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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Genworth Financial's Second Quarter 2014 Earnings Conference Call. My name is Heather and I will be your coordinator for today. [Operator Instructions]

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, Genworth Financial

Thank you, Operator; good morning, everyone. Thank you for joining us for Genworth's Second Quarter 2014 Earnings Call. Our press release and financial supplement were released last evening and this morning our second quarter earnings summary presentation was posted to our website and will be referenced during our call. We encourage you to review all of these materials.

Today you will hear from our President and Chief Executive Officer, Tom McInerney, followed by Marty Klein, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period. In addition to our speakers Kevin Schneider, President and CEO of our Global Mortgage Insurance Division; Jerome Upton, Chief Financial Officer of our Global Mortgage Insurance Division; Elena Edwards, President of our long-term care business; and Dan Sheehan, Chief Investment Officer will be available to take your questions.

With regard to forward-looking statements and the use of non-GAAP financial information, during the call this morning we may make various forward-looking statements. Our actual results may differ materially from such statements. We advise you to read the cautionary note regarding forward-looking statements in our earnings release and the risk factors of our most recent Annual Report on Form 10-K and on our Form 10-Q as filed with the SEC.

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

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

Thomas Joseph McInerney

President, Chief Executive Officer & Director, Genworth Financial, Inc.

Thank you, Amy, and good morning everyone. Thank you for joining us for our second quarter earnings call. I will cover three points today and then turn the call over to Marty for a more detailed review of the second quarter. First, I will make a few comments regarding 2Q 2014 results. Then I will discuss our plans with regard to compliance with the new GSE standards. And finally, I will talk about the progress we're making on our long-term care insurance strategy.

Before I begin, let me take a moment to comment on Jim Boyle's decision to leave Genworth. As was announced last night, Jim has accepted the position of Chairman at HealthFleet Inc. While I am sorry to see him go, I respect his decision to leave the company and return to the New England area. I've enjoyed working with Jim and on behalf of our Board of Directors and all Genworth employees, I'd like to thank Jim for his thoughtful and steadfast leadership and wish him well in his future endeavors.

As you know, I have devoted much of my 18 months at Genworth helping to develop a new Genworth LTC business model and working closely with State and Federal Government leaders and regulators to change the regulatory framework for the LTC insurance market. Therefore, the Board and I believe it makes sense that I assume the additional role of CEO of the U.S. Life Insurance division until we are further along in the development and implementation of the new LTC business model and we have greater visibility into the go forward regulatory framework.

Now let's turn to 2Q 2014 results. Except for our long-term care business, I'm encouraged by Genworth's second quarter results. Turning to slide 4 of our 2Q 2014 earnings summary presentation, net operating income was $158 million, 19% above 2Q 2013. We are making great progress in each of our 3 core mortgage insurance platforms and GMIs operating earnings of $136 million show these positive trends.

Canada and Australia continue to perform very well with operating earnings of $47 million and $57 million respectively and loss ratios of 12% and 23% respectively. USMI had another excellent quarter with operating earnings of $39 million and a loss ratio of 43% and the 2009 and forward mortgage insurance books represent 50% of our risk in force.

As many of you know, on July 10 the GSEs released the new private mortgage insurer eligibility requirements. Slide 26 summarizes these new eligibility requirements. Although they could change depending on public comments in the final decisions of the regulators and the GSEs, we now have enough of the regulatory framework to take additional steps towards compliance. We intend to be compliant with the new capital requirements on or before June 30, 2015 and believe compliance by this date allows USMI to continue to play a strong role in the mortgage insurance market.

Our ability to be compliant by this date is dependent upon market availability, performance of our businesses, and the absence of any unforeseen developments. Of the sources of capital identified July 10 press release, we now have a specific priority for these sources in order to address the requirements.

Given where reinsurance markets are, we currently see multiple reinsurance options and we'll work to execute a reinsurance solution to address the majority of the capital need. If any shortfall remains after reinsurance, we expect to fund the shortfall with a portion of the $514 million of the net proceeds from the Australian IPO. Given our focus areas, we currently do not have plans to raise equity to fund the capital needs.

USMI is a core business for Genworth and we expect the business to be an important contributor to Genworth's results in the future. Despite the higher capital requirements, USMI remains one of our best business opportunities given our strong market position and return on equity. Given credit characteristics, we've been pricing new business assuming risk to capital of approximately 15 to 1, targeting returns in the mid-teens. We believe, even after the new requirements go into effect, new books of business in aggregate can continue to maintain returns in line with our expectations. We remain committed to ensuring that the private mortgage insurance market continues to grow with adequate returns. To that end, we will continue to work with the GSEs and FHFA to make appropriate refinements to the guidelines and move to implementation.

Turning to our U.S. Life Insurance division, our life and fixed annuity businesses achieved operating earnings of $39 million and $24 million respectively. Life results were about what we expected and fixed annuity performed above our expectations. Long-term care operating performance of $6 million was well below our expectations. And it's important to note, the 2Q 2014 LTC operating earnings were helped by $47 million of additional premiums and reduced benefits from the approved in force rate actions on our pre-PCS, PCS1, PCS2 and Choice 1 policies.

Now let's take a deeper look at our second quarter LTC insurance performance. We are seeing significantly higher incurred losses on our older blocks of business. Slide 27 shows the number of policies, average attained age and percentage of lifetime benefits on our LTC blocks. The higher losses from claims in the second quarter 2014 were primarily from higher severity on both new and existing claims, reflecting a more expensive mix than the prior quarter.

In the quarter, claims paid exceeded claim reserve releases which significantly reduced earnings. This significant adverse experience, although limited, is concerning as it could indicate a change in trend not reflected in our claim reserves. Given the strategic importance of this business and our desire to ensure we develop the best possible estimates of ultimate claim costs, we are conducting a detailed review of the associated claim reserve assumptions, methodology, and process to determine what changes are needed and we do not currently know whether or not these changes will have a material impact on reserves. We expect to complete this review by the end of the third quarter; however, given the complexity of the business, our review could take longer.

As a reminder, there are two primary reserves established to cover LTC policy benefit; one is the claim reserve, which primarily is made up of the Disabled Life Reserve or DLR. That reserve is a best estimate meant to cover the current inventory of claims and is reviewed periodically as experience warrants. The U.S. GAAP claim reserve was $3.5 billion as of June 30, 2014. The other is the Active Life Reserve, which focuses more on future claim funding and generally is locked in at the time a policy is issued. The U.S. GAAP Active Life Reserve was $15 billion as of June 30, 2014.

