first quarter earnings call or before.

Next, I wanted to discuss our progress on the material weakness remediation. As previously disclosed in 2015, we implemented additional controls within our actuarial processes, and successfully completed our test of design of the new controls. In connection with preparation of our year-end financial statements, we currently expect to successfully complete the testing of the effectiveness of the new controls and anticipate the material weakness to be fully remediated by the time we file our 2015 annual financial statements on Form 10-K. This is subject to, of course, the completion of our year-end testing.

Before moving to goals, I wanted to discuss our investment portfolio. The portfolio continues to perform well in spite of headwinds from a volatile macroeconomic environment with weaker growth in China, energy prices that are weighing on global economies and lower commodity prices to name a few. Given that, we remain disciplined in addressing risk across our portfolio. Our total energy holdings represent approximately 6% of our portfolio or approximately $4.2 billion in book value at year-end. It is a diversified, high quality portfolio that is not concentrated in any single name. Approximately 90% of the portfolio is currently investment grade. Metals and mining represents 1% of the overall portfolio or approximately $700 million book value at year end. It is diversified across 29 names, with approximately 75% of the portfolio currently rated investment grade.

Turning to goals. In 2015, we met or exceeded our expectations for subsidiary dividends, capital levels and holding company cash. We anticipate our loss ratios in Canada and Australia to be pressured in 2016, given the macroeconomic headwinds I discussed earlier. That said, if current external consensus economic forecasts hold, we would expect the Canada loss ratio to end the year in the lower half of the 25% to 40% range.

Our goals for the mortgage insurance businesses in 2016 include, expected dividends from Canada and Australia of approximately $100 million to $150 million in total, combined risk-to-capital ratio of less than 18 to 1 for our U.S. MI subsidiaries, a 220% or greater MCT ratio in Canada and a PCA ratio of 132% to 144% in Australia.

Our goals for 2016 in the U.S. Life Insurance segment include progress on our in-force rate action filings and approvals in line with our current assumptions, and meaningful progress on the U.S. Life restructuring plan, including the repatriation of the businesses in our Bermuda subsidiary, paving the way for our legal entity reorganization and potential isolation of long-term care and the execution of the expense reductions.

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Performance in the quarter was mixed. Solid earnings, dividends and capital in the mortgage insurance businesses and improved margins and progress on rate actions on long-term care insurance was offset by the unfavorable impacts of earnings from assumption updates and model refinements in universal life. We are focused on reducing our debt and we have options to handle our future debt maturities including cash at the holding company, dividend flows, capital optimization and potential asset sales if we are unable to access the capital markets.

The potential separation of legal entities would also be credit positive to bondholders to help isolate LTC while better positioning GLAIC to pay dividends to the holding company in the future. While we are making progress on our strategic initiatives, there is much work to do.

With that, let's open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Ladies and gentlemen, at this time, we will begin the Q&A portion of the call. [Operator Instructions] Our first question comes from Ryan Krueger with KBW.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Good morning. First, I was hoping you could provide some color, I know it's early, but how you're thinking about the standalone capital needs of long-term care compared to life and annuities in Runoff. I assume as a standalone entity you would want a higher capital ratio and buffer at long-term care, but maybe a lower one in life and annuity, so any color you can provide there would be helpful.

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Hey, Ryan. It's Kelly Groh. Obviously, it is early days, again as Tom said we're in – we've had discussions with our state regulators on that. The benefit of long-term care, as you know, are the – the needs in long-term care really are reliant on our premium rate increases, and we will be managing the appropriate capital levels for those entities accordingly. We have committed $200 million incrementally to put into Genworth Life Insurance Company to be able to facilitate that separation.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay. So is the way to think about it, as you're thinking now that the $200 million from the holding company plus the combined resources of everything in the life businesses would facilitate this?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Yeah. There is a variety of steps we would take to affect that transaction, including intercompany reinsurance, but the $200 million from the holding company really represents the majority of the tax payment that we anticipate getting in July. We've had discussions with regulators at this point in time, we have not provided them a formal plan for approval yet. So there is more discussions to come on that, but currently that's the plan enough what we've committed to.

