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Genworth Financial, Inc. (GNW)

Q3 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, ladies and gentlemen, and welcome to Genworth Financial's Third Quarter 2014 Earnings Conference Call. My name is Heather and I will be your coordinator today. [Operator Instructions] As a reminder, the conference is being recorded for replay purposes also we ask that you refrain from using cell phones, speaker phones or headsets during the Q&A portion of today's call

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

Amy Corbin
Senior Vice President, Investor Relations

Thank you, operator, and good morning, everyone. Thank you for joining us today for our extended call to discuss Genworth's Third Quarter 2014 results and to provide an update on the company's long term care claim reserve review.

Our press release and financial supplement were released last evening and this morning our third quarter earnings summary presentation along with the long term care claim reserve review materials were posted to our website. Both of these presentations will be referenced during our call and we encourage you to review all of these materials.

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Today you will hear from our President and Chief Executive Officer, Tom McInerney, followed by Marty Klein, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period.

In addition to our speakers, Kevin Schneider, President and CEO of our Global Mortgage Insurance Division, and Jerome Upton, Chief Financial Officer of our Global Mortgage Insurance Division, will be available to take your questions.

With regard to forward-looking statements and the use of non-GAAP financial information, during the call this morning we may make various forward-looking statements. Our actual results may differ materially from such statements. We advise you to read the cautionary note regarding forward-looking statements in our earnings release and the risk factors of our most recent Annual Report on Form 10-K and 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 references to statutory results are estimates for the quarter due to the timing of the filing of the statutory statements.

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

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

Thomas Joseph McInerney

President, Chief Executive Officer & Director

Thank you, Amy, and good morning, everyone. Thank you for joining us for the third quarter earnings call and LTC claims review update. Today I will briefly discuss the third quarter results, which are strong for the Global Mortgage Insurance businesses but disappointing for the life business. I will also provide an update on U.S. Mortgage Insurance capital and discuss the LTC claim reserve review.

Our objectives for this call are to provide an in-depth understanding of the LTC claim review and findings, outline our current position and path forward, and in doing so address your questions and concerns.

But first I owe you an apology. In trying to explain the second quarter LTC claim results relative to comments from the December investor call, I made a misstep when my comments shifted responsibility away from the company and me.

I recognize that the LTC claim reserve review is the primary topic of interest today so I'll keep my Global Mortgage remarks brief. The three key takeaways for our mortgage businesses are as follows. First, the mortgage insurance businesses continued to perform well in the third quarter, excluding the charge in U.S. Mortgage related to certain loss mitigation related disputes, which reflects important steps towards resolution, Global Mortgage results were in line with our expectations and benefited from strong fundamentals in each of our three main platforms.

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Second, we continue to work through the potential impacts of the new GSE capital requirements on U.S. Mortgage and remain focused on compliance by the anticipated effective date of June 30, 2015. Working with potential reinsurers, we continue to believe that we will satisfy the requirements for these new capital standards largely through reinsurance. Third, stepping back and looking at the big picture, we think our Global Mortgage Insurance businesses are well along in their turnaround.

Now, let me turn to the Life Division. Overall, results for this division were very disappointing. The life insurance business was negatively impacted by higher mortality and we experienced continued weakness in the LTC line. In contrast, the fixed annuity business had another good quarter.

As you saw in the press release, we announced three significant charges in the third quarter. The conclusion of the review of the LTC claim reserves resulted in the need to strengthen the claim reserves by $531 million for GAAP and $589 million for stat. Our annual goodwill review resulted in two impairment charges, $350 million for the life business and $167 million for long term care.

Let me provide some background. As we've communicated previously, we've been working to transition both of these lines of business. First, the life business is moving to more permanent products in order to improve returns. In doing so, we plan to limit sales of lower return capital intensive term insurance and increase sales of universal life, index universal life, and combo products, as they provide better market opportunities for the company.

Additionally, in long term care, we continue to introduce higher-return, lower-risk products, and with the launch of Privileged Choice Flex III our newest LTC product, our expectation is that near-term LTC sales will be lower than our historical run rate before gaining traction. These decisive actions resulted in the goodwill charges in the third quarter. While we are optimistic that our new product offerings across both businesses will result in increased sales and higher profit, our expectations reflect a more conservative ramp-up time for the distribution.

While any charge is disappointing, we believe these actions represent proactive and prudent steps as we work to turn around our Life Division. While in LTC we have clearly had a setback, we are leading the charge on reshaping this industry and our track record of securing premium rate increases is evident. Additionally, we are developing new products that will address the legacy issues of the older blocks and drive future profitability.

And now, I will turn the call over to Marty to cover the third quarter results, the claim reserve review, the changes in LTC claim reserve assumptions, and their impact on reserves in more detail. At the conclusion of Marty's remarks, I will comment on some of the implications of our third quarter performance and our strategy going forward.

Martin P. Klein

Chief Financial Officer & Executive Vice President

Thanks, Tom, and good morning, everyone. This morning, I will discuss our long term care comprehensive claim reserves review and impacts related to it. But first I will briefly review our third quarter results.

We reported a net operating loss of $317 million for the quarter, and a net loss of $844 million. As shown on slide three, there were several factors impacting quarterly performance, including, first, a $345 million after-tax impact from the long term care claim reserve review, a $35 million after-tax unfavorable correction of a long term care claim reserve calculation, a $34 million after-tax accrual in U.S. MI in connection with loss mitigation disputes, and $517 million of after-tax goodwill impairments in life insurance and long term care impacting only the net loss.

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In Global Mortgage Insurance, as shown on slide five, reported net operating income was $85 million, down slightly versus the prior quarter when adding back the non-controlling interest impact of the Australian IPO in both quarters and the loss mitigation dispute accruals in U.S. MI.

Let's cover Canada on slide six first, where operating earnings were $46 million for the quarter. We saw a lower unemployment rate and a modest sequential increase in home prices. The loss ratio increased nine points from the prior quarter to 21% from higher new delinquencies net of cures. We still expect the 2014 full-year loss ratio to be between 15% and 25%.

Turning to Australia on slide seven, operating earnings were $48 million, up $3 million versus the prior quarter when adding back the non-controlling interest impact of the IPO we executed during the second quarter. Macroeconomic conditions were generally stable in the quarter as there was a slight increase in the unemployment rate and overall home prices experienced modest gains. The loss ratio remained low at 21%. Given the strong loss ratio performance experienced so far this year and the stable economic environment, we now expect the 2014 full-year loss ratio in Australia to be between approximately 20% and 25%.

In Australia, we expect operating earnings before the impact of minority interest to be modestly above 2013 levels, assuming stable foreign exchange rates. With the impact of minority interest, earnings are expected to be lower compared to 2013.

Moving to slide 8 and USMI, the net operating loss was $2 million for the quarter, including $34 million of after-tax accruals recorded in connection with the settlement agreement with Bank of America subject to GSE approval to resolve pending arbitration as well as discussions with another servicer in an effort to resolve pending disputes over loss mitigation activities. Although this has been an unfavorable impact in the quarter, this is a positive development for the business as it will put the arbitrations behind us.

After adjusting to remove these accruals, earnings were down modestly from the prior quarter, reflecting a seasonal increase in new delinquencies. NIW benefited as the business increased its market share to approximately 15% and as purchase originations rose.

Turning to capital in the division on slide 9, the prescribed capital amount, or PCA ratio in Australia, is estimated at 156%, up from the prior quarter from continued strong statutory income. For Canada, the minimum capital test or MCT ratio is estimated at 224%, down from the prior quarter as the business paid a dividend to its holding company that was partially offset by statutory income. In U.S. MI at quarter end, the risk-to-capital ratio for GMICO was approximately 14.8 to 1, up from the 14.0 to 1 in the prior quarter from the loss mitigation accruals, an FX impact on affiliated investments, and increased risk in force from new business.

Turning to the U.S. Life Insurance Division as shown on slide 10, the operating loss was $322 million, reflecting the impact of the long-term care claim reserves review. Higher mortality in life insurance was partly offset by good performance in fixed annuities. The division's results also included a $14 million adverse impact from an adjustment to prepayments paid assumptions on mortgage-backed securities.

Moving to slide 11, operating earnings in life insurance were $13 million for the quarter. Mortality experience was unfavorable versus the prior quarter and prior year. The long term care insurance net loss in the quarter was $361 million as shown on slide 12, driven primarily by the completion of the claim reserves review and an unfavorable correction of the claim reserve calculation of benefit utilization. I'll provide greater detail on the claim reserves review in just a few minutes.

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Moving to slide 13, the in-force rate action continues to favorably impact earnings, benefiting results by $44 million, $21 million higher than last year but $3 million lower than the prior quarter. For fixed annuities, on slide 14, earnings were $26 million, slightly improved over the prior quarter and up $10 million from the prior year, driven by favorable investment income and higher levels of customer account values.

Turning to U.S. Life statutory performance, results were clearly adversely impacted by the claim reserves review as unassigned surplus decreased by approximately $270 million and the RBC ratio decreased approximately 45 points to approximately 445%. I'll provide more detail on the capital impacts on the long term care claim reserves review in just a few minutes as well.