As you know, adverse experience from our oldest books of business was the catalyst for the large rate actions we are requesting in order to bring our oldest business close to breakeven. As received, the incremental premium for the rate actions helps to offset adverse experience. Currently, reserving rules do not allow us to consider when establishing the Active Life Reserve, the incremental premium that we have both implemented and continue to see. Under U.S. GAAP, unless the underlying margins become negative, demonstrating inadequate reserve levels, we cannot reflect the incremental premium for the rate actions in our Active Life Reserves.

We indicated in our December 4 LTC call, based on our margin review as of September 30, 2013, that we had significant positive margins even in certain stress scenarios. The margins reflected the future economic value of the anticipated $250 million to $300 million of annual premium increases meant to address adverse experience and had an NPV of $2.5 billion based on assumptions used in the analysis. This value, which resides in our balance sheet margins, will be realized over time.

The point here is that the accounting rules serve to create some mismatches: first, what is reflected in margins versus reserves; and second, a timing mismatch between when the economic benefits of the rate actions are realized and how LTC results are reported in the financial statements. With respect to the rate actions, we know that the original premiums on the pre-PCS, PCS 1 and PCS 2 and Choice 1 blocks have proven to be inadequate and we are seeking large premium rate increases to bring the pre-PCS and PCS 1 and PCS 2 blocks closer to breakeven and to improve the profitability of the Choice 1 business.

During the second quarter of 2014, two additional states approved rate increases, bringing the total number of state approvals to 43. The total gross annual premium approvals are now $330 million. And as we said last quarter, we adjust this number to get to our best estimate of the net incremental premium. After some refinements in our net premium projections this quarter, our slightly revised estimate of the net annual premium increase from the 43 state approvals as of June 30, 2014 is $190 million to $200 million when fully implemented by 2017.

We continue to work with the states that have not yet approved the increase and plan to refile in states where we didn't receive full approval. We still project that the ultimate annual net premium increase in these blocks, when fully implemented by 2017, will be between $250 million and $300 million.

As we've previously disclosed, margin levels are a key metric and we expect to complete our 2014 annual U.S. GAAP margin analysis during the fourth quarter of 2014 as we have done in the past. Additionally, our 2014 cash flow testing results will be reflected in our year-end statutory financials.

Now let me provide an update on our LTC strategy. Despite the challenges we continue to face on some of our in-force blocks of business, I remain convinced that Genworth can change the future business model and regulatory framework for our LTC insurance business in a way that will allow us to take advantage of the strong consumer need for LTC risk mitigation with attractive future growth, profitability and ROEs.

I believe we are making significant progress in the three key elements of our LTC strategy. We continue to make progress on convincing state insurance regulators, along with other state and federal government leaders, that it is in the interest of consumers, the states, all taxpayers, and insurers to create a robust private market for long-term care insurance. There are 150 million Americans between the ages of 40 and 75, including 78 million baby boomers between the ages of 50 and 68. But only 7.4 million Americans of all ages are covered by LTC insurance.

Since most baby boomers have saved significantly less than $100,000 in retirement plans, 70% of Americans reaching the age of 65 will need LTC services and 10,000 Americans are turning 65 every day between now and 2030, it is in the interest of all stakeholders to significantly increase the number of Americans who are covered by private LTC insurance. To that end, we launched our Privileged Choice Flex 3.0 LTC insurance product in July. This is a big deal.

As part of this innovative product launch, we are offering industry leading FlexFit packages that are simpler for consumers to understand while allowing them to pay as little as $80 to $90 per month for a reasonable amount of coverage. Consumers will have the option of choosing between several FlexFit premium or FlexFit coverage packages. We expect to see higher sales of LTC policies in the future as we begin marketing our new PC Flex 3 product as well as bring other new LTC products to market.

Next up on the new product front is a broader array of hybrid or combo life and annuity products with LTC riders. Our current hybrid offering, TLC, or Total Living Coverage, is selling well with gross deposits, net premium equivalents, of $42 million in the second quarter 2014 versus $25 million in second quarter 2013, an increase of approximately 70%. We expect to see TLC sales continue to increase in the second half of 2014.

I noted earlier that we continue to make progress on the large premium rate increases on pre-PCS, PCS 1, PCS 2 and Choice 1 blocks. We are up to 43 states approved and are in discussions with the remaining states. We are also starting the process of going back to the states where we didn't receive the full increase. Slide 13 in the presentation provides an update on the projected additional annual premium from these sources.

Of the remaining states yet to approve, there are six where we believe we have nearly exhausted all reasonable avenues that would allow us to effectively manage our business there. While we continue to work with these states to obtain the necessary approvals, we are evaluating all options up to and including the suspension of sales in these states.

We are also convincing more state insurance regulators that our new approach of smaller, more manageable rate increases sooner in the life cycle of an LTC policy makes sense. During 2Q 2014, seven more states approved our Choice 2 rate increase requests, bringing the total number of state approvals to 18.

Slide 27 shows in-force premiums, attained age, number of policies and percentage of lifetime benefits and other statistics on our Choice 2 blocks. The gross approved rate increases in these 18 states range from 10% to 13% of current premiums. So while we continue to be challenged by several of our in force LTC blocks, we remain confident that Genworth will be a leader in a more attractive LTC insurance market in the future.

Now I will turn the call over to Marty to cover 2Q 2014 results in more detail.

Martin P. Klein

Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

Thanks, Tom, and good morning everyone. I'll cover two topics today. First, I'll give an overview of results for the quarter. And second, I'll give an update on our 2014 goals.

Let's begin with second quarter results, starting with slides 3 and 4 of the earnings summary. We reported net operating income of $158 million for the quarter and net income of $176 million. With the completion of the IPO, a portion of the earnings in Australia are now accounted for in non-controlling interests. For the quarter, the non-controlling interest in Australia was $11 million and only related to earnings since May 21 of this year.

Adjusting for that, net operating income was up 27% versus the prior year but down 13% from the prior quarter, largely a result of adverse claims experience in long-term care, partially offset by continued strong loss performance in our Mortgage insurance platforms in Australia, Canada and the U.S. The results also reflect $11 million of unfavorable foreign exchange versus the prior year.

Turning to slide 5 in Global Mortgage Insurance, reported net operating income was $136 million up 11% versus the prior quarter when adjusting for the IPO impact. Let's cover Canada first, where operating earnings were $47 million for the quarter. Moving to slide six, unemployment in Canada at quarter end was 7.1%, a slight increase from the level at the end of the first quarter. And there was a modest sequential increase in home prices. Premiums were down sequentially from the maturing of the larger 2007 and 2008 books of business and unfavorable foreign exchange.