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Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks. And then, do you have an update on the BLAIC capital and RBC ratios at year end?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Yeah. Our capital and RBC ratios for BLAIC is roughly I believe about 330% at year end.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

And do you know what the capital is?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Let me see, if I can find that. You know what, we'll get back to you Ryan and we'll make sure we have that information for you.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay. And then just, if I could, one more, the holdco debt other items – we – I guess, was the takeaway that you would expect kind of $70 million would be a better run rate going forward than what we saw this year or are you actually suggesting that it could be better than $70 million based on the changes to tax settlement expectations?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Yeah, Ryan my expectation is the $70 million is really kind of the net negative item, so about $40 million related to our tax matters agreement and roughly $30 million related to corporate expenses ,and just timing on intercompany settlements, but that will vary from time-to-time. We should have positive benefits from the tax that would somewhat offset that $70 million, but again it does depend on timing. And my friend here from FP&A just handed me the BLAIC capital numbers, it's roughly about $855 million at year end.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you very much.

Operator: Our next question comes from Michael Kovac with Goldman Sachs.

Mike Kovac
Goldman Sachs & Co.

Q

Great. Thanks. Wanted to walk through some of the RBC changes that we saw in the quarter. It looked like it was down partially from the VA business as you mentioned, but wanted to think kind of your thoughts to buffer at $400 million. How do you think about that relative to potentially repatriating BLAIC with where you stand and also relative to your energy exposure?

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Kelly L. Groh
Chief Financial Officer & Executive Vice President
A

Yeah. Let me address firstly just the main drivers of the RBC ratio. As I think about the walk on the RBC ratio from about 445%ish to 430% this quarter, about 8 points of the decline really related to the variable annuity assumption review, another five points are kind of our placeholder related to long-term or New York long-time care cash flow testing reserve. And then just about another two points just miscellaneous other in-force items, so in terms of the BLAIC repatriation, we think it's the impact from that is roughly on a consolidated basis maybe 20 points to 30 points of risk-based capital.

Oh, and let me turn it to Dan, actually to address the energy stuff, Dan Sheehan, our Chief Investment Officer.

Daniel J. Sheehan
Executive Vice President, Chief Investment Officer
A

Thanks, Kelly. Just a couple of points that I'd make on energy. One is just a step back for a minute and look at the overall portfolio. We're in a gain position at year end of about $3 billion on the portfolio. The corporate book itself is in about $1.7 billion gain position. So we're starting off in a very good position from a quality or portfolio perspective.

Energy, which is under a little bit of stress, is about $4.2 billion. As Kelly mentioned a little less than 6% of the overall portfolio. At this point that book is trading at about $0.98 on the dollar, so a mark of negative $0.78. If you want to talk about what happens in a stress scenario, one-notch downgrade for that entire portfolio would be about a 10 RBC point impact.

Mike Kovac
Goldman Sachs & Co.
Q

Thanks. That's helpful. And on long-term care, so you can help us kind of think about the changes that were made in the quarter in terms of thinking about overall rate increases that you're anticipating, did you change the percent of approvals that you expect to get? I saw some comments on page 13 of your presentation that you're getting approvals at a higher rate, that maybe you had anticipated in the past, but did you make a change to that, and can you remind us of where that's running at in your assumptions?

Kelly L. Groh
Chief Financial Officer & Executive Vice President
A

Sure. This is Kelly again. I'll address it. Really from an overall approval percentage, we've been getting roughly 70% to 80% of the filed rate increases based on actuarially justified rate increases. And we really have not changed our expectation of that. Really, there is a few things to think about when you think about the $6 billion of in-force rate actions. We did make updates to our morbidity and mortality assumptions just based on emerging experience. It led to an increase in projected claim cost, and therefore an increase in the value of the future rate increases and benefit reductions. So part of is, as we adjusted our mortality assumption, we're going to have some customers paying premiums longer.

