

30-Oct-2015

Genworth Financial, Inc. (GNW)

Q3 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Please stand by, we're about to begin. Good morning, ladies and gentlemen, and welcome to the Genworth Financial's Third Quarter 2015 Earnings Conference Call. My name is Mar, and I am your coordinator today. At this time, all participants are in listen-only mode. We will facilitate a question-and-answer session towards the end of this conference call. The conference is being recorded for replay purposes.

Also, we ask that you refrain from using cell phones, speaker phones or headsets during the Q&A portion of today's call. I would now like to turn the presentation over to Amy Corbin, Senior Vice President of Investor Relations. Ms. Corbin, you may proceed.

Amy Corbin

Senior Vice President, Investor Relations

Good morning, everyone, and thank you for joining Genworth's third 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 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 Kelly Groh, our Chief Financial Officer. Following our prepared remarks, we will open up 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, Dan Sheehan, Chief Investment Officer and David O'Leary, our President of our U.S. Life Insurance Division will be available to take your questions.

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 presentations as well as the risk factors of our most recent Annual Report on Form 10-K and our quarterly filings on 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

Thanks, Amy, and good morning, everyone. Today, my remarks will cover three areas. First, a recap of Genworth's strategic priorities; second, actions taken to date and third, my views on third quarter results. I will then turn the call over to Kelly Groh, our new CFO to provide more details on the quarter results in addition to addressing liquidity and capital management.

Before I begin, I would like to acknowledge Marty Klein, our departing CFO as he accomplished much during his years with the company, including developing many executives on the Genworth Finance team. We had three or four well qualified internal candidates to consider for his replacement as CFO. However, Kelly was an ideal candidate to step into this position at a critical time. She had been with GE and successor companies for almost 20 years and with the company, since prior to its 2004 IPO. She served as our Controller and Principal Accounting Officer for the last three years and she has a deep knowledge of our internal structure, GAAP and statutory accounting and our financials. She has been working closely with Marty and has been instrumental in recent moves to strengthen our financial position.

On that note, I want to thank Marty for being a good partner and advisor to me and for his years of steadfast service and commitment to Genworth and all of our stakeholders. Marty was a key member of the senior management team, an exceptional leader to our many employees and a key contributor in the establishment of our core strategic priorities, which have not changed. We wish him well in his new role.

As you know, since July 2014, I've been responsible for running the day-to-day operations of the U.S. Life division in addition to my role as CEO. I'm pleased to announce today that we recently appointed David O'Leary as President of the U.S. Life division. In that role, he will take over the daily responsibilities for managing our life, annuity and LTC businesses.

David has over 30 years of experience in the insurance industry and has held leadership roles at Aetna, MassMutual, AIG American General and AXA Financial. David has been initially focused on the commercial front, seeking to rebuild relationships with distributors given uncertainties sparked by downgrades to the company's ratings and our strategic review. Additionally he has been and will continue to be active in our efforts to bring the cost structure of both U.S. Life and headquarters in line with our near-term commercial expectations. He is with us today and he'll be happy to address questions.

With these management changes, I will now focus my attention on driving Genworth's overall strategy, including the implementation of our strategic priorities and obtaining significant LTC premium rate actions, including changes to the existing regulatory model. Our strategic priorities remain to strengthen our core businesses, simplify our portfolio of businesses and increase our financial flexibility.

As denoted on slide two, we have made progress against these strategic priorities by first achieving early U.S. MI Compliance with PMIERS, including working to establish a prudent capital buffer. Second, working to generate capital from low return businesses through divesting the lifestyle protection business, selling select blocks of term life insurance and the recently announced sale of our European mortgage insurance business. These transactions are on track to close in the fourth or first quarters. Third, reducing our stake in Australia to 52% and fourth, continuing to fix LTC legacy block issues by aggressively pursuing substantial premium rate increases and reducing tail risk and advocating for regulatory change.

With regards to PMIERS, we have executed our third excess of loss reinsurance transaction, covering our U.S. MI's 2015 business. The deal which is still subject to GSE approval would provide approximately \$225 million of capital credit and similar to our previous XOL treaties is priced at a cost of capital in the mid-single digits. Year-to-date, that would bring total PMIER capital generation close to \$725 million with the reinsurance portion reducing 2016 premiums by roughly \$20 million.

Stepping back, the reinsurance market has clearly proven to be an attractive source of capital and as conditions warrant may continue to be leveraged as needed. Additionally in September, S&P raised the financial strength ratings of our two primary U.S. mortgage companies to BB+, reflecting the improving financial profile and strategic importance of this business.

To date, given ratings pressures and interdependencies among our subsidiaries, our ability to take more substantial steps to simplify our business portfolio is limited in the near term. However, we are taking steps to reduce certain complexities within our business such as with the planned repatriation of LTC business. As we make progress with regulators and other key stakeholders in the future, we'll discuss that progress with investors and the market. We continue to act with urgency and are doing what is feasible and prudent for the company and its stakeholders.