Flow NIW in the quarter increased 72% sequentially with the normal seasonal variation we see in the second quarter of each year combined with the strong rebound from the first quarter that was impacted by the more severe winter weather. Bulk NIW, which is lender dependent and varies from quarter to quarter, was up versus the prior quarter. We continue to expect Flow NIW to be flat to modestly higher than 2013 for Canada.

The loss ratio decreased 8 points from the prior quarter to 12%, the lowest level since 2006. Given the strong performance of the business so far this year and a stable economic environment, we now expect the 2014 full year loss ratio to be between 15% and 25%.

Turning to Australia, operating earnings were $57 million, up $6 million versus the prior quarter when adjusting for the IPO we executed in the second quarter. Turning to slide 7, unemployment in the country was 6%, up from 5.8% in April 2014, and overall home prices moderated in the quarter. Taxes were more favorable in the quarter; however, foreign exchange was unfavorable versus the prior year.

The tax favorability was related to the IPO and included a $4 million increase in expected quarterly tax benefits and a $5 million favorable adjustment to catch up year-to-date taxes. We still expect the 2014 full year tax rate in Australia to be approximately between 20% and 25%. Excluding the impact of foreign exchange, premiums were up from the prior year as the larger, more recent books mature and more premium is recognized. Flow NIW was down 3% sequentially. NIW is still expected to be flat or modestly lower compared to 2013.

The loss ratio remained low at 23%, although up 6 points from the prior quarter from seasonally higher new delinquencies and lower cures. We now anticipate that the loss ratio for 2014 will be between 25% and 30%. In Australia, we expect operating earnings before adjusting for minority interest to be in line with 2013 levels assuming stable foreign exchange rates. After adjusting for minority interest, earnings are expected to be lower compared to 2013.

Moving to USMI, net operating income was $39 million for the quarter. As shown on slide 8, NIW rebounded from the severe winter weather that impacted the first quarter home sales and it was up 56% to $6.1 billion. Given that the 2014 mortgage insurance market is now estimated to be approximately 15% lower than last year, we have reduced our expectation of NIW in 2014 to be in line with 2013 as the decline in originations is offset by higher MI penetration and market share.

New flow delinquencies dropped 19% year-over-year, in line with our 2014 expectations; and total flow delinquencies fell by 26%. Loss development within the quarter was in line with a modest loss reserve strengthening completed in the first quarter of 2014. Loss mitigation savings for the first half of 2014 were $216 million and we continue to expect full-year savings to be between $250 million and $350 million.

The new better performing books from 2009 forward are now 50% of risk in force. We expect this percentage to continue to increase throughout the year towards the higher end of our 2014 year-end goal of 50% to 55%.

Turning to capital in the division on slide 9, the prescribed capital amount, or PCA ratio, in Australia was estimated at 154%, up from the prior quarter from continued strong statutory income. For Canada, the minimum capital test, or MCT ratio, was estimated at 230%. After consultations with its regulator, the business established an interim target at 220% MCT, up from our internal target of in excess of 190%. We will review the target again pending the development of a new regulatory capital test for mortgage insurers.

While this interim target is higher than our previous management target, it adds clarity to the level of regulatory capital, which is below our current levels. The business continues to evaluate opportunities to optimize capital in light of this new target.

USMI at quarter end, the risk-to-capital ratio for GMICO was approximately 14.0 to 1. The 4-point decrease this quarter was from positive statutory earnings as well as the $300 million contribution of cash that was being held at an MI holding company from the December 2013 debt transaction as a first step in addressing the draft private mortgage insurer eligibility requirements.

Turning to the U.S. Life Insurance division on slide 10, operating earnings were $69 million, down $25 million from the first quarter, driven by the adverse claims experience in long-term care. Operating earnings in Life Insurance were $39 million for the quarter. Mortality experience has improved versus the prior quarter and generally in line with our expectations while versus the prior year, mortality was modestly improved.

Long-term care earnings fell to $6 million. The in-force rate action continued to impact earnings, benefiting results by $47 million, $34 million higher than the last year, and $3 million higher than the prior quarter. Moving to slide 12, the reported loss ratio for the current quarter was approximately 73%, up 10 points from the prior quarter.

The results in the quarter were significantly worse than expected, largely because of higher incurred losses. This quarter we saw a poor experience due to higher severity on new claims while at the same time we also had worse severity on existing claims, although, the causes for the higher severity are different. I should also note that this poor experience on existing claims is coming primarily from the older generation of policies on which we've enacted the significant rate actions which Tom discussed earlier.

Before I provide more perspectives on the new and existing claims, let me first remind people about claim reserves or what the industry commonly calls disabled life reserves or the DLR and how they work. Upon receipt of a valid claim, we set up a corresponding claim reserve, or DLR, to represent our best estimate of the present value of what we expect to pay out on that claim overtime. There are many assumptions that go into that best estimate reserve including the expected length of time payments will be made and how much of the available benefit will be used.

The reserve estimate is a function of several factors including the policy's daily benefit amount, the benefit period such as whether or not the policy has a lifetime benefit, diagnosis of the claim, for example dementia or physical issues such as stroke, and the situs of the claim, that is whether the treatment is at home, in an assisted living facility, or in a nursing home.

For existing claims where a DLR has already been established, a reporting period's earnings will depend on the actual payments made on those claims as well as by the change in the corresponding claim reserves. Earnings in a period are impacted if the actual experience in the quarter is different than what was assumed in the DLR.

For example, if there were fewer recoveries or deaths than assumed, then the paid claims would exceed the associated claim reserve release. Of course, given the complexity and number of factors impacting actual claims, we expect that in any given quarter there will be a gain or loss from the difference between actual paid claims and the change in DLR.

With that backdrop, now let me discuss what happened to new claims in the quarter. The number of new claims received in the second quarter of 2014 was actually slightly lower than in the prior quarter, down approximately 3%. So frequency of claims is not the issue; rather it was the severity of new claims which was higher as we had higher average claim reserves, which were about 3% to 4% higher on new active claims than we had in the prior quarter.

In this quarter, we had a shift in the mix of claims for which there were higher assumed payments, which was reflected in a higher average claim reserve that was set up, adversely impacting earnings versus the prior quarter. In particular, we saw a shift in the mix of claims from the prior quarter to policies with a higher daily benefit amount as well as a higher mix of lifetime benefits claims, which are expected to be paid for a longer period of time. The total earnings impact in the second quarter versus the prior quarter for new claims was approximately $12 million after tax.