We also did assume a modest increase in the planned rate filing, just on one block. We also did assume some additional catch-up filings for states that had not given us full approvals and on those catch-up filings that's really just to help eliminate cross state subsidization, and lastly made some model refinements related to the calculation of NFOs and RBOs or nonforfeiture options and reduced benefit options.

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The one thing I'd put in perspective though is – obviously every filing is state-by-state dependent, but when you think about the $6 billion in connection with the present value of future premium, taking a really high step back, that's roughly 20% to 25% overall of that PV of future premiums. So really same methodology, same approval percentage, and just to give you a little context there.

Mike Kovac
Goldman Sachs & Co.
Q

Thanks.

Operator: Our next question comes from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JPMorgan Securities LLC
Q

Hi, good morning. The first question is just around your confidence level in receiving dividends from the U.S. MI business and I think you mentioned 2017 or beyond. But do you realistically expect to get dividends in 2017. And maybe if you could give us some idea on the potential magnitude, is it in the $10 million to $20 million range or could it be $100 million or higher? But just give us some idea on your confidence and the potential magnitude, specifically in 2017?

Kevin D. Schneider
Executive Vice President & Chief Operating Officer
A

Hi, Jimmy. This is Kevin. We expect to generate sustained statutory earnings coupled with PMIERs compliance to allow for future dividends. As we consider restarting annual dividends in 2017 or later, we think we're well positioned given our financial profile and that includes a low risk to capital, five years of increasing statutory income, PMIERs compliance with a prudent buffer, and I would add compliance generally to the new NAIC Model Act standards. We would assume a low-dividend payout ratio. As we talked about in some of the preparatory remarks, we've continued to reduce our reliance on affiliate assets in our overall capital profile, and we just have a really – as you look through our planning horizon, we have a robust level of statutory assets and capital.

As it currently stands in the early years of the reemergence of dividends, it could require extraordinary dividends as opposed to regular ordinary dividends, but we got a relatively good confidence level in our overall profile that we'll be able to work constructively with our regulator, and I would – I can't – on the order of magnitude, I'd say, less than $50 million probably in the early – in the first period growing as we get out beyond the '17 year.

Jamminder Singh Bhullar
JPMorgan Securities LLC
Q

Okay. Thanks. And then on your decision to stop selling life insurance and fixed annuities, your sales haven't been that good to begin with, so I don't think it should have a major impact, but why are you continuing to sell long-term care, and I don't know if that product by selling it, you're better positioned to get rate hikes or not, but maybe just explain your logic on continuing to sell long-term care, but stopping the other product.

Thomas J. McInerney
President, Chief Executive Officer & Director
A

Yeah. Jimmy, it's Tom. On life and annuity, there are 8,000 life companies selling the product, and if you compare Genworth to the top 20 providers, their ratings were much higher. So while we have monitored the sales in the last few quarters, our conclusion is given that rating differential, we just felt we couldn't be competitive, and we obviously don't have the scale that some of the top 20 players have.

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And by suspending sales, we save the $50 million of expenses that we talked about. In addition, as you know, because of the significant upfront commissions, particularly on life insurance, that has led to significant statutory strain, so by stopping the sales that also will improve statutory earnings. And under the restructuring where we hope to have GLAIC and GLIC now be sister companies versus GLIC owning GLAIC, we would hope that those higher statutory earnings over time will provide a good dividend stream up to the parent. So that's the story on life and annuity.

On LTC, unlike life insurance, there is only a dozen or so LTC players, and really if you look at where the sales are coming from, it's the top five players. And we've – we have always been in the top five, we remain in the top five. So we still do believe competitively we can sell long-term care, and there is no question, if you talk to any of the regulators in any of the states, that our commitment to remain in the business and sell, continue to sell LTC, because of the benefits to the state, Medicaid exposures going forward. They have clearly given Genworth, and I think the other players have remained in more premium increases than those that have discontinued sales.

Jamminder Singh Bhullar — Q
JPMorgan Securities LLC

Okay. And then, just lastly, could you remind us, what your interest rate assumption is in your long term care reserves?

Kelly L. Groh — A
Chief Financial Officer & Executive Vice President

Yeah. This is Kelly. I'll take that. We actually have that I believe in the slides.