While we remain mindful of the importance of our ratings, the rating agencies have placed certain of our subsidiaries on negative outlook, which creates a meaningful risk of a downgrade. With this in mind, we continue to evaluate strategic options with an eye to accelerate our progress. Until such time as we're able to execute larger transactions, we anticipate continuing to take incremental actions to simplify the business portfolio, which could include additional divestitures of businesses and/or select blocks of business.

Regarding Australia, this business continues to be a solid performer with good profitability, returns and capital generation. We expect capital management opportunities in Australia to provide significant cash to the holding company over the next couple of years. At its current valuation, we believe realizing those opportunities is more valuable to Genworth stakeholders than selling more of this business.

Turning to long-term care, we continue to make strong progress in obtaining rate increases to address our legacy LTC blocks and some of the newer blocks. During the quarter, we obtained five additional approvals with an average rate increase of 29% on \$9 million of impacted in force premium. Since the end of the third quarter, we have received additional approvals covering approximately \$190 million of additional in force premium with an average rate increase of 26%, bringing year-to-date total in force premium impacted close to \$700 million with an average rate increase of 29%.

The average premium rate approved and the level of impacted premium achieved through the third quarter of 2015 remains in line with our 2014 ALR margin assumptions. We continue to expect to see a more meaningful benefit to LTC earnings from these actions later in 2016 as the significant increases approved in 2015 are implemented on policy anniversary dates.

Now let's turn to results for the quarter. Our third quarter operating results show continued good results in GMI and disappointing results in LTC. I would point to three key takeaways. One, normal seasonal loss pressure in Canada and U.S. mortgage; two, underlying LTC performance was in line with expectations, but we made additional corrections driven in part by our work to remediate the LTC material weakness. And three, adverse impacts in corporate and runoff from equity market volatility on a runoff block of variable annuities and increased expenses in corporate as we increased our legal accruals.

Turning to slide five of our third quarter earnings deck, net operating income was \$64 million, which is down 46% compared to the prior quarter. While results were down overall, fundamentals remained strong across our Global Mortgage Insurance platforms as evidenced by year-to-date loss ratios of 20%, 24% and 36% for Canada, Australia and the U.S. respectively. We continue to believe our full year 2015 loss ratios will be comfortably within our targeted ranges.

As you know, Canada and Australia are exposed to energy and mining industries and those two countries have experienced increased economic pressure due to declining commodity prices. We've taken actions to strengthen underwriting in the impacted areas on new flow insurance and while we have seen some loss pressure in these areas, our overall portfolio loss ratio performance remains solid to date. We will likely experience additional pressure from these regions, as we move into 2016. And we expect an increase in the loss ratios in both Canada and Australia compared to 2015.

In the United States, housing conditions continue to improve, benefiting from continued improvement in unemployment, historically low interest rates and high home affordability. Price competition is intensifying in the MI marketplace and now includes pricing pressure within the borrower-paid mortgage insurance product.

We continue to assess the market dynamics and intend to remain competitive across price and guidelines within risk-return tolerances and with differentiated service levels.

Mortality was lower in our U.S. Life Insurance Division and had a net favorable impact to earnings in the quarter, primarily from life insurance. In LTC, earnings were reduced by \$21 million, primarily from adjustments that relate to our efforts to remediate the material weakness. Without these adjustments, LTC earnings would have been up slightly from the prior quarter, reflecting our progress on in force premium rate actions.

We continue to expect modest LTC earnings with the potential for quarterly volatility, although we expect some improvement in LTC earnings by the end of 2016 into 2017, as the 2015 approved premium increases are implemented.

New insurance written levels were solid across our three primary mortgage insurance platforms with Canada in particular benefiting from increased market penetration. Sales in U.S. Life continued at low levels as this business works to restore its commercial presence. Regarding annuities, given the transactional nature of the sale, submits rebounded for this business and we saw sales increase versus the prior quarter. Additionally, we are evaluating new product and distribution strategies for life and long-term care to grow sales from current levels.

In summary, we continue to make some headway on our strategic priorities to rebuild shareholder value, but there is much more work to do.

And now, I'll turn the call over to Kelly to provide a deeper overview of the quarterly results.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

Thanks, Tom, and good morning, everyone. While we certainly have challenges, I'm excited to be in this new role and look forward to updating you as we make progress. Today, I will discuss our third quarter results and key performance metrics, provide perspectives on our approach to liquidity and capital management and provide some thoughts on our upcoming fourth quarter actuarial assumption reviews. And finally, I will also update you on our progress on the remediation of our material weakness.

We reported net operating income of \$64 million and a net loss for Genworth shareholders of \$284 million for the quarter that included a \$296 million loss on the life block sale we announced in September. Overall, our results were lower in the Global Mortgage Insurance division, primarily from seasonally higher losses in Canada and the United States. Results were also lower in the U.S. Life Insurance division as net favorable mortality experience and benefits from the LTC rate actions were offset by \$21 million of adjustments to long-term care reinsurance, premium taxes and group reserves. We also recorded higher legal accruals and expenses totaling \$17 million after tax in corporate, primarily related to litigation. Additionally, the decline in the equity market negatively impacted our runoff segment.