Shifting to slide 17 and the Corporate and Other Division, the net operating loss for the quarter was $80 million as International Protection earnings improved slightly over the prior quarter, Runoff earnings were lower by $10 million in the quarter as equity market growth was below that of the prior quarter and we had unfavorable taxes in Corporate and Other.

Moving to investments on slide 18, the global portfolio core yield was up slightly from the prior quarter at 4.46% and we continued to experience a low level of impairments. As shown on slide 19, at the holding company, we continue to maintain significant liquidity with cash and liquid assets of approximately $1.1 billion at the holding company, representing a buffer of approximately $720 million in excess of 1.5 times debt service and well above our $350 million risk buffer over that 1.5 times level.

Unfortunately, our leverage ratio increased to 25.1% above our year end expectation of 24% which we are now not likely to achieve given the impact to equity of the claim reserves review and goodwill impairments.

Let me now discuss the U.S. Life goodwill impairments. In the third quarter, we recorded after-tax goodwill impairments of $517 million in the life and long term care insurance businesses in connection with our annual goodwill review.

The goodwill impairments are reflected in our net income figures but excluded from net operating income and only impacted our GAAP financials as we do not have any goodwill on our U.S. Life statutory financials.

Results of our goodwill analysis are highly dependent upon new business. We conservatively lowered future sales assumptions and did not reflect certain anticipated actions which we believe could increase sales over time. These lower sales assumptions resulted in this charge. We've provided more background information on this charge in our earnings slides.

Now, I will turn to long term care and discuss our comprehensive claim reserves review. As a reminder, the claim reserve represents our best estimate of what we will pay on our existing claims, which currently number about 50,000 in total. That I will discuss in more detail later. The results of the review indicate people are using more of their benefits in aggregate and people are staying on claim longer than we had previously assumed. Today I will provide some background on the impact to the claim reserve, the process we used, and key findings and changes made. But first, let me provide you a summary of the results and their impacts.

As shown on slide two, on a GAAP basis, the claim reserve increased by $531 million net of reinsurance, which has an after-tax earnings impact of approximately $345 million while on a statutory basis, the reserve increased by $589 million. The difference between GAAP and statutory figures is solely a function of the discount rate used.

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This statutory claim reserve increase impacts capital levels in the Life Division. As a result, U.S. Life company unassigned surplus was reduced by approximately $230 million while the associated RBC impact is about 40 points, with the U.S. Life RBC now approximately 445%.

In our Bermuda company, BLAIC, which reinsures almost half of the long term care business in the U.S. life companies, the impact given the smaller size of this platform is larger, decreasing BLAIC's capital ratio by about 135 points, now approximately 245%. Given tax plans and timing, we believe BLAIC's year-end RBC ratio will be over 300%.

Notwithstanding these impacts, with the significant increase in capital and unassigned surplus levels we have achieved in these companies over the last couple of years, capital and RBC levels remain solid, although well below where we want to be. Before I get into the specifics of the review process and changes, I want to first provide some background and context on LTC reserves.

Turning to slide three, as you know, there are two primary factors that affect claim costs: the frequency of claims and the severity of claims. Both of these factors impact the assessment of future claims for our policyholders for which we hold an active life reserve.

However, the claim reserve is the reserve for current claims, so frequency is not an issue since the claims have already happened. Only severity impacts the claim reserve, and that impact is driven by how long we expect to pay a claim and how much of the benefit we expect to pay.

Key assumptions behind those primary drivers are claim termination rates, or the rate at which claims end, and benefit utilization rates, or how much of the available policy benefits are expected to be used.

As you can appreciate, the characteristics of the person going on claim, such as the age and sex of the person, the nature of the claim itself or the diagnosis for the claims, such as dementia or stroke, where the claimant is being treated, such as at home or in a facility, and the corresponding policy benefits all influence these drivers.

Moving to slide four, the review which took several months included extensive internal resources as well as the engagement of a well-known actuarial firm with long-term care specialists who worked closely with us as we reviewed our claims experience and developed our assumptions. This firm also was very helpful in providing context on industry practices and assumptions as well as providing specific long term care expertise. We also have the results of our work peer-reviewed by a separate and independent firm using their long term care experts.

Having been in the business for almost 40 years, Genworth has more experience than most, if not all, other long term care providers and that 40 years of experience has now given us about 200,000 paid claims to review as we develop our assumption. During this review, we looked at all of our claims experience, the majority of which comes from the last 20 years, given that we did not see many claims in the first 10 to 20 years we were in business.

The claims review included approximately 3 additional years of claims data as compared to the last extensive claims review. This has been extremely helpful, particularly in assessing behavior for later stage claims where we've historically had significantly less claimant data, given most claims end after just a few years.

Before diving into this year's review, I want to describe the claim reserve review that took place in 2012. That review was based on our data through 2010. While this claim review was extensive, at that time we still did not have enough experience on which to base assumptions for claims in the later durations. So for claims of five years or more we, like others in the industry, look to relevant industry tables, essentially mortality tables, on which to base these assumptions.

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Our review at that time included analyzing claims patterns before and during the economic crisis, which showed claims were tending to persist longer in the crisis. That observation led us to assume we would see claims revert back to more historic termination levels as the U.S. economy recovered. We also instituted new claim oversight protocols that, at the time, we expected would improve claims experience going forward.

In our current review, we revisited those two assumptions and we removed them as we have not seen sufficient evidence in the last three years to continue to support that view. After implementing the new claim reserve assumptions and methodologies in 2012, we monitored claims experience versus the reserve.

For example, we did quarterly hindsight testing of paid claims against the associated reserves throughout 2013, which indicated in the aggregate that the reserves were covering payments made on our existing claims.

We also did a high level reserve adequacy review in the third quarter 2013, although not as extensive as that done in 2012 given that the reserve appeared to hold up well since the 2012 update. We continued to perform hindsight testing into this year.

In our December 2013 long term care disclosures, we described at length our work in assessing margins for our long term care business which are basically the margins on our active lives or the policyholders not on claim under an economic basis as well as using GAAP and statutory approaches as called for under loss recognition testing and cash flow testing respectively.

As we noted at the time, in contrast to claim reserve as the best estimate – a best estimate by definition has zero margin. In other words, accounting prescribes that the claim reserves should be set sufficient to offset the claims expected to be paid with no incremental margin.

As a best estimate, the claim reserve can and will change when the underlying best estimate assumptions are modified. This works very differently than the active life reserve or ALR for which we were assessing margins.

In assessing margins for GAAP, best estimates are used to determine adequacy but there is no change to the active life reserve until the margins become negative. The process is similar for statutory purposes, but the assumptions of the margin testing do have provisions for adverse deviation or PADs. Therefore, changes in assumptions impact the claim reserve in the period adopted, but do not impact the active life reserve unless it's associated margin becomes negative. We'll come back to margins shortly.

Turning to key findings on slide five, with the additional three years of data in the current review as compared to our last review, we now have a significant increase in the number of claims, by almost 45%, on which to base assumptions. This additional data gave us greater reliability, more statistical credibility on which to base assumptions, which we did not have before in the later claim durations.

While we have high credibility in the earlier claim durations, or years one to six, for subsequent claim durations, the credibility declines as claim durations extend, given that most of our claims on average terminate within three to four years.

Lack of credible experience data for later claim durations was a key reason why historically we used relevant industry tables instead of our own experience, which we believe has been the case for others in the LTC industry as well. The additional data we now have better enables us to use our own experience in later claim durations as we develop assumptions.

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We also refined our methodology to enable us to improve the reliability of our own data by grouping the claim population into fewer segments, increasing the amount of data in those segments and further informing our ability to use our data in developing assumptions.

With our updated and broader experience, we made two critical observations. First, we saw that the duration of claims we were experiencing is longer than what we had assumed, particularly in the later claim durations where we had been relying significantly on an industry table to base assumptions. And second, we are seeing claimants use a higher amount of their available benefits than previously assumed. That is, we saw higher benefit utilization, again more significantly in later claim durations.

I will now discuss these two observations and the changes they led us to make in more detail. Turning to slide 6, let's first talk about claim termination rates. Claims terminate for one of three reasons, claimants either recover, die, or exhaust their available benefits. I should note that benefit exhaustion is a policy feature explicitly in our reserve and projection models. The claim termination assumptions need to cover only recoveries and deaths.

In the earlier years of a claim, recoveries can play a significant part of the overall claim termination rates experienced. But generally after someone has been on claim for about seven years, the recovery rate is insignificant, so the claim termination rate thereafter is effectively a mortality rate.

While the life insurance industry has many accepted life mortality tables, in the case of long term care claimants, the population is essentially older lives which are impaired there are no accepted industry tables due to limited mortality experience for such a population. Given the lack of credible data in the later claim durations, actuarial judgment is applied and the assumptions are assessed periodically as experience evolves.

Up until this claims review, given the lack of statistically credible data for these later duration claims, we had been using claim termination rates at claim duration 6 and beyond in part on the industry mortality table adjusted by a multiple, an approach used by others in the long term care industry.