Jamminder Singh Bhullar — Q
JPMorgan Securities LLC

Yeah. I was going through it, I couldn't find it, but...

Kelly L. Groh — A
Chief Financial Officer & Executive Vice President

Okay. I'm sorry. We may. I'll go ahead and just provide that then, one version of the slides had it at one point. On our PGAAP book, our discount rate is 7.02%, which equals our portfolio rate, on our HGAAP book, it's 5.24% which also equals the portfolio backing our HGAAP product.

Jamminder Singh Bhullar — Q
JPMorgan Securities LLC

But I'm assuming that you can't – new money yields are lower than those numbers, so they seem a little high, like I can understand your in-force yield being high, but as new premiums are coming in new money is got to be a lot lower.

Kelly L. Groh — A
Chief Financial Officer & Executive Vice President

Well, new money rates obviously right now are a lot lower, just given where the 10-year treasury is trading. We don't have a significant amount of portfolio turnover. If I look at the discount rate on HGAAP last year versus this year, it's roughly stable. Our PGAAP rate went down about 11 basis points. Our HGAAP rate last year was 5.23%, it's actually 5.24% this year, so we haven't seen a significant amount of movement, but obviously we provided you

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a sensitivity that for a 25 basis point decline in our HGAAP book, I think it would have about a $1.1 billion impact on our $2.5 billion to $3 billion of margin.

Jamminder Singh Bhullar
JPMorgan Securities LLC Q

And how – like if rates remain where they are, do you expect to review your assumptions sometime later this year, how often would you – or would you do it in the interim, like during the year sometime also?

Kelly L. Groh
Chief Financial Officer & Executive Vice President A

We update, for our disabled life reserve, we actually update our interest rate every quarter. For GAAP loss recognition testing, we really do it annually, but given a 25 basis point impact move on a huge portfolio that we have behind our HGAAP product, would be a very dramatic move given the duration of that portfolio. And given the fact that it would only impact the overall margin by $1.1 billion of our $2.5 billion to $3 billion margin, I don't anticipate needing to review it any earlier than our annual process.

Thomas J. McInerney
President, Chief Executive Officer & Director A

Yeah. And the one last thing I would say on that Jimmy, remember that when we are doing the premium increase request, we are looking for actuarially justified premium increases, and on the old book to get them close to breakeven, to the extent we did over time have a significant decrease in that interest rate, which as Kelly said because of long duration that the rollover isn't as quick as it is on other shorter duration products. We would take that into account when we're filing premium increases in the future to recover that.

Jamminder Singh Bhullar
JPMorgan Securities LLC Q

Okay. Thank you.

Operator: Our next question comes from Suneet Kamath with UBS.

Suneet L. Kamath
UBS Securities LLC Q

Thanks. Good morning. So just on the separation, the first question is the $200 million that you expect to get in July from the PL reinsurance deal, is what you're saying effectively that will go back into the life insurance sub to – that's what you've committed to putting in to affect the separation?

Thomas J. McInerney
President, Chief Executive Officer & Director A

Yeah. So Suneet, as Kelly said, under the tax sharing arrangement because of the River Lake I and II, there is $230 million going to the holding company in July. And in our discussions with the regulators, we have committed $200 million of that to basically the GLIC to create more capital. And so, right now that's the basis that we're talking to the regulators on.

Suneet L. Kamath
UBS Securities LLC Q

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Okay. Got it. And then, I guess just philosophically in terms of the separation, I guess the question is why are you pursuing this now versus say a year ago when I would argue, you probably had a lot more flexibility in terms of your stock price, in terms of the macro environment, just curious why now?

Thomas J. McInerney
President, Chief Executive Officer & Director

A

Obviously, over the last two years, we've had a lot of discussions with the regulators focused on the premium increases and their overall view. And we have been talking to them about GLAIC and GLIC, and I think there's been a much more of an openness on the part of regulators to consider that. I think they do understand that we can't go on for much longer with no dividends coming out of the U.S. Life division. So by doing this and having GLAIC and GLIC be sister companies versus GLIC owning GLAIC, and with GLAIC, it has life and annuity business, plus we're going to reinsure the life and annuity from GLIC to GLAIC, and with lower expenses, and no statutory strain on the life and annuity going forward, because we are suspending sales. All of that should lead to better statutory earnings over time and ability to dividend that to its holding company. And I think the regulators appreciate that.