Looking at key performance metrics, sequential operating revenue reflects three main drivers. One, earned premiums continue to be favorably impacted by LTC rate actions, earned premiums were also higher in the quarter from an earnings curve update in Australia. Two, investment income is down slightly from \$10 million after-tax from lower limited partnership income, primarily in runoff and fixed annuities. And three, foreign exchange had an unfavorable impact of \$10 million pre-tax in the quarter.

Our underwriting results were mixed. Sequentially the mortgage insurance loss ratios remained solid, but were seasonally higher in Canada and in USMI and up in Australia, primarily related to actuarial updates, which impacted the earnings curve and loss reserves in similar amounts but increased the loss ratio by 7 points. We still anticipate the loss ratios in Global Mortgage Insurance to end the year within and in some cases at the low end of our previously disclosed ranges.

The loss ratio in long-term care was up from the prior quarter to 76%, primarily from a number of corrections associated in large part to the work related to the remediation of our material weakness. Life insurance results were positively impacted by improved mortality.

Total operating expenses were up 6% sequentially, mostly in corporate and other from higher legal accruals and expenses. As we've communicated in the past, as part of our strategy to increase financial flexibility and strength, our goal is to reduce cash expenses by \$100 million or more in U.S. Life Insurance and headquarters to size the business closer to our current sales levels.

We've made meaningful progress implementing expense initiatives this year absent our legal accruals and expenses. And 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 achieve our goal in the first half of 2016.

Turning to liquidity and capital, we have made good progress against our goals. Let me highlight examples of that progress and update you on capital levels. First, we maintained solid capital positions in our operating companies.

Second, as Tom mentioned, USMI capital as measured under PMIERS is expected to benefit from a third reinsurance transaction that, subject to approval by the GSEs, will be effective as of October 1. This is helping to achieve a major goal of creating a prudent buffer over our compliance with PMIERS.

Third, we received \$102 million in dividends from the operating companies, plus the remaining \$50 million in proceeds from the sell down of our ownership to 52% in Australia that was completed in May. Dividends from International MI through the third quarter totaled \$233 million, achieving the upper end of our goal for the full year. Fourth, our available cash and liquid assets at the holding company were approximately \$1 billion and represent a buffer of approximately \$490 million in excess of our 1.5 times debt service in restricted cash as well as above our \$350 million risk buffer.

And finally, turning to U.S. Life statutory performance, unassigned surplus decreased approximately \$20 million sequentially to around \$75 million from the unfavorable equity market impacts on variable annuities in addition to LTC results mainly due to the corrections that were both partially offset by favorable taxes.

RBC levels in our Bermuda subsidiary, BLAIC, were approximately 305%, down from the end of the second quarter, but that entity still maintains capital above Bermuda's minimum requirements. The first phase of the BLAIC LTC repatriation is underway and we expect to complete the repatriation in either 2016 or 2017.

Regarding liquidity and capital management, our guiding principles which have not changed, are first to ensure that each of our businesses are adequately capitalized at levels we believe are appropriate given the risk. Second, to generate capital through regular operating company cash flow to the holding company, selective assets sales and active management of excess capital in our businesses. Third, to manage our holding company debt levels, maturity, timing and costs prudently and fourth, to maintain strong near-term liquidity.

The actions we have taken and continue to take are focused primarily on improving shareholder value. Let me provide a few examples. First, our U.S. Life Insurance and Mortgage Insurance companies have capital levels above both the regulatory minimums and our management targets. As a result, the excess capital above the management target is available to handle stress scenarios, and in the near term, we anticipate liquidity to be sourced from dividends from International MI.

In Australia, we continue to evaluate ways to optimize capital and announced last night Australia intends to conduct share buybacks of up to A\$150 million, depending on the business and market conditions. It's our intention to participate pro-rata to keep our ownership percentage at approximately 52%.

In U.S. Life, we continue to hold capital above our 400% RBC target as a buffer and given unassigned surplus levels, we do not anticipate receiving capital through ordinary dividend flows for some time. However, with the life block sale we announced in September, the U.S. Life companies expect to utilize all of their net operating losses, which will make the business a taxpayer going forward. This means that as U.S. Life companies generate taxable income, a portion will utilize deferred tax assets in the system and will move cash and capital to the holding company, opening another source of liquidity to the holding company.

Second, we've completed or announced more than \$1.5 billion of capital initiatives this year, including executing reinsurance deals, to ensure we are PMIERS compliant with a prudent buffer to enable us to continue our strong presence in the USMI market, selling down our stake in Australia to our current 52% ownership, receiving dividends from both Canada and Australia, and we still anticipate closing the sales of our lifestyle protection business or LPI later this year, and Europe MI and life block early next year.

We expect USMI to be a contributor of dividends to the holding company beginning in 2017 or later, but dividends may require regulatory approval. Third, we are intent on reducing our debt levels over time. The first step in that process is the expected use of a majority of the LPI sales proceeds to fund the 2016 debt maturity.

After addressing the 2016 debt, we have no other debt maturity until May 2018 or over two and a half years from today. Regarding our 2018 debt, while we continue to evaluate which additional strategic actions makes sense for the company and shareholders, refinancing the 2018 debt is certainly an option we would consider. And fourth, we continue to maintain holding company cash levels in excess of 1.5 times annual debt service plus a \$350 million buffer. We believe we have sufficient liquidity to maintain our cash buffer and meet our cash needs for the foreseeable future.