In our 2014 review, the additional data since our last review provided us with more experience to assess. With this additional information, we saw that our experience was different from the assumptions used in our prior approach. While the statistical credibility of this data is still limited, and decreases the further out a claim goes, we believe it is appropriate now to change our assumptions and accordingly reduce our claim termination rates in line with our emerging actual experience.

Until this review was completed, we did not have in our view sufficient data in the later claim durations to begin fitting our assumptions to our experience. As a result of this review, our claim termination rate assumptions changed only modestly in the early claim durations with the more significant changes for claim termination rates at duration seven and beyond.

These new and lower claim termination rate assumptions reflect longer length of stays on claim then assumed before. For example, as shown on the top of slide six, when a policyholder first goes on claim, our expectation now in that first year is that the length of the claim will be on average about 2.9 years, an increase from 2.2 years before.

Given that most of the change in claim termination rates is in the later claim durations, the resulting difference in length of claim for claims which last longer is even larger. For example, for claims which remain open or ongoing by duration seven, the expected length of claim on average is now 2.8 years remaining versus 1.7 years remaining previously. The changes we've made in claim termination rates, which again are more significant for the later claim durations, drive about half of the overall increase in our claim reserves.

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Now I will turn to the second of the two major assumptions driving claim severity, benefit utilization rates. Based on our review of all of our experience, and here again benefiting from the additional data we now have for claims in later durations, we have revised our assumptions and methodology. As shown on the bottom of slide six, in aggregate across all claim durations, the benefit utilization rate assumptions increased by about one percentage point from 66% to 67%.

In other words, in the aggregate across all claims, we assume our claimants are using about 67% of their available benefits. We have different benefit utilization rate assumptions based on a variety of factors including age of the claimant, whether the policy has a lifetime or non-lifetime benefits, whether the policy features have benefits which grow each year at some rate such as 3% or 5% or remain flat, the type of care facility such as homecare or nursing home, and claim duration.

To better align our assumptions with this experience, we slightly lowered utilization assumptions in the first three years on claim by about one percentage point, but notably raised utilization rates at claim duration four and beyond by 10 to 13 percentage points. In addition, we've changed our methodology to self-adjust as utilization rate behavior evolves by incorporating a 12-month rolling average approach to update utilization rates each quarter.

Moving to slide seven, let me provide some perspectives on these changes to our claim reserve methodology and assumptions. The new claim reserve assumptions we developed fit well with our actual most recent experience. This is evidenced by the actual to expected back testing we did comparing the new assumptions to our actual experience over the last four, three, two and one-year periods. In particular, we looked at ratios of actual to expected claim termination rates, and also compared actual benefits paid to what would have been assumed to be paid using the new approach. In addition, we performed reserve adequacy hindsight testing using the new assumptions against our actual claims experience over the last four years and shorter periods within that time.

We believe this update to our claim reserve assumptions and methodologies brings us to our best estimate. However, I do want to make two points. First, we like others in the industry still must apply actuarial judgment in developing reserve assumptions. While we have based our assumptions largely on our experience and have more data than in past years, we still do not have complete statistically credible experience in the later claim durations seven and beyond. However in our judgment, given our additional data, we believe placing more weight on this experience to set claim termination rates provides a better estimate than using a single multiple of an industry table as we'd done before. And second, changes in experience and related trends in the future will, of course, require modifications to our claim reserve assumptions.

Turning to slide 8 and 9, let me now shift from our claim reserve assumptions and discuss how such assumptions impact our view of the active life reserve or ALR. The ALR represents the liability for future claims from the active lives, that is the policyholders who are paying premiums and not currently on claim. This reserve is about $15 billion on a GAAP basis and $16 billion on a statutory basis. ALR assumptions are established in the year the policy is sold and the reserve builds over time until that policyholder dies, lapses, or goes on claim.

Under both statutory and GAAP accounting, the reserve assumptions are locked in at policy issue. When a policyholder goes on claim, a claim reserve is set up at that time and the corresponding ALR for that policyholder is released on a GAAP basis although on a statutory basis it continues to be held until the policyholder is no longer on claim.

As noted earlier, the claim reserve is based on best estimates and updated as those assumptions change. Given the ALR assumptions are locked in, the ALR needs to be assessed at least annually to assure that the reserves remain adequate given emerging experience and updated views on assumptions.

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The process to do this is margin testing, which is done under the loss recognition testing frame work for GAAP and under the cash flow testing framework for statutory purposes. The margin tests project income over 40 or more years from expected future premiums and investment portfolios behind the reserves and also the expected benefits and expenses to be paid using current best estimate assumptions with a PAD reflected in statutory testing only.

So the set of assumptions influencing those projections is broader than are the assumptions behind claim reserves. Claim projections and margin testing also reflect the severity factors that we discussed earlier but in addition must include assumptions regarding claim frequency as well as other inputs including interest rates, lapses, investment spreads, premium expectations for both original and additional expected premiums, and so forth.

It is important to note that the ALR essentially remains locked in unless the margin becomes negative. Changes in margin prior to that time generally have no current earnings impact, although increases or decrease in margin correlated to future profit margin increasing or decreasing for that particular block. This is different from the claim reserve where, as I said earlier, changes to assumptions are reflected immediately and recorded in the current earnings period.

Shifting to slide 10, we are in the process of conducting our annual margin analysis. As we assess our long term care margins, clearly our updated assumptions on claim severity are relevant and are expected to materially reduce margins.

However, we are focused on management actions that are expected to offset much or possibly most of that impact. As we mentioned, we will pursue additional rate actions given the results of our claim reserve review. We will also evaluate additional actions to reduce risk, which Tom will discuss shortly.

In addition, we are reviewing and updating other assumptions associated with our margin analysis. I should also note that under the special rules of New York, margins in our New York subsidiary, which is less than 10% of our overall long term care reserves, have been essentially zero and management actions have typically been limited to only those that have been implemented.

There are some key differences between our active and disabled lives that will be factored into the analysis as they have been in the past. Given the majority of our disabled lives underwent less underwriting and have older generation products with different policy features and benefit options than do our active lives, our margin testing will reflect those differences.

We very much understand the importance of our updated margin analysis to all of our stakeholders. We've accelerated our normal timeline from this analysis and are actively working to complete it. We plan to disclose the results of our margin analysis in December.

I've covered a lot of ground this morning to provide investors more transparency on these changes. Let me just quickly sum up what we've done in our claim reserve review. First, we leveraged more Genworth data than in the past, now that we have additional data. Second, we refined our methodology to better capture changes in benefit utilization as it happens. Third, we tested our work and conclusions to ensure a good fit with recent experience. And finally, while the impact of these changes is certainly significant, we have solid capital and strong liquidity levels and we are committed to increasing our strength from here.

And now, I will turn the call back over to Tom.

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Thomas Joseph McInerney

President, Chief Executive Officer & Director

Thank you, Marty. In light of the outcome of the LTC claim reserve review and the poor performance of our legacy older blocks, the turnaround in our LTC business and thus the Life Division will take longer to accomplish than previously expected. This will not be an easy process but we remain committed to improving this business to create value for our shareholders.

Let me leave no doubt that we are focused on improving this business across the board, and while we have made some progress, there is more work to do. In that regard, we are taking the following steps to move the Life Division forward as outlined on slide 11. Given the holding company's financial stability, we plan to forgo dividend payments from the Life Division for the remainder of 2014 and into 2015.

This will strengthen Life Division capital, allowing operational flexibility in the near-term. Additionally we are taking actions to build capital and improve statutory earnings, including stepping up existing and initiating new LTC premium rate actions, pursuing actions to capitate risk on in-force blocks, exploring block transactions, expanding our use of reinsurance, and adjusting sales mix.

We believe these steps will allow us to rebuild capital in the Life Division to even higher levels than before the charge. We believe it is prudent to maintain a higher capital level to provide a cushion if in the future there's a future deterioration in LTC reserves, which we currently do not expect but believe it is prudent to prepare for. Additionally, our goal is for these steps to enable the Life Division to return to paying a regular ordinary dividend as soon as possible.

With regard to other capital needs, specifically the new GSE capital requirement within U.S. Mortgage, we continue to focus on reinsurance as the primary funding vehicle.

In light of our plan to forgo life dividends in the near term while at the same time maintaining strong liquidity at the holding company, we are taking the following steps. First, we will maintain our current cash target of 1.5 times interest coverage plus a risk buffer and may choose to hold in excess of that amount.

Second, we will retain a majority of the Australian IPO proceeds at the holding company for the foreseeable future. We previously earmarked these proceeds for delevering after ensuring adequate capital levels existed across all platforms. As a result, our ability to reach our leverage target of 20% to 22% will take additional time.

Third, we will shift more of the debt obligations in the near term to our Mortgage Insurance Division given its continued strength. Our ability to do so has largely been driven by International Mortgage Insurance performance and we will eventually be bolstered as U.S. Mortgage returns to paying regular ordinary dividends in the next several years. And finally, we'll consider monetizing additional non-core assets at the appropriate time.