Now let's discuss existing claims, where severity was also adverse this quarter. In the first quarter, our experience relative to our disabled life reserve assumptions was favorable, resulting in a favorable impact of approximately $5 million, while in the second quarter our experience was unfavorable resulting in an unfavorable impact of approximately $24 million; or a $29 million difference between the quarters or about $19 million after tax.

In other words, disabled life reserve releases on claims were more than sufficient to offset paid claims in the first quarter, but in the second quarter paid claims significantly exceeded the associated DLR release. The largest driver of the difference between quarters that fewer claims were closed or terminated during the second quarter, down approximately 5% compared to first quarter, which contributed to higher paid claims during the quarter and a higher ending claim reserve than anticipated.

When comparing to the prior year, both increased severity and higher frequency in new and existing claims drove the increased incurred losses. New claims accounts received in the quarter were up 8% versus the prior year. The average claim reserve for both new and existing claims also increased versus the prior year.

As Tom mentioned, given the second quarter results as well as our annual review process, we have started a deep review of our long-term care disabled life reserves and intend to complete it by the end of the third quarter. We last performed an in-depth DLR review in the third quarter 2012 and strengthened components of the claim reserve at that time, although there was a minimum net impact to our earnings as we also released another claim reserve component that was redundant. Our last annual review in the third quarter of 2013 did not indicate a need for any strengthening at that time.

Moving to the 2012 rate actions, we saw an incremental $32 million of premium in the second quarter and now anticipate that after-tax earnings for 2014 should benefit by $150 million to $175 million from the rate actions, higher than our initial forecast. However, we now expect the incremental premium that will be recognized in 2014 will be between $120 million and $140 million pre-tax, lower than our initial forecast given the timing of approvals and a further refinement of the projection model.

For fixed annuities on slide 14, earnings were $24 million. Mortality was unfavorable to both the prior quarter and prior year.

Turning to a review of statutory results on slide 15, unassigned surplus for the second quarter was up from the prior quarter at approximately $560 million. The unassigned surplus growth came primarily from a reinsurance transaction we completed in the quarter on our term insurance block as well as from operating income in the businesses.

Reported statutory income from the U.S. Life companies was up from the prior quarter and included benefits from a restructured life insurance transaction and inter-company dividends. Excluding the life insurance transaction and intercompany dividends, pre-tax statutory income was approximately $80 million on the quarter. The risk-based capital ratio for the quarter in the U.S. Life companies is estimated to be approximately 490%.

Shifting to the Corporate and Other division on slide 16, the net operating loss for the quarter was $47 million. International protection earnings were $2 million for the quarter. Reported net written premiums in the first half of the year are up compared to the same period last year as the business is beginning to see some relief in the top line pressure it has been experiencing given the challenging environment in much of Europe. Also during the quarter, S&P affirmed the financial rating of the business at A-, revising the outlook on the rating to stable from negative. Run-off earnings were $15 million in the quarter as equity market growth was modestly higher than the prior quarter.

Shifting to investments on slide 17, the global portfolio core yield was up slightly from the prior quarter at 4.45% and we continue to experience a very low level of impairments.

Let me now cover some topics at the holding company on slide 18. We continue to generate and maintain significant liquidity with cash and liquid assets of approximately $1.2 billion at the holding company, representing a buffer of approximately $800 million in excess of 1.5 times debt service and well above our $350 million target buffer over that level.

Cash levels benefited from our successful execution of the Australian MI IPO with net proceeds paid to the holding company of approximately $500 million in the quarter, but we're also impacted as we paid off the $485 million 2014 debt maturity. Our leverage ratio has now declined over two points to 23.9% in line with our year-end expectations of 24%. Important priorities for us for the IPO proceeds remain ensuring our operating businesses are appropriately capitalized and seeking opportunities to accelerate progress on our medium-term leverage targets.

As Tom mentioned, USMI is currently focused on reinsurance alternatives in large part to meet the GSE requirements. We will determine the use of IPO proceeds after we assess the final GSE requirements and alternatives to comply with them as well as evaluate U.S. Life performance, particularly long term care results.

I'd now like to provide an update on our goals and earnings drivers for 2014. In the U.S. Life insurance division, our expectation in February was that the division's earnings would increase 5% to 10% over 2013 largely driven by improvement in long-term care from the rate actions. However, given incurred loss results in the quarter, it is likely that 2014 earnings for the division will be lower than that expectation.

Our views on 2014 earnings for life insurance remain unchanged from those we laid out back in February while fixed annuity results this year in our view to be somewhat better than expected in line with overall 2013 levels given strong investment performance. Long term care experience in the quarter was well below expectations. We will watch results closely in the third quarter to see if there are any underlying trends or if the second quarter results are merely an aberration. In addition, results could be impacted by the long-term care disabled life reserves review.

If long term care experience remains adverse, our unassigned surplus target could be impacted. Given our desire to maintain healthy capital levels and with approximately $500 million of Australia IPO proceeds at the holding company, we currently expect to reduce 2014 U.S. Life dividends below the targets, perhaps significantly if needed, even with strong dividend capacity in order to support healthy levels of unassigned surplus and RBC ratios. As a reminder, our capital plans did not assume the execution of the IPO, but now that it is executed, the proceeds give us enhanced flexibility.

With the upcoming long term care DLR review, the repatriation of the long-term care business in our Bermuda-based captive BLAIC likely will move to 2015, given the time required for regulatory approval after we update our filings during the fourth quarter to reflect any potential changes to the disabled life reserves in the third quarter.

Let's move now to the Global Mortgage Insurance division. After adjusting for earnings attributable to minority shareholders, we currently expect our reported operating earnings for the division to be flat to up modestly, reflecting strong loss performance and lower effective tax rates and assuming stable foreign exchange rates.

Dividends for the international MI segments in 2014 are expected to be between $70 million and $110 million, reflecting the impact of the IPO and would be in addition to the proceeds received from the Australia IPO. Finally, our expectations for businesses in our corporate and other divisions have not changed.

Let me wrap up. We continue to make good headway in executing our strategy and taking actions to improve our business performance, although the incurred loss experience in long term cares this quarter was very disappointing. As we move to the second half of the year, we have much work ahead of us to deliver on our strategic priorities and continue to rebuild shareholder value.

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

QUESTION AND ANSWER SECTION

Operator: And ladies and gentlemen, at this time we will begin the Q&A portion of the call. [Operator Instructions] We'll take our first question from Sean Dargan of Macquarie.