Next I would like to cover our LTC claim reserve review that was completed in the third quarter and the margin work that will take place in the fourth quarter as well as our progress on the material weakness remediation. During the third quarter, we reviewed our assumptions and methodologies for our LTC claim reserves. Our actual experience in aggregate has been in line with our claim reserve assumptions developed last year, and we did not make significant changes to the claim reserves assumptions or methodologies other than updates for interest rate levels and utilization rates as we do every quarter. We will continue to monitor our experience assumptions and resulting reserves closely and make changes when appropriate.

In the fourth quarter, we will conduct our annual review of LTC and Life Insurance and fixed and variable annuity assumptions relative to current experience and future expectations. This work will include our long-term care margin testing, and we will provide more details on our fourth quarter earnings call.

Before opening it up for questions, let me address the material weakness remediation. We have implemented additional controls within our actuarial processes in both the second quarter and third quarters and in executing our controls, identified the corrections for LTC that were recorded in the third quarter. Although we have successfully completed our test of design of the new controls, we do need more instances of testing the effectiveness of the new controls to finalize our conclusions, and we plan to test the controls again in connection with the preparation of our year-end financial statements. We believe we're on track to remediate the material weakness by the time we file our year-end financials.

To recap, while we've made good progress in several important areas this quarter and believe we have sufficient liquidity for the foreseeable future, we have much work ahead as we focus on improving business performance and achieving our goals.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, at this time, we will begin the question-and-answer portion of the call. [Operator Instructions] Our first question comes from Nigel Dally with Morgan Stanley.

Nigel P. Dally

Morgan Stanley & Co. LLC

Q

Great. Thank you. Good morning. First question just on the life block sale. With the capital freed up, should we take it from your comments that all of that capital is going to be retained at the sub level? And also under the tax sharing, how much cash would you expect GLIC to be paying to the parent annually?

Thomas J. McInerney

President, Chief Executive Officer & Director

A

So, Nigel, in terms of the sale of the two blocks, the capital is \$100 million to \$150 million, and we'll have the flexibility to either have that go to the parent or retain it into the sub. What was your second question?

Nigel P. Dally

Morgan Stanley & Co. LLC

Q

Just the amount of the cash coming up from the tax sharing.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

I'll take that one.

Thomas J. McInerney

President, Chief Executive Officer & Director

A

Okay.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Hey, Nigel, it's Kelly Groh. I'll take that. We're going to provide more details on that when we get closer to closing the transaction in the first quarter. Obviously, it depends on the tax position of the rest of our subsidiaries and we'll be utilizing the NOLs in the other subs subsequent to the closing of the transaction.

Nigel P. Dally

Morgan Stanley & Co. LLC

Q

Okay. Then to the question on domestic MI. So the single premium lender paid NIW was up about 64%. Now you talked about being selective there. It seems like a very large increase. So just hoping you can discuss what's driving that increase.

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Hi, Nigel. This is Kevin. Overall we had good growth in the total market, both in the lender paid portion and in the borrower paid portion of the market. We've previously discussed that we'll participate in that selectively and

there'll be quarters where it'll be a little bit lumpy. But we saw some opportunities this time that were good profitable opportunities for us. The overall change it was up probably \$500 million overall in terms of the overall growth in the single premium side. So I don't consider it a particularly a big up take. I'm not sure, you'd consider that as a run rate. It was just some opportunistic pricing opportunities for us within the period. And it was frankly within our expectations of where we'd be for the year.

Nigel P. Dally
Morgan Stanley & Co. LLC

Q

Great. Thank you.

Operator: For our next question, we move to Ryan Krueger, KBW.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Hi, thanks. Good morning. I first had a follow-up question on the Life Insurance taxes and intercompany tax sharing payments to the holding company. I guess I just wanted to clarify, the Life company will be able to pay taxes to the holding company to utilize, I guess, tax positions with overall tax-sharing agreement. But won't those payments still ultimately be sent to the IRS, or they're actually being retained at the holding company?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Sorry about that. I'm just trying to make sure my mic is on. No, they won't. We currently have ample foreign tax credits and net operating losses in the rest of the system. So really what happens is, we're utilizing with this transaction all of NOLs within the U.S. Life companies. Then once those are utilized, those go to cover NOL utilization, given the Life, non-Life election we did a few years back. So there's no payments to the IRS in the foreseeable future.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

Okay, okay. Got it. Thanks. And then a question on I guess the holding company cash usage. Every quarter you disclose the hold company net other items, which I assume is primarily expenses. And on a year-to-date basis that number is \$219 million. Can you just give us a sense of how you'd expect that to run going forward if this was a fairly normal level at this point or should we expect any changes going forward?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

Yes. You know in our slide we did go through that, and the net other items for the quarter were about \$57 million. The thing that would I say on that is we did opportunistically buyback some debt, so that was about \$50 million of the total there.

Ryan Krueger
Keefe, Bruyette & Woods, Inc.

Q

\$50 million of the year-to-date total?

Kelly L. Groh
Chief Financial Officer & Executive Vice President

A

No, \$50 million of the quarter total of the \$57 million.