Turning to slide 12, enhancements to the internal processes surrounding our LTC claim reserve are underway, including but not limited to more robust and frequent reviews combined with the establishment of additional metrics in order to better identify changes in behaviors. We have also taken steps to enhance our LTC bench strength, adding key actuarial and financial positions.

Turning to slide 13, despite these challenges, we believe the best path forward is for Genworth to continue with the three-part LTC strategy we announced last year, which is focused on improving returns through premium rate actions on our in-force business and new products with more conservative assumptions in underwriting.

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We believe staying in the LTC business is the right decision for three reasons. First, in our opinion, the best way to improve near-term performance of these legacy older blocks of business, which were written over a decade ago, is to continue to work with regulators on premium rate increases to limit losses and improve returns. We believe that our commitment to the LTC business is a positive catalyst towards continuing to obtain these premium rate increases.

If there is a silver lining in the claim charge, it is another data point for regulators on why we need to work together to find the appropriate premium level on an important product for retiring baby boomers.

Second, we believe our new LTC products have strong returns and manageable risks. And third, we believe there is future demand for LTC insurance as Americans seek to mitigate long term care costs in retirement and there are a limited number of providers. On that basis, we remain confident that over time the LTC insurance business can become a very good business for Genworth.

Turning to slide 14 and an update on our LTC premium rate increases, we continue to make solid progress. On the 2012 premium rate action as of the end of October, we have reached an agreement with 47 states and we are working closely with California, which has already approved a rate increase on one of our blocks.

All told, we are on track to meet our 2017 expectation of $250 million to $300 million on our 2012 premium rate increases. We have, however, notified three states – Massachusetts, New Hampshire, and Vermont – that we will suspend business in their state because we were not able to reach an acceptable agreement on the 2012 premium rate action. These states represent only 4% of our LTC premiums.

For the smaller premium rate increases on the newer Choice II blocks, as of today, we have heard back from 30 states and received approval from 22 states. We believe the Choice II approvals received so far will add an incremental $25 million to $35 million in annual premium increases once totally implemented.

As you can see from the tables on slide 14, we have been successful in securing rate increases over the last seven years. We will continue to file for and pursue rate increases on our LTC products in order to get the legacy older blocks closer to breakeven as well as to help maintain returns in our newer blocks in line with their pricing assumptions.

Turning to slide 15, in summary, as we look at the overall strategy for Genworth, we continue to believe the best way to enhance shareholder value is to improve the operating performance of the Global Mortgage and Life Divisions so that each can stand on their own and support an appropriate level of our overall debt. This strategy increases our flexibility to pursue other options to create shareholder value in the future. Today, we have taken a step back in the Life Division's ability to accomplish this. As we work toward these priorities with urgency, we remain open to all feasible strategic alternatives that increase long-term value to our shareholders.

And now, let's open the floor to your questions.

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QUESTION AND ANSWER SECTION

Operator: 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 Suneet Kamath from UBS.

Suneet L. Kamath
UBS Securities LLC

Q

Thanks. First question is on BLAIC, could you just give us the nominal amount of capital that's in that reinsurance subsidiary?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Sure, Suneet, it's Marty. Before this update we had close to about $900 million of capital, and that's dropped now to a little bit over $600 million, probably closer to about $630 million, I believe.

Suneet L. Kamath
UBS Securities LLC

Q

Okay. And then I guess the second question and I'll requeue is for Tom on the ROE targets. I mean, it sounds like you didn't mention the 7% to 9% target for 2016, I don't believe. Maybe you did, but I'm assuming that that's off the table at this point?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

We will, obviously, going forward do the work in the fourth quarter on the ALR margin and we will also likely then in December give you an update on the ROE targets for the Life Division and also for the Global Mortgage Insurance Division.

Suneet L. Kamath
UBS Securities LLC

Q

And I guess based on everything that you're saying today around the capital flexibility, can you rule out an external capital raise to deal with long term care?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah, Suneet. It's Marty. I believe that we still have, if you look at some of the numbers, very solid capital levels within U.S. Life Division, kind of the mid-400s in RBC, still significant unassigned surplus.

We also have very solid capital levels and strong capital levels in some of the other platforms, and we have a very big chunk of liquidity up at the holding company with the Australia IPO, over $700 million north of our 1.5 times debt service buffer. So certainly not something we anticipate doing at this time. It's certainly something we don't want to do. But we'll watch and if circumstances change, we'll certainly have to consider everything involved.

Suneet L. Kamath
UBS Securities LLC

Q

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All right. Thanks. I'll requeue.

Operator: We'll take our next question from Sean Dargan with Macquarie.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Yeah. Thanks. I guess I have an overarching question for Tom. Given that I think you can make a plausible argument that the non-LTC businesses are worth more than where the stock will probably open up this morning, why don't you put LTC into runoff?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Sean, that's certainly an option we've considered. In our opinion, that would not be a good thing to do because I think we have done a very good job of receiving rate increases from the regulators and we are stuck with these old blocks whether we keep the business, continue the business, or put the business in runoff. And I think we have and it shows on that slide 14, we've done a very good job working with regulators. I think we have a very good working relationship with all of them, very proactive.

I think they understand the need for these increases, and I think it's, one, our position in the industry as a leader and, number two, our commitment to the business that has made regulators very comfortable with giving us these increases. Because as they look at it, they need us and they need a private market. There's less than 10% of Americans in the appropriate age categories have private insurance. And that means that the states are already seeing – I've said this before, Sean, that 25% to 50% of the state Medicaid budgets today go towards long term care and that's only going to continue in the future.

And so I think that these states have been willing to give these very large increases that they haven't always been willing to do in the past I think because they know if they can keep Genworth the leader in the business, committed to the business, we help them by taking through private coverage some of the future burdens that they see. I mean, they see these same, I'm sure, claim terminations, rates going down, and higher utilization of benefits and that is covered today by Medicaid. So I think it's important to remain in the business so that we can continue to get those significant premium increases.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

All right. Thanks. And one follow-up, can you tell us how much DAC is associated with long-term care and can you remind us what that amortization is tied to? Is that EGP or is it premium levels?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

You know, Sean, it's Marty. I don't actually have that right at my fingertips, but I am surrounded by people that do have it. So let me come back to you a little bit later in the call with that number once we have it.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Okay. Thank you.

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

And actually that time is now. We have about $1.4 billion in DAC behind the long-term care business.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

And I guess what test do you use to – what would make you have to write that down?

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

Yes. It's really the loss recognition testing that I referenced earlier. So in loss recognition we look at the overall margins on a GAAP basis in loss recognition and then to the extent margin goes negative, then you begin to write down GAAP and then reset the reserves from there.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

Okay. So you would write down DAC before you reset GAAP reserves?

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

Correct.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

Okay. Thank you.

Operator: We'll take our next question from Ryan Krueger with Keefe, Bruyette & Woods.

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

Hi. Good morning. I was hoping you could help me think more about the timing of the additional rate actions and how that will come into play when you do the active life margin testing?

So you haven't requested the rate actions yet. I'm not sure when I guess that will be done but when you think about updating your active life reserve margin, I guess, will you incorporate the planned rate increases into both the GAAP and the statutory test?

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

Hey, Ryan. It's Marty. Let me kind of start out with that. Obviously, these new claim assumptions as a result of our study are really just a few weeks old so we've been obviously assessing those and putting them into our balance sheet and earnings for the disabled life reserve. Now we have to kind of project those forward and see how we think they may impact our active lives policyholders not on claim and try to get a sense for the incremental claims that we might expect over the next 10, 20, 30 years from that.

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From there – we've on a preliminary basis begun to do that, working very actively to then see what does that mean as far as call for a rate action. So we're creating a multi-year plan for rate actions that would also include reduced benefit options that we think regulators and policyholders find very acceptable.

And so we're working through that very actively as we speak and we've been in discussions with our regulators. As I said earlier, we will have more of an update on our margins sometime in December and should have a pretty good sense of that by that point in time.

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

Q

I guess the timing consideration, though, seems important because if you're basically telling us that, all else equal, your active life margins are going to decline substantially, and I don't think you've ruled out that they could potentially go negative, but there's this big offset potentially from higher rate increases. I guess it seems important to know if you can incorporate higher rate increases when you do the test this year or if you have to wait until you start getting approval sometime in the future?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Right. Sure, Ryan. Very good question. And it actually for GAAP loss recognition testing we put in our best expectations in the future. So, that would include future rate actions, not just the ones that we have that we're implementing and have approved but ones that we'd intend to do down the road.

Similarly for stat, as we've looked at the guidelines, the statutory regs and actuarial guidelines and had discussions with the regulators, we also believe that is what we'll be doing on a statutory basis, albeit with probably some PADs or a little bit of conservatism in what we might expect to get over time.

Again, I think that you're dealing with a situation with claim costs that you expect to see probably 10 or 15 to 20 years down the road, so it's hard really, obviously to project with certainly what those are going to be. Obviously, if our new assumptions are right, and we end up seeing those claims 10 and 20 years down the road, we'd be filing for rate actions at that time. So that's what we'd be embedding in. So based on both GAAP and stat, we'd be building in those rate actions into the margins even though they'd happen in the future, again, and establish some conservatism.