Sean Dargan
Analyst, Macquarie Capital (USA), Inc.
Q

Thanks and good morning. Yeah, I don't know if Tom or Marty wants to answer this, but I'm wondering if you could help us think about how to size a potential reserve strengthening, because you did say that a change in assumptions is likely as a result of this review. I mean what should we be looking at?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.
A

Sean, there's a complex answer to that question. And so I think probably the place to start would be if everybody could focus on Slide 27 in the presentation, because I think it's very important. And so if you look at, we divided there the old block, which is pre-PCS, PCS1 and PCS2 and there are 331,000 lives in force. So those are the policies that we know we have issues with and that's where the bulk of the $250 million to $300 million of additional premiums is coming in.

And then on the new block, we have Choice 1, so that's a block that's the oldest of the new blocks and there are 316,000 lives covered there. So between the old block and Choice 1 together, that's about a little over 50% of our lives in force. And so those are the challenged; then on the new block it's about 570,000 policies. And you can see on that slide that the average attained age on the old blocks, so pre-PCS is 85, PCS 1 is 82, and PCS 2 is 76. So that's – just given their ages, that's where we're seeing issues. And of course, if you look at the percentage of lifetime benefits it's also much higher than say the newer blocks where it's very low and now we don't offer that.

And the other thing – you know, there's a confusion I think on the part of some and maybe it's our fault, between what we did in December and what we're saying now. So if you go back to the December 4 review, there we were looking at the overall margins. And we did that because many investors and analysts were concerned because other companies had taken reserve additions primarily around different views or assumptions that they had on the Active Life reserves.

So when you look at December 4 and you talk about the overall number of policies that we have, it's about 1.2 million individual policies, then we have group policies on top of that, but it's relatively small. And so what we did in that margin review on looking at all the policies, including those on claim. The basis was economic and then you have to adjust for the U.S. GAAP and U.S. stat accounting rules when we do our actual GAAP margin and stat cash flow testing.

But remember, the margin is very different than just a reserve. The margin is the net present value of the cash flows from all sources, so that would be reserves plus current and future premiums plus investment income, less the projected claims and expenses going forward. And so as we said in December, when we look at all of that the economic margin was $4.6 billion on a stat basis and $4 billion on a GAAP basis. Then when you do the margin testing, it's less than that.

But the other thing that is very important to remember is that there are two key drivers for a big part of that margin, and we also explained in December, which is there's $2.5 billion of net present value in the margin from incremental premiums that we're seeking. So those are those large premiums where we're expecting $250 million – $300 million, at this point, we're at $190 million to $200 million. In addition to that $2.5 billion, there's $1.5 billion or maybe a little more of realized gains from the terminated interest rate swap.

So a big driver for that economic margin were those two things. When you look at the claim reserve – and that's what we're talking about here, not the overall margins, not all the policies, the claim reserve, there are 50,000 people on claim. So you look at 50,000 compared to the $1.2 million overall individual policies, that's about 4% of the policies are on claim. And there, the accounting rule is it has to be your best estimate. There can be no margin in that; it's your best estimate of the net present value of the claims. So on those 50,000 claims – and those turn over because the average claim is only three or four years, and then you have new people on claim.

So we're talking about what we may decide to do in terms of assumption changes on 50,000 claims. And if you look at in the December 4 presentation, it was based on what we saw as of 9/30/2013. And if you look at the claim reserve in the first half of 2013, in fact, we had higher than normal claim terminations, basically deaths. So when we did our December 4 review, the claim reserve or the DLR looked okay and most of the focus was on the overall broader margins.

Now what we're seeing – of course we're seeing this in three months, April, May and June; but they were much higher, and much higher and it – what we can't figure out is that a trend or is that just three months and things will go back. We compare to last year's first half we would say, it's much more severe than that. So that's really what we're doing in this review that we're going to do in the third quarter. For now, we will do our normal margin thing as we said, the GAAP margin in the fourth quarter and stat cash flow testing when we file the statutory statements; what we're looking at third quarter is the DLR or claim reserve, which is $3.5 billion of the total reserves. I think the ALR is $15 billion and then there are some other reserves.

So the only thing I can say, we don't know because we've got to analyze whether this basically three months of data is significant or not. We just don't know that. And that's what we're looking at. But just to put it in perspective, it's the actual existing claims and not the overall book of business. I hope that helps, Sean.

And the last thing I'd say, this is very complex. It is the primary reason why I'm pushing so hard with the states that you can't predict the stuff. You are going to see changes in severity. And one of the issues, we're seeing more assisted living claims versus nursing home claims, which we saw in the past. On the really old policies, they're only nursing home policies.

So it's complex and I think we can't tell you what the ultimate result of this until we really spend the time. We'll have some of the best outside experts helping us figure out. Do these – these higher claims in those three months, is that a trend? Is it a new trend or not? All of that, as Marty said, will be factored into whether or not we decide to make any changes in our assumptions for the claim reserve. And as I said, last year when we are doing the overall margin review, we did – we decided we didn't have to make any changes in the claim reserve because in fact, the first half of the year that claims were lower because of terms – of higher terminations.

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

Sean, it's Marty. I would just add a couple of things. One is since the reserve review and some strengthening we did in the third quarter 2012, what we saw throughout 2013 and actually in the first quarter is that generally the DLR has been appropriately funding paid claims and existing claims so this is the first quarter where we've seen such a significant kind of loss on that. And as I mentioned in my remarks, we saw a loss of about $24 million this quarter pre-tax; that's by far the largest loss.

In general for all of last year, quarter-by-quarter, if you add it up that was a slightly positive number and it was a slightly positive number in the first quarter. So this is the first quarter we've seen such a loss, to Tom's point, in the last three months.

The other thing I'd mention, you might find it helpful; while, as Tom said, we don't really know as we look at these assumptions and make changes what impact if any of the reserves will – it will be on the reserves, I'd say there's kind of a helpful rule of thumb as you're thinking about potential impacts on the statutory entities of U.S. Life companies. Think about a pre-tax DLR increase, let's say, for every dollar of DLR increase if it increases, roughly a third of that dollar, say $0.33, would actually impact unassigned surplus.

There's really a couple of reasons behind that. You'll recall that half the business is reinsured into BLAIC, the Bermuda subsidiary, so only half of it hits the U.S. statutory entity. And then there are other tax benefits, let's call it generally 35%, up to some amount that we hit. So basically, one third, roughly, as a rule of thumb of every dollar of DLR impact hits unassigned surplus, so it would be, I think, a fairly modest impact on a percentage basis on unassigned surplus.