Ryan Krueger

Keefe, Bruyette & Woods, Inc.

Q

Okay. Can you give us any sense of on an annual basis what you'd typically expect that to be?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yes. I mean, we'll continue to opportunistically look at debt repurchases, but I don't have a forecast for you.

Ryan Krueger

Keefe, Bruyette & Woods, Inc.

Q

Okay. All right. Thanks.

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

Geoffrey Murray Dunn

Dowling & Partners Securities LLC

Q

Thank you. Good morning. Just a quick follow-up on the last question. What piece of debt did you buyback this quarter? What maturity?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yes, Geoff, we kind of went across the spectrum, obviously focusing on shorter-term stuff, and we'll fully disclose that in the 10-Q when we file it.

Geoffrey Murray Dunn

Dowling & Partners Securities LLC

Q

Great. Then in terms of the PMIERS, your original range was \$500 million to \$700 million, now you're up at \$725 million. Can you give us an idea of the relative cushion you have over your minimum required assets?

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Yes. Geoff, we have continued to assess our PMIERS compliance really from the beginning, thinking about the buffer we might need, and we're probably not going to disclose the relative levels until we get through the fourth quarter and conclude all of our full compliance and repping of that compliance with the GSEs. But this is how I think about it and how it might help you see where we're headed.

There's really sort of two components we think about in our buffer. The first is you have some uncertainty in the performance metrics of the business. So the relative levels of NIW, the different mixes of that NIW, which have different capital charges associated with it, where persistency goes. If your lapse is higher, you may lose some of the benefit of some of the buffers or it may go the other way for you and you may gain some benefits and then ultimately loss volatility. So on one respect we've got to account for that in our buffer; and then secondly, because of – we also have to deal with the actual asset volatility specifically related to things like FX and stock price variability in our Canadian mortgage insurance asset.

So those are really the two things we have to account for. Obviously from quarter-to-quarter, there's been some volatility in both FX and share price for mortgage insurance Canada. Just to give you a sense for what that drove probably from the end of Q2 to the end of Q3, it's close to \$50 million. So our buffer needs to account for that.

So that's the type of perspectives we're building in as we think about our buffer. When we get to the fourth quarter earnings results, we'll probably try to find a good metric for you to evaluate that.

Geoffrey Murray Dunn

Dowling & Partners Securities LLC

Q

Okay. And then the last question. Have you followed a couple of your peers with rate increases on the lender paid singles business and what were the – I'm sorry, go ahead.

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

No, please. I interrupted your question, please.

Geoffrey Murray Dunn

Dowling & Partners Securities LLC

Q

And what were the returns that you priced to this quarter under the new capital requirements on the singles business?

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Yes, Geoff, we have not filed new increases yet in the single premium card rate pricing. We continue to price our business on a portfolio basis in the aggregate to a low-to-mid-teens type return level. I've seen a lot of questions around pricing overall as some of our competitors have gone through the various earnings calls. And we price our business to maximize returns to our shareholders. There absolutely is some price competition going on right now, which I think sort of gets at the root of your question, but I think it's coming from some of the competitors that have some objectives they're trying to achieve such as to get to scale.

So our pricing is going to be to try and maximize our overall shareholder return. That said, we intend to remain competitive within our risk and return targets. But I'm just not going to discuss our commercial strategies and pricing strategies on the call. I just don't think it's the right forum for it. Unfortunately, it's not only you that are on the call, but some of our competitors listen. So we will update you. We're going to follow the market, we're going to remain close to our customers, and I think we provide a fair level of transparency around both our borrower paid and our single premium pricing that will be available in our QFS.

Geoffrey Murray Dunn

Dowling & Partners Securities LLC

Q

Okay. Thanks for the comments.

Operator: We move now to Steven Schwartz, Raymond James & Associates.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

Hey, good morning, everybody. First, Kevin, just a quick follow-up to your comments there. The reference to competition in the MI, I'm assuming you're referencing tiered pricing. Is that correct?

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

I'm referencing competitive pricing from – when you said tier pricing, I think we're seeing it in all of our pricing right now, both the borrower paid pricing and the lender paid premium pricing.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

Okay. All right. I'll move on to other stuff. Just wanted to make sure. Kelly, can you maybe tell us – the loss ratio in LTC was up. That was due to some of these remediation efforts. Can you give us a clue as to what that ratio might have been ex what you discovered during the remediation efforts?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Sure. I think that ratio excluding those would have been about 74%, instead of 76%.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

Okay, great. Thank you. And where would you be so far in the run rate of cash savings?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Oh, yes, I think you're talking about our run rate that we put out there from a target perspective, \$100 million.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

Right, yes.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Okay. Marty last quarter said we were on a run rate of about \$50 million. I've reviewed that so far, and we've made more progress as we've been really looking at our processes and trying to realign jobs and efforts to maximize that. We feel right now that we're set to really reach that \$100 million run rate by the first half of 2016. And so we feel good about what we've done so far, and really just are working to size the business based on the current sales levels as well as really simplified portfolio of companies.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

So did you make progress off of that \$50 million...?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

We did.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

...in the quarter. We did, okay. All right. And then just one more, I noted there was actual explicit guidance for Canada MI loss ratio. You said in the comments or in your statements that you expected both Australia and Canada to be up obviously due to the pressures. Could we assume that Australia might be up as much as what you're thinking Canada would be up in terms of the loss ratio?