I should mention there is an exception, as is sometimes the case with the State of New York. New York does preclude future rate actions in their – at least at the moment, typically in their margin testing. Rate actions that haven't been yet implemented or approved and filed, I should say. So we're having discussions with them. We also have rate action filings with them on a number of the old block policies. So we'll see how that plays out and that will be reflected in our margin testing in December. I'd say that New York subsidiary, GLICNY, has a little bit under 10% of the overall business.

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

Q

All right. And then just last one for now, I think last year you had in addition to the New York on a statutory basis you mentioned that you have an acquired long-term care block, I think with $2.5 billion of reserves, that you had to test independently on a GAAP basis. Is that something we should also be considering?

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

Yes. And first, let me go back to on the GLICNY piece, the New York piece, that is a statutory phenomenon that I talked about with not including future rate actions for statutory cash flow testing. So it's more of a statutory consideration, not GAAP. Moving to the acquired block which is about $2.5 billion, that's actually more of a GAAP phenomena. We have a pretty thin margins in that block on a GAAP basis. And given the block is an older group of policies, the ability for future rate actions to really have a significant impact on the margin is less. So we do anticipate there's potentially going to be some pressure on that particular block from a GAAP standpoint, so we wanted to make sure we called that out for investors in our disclosures.

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

Got it. Thank you.

Operator: And we'll take our next question from Ken Billingsley with Compass Point.

Ken G. Billingsley
Compass Point Research & Trading LLC
Q

Good morning. On the margins, when you are looking at it and making adjustments – and I'm thinking about the December 2013 slide 8. When you're looking to unlock, is it one adjustment and you are unlocking it or are you able to make changes or does it have to be a cumulative effect from all of the changes and that your margins have to go down to zero before there's any reserve adjustment?

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

Yes, Ken, it's Marty. Yes. Essentially when the margins become negative, that's the point generally in which you unlock. And at the time you unlock, you basically reset your reserve assumptions so that you basically predict it's going to be zero profit in the future. For the stat, you put a little bit of conservatism into that reserve calculation.

But that becomes effectively your best estimate at that time and you set the assumptions based on your best estimate at that time to basically assume that the business is going to break even from that point forward.

And then from there on, obviously, there's effectively zero margin in it at the time you do that because you assume that as you reset the reserves there's zero profit. And then obviously you retest that every period and see how that's performing at that time under those new assumptions.

Ken G. Billingsley
Compass Point Research & Trading LLC
Q

Just to clarify for me, it still has to be a cumulative effect taking it to zero, not just an assumption of 10 year treasury rates going – I think your estimate was...

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

Right. You're looking at your – exactly. You're looking at your present value of all your revenues, if you will, over the 40 years plus your projection premiums and investment income. Then you look at your present value of all your claims and expenses and you net those two, but it's on a PV basis and not a current basis.

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Ken G. Billingsley
Compass Point Research & Trading LLC

Q

And this is going to allow you to what you believe to get rate increases. My question on the future rate increases, the $250 million to $300 million expectation, and the new rate increases that you're going to go for, that actually will flow into book value as you get those rates? Essentially, isn't there going to be a future claim on those rate increases, specifically for the older block of business that you're just trying to get back to breakeven? So technically, some of that book value is actually going to be utilized for paying claims in the future?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Since I've been doing most of the work with regulators on rate increases, let me comment on that. I think what we will now do is on the old blocks, as we describe them in the slides that you have, we have been and will now seek additional rate increases or benefit reductions to restore the margin back to – essentially on those blocks we're trying to get to breakeven. So we'll take the new claim termination and benefit utilization assumptions that Marty went through in his DLR presentation, apply them to the old block, and then estimate what we need in the future for additional premium increases beyond the $250 million to $300 million to get those blocks with the new assumptions closer to breakeven. And then we'll work with the regulators to get those.

In addition, we'll also apply those same claim termination and benefit utilization assumptions to our Choice I, Choice II and the three Flex blocks, Flex I, Flex II and there's also an AARP block within there.

And so again, we'll apply those same new assumptions. We'll see what premium increases we need or benefit reductions to get those blocks back to the original pricing assumptions. And that sort of as we've discussed with all the regulators, it's getting the old blocks closer to breakeven, counting all the new assumptions and things that impact the block, and then on the newer blocks to get those back to the original pricing margins.

I'll also note that on PC Flex III, while we'll look at the impact of these changes for Flex III, we've already capitated the length of duration on those to 5 years. And since, as Marty said, most of the claim termination and benefit utilization assumption changes apply to durations seven and longer, it shouldn't have a big impact on the PC Flex III pricing or returns.

Ken G. Billingsley
Compass Point Research & Trading LLC

Q

But does that mean that those rate increases, there is going to be a future claim on those, especially if these people are not – if they're active reserves right now, there is going to be a future claim on those new rate increases?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yes. It's Marty. Maybe – there is, while you look at all of that on the margins, the present value of all those things, there's obviously going to be an earnings timing mismatch obviously over time because the amount of additional premium you get is going to come into different periods versus the claims you pay. So I think to some extent that's right. There's going to be, over time, just a difference in the period of recognition in a statutory earnings, for example, of when you're recognizing the premium versus when you're going to pay the claims. And that's what the reserves are kind of set up for, to build over time. You get the premiums generally sooner, you play the claims later and the reserve is meant to build up to offset a lot of that difference.

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Ken G. Billingsley
Compass Point Research & Trading LLC

Q

Okay. Thank you.

Operator: And we'll take our next question as a follow-up question from Suneet Kamath from UBS.

Suneet L. Kamath
UBS Securities LLC

Q

Thanks. Just wanted to get a sense on the Choice II, I think you said whatever $25 million to $30 million of additional premium. But obviously, that's a younger block and you're going to collect those premiums for a longer period of time before they go to claim, on that assumption. So I guess how material is that to the balance sheet margin, would you say?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

So it's – again, we've received approvals from 22 states. So we still have the remaining states to go through and get approvals on. We will obviously in the Choice II discussions with regulators bring in to the calculations, additional premiums we may need to reflect these new assumptions for the claim reserves.

But the $25 million to $35 million, as you correctly noted, is going to – while it's lower than the 2012 increases, it will apply for many more years because we're getting those increases much sooner in the lifecycle, if you will, of the Choice II products. So the present value in the margin of the $25 million to $35 million will mean more because you're going to get that for more years into the future.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Maybe and just to add on to Tom's comment. If you think about the $250 million to $300 million that we've expected to get on the 2012 rate actions, that's worth maybe about $2.5 billion of margin. So if you carried that forward and think about $25 million to $35 million on Choice II, as Tom was speaking, you expect to get that premium longer. The kind of annuity factor, if you will, is going to be better for Choice II. Don't have that available for you today. That will be part of the margin testing work that we'll provide in December.

Suneet L. Kamath
UBS Securities LLC

Q

Right. I was just doing the math of the $2.5 billion divided by I think I used $280 million which is, I don't know, nine times or something and then multiplying that against the $30 million for Choice II which gives you $260 million, $270 million of additional margin but obviously that doesn't factor into the calculation the fact that you're going to be collecting them for a longer period of time.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Correct.

Suneet L. Kamath
UBS Securities LLC

Q

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So it would be above that. Okay. And then can you just – I mean, thanks for all the detail on the qualitative side, but there's not a lot of quantitative detail in the presentation about the additional strategies that you're looking at.

So on page 11, where you walk through opportunities to reduce risk, utilize reinsurance, block transactions, I mean, is there some way that you can frame how material these levers could be to the margin?

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

Well, let me go first. It's Marty. I think, obviously, while the U.S. Life Division has significant dividend capacity this year and we still anticipate it having very significant dividend capacity next year, with the liquidity we have at the holding company and with the dividend flows that we can achieve from the other businesses particularly the International Mortgage Insurers, we have the ability to forgo dividends not only this year, but I think we also plan to forgo most if not all of the 2015 dividends from the US Life Division.

So that basically – if you think about the dividends we were expecting to get this year, call it $200 million, and it's probably a little bit north of that next year, that basically is an expected dividend flow that the Life Division is no longer really expected to pay given that we're going to forgo it because we have these other sources. So that will help a lot in helping the life company rebuild its capital. So I think that's probably one of the most impactful of all those things.

Suneet L. Kamath
UBS Securities LLC
Q

Okay. I mean, I guess I was referring to some of the other things, like reinsurance and block transactions, but I don't know if you have any more color you can provide on the materiality of those numbers?

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

Well, we'll continue to look at reinsurance opportunities or block transaction opportunities on all the in-force life and annuities. I'd like to be able to say that we'd do the same for long term care, but I think on the old blocks we're on the hook for those. Those are probably not reinsurable and I think there the fix to those is to get the additional premium increases, etcetera. We will also look at reinsurance going forward on new life insurance sales and we are also talking to a variety of reinsurers about their interest and I think there is interest in reinsuring the new long term care blocks. And so I think that will allow us, over time, to manage capital.