We've got a lot of debt in the parent that we can't continue to rely on just Canada and Australia and we are expecting, as Kevin said, U.S. MI to start paying a dividend in 2017, but we said we've got to get some dividends out of the life companies.

And so I think, this separation will allow GLAIC to pay dividends, where it can't pay today, because it has to go through GLIC, and GLIC has, as you know, a big negative unassigned surplus. And also, I think the regulators – and part of the premium increase requests – obviously we've been giving them a lot more transparency. I do think the regulators do think that by separating GLAIC and GLIC it also allows them, because it's easier for them to see GLIC's performance and therefore the LTC performance, and it makes them more comfortable in giving the large increases that they've been giving.

Suneet L. Kamath
UBS Securities LLC

Q

Okay. And then just maybe lastly, on the holding company cash flow. The goals for 2016 of $100 million to $150 million of dividends from Canada and Australia, I think is lower than what we were thinking as well as lower than what's been in recent years. I think part of the reason is you're not assuming any special dividends or anything like that. But is there a case to be made for those special dividends to continue?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

We do have excess capital within some of our international subsidiaries. I think they are having calls today as well, and will talk about their capital plans and trying to work within the buffers over their solvency margins. I guess what I think of the $100 million to $150 million definitely does not assume much of special dividends. We had originally announced the Australia IPO, which we benefited $55 million in the fourth quarter. We had originally anticipated that would take a little bit longer than it did and that was really part of our plan, but now, it's part of our holding company cash.

As we look forward, when I think about 2017 and 2018, we do have quite a few more sources of dividends just beyond Canada and Australia. Kevin mentioned, U.S. MI and the planned growth in there given statutory earnings and PMIERs compliance. We do have capital optimization absolutely just given the lower level of lending in Australia and the pretty high solvency ratio that they have. The legal entity unstacking that Tom mentioned will

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provide a source of dividends over time there as well. And then we also have the tax benefits to the holding company that I think will be positive now versus negative before.

Suneet L. Kamath
UBS Securities LLC

Q

Okay sorry, one last one if I could. On the 2018 debt, I think Kelly, in your prepared remarks, you talked about potential for incremental asset sales. So I guess what's left to sell? I mean you've done LPI, you've done the European mortgage, what else would you think about selling?

Thomas J. McInerney
President, Chief Executive Officer & Director

A

Suneet, there are a number of things we can consider. We are continuing to look at life and annuity blocks. At this point, as I think we said last quarter for GMA given its ordinary dividends and its potential for special dividends or share buybacks, we think it's better to hold that than to sell it now given the current prices. So I think if you look at near term at potential asset sales, it's probably more oriented towards perhaps considering some of the blocks in life and annuity.

Suneet L. Kamath
UBS Securities LLC

Q

All right. Thanks.

Operator: Our next question comes from Geoffrey Dunn with Dowling & Partners.

Geoffrey Murray Dunn
Dowling & Partners Securities LLC

Q

Thanks. This might be just reading too much into your wording, but when you look at your 2016 through 2018 plan for the various MI operations, you vary your commentary between growth and optimization. Can you just clarify what you mean by your optimization of Canada and Australia?

Kevin D. Schneider
Executive Vice President & Chief Operating Officer

A

Yeah. Geoff, this is Kevin. As we look through our plans over the next couple of years, we absolutely think that the U.S. Mortgage Insurance business is going to continue to provide sustained growth opportunities. So think of the U.S. Mortgage Insurance business as continuing to grow, potentially getting to the point as we expect to be able to kick into the dividend stream in 2017 or later.