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Yes. At this time, we're still assessing where we think we will be with Australia. There has been some pressure due particularly to some of their commodities pricing or commodities pressure. But I would really sort of say for Australia we need to wait until we see how things settle out the balance of the year and we'll provide that update as we usually do with outlooks on loss ratios across all the platforms in the early part of next year.

Steven D. Schwartz

Raymond James & Associates, Inc.

Q

Okay. All right. Thank you. That's all I had.

Operator: We'll take the next question from Sean Dargan of Macquarie.

Sean Dargan

Macquarie Capital (USA), Inc.

Q

Thanks and good morning. Just sticking to Australia, so GMA announced the share repurchase program last night or authorization and you will participate in that to keep your ownership level stable. I'm just wondering what the thought process is there because you'll in a sense be I guess using capital to buy back the shares of that company. I guess what the thought process of that versus a common dividend increase is? And what's the end game? Is it to get up the share price so that you can exit your ownership stake and use that to address the 2018 maturity?

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

Sean, Australia has significant capital levels in excess of their management targets. I think there's a number of capital management initiatives that are available to the business, you'll see continued steady common dividend payment. There has been some level earlier in this year in terms of special dividends. There is some limitation on those due to the franking credits associated with the business. The share buyback opportunity for the Australian business will come out of their capital base and I think it's sort of an interesting time to do that given where the share price is trading, which is significantly below the book value of the business.

So, there is a number of different opportunities. We're going to work to continue to really to manage and optimize that capital. If we get some share improvement that will certainly be helpful along the way. But there is a number of opportunities there, and maybe Tom has some additional comments on that.

Thomas J. McInerney

President, Chief Executive Officer & Director

A

Yes, I would say, Sean, as I said this in my comments, I think given where the current share price for Australia is, we think it's a very good time for GMA to be repurchasing its shares. We don't think it makes sense for us at the current valuation to sell any of our 52% position. We also believe that it will be, as it has been, a good generator,

both of ordinary dividends, opportunities for special dividends and future share repurchases depending on how the business goes. And so therefore, I think it makes sense to participate in the buyback and we won't be a seller at the current valuation. We'll see how things play out. And if we do get an increase in the share price significantly, we'll reconsider our ownership position.

Kevin D. Schneider

Executive Vice President – Genworth and President & CEO, Global Mortgage Insurance Division

A

And just to add one final thing to that, Sean, this is kind of obvious, but just in case it's missed, the holding company will benefit from our participation in the buyback. So Genworth Financial will get some of the proceeds associated with the maintenance of our 52% share position as we go through that buyback process.

Sean Dargan

Macquarie Capital (USA), Inc.

Q

All right, got it. And just switching to Life capital, unassigned surplus contracted a bit, which I think was in part due to equity market movements and what that did to your variable annuities and run-off. But in the past, we've been asked to focus on an unassigned surplus. And I assume some of the capital that's going to come back from the Protective Life transaction will help RBC and unassigned surplus. But is that something we should be focusing on in the near-term? Is it really as important right now?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yes, Sean. This is Kelly. I guess the way I look at it, you're right, really the equity markets impacted unassigned surplus. We really don't anticipate the U.S. Life company to be a dividend payer in the near-term. So, we're trying to manage it to a 400% RBC, and unassigned surplus probably is a metric that manages dividends, but we really don't anticipate to extract dividends in the near-term.

Sean Dargan

Macquarie Capital (USA), Inc.

Q

Okay. Got it. Thank you very much.

Operator: Next we go to Suneet Kamath with UBS.

Suneet L. Kamath

UBS Securities LLC

Q

Thanks. Good morning. I wanted to follow-up on Ryan's question about the HoldCo net other items. This number has been moving around quite a bit. But, if I just track it so far this year, it's quite a bit higher than last year, and in some quarters it's actually exceeded the interest expense. So I don't know if this is a question or more of a request. I think it'd really be helpful given so many of us are focused on holding company cash to really get a sense of what's in here.

And then, Kelly, I think you were asked for a forecast, which I don't think you were able to give. But I really encourage you to rethink that because to the extent that this number is moving around a lot, it really can have a significant impact on the cash position, and it calls into question whether that 1.5 times interest coverage number is enough, particularly in quarters when it exceeds the interest expense. So, I just wanted to get some thoughts there.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yes. We'll acknowledge your input and consider giving a forecast in the future.

Suneet L. Kamath

UBS Securities LLC

Q

Okay. And then I guess, Tom, for you. We've been on this consistent track over the past couple of quarters of talking about \$1 billion to \$2 billion of debt reduction. So I was a little surprised to hear the comment earlier that you're thinking about potentially refinancing the 2018 debt. Obviously that would move us off that debt reduction. So what's going on in terms of your thinking around that?