Suneet L. Kamath
UBS Securities LLC
Q

All right. And then maybe just lastly for Tom on the – a while ago, you talked about changing the model of long term care where the pricing on the business would reflect more like the health insurance business where you could reassess every couple of years. I know you've been out talking to regulators about that. Any color on what the response has been and how feasible you think a change in the model could be down the road?

Thomas Joseph McInerney
President, Chief Executive Officer & Director
A

No, on that I think we've made a lot of progress with regulators. So if we go back to 10 or 20 years ago, they were very reluctant to grant premium increases. And of course we and others in the industry did not regularly do that. I think they now accept and I think this claim review that we just did will be more strong evidence for them that it is impossible to predict all this stuff in advance, whether it's interest rates or lapse rates or claims. And that,

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ultimately, the only way you can be in this business – I've said this since the day I got here – is you have to be able to receive regular increases as soon and as often as you need them. And I think by doing it – and what I've said to them every year or every other year in doing single-digits, it's a lot easier for them to approve it and it's a lot easier for our customers, policyholders and consumers in general to absorb it.

So there really is no way, in my opinion, that any insurance company can stay in this business unless the regulators allow frequent rate increases so that you can adjust as the real world place out and interest rates change and lapse rates change or morbidity claim costs change. People are living longer. That will probably continue and so I think we'll have to do that.

And I think it's critical for the regulators to understand that – I think they do – and to allow us to receive those increases, so we can make this business more manageable going forward.

Suneet L. Kamath
UBS Securities LLC

Q

All right. Thanks.

Operator: And we'll take our next question from Steven Schwartz with Raymond James and Associates.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Good morning, everybody. I'll apologize in advance. I got on late so maybe these were already addressed in the presentation before I got on. But I did have a couple still on LTC and then I did want to address MI.

Marty, can you talk about, if you haven't already, kind of the differences between the stat charge and the GAAP charge – the stat charge was higher. Maybe I'm thinking about the ALR but I would've thought the stat charge would've been lower because LTC – my understanding is that's all tested together but life is in there and other things are in there as well, so I'm kind of interested in why that stat charge was higher?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Sure, Steven. Really again just say the life reserve or the claim reserve, as we call it, is for both GAAP and stat on a best estimates basis. So it works differently than a lot of other reserves on our balance sheet, which are where the assumptions are sort of locked in and you test them every year with margins. For the claim reserves, you basically every year look at the assumptions, and you modify them if you think you have then better assumptions. So it works very differently from accounting standpoint, both for GAAP and stat.

The difference then really is only related to the discount rate. You're dealing with claims that kind of have a duration of two to three years and they use different discount rates. For GAAP, you use your best estimate of a discount rate. And for stat, it's a prescribed rate from the regulators. So that's really the only difference.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. Was I right, the ALR, is you test the ALR on a statutory and it's for – on GAAP? For stat purposes, you test the ALR on an entity basis, and it's all mixed up? For example, if you have lack of margin in LTC, you might have excess margin in life and they offset?

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Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. For GAAP it's all, we look at it in aggregate for GAAP, because it's all Genworth business, it all rolls up. For statutory purposes, we do the margin testing, which is cash flow testing, on a legal entity basis. So we do it for our Delaware – well, we do it for all of our legal entities but in the case of long term care, it resides in our Delaware company, in our New York company, and then in our Bermuda affiliate BLAIC.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Right. Okay. So – but the DLR is not done on that entity basis?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

The DLR is also on an entity basis, but there's not really a concept of cash flow testing for that because it's just a best-estimate reserve. So there's really not a margin in it, just every year you set up a reserve for it.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. So there is no offset. Okay. I get that. And then, kind of the same question, can you talk about the DTA offset. Obviously, a lot less than 35%. Does that have to do with how much deferred taxes can be admitted? There's like a 10% limit or something like that?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. There's a little bit of a limit on that that we saw in the U.S. Life companies that we expect is really more of a timing thing. And over the next quarter or so, we expect that to come into the capital. But that's really a smaller amount. The larger amount's really in BLAIC, the Bermuda company, where the regs there don't really permit you to allow any DTA, but we do expect that there'll be some current tax benefits that the business has in the next quarter that'll basically get the capital back up. So we do kind of expect over the next quarter or so to kind of get that full tax benefit or pretty close to it.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. So if I take the – I think it was on a stat basis 585, I guess I'm a little lost here, and I divide by 2, all right because half of that went to BLAIC. Yes. Maybe we should work through that.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yes. Real quickly, just help with the math and then we can do it offline as well. But call it 10% of the business sits in GLICNY; it's actually a little bit less. The other 90% resides in the Delaware company, GLIC. Of that 90%, half of it goes down to BLAIC. So BLAIC's closer to, call it, 45%.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay.

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Martin P. Klein
Chief Financial Officer & Executive Vice President

A

And then we expect – we didn't get it this quarter but we expect to get the full tax offsets, if you will, over the next quarter or so. So there's a little bit of a timing mismatch. That timing mismatch is more on BLAIC because none of the tax benefits or offsets were really realized the third quarter. We expect that end of the fourth quarter.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. All right. Good. And then if I can, I have a feeling nobody's talked about MI. Could you talk about the PMIERs and the change in the estimate? I'm interested in how much of that had to do with the change in value of Genworth Canada? And then risk retention rules came out and I believe they are not going to give credit for MI and I was wondering if I could have some thoughts on that?

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

A

Steven, this is Kevin. First of all, if you think about the revision we made to the PMIERs, the biggest impact right out of the gate was really the settlements that we disclosed during the quarter. That drove a major portion of the refinement.

There was some additional assumption changes and some clarification of interpretation of what was going on with the GSEs. We did have some downward pressure relative to primarily FX and the translation value of the holdings that U.S. MI has in the Mortgage Canada business but the lion's share of it upfront was really the settlements and I would say over the longer term, that the MIC piece may add a little bit more pressure but we still – I think the important point is we still intend to comply by the June 2015 deadline. Again, primarily through reinsurance, as we stated.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

How does the – maybe I'm not understanding it, but how does the $34 million settlement affect it that much?

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

A

Well, first of all think about it pre-tax.

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay.

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

A

And the actual comprehensive accrual – the accrual we did related to the settlements in the quarter. They actually didn't hit it up today. It's just an accrual but ultimately when we pay the cash out for that settlement, it will have impact on the assets available. And then longer-term also as it relates to the nature of the agreement, we'll be doing some less curtailment of claims with the settlers and that will have more upward pressure on the outward end of the range.

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Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. Got it. All right. And then on the risk retention rules?

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

A

The impact, if you're referring to the recent clarification on the QRM rules?

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Yes.

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

A

Which I think is what you're focusing on?

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Yeah.

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

A

Basically, I think it was a reasonable outcome for the industry. Essentially what has come out is QRM is going to be equal to QM. And basically what that means is initially when the regulators came out with their preliminary guidance or request for comment around QRM, there was some initial request to have a 20% down payment requirement. Essentially that goes away with the new requirements. That's the most important thing for you to know. And then outside of that, it does not – the GSEs and the FHA are not required to comply with those rules either.

So in our principal space, the GSE business, no impact for us. But perhaps a bigger opportunity for the industry outside of the GSE space going forward, because there is not that 20% down payment requirement.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Steven, it's Marty. Really appreciate your questions, but we have some others in the queue...

Steven D. Schwartz
Raymond James & Associates, Inc.

Q

Okay. I'm done.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

I'm happy to talk to you off-line.

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

I'm done, Marty. Thank you.

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

Thanks very much.

Operator: And we'll take our next question from Geoffrey Dunn with Dowling & Partners.

Geoffrey M. Dunn
Dowling & Partners
Q

Thanks. Morning. I wanted to follow up on the MI question there. As you've been exploring reinsurance options, is there any appetite out there for 2008 and prior vintages or would reinsurance still be concentrated on the 2009 and after?

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

Great question, Geoff. We are actually in good discussions with reinsurers across all of our various books of business. So our current negotiations are not just on the new books. There is, in fact, appetite for the old books as well.

Geoffrey M. Dunn
Dowling & Partners
Q

Okay. And I know you can't get into specific details, but if we're trying to evaluate potential cost impact, is there any reason to think that any reinsurance that you'd enter is materially different than some of the examples we've seen among your peers?

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

Depending on the nature of – I can't comment exactly on what my peers have done. I do know there's been some more quota share business out there and our focus would probably be more on an excess of loss type transaction. So that might – just because of the nature of the losses covered, that might have some different impact on the pricing.

Geoffrey M. Dunn
Dowling & Partners
Q

Okay. And then last question relating to what changed this quarter, was there anything surprising that you had to strip out of your calculation? I understand the two major impacts, but was there anything you were including in your previous estimate of note that you had to take out as you further interpreted the proposal?