Sean Dargan
Analyst, Macquarie Capital (USA), Inc.
Q

Okay, thank you. If I could just ask one quick follow-up and then I'll let others get on, the process in which you come to your best estimate of NPV of claims, is that the same for GAAP and stat reserve? So in other words, it's – we won't have a scenario where you can add to GAAP reserves without having to add cash to stat reserves?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.
A

Basically, Sean, the only difference between what we would have to do for the claim, a best estimate for the claim reserve for GAAP and stat is there's a different discount rate between the two. But remember, these on averages are three or four year claims so the NPV, there'll be some difference but it's not all that significant. So to the extent that we change anything, we would change both for GAAP and stat. They'd be a little bit different because of the different interest rate assumptions for the discounting.

Sean Dargan
Analyst, Macquarie Capital (USA), Inc.

Q

Okay, thank you.

Operator: And we'll take our next question from Nigel Dally with Morgan Stanley.

Nigel Dally
Analyst, Morgan Stanley & Co. LLC

Q

Great thanks; just going back to Sean's question, perhaps from a little different angle. I appreciate the complexity of it all, but in the past you provided sensitivity to different factors and so you've got this $3.5 billion of disabled life reserves; say the severity was 10% worse in perpetuity. Possible to come up with a number as to what that would mean for the potential changes to the DLR?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.

A

You know, Nigel, you just can't do it that way. There are so many different factors that you look at and so I just don't want to get into speculating, because we really need to do the work to see based on the second quarter, do we need to change the assumptions or not. The other thing that the last – we and most other companies probably every three or four years do, regardless of what's happening in the claims, do a deep dive into the claim reserves.

And so as Marty said last time we did that was in 2012. And so that would have reflected all of our experience, the history, 'til the year before, say. Since then, we have whatever that is, two more years, two-and-a-half more years of claims data. So we'll look at all that again and so there will be, let's call it two years plus of new claim data to look at and then we also will consider what to make of April, May and June and then what we may need to do in terms of our assumptions on the claim reserve.

Again, it comes back to the requirements are that we book our best estimate. So where we are in the claim reserve in the second quarter is our best estimate, but we do want to review all the assumptions given what we saw in April, May and June because it was unexpected. But to get into speculating on what that could mean, I mean, I just think we just don't want to do that because we just don't know; we have to do this fulsome review. We'll have inside and outside actuaries looking at all of that.

And so because there are so many different drivers, you've got females and males; females are in claim longer than males, 85-year-old versus a 65-year-old on claim, whether it's dementia related or non-dementia related, whether an assisted living facility or a nursing home or in-home. There's so many variables that you have to look. There's transitions now; people generally start on claim in home care, then they go to assisted living, and then it's usually the last case nursing home. The nursing home costs are double assisted living costs. So there's just so many complexities that to try to get into what the three months and the change based on claims since we did the last study, there's just too many things to factor in for us to be really be able to give you any guidance yet.

We obviously will do a full look and we'll see whether we need to change the assumptions and if we do, that may or may not have a material impact on our best estimate for the claims. And again, I come back to where we're only talking about 4% of the total policies; 50,000 versus the 1.2 million.

Nigel Dally
Analyst, Morgan Stanley & Co. LLC
Q

Right, understood. Just another follow-up on long-term care as well; you mentioned the six states where you've exhausted your ability to re-price. Can you give us an indication as to how large those states are? Perhaps what percentage of your total premium comes from those states?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.
A

I think what we've received to date represents about 70% of the overall premium. The remaining states are some large and some small. The six states include some of the New England states, so some of them are small. And then, of course, we're going back to 30 or more states where they didn't give us the full rate increase to ask for more.

And the other thing I would say, again, because I'm sure we may get this question is we're not necessarily done on the rate in – premium rate increases on those old books. What we have agreed is on the states that gave us the full increase, and that's – of the 43 states, that's less than half of the states, they gave us a full increase. In general, we're agreeing not to – these are increases well above 50%. We've agreed not to ask for a rate increase until 5 years from now. But on the other states where they didn't give us the full rate increase, we are going back. We're also going back with April, May and June claim statistics. So we are for those going back and factoring that in and talking to the regulators.

Clearly, I think this is one more hopefully good argument for them that they do need to give us the increase because we may be seeing claims – and again going back to slide 27, on this pre-PCS, PCS1 and PCS2, part of the problem is that at least on the 2 oldest blocks the average age is 85 for the pre-PCS and 82 for PCS1 and so those are clear – and there's a lot higher percentage of life time; now we don't offer that on FLEX 2 or the new Flex 3.0 product, but in the past we did.

Nigel Dally
Analyst, Morgan Stanley & Co. LLC
Q

Great, thank you.

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

Nigel, it's Marty. Just want to go back for just a second on the DLR reviews. On the 2012 review we did, that was really based on experience that we had up through about 2010. We've got credible experience going back, probably back to 1994 at this point; about 20 years of experience. We looked at it again in 2013, didn't see any need for any changes at that time. In fact, the DLR was actually, probably behaving over sufficiently the first couple quarters after that.

So now as we do the review, now we'll be looking at really experience since 1994, really all the way up through what we've seen here in the second quarter. So it will really be taking on additional experience from the 2012 review of say the experience we've seen additionally from 2010 all the way through where we are this year.

Nigel Dally
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thanks.

Operator: We'll take our next question from Suneet Kamath from UBS.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

Thanks, good morning. A couple more on long-term care. First, Marty, on your rule of thumb around that one-third hitting unassigned surplus, won't that change once you bring BLAIC on onshore or combine it? I mean you said you're getting a benefit because some of it's reinsured to BLAIC. But once you bring it onshore, I mean does it really matter then?

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

Well, again, this – the repatriation, which is still a priority of ours is going to really get – looks like it will be postponed to 2015 for the reason that we're doing this DLR update. And if there is an impact on reserves, we have to update our pro forma filing, so by the time you'll see that, it will be the fourth quarter so it will kick into 2015. But if we do – if we make any changes in the third quarter with the DLR review, which is our intent, that will impact where we are at the end of third quarter and half of the business is down in BLAIC. And so the unassigned surplus impact will roll through at that period of time.

Later on when we recapture the business, repatriate the business from BLAIC, the unassigned surplus impacts will have already happened so it'll be not – it won't be an additional hit. It will be actually a benefit in bringing the business up.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

Okay. And then I guess just to think about that again, the one-third; just to make sure I'm understanding this correctly, so let's just say that the reserve requirement increase is $100 million. That effectively is what you're saying that you would only have to put $33 million – if you wanted to fund that increase with new capital from the holding company or whatever, are you basically saying that if it was $100 million you'd only have to put in $33 million?