Thomas J. McInerney

President, Chief Executive Officer & Director

A

Yes. So, Suneet, we still look at the \$1 billion to \$2 billion as a firm target for debt reduction. And let me tell you the principal driver of that \$1 billion to \$2 billion is because we do want to increase the optionality for the company. We do think that with the debt at its current levels – now it will come down because we will take care of the 2016 with the proceeds from LPI. But we do think by getting the debt down in that range of \$1 billion to \$2 billion, it allows us to look at strategic options that we can't look at or aren't feasible without doing that.

So that's still the focus. I think what Kelly said is we have a number of levers to use to reduce debt, and we've done the LPI deal, the term life blocks, we're continuing to look at other life annuity blocks, the MIE deal. I think Kelly just meant that one of the options we have for the 2018 maturity would be to refinance it. I'm not saying we will refinance it, but it is an option. I think that's all she meant by that.

Suneet L. Kamath

UBS Securities LLC

Q

Okay. And then I guess on the active life reserve review in the fourth quarter, I think you said you're going to be looking at all of your assumptions, but I just would note there were some comments out of Moody's around it becoming more difficult to get price increases approved by the regulators. And given that's such an important component of your active life reserve, does that play into your thinking around what you've built-in in terms of that reserve, i.e. the Moody's commentary?

Thomas J. McInerney

President, Chief Executive Officer & Director

A

I don't want to comment on Moody's. I will say and I mentioned this in my remarks. I think we've made very strong progress in premium increases. Year-to-date, we have received on average 29% increase on \$700 million of premiums. And you don't see that yet because obviously that, we'll call it, rounded to \$30 million, and \$700 million will come in on the anniversary days going forward. So I think we're making very good progress on premium increases. We're right on track. I know a lot of investors questioned, our target was \$500 million at its peak and \$5 billion net present value, but we're right on track with that. So I'm very pleased with how we're doing.

As I have said in the past and I said today, one of my key priorities personally is to work with Elena Edwards and the team with the regulators. And I think that's all going very well. We continue to spend a lot of time with individual states, with the NAIC, with a number of key regulators who are focused on long-term care, and I do believe that they agree with us. They need to give us increases on the old blocks to get those to breakeven and I think we're making very good progress on that.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yeah, Suneet. Let me add one more thing to that. We are currently working on our margin testing, we'll finish that in the fourth quarter, and definitely provide lot more details on the fourth quarter earnings call. The one thing I did want people to remember though, is last year we did unlock our PGAAP block because we have to test our PGAAP and our direct written business separately. And since we unlocked that, it has no margin, it will be more sensitive to adverse changes. But it's less sensitive to interest rates. It benefits less from rate increases just given the age of the business.

Suneet L. Kamath

UBS Securities LLC

Q

Okay. Thanks.

Operator: We'll move next to Scott Frost of Merrill Lynch.

Scott Frost

BofA Merrill Lynch Global Research

Q

Hi. Thanks for taking my question. Just a couple of things. What's the unassigned surplus of GLIC in Q3 right now?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yeah. We've got that in our slides, it's about \$76 million.

Scott Frost

BofA Merrill Lynch Global Research

Q

Okay. The question – I'm trying to piece it all together with the debt guidance, a couple of things. USMI pays dividends, you said probably 2017, the long-term care premiums in force, but no expectations of dividends from GLIC by 2018, that's kind of what it sounds like. I'm trying to figure out how long is near-term when you said you're not going to be a near-term payer? And the reason I ask is, it looks like your liquidity might be challenged if they don't start paying dividends to the HoldCo at some point. Is that the right read?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Scott, I guess what I would say on that is, that was one of the reasons we did the life block transaction is frankly that ate up all of the – or that will eat up all of the NOLs in the Life companies. So, even though we're not planning on necessarily taking explicit dividends out of the company, it will help holding company cash to pay for accumulated NOLs related to past debt payments as the Life companies earn taxable income over time.

Scott Frost

BofA Merrill Lynch Global Research

Q

Got it. Okay, okay. You talked about the refi of the 2018s as one potential option. And I'm curious as to how you think you would do that. What capital markets options do you see as open to you?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yeah. I mean there's obviously a high yield market that's available. When you look at where our debt is trading right now, you could do a five-year issuance around an 8% coupon. We've got 2.5 years really to make that decision, and a lot of time to evaluate the best options for our bondholders and our shareholders.

Scott Frost

BofA Merrill Lynch Global Research

Q

Okay. Great. And I just want to ask one last one. Could you remind us, I want to make sure I understand, there is an intercompany reinsurance arrangement regarding long-term care. Is it Brookfield Life or Brookfield Life and Annuity, and what I'm getting at is, you said you're unlikely to sell more of GMA AU. But if you were to do that or sell Canada, would proceeds be available to the holding company? And more specifically, if you had some adverse experience in long-term care, would the arrangement require you to pledge additional blocks of those two entities to support the reinsurance arrangement?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yeah. I mean, Scott, this is Kelly. One of the things we've talked about in the past is the desire to repatriate that business, that's still a goal of ours, to repatriate from Bermuda the long-term care business. We think it adds transparency and it likely would be credit positive. We've evidenced that we've been able to bring capital up through our Bermuda subsidiaries, as we obviously talked about what we got from Australia this year. So, I'm not necessarily concerned about that at this time, but just it still is a goal of ours to do the long-term care repatriation either in 2016 or 2017.