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

Yes. I think not materially in terms of things we had to take out. I think the issue is, Geoff, we still don't know exactly where this thing is going to end up. I mean, I think the PMIERs is still subject to some change. So I'll give

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you one example. As written, we're still working through with the GSEs trying to understand exactly what the GSE's interpretation of everything's going to be. They're trying to work through it on their side. They've got several mortgage insurers that they're trying to sort through this with. So they were complex eligibility guidelines to begin with. And as we've worked through them, we haven't gotten clarity on everything. So perhaps we're just being a little bit more cautious in providing a range that we can all live within.

Geoffrey M. Dunn
Dowling & Partners
Q

Okay. Great. Thank you.

Operator: And we'll take our next question from John Hall with Wells Fargo.

John A. Hall
Wells Fargo Securities LLC
Q

Good morning. I have a couple of questions. The first one has to do with the claim reserve review. I just want to make sure that I am understanding it correctly.

In broad brush strokes, essentially you've pushed out terminations by about eight months and on the utilization rates in the aggregate, they went up by about a percentage point? Just wondering if you could break down the charge to the component associated with the termination and utilization?

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

Hey, John. It's Marty. Yes. It's very roughly about 50/50. About half of the increase is really related to lower claim termination rates that we're putting in place now that we've had a chance to look at our experience and the tail of information we didn't really have before.

So of the claim termination rates, that's about half and much of that impact is really for the termination rates we see much further out in the tail, probably beyond claim duration six or seven And then the other half is really around the increase or difference in utilization. It's about 1% in aggregate, but it does – if you look at that slide – vary quite a lot by the claim duration.

We actually decreased our expectation of utilization by about 1% in the first three years but then increased it more significantly by, I think, 10 points or 12 points or so in the later claim durations. In aggregate, we expect utilization to go up 1% but obviously in the later durations we're now seeing that people are utilizing more of their benefits than we'd previously assumed and that's about the other half.

John A. Hall
Wells Fargo Securities LLC
Q

Okay. Now, if I think about that, Marty, and I just broad math – 500 divided by 2.00, 2.50, and I say, well, maybe utilization rates go up in the aggregate another 1% in the future, should I think about 2.50 again?

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

Well, the way that it works is it's – we tried to in a way simplify what's more complicated, but we really have a variety of utilization assumptions. And they basically start a little bit lower and then they lift up over time and flatten up. So basically we expect and it's in our disabled life reserve calculation that's on our balance sheet now,

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we expect utilization for the claims that are on the book to the extent to stay on the book to be increasing over time sort of automatically. Because as they go from claim duration two to three to years four and five and six, that's kind of built in that we expect utilization to be increasing over time.

Obviously, if there are different trends that we see where people just in aggregate begin using even more of the benefits than the historical pattern has been that we've seen, then there could be a change there.

John A. Hall
Wells Fargo Securities LLC

Q

Okay. Moving on to the active lives reserve, slide eight shows about $15 billion or so currently on the books. In your discussion about what you're going to be doing going forward, you mentioned management actions being able to address and potentially preventing or eliminating a need for any additions. Can you break out that $15 billion between the reserves that are subject to management actions and those where you don't think you're going to be able to do anything?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. John, it's Marty again. I'd say basically the entire universe is really things that we're going to be looking at. I think that universe of the $15 billion consists of older policies where we've already been enacting some larger rate increases. And we'll continue to look at that with the new claim assumptions which we have which are incrementally – we expect more claims on that. We'll also do it with Choice I and Choice II where we've had these smaller rate actions going on. And then we'll look at it with some of the newer vintages of product, Flex I and Flex II, where those are newer products, but we now, if we have an expectation of some higher claims on those, we'll reassess what we expect for our expected loss ratios and file for those as well.

So it's really across the board and that's what we're looking at very actively right now and devising these kind of multi-year rate action plans that I talked about earlier and building into our margin testing that we'll talk about in December.

John A. Hall
Wells Fargo Securities LLC

Q

But you can't identify a block within that $15 billion that really you're not going to be able to move on rate?

<A – [0746D2-E]Marty Klein – Genworth Financial, Inc.> I think it's really mostly all of them. I think from a GAAP basis, that PVFP block, this block that we acquired which is about $2.5 billion, it's certainly a block that we can ask for additional rate actions. It's just that that block is older so the kind of the annuity factor, if you will, of that additional premium is going to be just much smaller. So its not to say we can't get additional rates on it, but it's just not going to be for as long a period of time so the impact of that will be less.

John A. Hall
Wells Fargo Securities LLC

Q

Right.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

And basically the entire block is something we'll be looking at – the entire book of business and filing for rate actions where our rate actions are no longer current with our new claim expectations.

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John A. Hall
Wells Fargo Securities LLC
Q

Great and I just want to make sure that I heard you correctly. You said in December, you'll have the results of the ALR study?

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

Yes. We are actively working on it . People working around the clock and on weekends to get it to everybody as soon as we possibly can so it will be sometime in December.

John A. Hall
Wells Fargo Securities LLC
Q

Thanks very much. Good luck.

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

Thank you.

Operator: And we'll take a follow up question Sean Dargan with Macquarie.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

Yeah, thanks. I just wanted to follow up on John's question about the timing. So as we sit now, you have roughly $4 billion of margin give or take on a GAAP and stat basis.

You will run your tests, come back to us in December. And would there be a scenario in which you might need to raise external capital if you still have some positive margin or what kind of cushion would you like to have in terms of life statutory capital? I'm just trying to think about what would it take for you to have to raise external capital?

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

I think that it would take a lot to do that. I think that we're sitting at mid-400% to RBC, over $300 million of unassigned surplus, very high capital from Life Division. We have over $1 billion of holding company cash, $700 million north of our expectations.

We want to maintain a minimum RBC ratio of 400%. We want to build it from the mid-400%s where we are over time. But we have a lot of internal cushions, if you will, in case margins do go negative, between the capital in the business and ultimately some holding company liquidity.

So I think as we sit here today, not something that we see a need to do or plan to do. Obviously we will look at circumstances as they play out. And we do anticipate while we have higher claims expectations that we do expect that much of that, if not most of it, should be offset by these rate actions because it's what we're looking at.

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Sean Dargan
Macquarie Capital (USA), Inc.

Q

Thanks. And can you just remind...

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Let me just as a point of clarification because I think – you may understand this, but I want to make sure that all the folks listening understand it. If the margin becomes less, it doesn't – there's not a capital impact. It's only if a margin goes negative, so if a margin goes from – and again the stat margins are actually $2.6 billion as of last year with some of the PADs that are built in. But if a margin goes from $2.6 billion to $1.5 billion, that obviously is a reflection that that business is potentially going to be less profitable over the future. But it's not that it will call for any kind of capital need. It's only if the margins become negative, that there's a capital impact.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Got it. And can you just remind us how much the maturity in 2016 is?

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

Yeah. It's $300 million.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Okay. Thank you.

Operator: And we'll take our next question from Donna Halverstadt from Nomura Securities.

Donna L. Halverstadt
Goldman Sachs & Co.

Q

Hi. I had a question about the upstream dividends, and you talked about your ability to forgo the upstream dividend for the rest of this year and for most if not all of 2015, which is fine for now. But can you talk to us or give us some color about what needs to happen either qualitatively or perhaps you've set some specific metrics for yourself that you'd like to meet before you get to the point that you're comfortable resuming that dividend stream? And along with that, kind of what's your best guess as to when that might happen? When do you think you might be comfortable resuming the dividend stream?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Again, it's Marty. I'd remind folks that we do have dividend capacity in the business. And we expect that to continue even next year, dividend capacity next year would be, call it, a little over $300 million probably. It's just we would make a conscious decision not to take it to allow the business to retain their earnings and build that capital up over time. So it'd be a conscious decision.

We have a lot of holding company liquidity right now and, frankly, we expect our dividends from our other platforms next year to really cover the debt service that we have next year. So I think we're in pretty decent shape. We are going through our multi-year planning process now.

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We don't expect to get a dividend out of U.S. Life this year. We want it to recover and probably next year. We'll have to assess 2016. As we get into our fourth-quarter call where we usually talk about what our plans are for the next year or two, we'll have more of an update on that. But from what we see now, we have the ability to forgo a dividend in U.S. Life for the next couple years while maintaining very high holding company liquidity of $350 million more above our 1.5 times debt service target.

Donna L. Halverstadt
Goldman Sachs & Co.

Q

No, it's very clear that you have the capacity to forgo it and it's understood that you are making the decision not to. The question is, what makes you comfortable enough to resume the upstream dividend?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yes. Okay. That's a good question. And again we'll provide more specifics. What we want to do is really manage the U.S. Life business to a higher level of capital over time. We are working on that behind the scenes. I don't really want to get into the specifics right now, but I'd say that, directionally, within the long-term care business, I think we're likely to manage for that business line to a higher level of capital to absorb volatility over time.

We'll provide more specifics but it's probably along the lines of having higher RBC capital ratios that we manage to in old blocks, in new blocks but we're working through that. And then also I think we want to have certain unassigned surplus levels that we get to before we take a dividend target out. So those are the types of things that we're looking at. And as we work on those plans over the next couple months, we'll have more details in our fourth quarter call on that stuff.