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

What it means is – first of all, it's all hypothetical; we don't really know what the number is going to be. But if it were, say, $100 million of DLR increase that means that the unassigned surplus impact would be around $33 million. So where we are now is at $560 million of unassigned surplus that would go to, call it, $530 – $527 million technically. So if you find that helpful.

The other thing is that another rule of thumb to give you is the impact on RBC points. So $100 million DLR impact – gross pre-tax DLR impact would be probably after-tax $70 million. That's maybe 8 points or 9 points of RBC impact, roughly.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

Right, but should we be thinking that – since you're guiding us to understand surplus in RBC, should we be thinking about those as the – I mean, those are the metrics that we should be thinking about in terms of what you want to protect?

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

Yeah, I think that's right. I think that we want to make sure our U.S. Life businesses is very well capitalized and also make sure it maintains very high dividend capacity. The dividend capacity in U.S. Life right now is about $350 million and that's a function of capital levels and stat earnings and is constrained by unassigned surplus. So we'd certainly like to keep unassigned surplus and RBC ratios at lofty levels and that's our priority.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

Okay, got it. And then just I guess for Tom and just based on my conversations with folks yesterday, I'll ask the question this way. Why should we not interpret Jim Boyle's decision to leave as sort of an indication or a sign that maybe this long-term care turnaround is going to take a lot longer? Frankly, he was only there for six months and I think when you hired him, you touted his experience in long-term care as one of the reasons. So I just don't know how you want to respond to that, but I think a lot of us on the call would like hear the response.

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.

A

Yeah I would say, certainly Jim did have a lot of experience and good executive. He was a good addition to our team and I worked closely with him. As our press release and then the Health Fleet press release states, I mean he resigned and he's taken on the role of Chairman there. So I mean I don't know what more to say on it.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

All right, last one is just on your longer-term ROE guidance, that 7% to 9% by 2016, obviously that was pre-Australia and obviously before you knew what you know now about long-term care. So how should we think about that 7% to 9% based on what we know today and what's happened?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.

A

Yeah, I think what you all seem to be missing is a very big point. We're – this is an issue around our claim reserve. We also are seeing higher premiums every quarter. We ultimately think we're going to get to a point of $250 million to $300 million of incremental premiums by 2017. And that will go forward, and so, yeah, whatever reserve action, if any, that we have to take this quarter or in the future – one of the challenges I think for analysts and investors to understand is because of the way U.S. stat and GAAP works, those premium increases, or any reserve releases, that – and you're seeing it in that one slide, slide 13. That falls to the bottom line.

And so part of our projection of the 7% to 9% increase in the ROE is certainly improvement in GMI and we're seeing that and USMI in particular will be a big driver of that. But also those premium increases – again, our point estimate is $280 million a year going forward and we'll be building towards that through 2017. That's going to add significant incremental benefit to the returns of the business.

We've always said – I've always said that on the old blocks, so again going to page 27, pre-PCS, PCS 1, PCS 2; those blocks, we underpriced them. We are now seeking very high premium increases on those. That doesn't mean we can't even get more premiums down the road. And so, look, the way I look – and I think I've been clear, but let me state it again. We know we have issues on those three blocks in particular. We're losing money, a significant amount of money, and these premium increases are trying to get those back to breakeven. And that also will help for the fact that on those, given the average issue age, we will see higher claims over the long run on those blocks from where we are today.

But – so I still remain very confident of the long-term care three-part strategy. As I said, it's three parts; we launched a new product, Flex 3.0. I think these FlexFit packages will allow us to grow premiums. We are getting 18 states now. They don't have to give us the Choice 2 approvals because right now the actual losses are well below 10% from a loss ratio perspective. But I think – we're convincing more and more states that it is much better. This is complex business; you can't project interest rates, lapse/persistency and morbidity and this is another evidence of that in what we've seen in the second quarter.

And so I do think going forward, why I'm confident of the new model for long-term care, is because I do think we're going to get states to allow us to re-rate based on experience. And that's the only way you can really be in this business if that regulatory framework changes.

We still have – you called us on costs; we have 331,000 of these old policies and we know we have to deal with them, but that's a big – it's the biggest reason that we're seeking the large rate increases. So I remain – in terms of the 2016 returns, I think we said 12% to 13% for the GMIs and I think we still believe that's right and I still believe 7% to 9% in the life companies, and then overall 7% to 9%.

Suneet L. Kamath
Analyst, UBS Securities LLC

Q

Okay thanks.

Operator: We'll take our next question from Geoffrey Dunn, Dowling & Partners.

Geoffrey M. Dunn
Analyst, Dowling & Partners

Q

Thank you. Good morning. I had a couple of questions on your commentary about the PMIERS. First, I think you indicated that as written you thought the pro forma returns would be in line with your expectations. Is that commentary including leverage from reinsurance or without?

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

A

Jeff, it's Kevin. We think – it doesn't include it right now. I mean we're pricing this business, all of our new business given the credit characteristics of that business, really on a risk adjusted basis now from a capital standpoint. It's about in the same range as where the PMI falls out right now so it does not include the benefit we'd get or the inclusion of whatever leverage is associated with reinsurance.

Geoffrey M. Dunn
Analyst, Dowling & Partners

Q

Okay. And then in terms of that same commentary, is that based on the current scope of the business or do you think the returns in the sub 700 FICO world would also be as expected as currently priced?

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

A

Yeah, good point. I think as Tom or Marty mentioned, in aggregate, we think the returns are fine. In our opinion, there's probably some capital inefficiencies around the edges embedded in some of the current drafting of the guidelines. It really had the greatest impact on lower credit borrowers so a little, maybe lower FICOs, higher LTVs, so on the edges there we may – there may need to be some refinement. But in aggregate, based upon what we're writing today and what we'd expect to write going forward, we think the returns would meet our return expectations.

Geoffrey M. Dunn
Analyst, Dowling & Partners

Q

Okay, and then last question, what is the benefit of being compliant by mid-2015 rather than taking the 2-year grace period? Is it really that much of a competitive factor?

Thomas Joseph McInerney
President, Chief Executive Officer & Director, Genworth Financial, Inc.

A

You know, this is Tom, what I would say on that is we think USMI, given our position in the market, given the returns we're seeing on new business, so incremental returns on new capital put to work, as well as the fact that over time, I mean we'll see where all the politics come out, that we could have a larger private mortgage insurance market in the U.S. because Fannie Mae, Freddie Mac may pull back. So there's more opportunities.