Scott Frost

BofA Merrill Lynch Global Research

Q

Okay. And just to be clear, the repatriation would – I mean that would – there would be no encumbrance anymore if there is one now, on any of the other stakes that you have in International MI, is that accurate?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Yeah. That's accurate.

Scott Frost

BofA Merrill Lynch Global Research

Q

Okay, great. Thanks for taking my questions and congratulations on the new position.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Thanks, Scott.

Operator: Ladies and gentlemen, we have time for one final question, which will come from Ken Billingsley of Compass Point.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Hi, good morning. Thanks for taking my question. I had a few long-term care questions here. From the press release, you talked about the higher mix of new claims with average reserves. I think that's multiple quarters that's come through. Does this mean that in the future that this is actually going to decline as it seems like there is a mix of new claims that actually have lower average reserve expectations coming in, and that there should actually be an improvement at some point in the future?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

We reset our assumptions last year as a part of our disabled life reserves. So, we look at our utilization and update that on a quarterly basis. And I'm not concerned with the claims trends we're seeing right now, they're as expected and they're what we're really building our rate action plans to address. And in terms of as we put on new claims, we obviously put those on at the higher factors on a per claim basis and really the development we saw in the quarter was consistent with our expectations.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Then I guess my understanding was that these claims that were coming in, that there was just a higher percentage that had made, I guess, higher average daily amounts than what a normal mix would be. Is that wrong?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

No, no. I think you're right. As we see the aging of the business, that's automatically going to transition that way, because we have more policies that have benefit inflation options and higher average mix. But I think as we updated our factors and we update utilization on a quarterly basis, I think you will see that normalize.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Okay. So, you already built the expectation that there is a number of policies with lower daily amounts that are going to flow in and that's built into the numbers as of today.

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

Absolutely.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Okay. And the favorable impact of \$19 million from rate increases and reduced benefits, how much of that was one-time related to reduced benefits?

Kelly L. Groh

Chief Financial Officer & Executive Vice President

A

You know, I think we break that out specifically on the slide. And so, you see that there is about – of the total of \$64 million in the quarter, \$27 million related to reserve changes, and about \$42 million related to ongoing premiums. So, the delta from last quarter, that was really a \$12 million pre-tax increase.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Okay. I thought it's on slide 13. And then the last question I have is, this is looking a little bit historical, at one point you had talked about long-term care pricing increases in some of the states was going to be a multiple year process, and the discussion with the states was they understood what you needed, but they wanted you to come back over a couple of years. Regarding those states, how have the actual results of going back to them matched up with the original expectations when you first left their offices?

Thomas J. McInerney

President, Chief Executive Officer & Director

A

Yeah, I would say a few things on that. One is, all the states are different, so there are – it's around 20, a little over 20 states that have given us the full increase all at once. And then the balance of the states, some of that balance give us the full increase, but spread it out over three years or five years and then some give us the increase for a year and say come back each year. So, it really depends on what state you're talking to. I will say, I've been doing this now for going on three years. I'll say there is a marked change in the view of all the regulators, including the regulators that traditionally have been more challenging on rate increases that they have to give these premium increases that are actuarially justified to allow us to get to breakeven. And I think the regulators now – there is a bankruptcy in Pennsylvania, Penn Treaty, I think they have learned a lot from that that these increases are important.

So, I do think compared to two years or three years ago to today, there's a much more open view on the part of regulators that they really do have to step up, these are politically difficult to do. They get complaints, we get complaints. But in the end I think that they are much more supportive than they were. And we are still seeing generally that consumers, while no one likes these increases, we're still at about 87% to take the full increase and then the balance take either a reduced benefit with a nonforfeiture option.

So, I think things are going – continue to go well with regulators. And I do think – so maybe I disagree with the Moody's perspective. I think they're more open today to it in a significant way than they were two years or three years ago.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

And do you have an idea what the percentage is that it'd take the reduce benefits?

Thomas J. McInerney

President, Chief Executive Officer & Director

A

Today it's about 87% to take the full increase, it's 8% or 9% to take a reduced benefit and it's about whatever that difference is, the net 5% or so that take the nonforfeiture options. So, they have a paid up policy with claims equal to the premiums they pay today.

Ken G. Billingsley

Compass Point Research & Trading LLC

Q

Great. Thank you for taking my questions.

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

Thomas J. McInerney

President, Chief Executive Officer & Director

Thank you, Mar, and thanks to all of you for your time and your questions today. I just want to summarize and say, we remain focused on our strategic priorities. I think we have a strong management team and we're pleased to have Kelly stepping into the CFO role, and I think you've seen some of her talent today answering all of your questions. In addition to a good management team we've got talented and dedicated employees, who continue to focus on rebuilding shareholder value. We're doing all we can in terms of priorities to implement those that add value, and are feasible, but we're also staying true to our mission, which is to help families achieve and maintain the dream of home ownership as well as helping families with funding solutions for their long-term care needs.

So, with that, thank you very much, and we look forward to the next call in early February.

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

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