Australia for the next couple of years, we think we're going to have some depressed top line levels in that market. The regulator is trying to help through some macro prudential means, to cool off the market a little bit and manage the exposure down there to housing. We've seen the same thing happen in Canada over the last several years, and to-date, it has really allowed Canada to sort of have a soft landing and what had at the time been viewed as a really overheated housing market. So, right now, we'd expect and you could see it in with GMA's results for the quarter, which came out. They are going to have some top-line pressure. The biggest consumer of capital in this business is new business, particularly in that market. And so we do expect them to have continued cushions over their targeted solvency levels.

Those cushions will allow us the ability to continue to work at appropriate capital management opportunities, all within the constraints of what the regulator in that market and the local board will approve. So we see – I would

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say Canada or Australia over the next couple of years, going to be some capital management opportunities. Canada still had a decent market, decent top-line growth. And I would expect over the next few years you should probably think about Canada as continuing to grow and take care of share opportunities in the marketplace. But I would expect that to primarily be reliant on special dividends – or, excuse me, ordinary dividends – ordinary dividends in Canada over the next few years, because of the capital will be dedicated to ongoing growth.

Geoffrey Murray Dunn
Dowling & Partners Securities LLC Q

Okay. Great. Thanks for the clarification.

Operator: Ladies and gentlemen, we have time for one final question. We'll go next to Steven Schwartz with Raymond James.

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

Good morning, everybody. Thank you for taking the questions. Just quickly a number's question Kelly. What was the benefit from benefit reduction for the LTC business for the quarter, you said it was $38 million total with the premium, but what was just the effect on the reserves?

Kelly L. Groh
Chief Financial Officer & Executive Vice President A

Yeah. Steven, the benefit, reserve change benefit was about $55 million in the quarter. So the total benefit from both net premiums and reserve changes in the quarter was $102 million, of which $55 million was the reserve change.

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

That's okay. That was a slide I didn't understand, so how does that fit with the $38 million, Kelly?

Kelly L. Groh
Chief Financial Officer & Executive Vice President A

Yeah. Steven, it's up $38 million versus the last quarter.

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

Got you. Okay. Very good. And then just as an understanding here, you would have – I guess my question is how does this, for Tom, how does the separate in isolation feed in eventually to the split of the companies? Is it this idea that maybe this closed block of fixed annuity and life business will be reinsured somewhere? I mean, there is going to be no operations. You'll have a long term care. I'm just trying to envision what happens after this is done?

Thomas J. McInerney
President, Chief Executive Officer & Director A

Well, Steven, in terms of going forward, we still are open to separation of the company, splitting the company. I think that this reorganization – and if we do the last step you'd have GLIC, which would be the LTC business owned by Genworth Financial, Inc. and whereas today it's owned by Genworth Holdings, so it'd be outside of the bond covenants. And for life and annuity, it's a closed block, but given the nature of those liabilities that will be for

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a long period of time. And so I think that ultimately if we decide down the road to split this, reorganization, certainly makes it easier to do. But again this – the real purpose for doing the split now is to for the three reasons we talked about previously, which is to allow GLAIC to begin to be a dividend contributor again, and then ultimately have the LTC business isolated. And we hope a plus from a credit and a bondholder perspective.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. One more quickly, there is – you're well above buffers at the holding company, it wasn't clear to me this $200 million that's going to go down to GLIC, is that take into account on the buffer or does that lower the buffer?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

This is Kelly. The $200 million that we're – that we've committed to....

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

That hasn't come in yet, right.

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Correct.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay.

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

That's planned to settle in July.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. So given where cash is today, does it make any sense to begin to buy back the 2018 debt in the open market, big discount?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Yeah. It's absolutely something we'll look at.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. Thank you.

Operator: Ladies and gentlemen, I'll now turn the call back over to Mr. McInerney for closing comments.

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Thomas J. McInerney

President, Chief Executive Officer & Director

Thank you, Lauren, and thanks to all of you for your time and questions today. As we said we're taking significant steps in restructuring our U.S. Life Insurance businesses as well as improve the overall operating and financial performance of the company. We're committed with the sense of urgency that we build shareholder value and will update you on our progress over the quarters this year, and thanks again for your continued interest in Genworth.

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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