We think given all those factors, USMI is one of our best businesses. I said that; and therefore, we do think it's a competitive advantage and also would be better in terms of our relationship with our bank customers that we're compliant sooner rather than later. And so our goal would be, as I said in my remarks, to be compliant on June 30, 2015 or before. We think that we can do that. We hope that we can do that mostly through reinsurance and we'll see where that ends up. And then obviously we have some excess cash at the holding company.

So it's becoming, I think, a better and better business every day. We're at 50% of the RIF, is the new blocks, that will continue to go forward. So it is one of our best businesses and what we've said, in terms of – a lot of reasons we did the Australia IPO, to reduce the risk, to also re-balance the capital, but it also allows us to re-balance the capital in a way that if we do need – we knew we needed to do some increase in capital given where we thought the GSEs would come out. I think it came out a little bit more stringent than we thought. Overall, we think that's fine. It's important to have a strong private mortgage insurance market, but we have always said with the use of the proceeds, the primary purpose would be to do what we need to do to correctly capitalize the businesses so they're competitive; and then second, to de-lever. Those are our two top priorities and then we'll look at other things going forward, capital management, et cetera.

Geoffrey M. Dunn
Analyst, Dowling & Partners

Q

Okay. And Kevin, sorry, one follow up; just to push you little bit, when you say there's items around the periphery that might need to be adjusted, would you write the majority of the 680 to 620 offering you have today as currently priced under the proposed PMIERS?

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

A

You know Geoff, I think we have some subsidization across our credit profile and we would have to – if that's all we were writing, we'd have to take a different look at it, I think, in terms of how we'd approach it from a pricing standpoint. It's not all we're writing, but I – what I'm trying to do and Rohit and his team are trying to do here is really balance the – making sure we have a good solid capital framework that will make us absolutely part of the process going forward and balancing it against some access for first time homeowners.

And so I think there's a policy element there you've got to weigh in as well as really having a strong regulatory framework. We're supportive of where this thing's at; we've got some opportunities and will be working actively with them to participate in this public comment period and I think we'll end up in a good place.

Geoffrey M. Dunn
Analyst, Dowling & Partners

Q

Okay, I appreciate the comment. Thanks.

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

A

Thank you Geoff.

Operator: Ladies and gentlemen, we have time for one final question from Ryan Krueger of KBW Investment Bank.

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

Q

Hey, thanks, good morning. I had a question on slide 13, which is helpful. The 150 that – $175 million incremental benefit to earnings this year from LTC rate increases, I guess, if I gross that up for – on a pre-tax basis of $230 million to $270 million, is the way to think about that the future benefit is kind of the difference between that $230 million to $270 million and your ultimate $250 million to $300 million expectation for incremental premiums and that the mix of how it kind of earns in will just change? You'll have less reserve benefit but more premiums coming in?

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

Yeah, Ryan, I think that's a reasonable way to look at it. As Tom mentioned, we expect ultimately to have $250 million to $300 million of incremental premium. I think what we're seeing as we implement the rate actions is obviously those people – and it's a relatively small proportion of people, that are electing, reduce benefits or taking a non-forfeiture option. When they take those options at the time that get the rate increase notice, they make that decision and there's an immediate impact on those policies in the current period and that comes in the form of the reserve release. But obviously, once the rate actions are fully implemented then it's just the matter of getting the ongoing premium on people in all the future periods for those people that are paying a higher premium.

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

Q

Okay, understood. And then in terms of the severity on LTC claims, I understand the difference between active life reserves and claim reserves. I guess my question is does the trends you're seeing on claim severity, is that really isolated to policies that have life time benefits? In other words, if those trends continued, they wouldn't really have much of an impact on the newer blocks of business you've written? Or could have some impact there longer term as well?

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

You know, what we have to look at and we have looked at in the past and will look at it now is that what are the claim termination rates and the benefit utilization thing look like and lot of other complex factors that Tom talked about. And those vary by lifetime versus non-lifetime benefits, situs, sex, all types of factors. So we'll have to take a look at it. Clearly, claim termination rates were very different this quarter by about 5% versus the prior quarter and so had a big impact on existing claims.

Our new claims this quarter, we did see an uptick on new claims severity where we had a dynamic where we had a little bit of higher mix than we had in the prior quarter of lifetime benefits, claims coming with lifetime benefits or with higher DBA. But again, when think about the DLR, think it terms of the existing claims and we'll have to look at the factors that go into all those different types of claim patterns from all the policies.

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

Q

Okay, great. Thank you.

Martin P. Klein
Chief Financial Officer & Executive Vice President, Genworth Financial, Inc.

A

One additional point, that and if you look at one of the slides in there, you can see that over time, over the years that we've been issuing different blocks of policies, there's a row in the chart that illustrates the percent of lifetime in each of those blocks. So that's been dropping down pretty significantly, especially over the last several years. And as I think you know, we discontinued lifetime benefits a couple years ago.

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, Genworth Financial, Inc.

Thank you, operator, and thanks to everybody on the call and you know we appreciate all the questions on long term care and how complex it is and there's the margins and there's reserves and there's timings of the premiums and so on. And so hopefully we've made some progress today in educating you a little bit more on that. It is complex and follow ups that you have with Amy and her team, hopefully she can help you understand that if you have any future questions.

As I said earlier, with the exception of our long-term care business and we know we have issues with the back book, that's not new news; what's really new is that – the three months in the second quarter and the claims we're seeing.

But I – and it's – I understand why we didn't get many questions on GMI or the other businesses, but I would say I hope what doesn't get lost in the overall result is that the three main GMI platforms are performing very well. I think that we continue to expect, while there's seasonality in USMI, we've continued to expect that USMI will have significantly increased earnings this year over last year and as the 2009 blocks and forward become a bigger part of the portfolio that should continue over time.

And we're also – I guess we also lost sight of the fact that we did do the Australia IPO. We're very pleased with that. So while we have significant issues on our back book in long-term care, I think overall, putting it in context, I think we're making progress on the overall turnaround strategy and we never said it was going to be easy. We always have said much more work needs to be done and particularly on long-term care and the back book.

But hopefully we're getting to a much better regulatory framework going forward and so that, I believe the ultimate answer in long-term care is it can be a very good business, but we have to change the regulatory framework because we – no one can estimate policyholder behavior and where the claims situs, may be where interest rates are and so hopefully this is just more evidence to the regulators and will make them work comfortable with new – moving to the new model.

So thank you for your questions. We're obviously going to do a lot of work in the third quarter. We'll have more to say in the third quarter call as we get through this claim review that we're doing on these – the claim reserve in the 50,000 policies.

So with that, thank you very much and look forward to talking to you next quarter.

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