Donna L. Halverstadt
Goldman Sachs & Co.

Q

Okay and the second question I had, on slide 5 where you talked about claims data and the lack of data credibility and claim duration seven and beyond, what percentage of claims are in the duration seven bucket and beyond? And then on slide 10, you also mentioned taking actions to seek to capitate the risk in long-term care, is there anything being referenced there other than the rate increases? And then when you wrap it all up, could you just help us think about how we can – how wide open is the door for material charges in the near to medium term and how can we go about sizing that breadbox? Thank you.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Sure. I'll try to take those in order and I think I'll kick one over to Tom. As far as the number of claims, first of all I'd observe that we have about – versus when we did our last study, about 45% more claims in aggregate. And we have over 80% more claims in duration seven to be looking at, so now we're in a position to use that additional data which is significant in the later claims on which to base our assumptions.

But really in aggregate, we only have a little bit less than 5% of the overall claims that we had really go to duration seven and beyond. So it's a pretty small percentage and that's where we saw the biggest changes.

Thomas Joseph McInerney
President, Chief Executive Officer & Director

A

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Yes. In terms of the management action steps. So there are several we can do with regulators which we are doing, which is seek additional rate increases and potentially also seek to reduce the benefit or capitate the benefit.

There been a few cases where regulators have worked with companies on the reduction of benefit and I think we've said this before, but we offer all of our policyholders – they don't have to take the rate increase that's been approved. They can reduce the benefit and we give them quite a bit in terms of options where they can keep paying the premium they've been paying and just accept less of a benefit.

In addition, and a number of companies did this in the past in other product lines, but we are also looking at opportunities for us to work directly with our policyholders on beyond whatever the regulators allow us to do overall for a class to work with other ideas where we would agree to reduce premiums for policyholders in turn for them giving up either their benefits, moving from a lifetime benefit to less than that, giving up a year of coverage, giving up an amount of coverage. Or potentially we call these elimination periods, but think of that as a deductible that they would pay more of the claims before the coverage would come into play.

So there's quite a bit of things in addition to what we've done to-date that we're considering and we'll come back and talk to you about those as we make decisions on that. But I do think there's quite a bit of flexibility beyond what we've done in the past to manage either to increase the cash inflows through premium increases or to reduce the potential cash outflows, claim payment by captitating or reducing the risk.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

And then, it's Marty again. Coming back to, I think, what your last question was on the potential for a material charge in the – I think you said near-term. Obviously, we took a really very long and close look at our claim reserve assumptions and really basically those assumptions now are very reflective of our experience. So I think that fits very well, so as long as the experience continues to fit closely with our assumptions which it's based upon, we shouldn't be anticipating any changes there.

Really the margin testing, I think, is probably the nearest term thing that we're focused on and looking at. And there, there would be a charge if the margins would go negative. Again, if you reference back to our December disclosures, it gets into the magnitude of the margins – statutory margin is about $2.6 billion. The GAAP margin for loss recognition testing is around $3 billion and there we'll be obviously modeling out claims under our new assumptions. We'll be modeling out premiums under our rate action plans that we're developing and we'll look at how those offset as well as look at some of the other assumptions that we'll be looking at as well. And we'll see how all that nets out but the amount of additional claims would have to very significantly offset the rate actions.

And as you can see on one of the slides that's in there, we've had a very good track record of getting rate action success for the rate actions that we've asked for – it's for the smaller rate actions around 90% if you look at slide, I believe it's 14, I want to say. And if you look at even just the first round of the larger rate actions, we've got about two-thirds of it so far and we expect that to go up. So we expect anywhere from 70% to 80% to 90% of that would be made back up in premium over time.

Donna L. Halverstadt
Goldman Sachs & Co.

Q

Okay. And if I could just slip in one last one, I think you briefly mentioned moving some of your debt obligations to the MI entity, but can you just give more color on what you meant by that? Did you literally mean moving them or did you just mean relying more on cash flows from that business?

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Martin P. Klein
Chief Financial Officer & Executive Vice President

A

It's really not actually physically moving them. Although Kevin's sitting across from me, I can ask him if he'd like us to do that. It's really more a matter of us having mortgage insurers cover the debt service for this year and next as opposed to physically moving it. We'll continue to report our debt service in our Corporate and Other Division.

Donna L. Halverstadt
Goldman Sachs & Co.

Q

Thank you so much for taking my questions.

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Certainly. Thanks for your questions.

Operator: Ladies and gentlemen, we have time for one final question. Our last question comes from Ryan Krueger with Bruyette & Woods.

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

Q

Thanks for taking the follow-up. I guess one question was I think is probably a natural inclination to say that your claim reserve charge was 15% of claim reserves. Would that, I guess, map to a 15% impact to your active life reserve margin? I guess, can you just talk through how it may – how to think about mapping those two and what maybe the key difference would be?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Ryan, I'm actually very glad you asked that question because that's a question we've been asked a lot and it hadn't come up yet amazingly enough. So I'm glad you asked it. It does not actually map like that. It maps actually very differently.

The way – if you think about margins, what it really is and, again, if I reference our December margins discussion, really what you do is when you're looking at your margins, you look at the present value of the claims you expect to pay and the expenses you expect to have and those are obviously outflows over time. And then you look at the premiums you expect to get, not only the premiums currently but premiums you expect to get over time through rate actions and so forth, as well as investment income, and you look to see how those offset.

So in looking at the margin impact, it's not a function of taking, in your example, 15% of the DLR, it went up, so you take 15% of the active life reserve. It's more a matter of looking at the present value of claims and trying to assess how much that present value of claims would go up and then looking over at the premium side and trying to understand how much those premiums will go up.

So I think it's really more a function of that. I would say that – and we made some note of this in the presentation – that for the active life reserves, these are the people that are not on claim currently, they're paying premiums and so the active life reserve is meant to help fund their future claims.

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That universe of policyholders is a very different set of characteristics than the existing people that are on claim. There's 50,000 or less than 50,000 people on claim. The folks that are on claim currently typically – not always, but typically bought their policies a long time ago.

We had very different – very much less underwriting back then. We also had very different product structures back then. So for example, we had a higher proportion of – actually a much higher proportion if you look at one of the slides in the appendix, of policies with lifetime benefits.

The newer policies really represented more by our active life policyholders have much less in the way of lifetime benefits, by way of example. In any event, you look at the present value of claims and try to get a sense for how much that's going to go up, and that's part of what our actuarial modeling would do. And then we'll obviously build in the rate actions.

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

Q

I guess, is the takeaway, though, all-in takeaway that it sounds like you're saying that if there was a 15% impact to the claim reserve based on better characteristics of the remaining block and other factors, that you would normally expect something less than 15% to impact the active life margin?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yeah. I don't – it's not quite – unfortunately, it's not quite as simple as that. There are certain different dynamics of it. So the lifetime aspect I talked about, that would make the impact on active lives less, if you will. There are certain policies that have more BIO or policies which have an inflating feature where that could actually work the other way. So we'll have to model all those things. And obviously, as we look at all those things that will be reflected in the corresponding rate actions that we look for.

By the way, one note I should make is it in the December presentation, I think we show in aggregate the present value number of – I actually have it here in front of me, just so people have it. $37.8 billion is the present value of future claims and expenses, about $33 billion of that represents claims, the rest of that represents expenses, which wouldn't, obviously, be impacted by these changes. It would be just the claims piece, which is closer to, I think, $32 billion, $33 billion.

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

Q

Okay. That's helpful and then last one. Would you anticipate needing, I guess, to change any of your interest rate assumptions at this point when you do the update?

Martin P. Klein
Chief Financial Officer & Executive Vice President

A

Yes. I think that obviously – yes, I don't think the longer-term assumptions much is going to change. And obviously, for cash flow testing, we look at a number of stochastic, as actuaries like to call it and I'm a former actuary, interest rates, but also we have kind of static ones we looked at. Again, in our December disclosure we provided kind of the view of what happens as interest rates would drift up to, I think, our yield's in the mid-fours, I believe and also we provided some sensitivities. So those sensitivities I think are still reasonable.

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Obviously, what we do in these things is look at our current portfolio which is a year older and we've got – it's pretty close to the same kind of portfolio and very similar portfolio rate and then we'll look at how that reinvests. So I don't know anticipate right now a large difference from that part of it, given where interest rates are. Interest rates at the moment are a little bit lower than they were but, again, that ultimate trajectory is not going to be a whole a different.

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

Okay. All right. Thanks a lot.

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

Thomas Joseph McInerney
President, Chief Executive Officer & Director

Thank you, Jennifer. And again, Marty, Kevin and I want to thank all of you for your time today. We thought you asked great questions. We do appreciate your questions and obviously your interest in Genworth. We hope you found today's discussion helpful, that we were transparent and forthright and that was certainly our goal. While challenges exist for Genworth, we are confident that we have the right strategy in place, and the right team to execute that strategy. We are very focused and determined to transform and build value in Genworth for all of you and we look forward to updating you on the margin impact next month. So thank you all very much.

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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