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GNW - Q1 2014 Genworth Financial, Inc. Earnings Conference Call

EVENT DATE/TIME: APRIL 30, 2014 / 12:00PM GMT

OVERVIEW:

GNW reported 1Q14 net income of $184m.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Genworth Financial's first-quarter 2014 earnings conference call. My name is Christy, and I will be your coordinator today.

As a reminder, the conference is being recorded for replay purposes.

(Operator Instructions)

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

Amy Corbin *- Genworth Financial, Inc. - SVP of IR*

Thank you, operator, and good morning, everyone. Thank you for joining us for Genworth's first-quarter 2014 earnings call. Our press release and financial supplement were released last evening, and this morning, our first-quarter earnings summary presentation was posted to our website. We encourage you to review all of these materials.

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

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

This morning's discussion also includes non-GAAP financial measures that we believe may be meaningful to investors. In our financial supplement, earnings release, and investor materials, non-GAAP measures have been reconciled to GAAP, where required in accordance with SEC rules.

Also, when we talk about international protection and international mortgage insurance results, please note that all percentage changes exclude the impact of foreign exchange. And finally, references to statutory results are estimates for the quarter, due to the timing of the filing of the statutory statements.

We did recently announce the filing of a prospectus for the Australian initial public offering. Please note that due to Australian and US security law restrictions, we could only provide very limited remarks today on this process. And now, I'll turn the call over to our CEO, Tom McInerney.

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Thanks Amy, and good morning, everyone. Thank you for joining us today for our first-quarter earnings call.

Today, I'll cover two topics. First, briefly discuss my view of results for the quarter and second, provide an update on our key priorities for 2014. I'll then turn it over to Marty to provide more details on our first-quarter earnings.

Now let's turn to the results for the quarter. Our first quarter results reflect the continued progress in our turnaround strategy.

Turning to slide 3 of our first-quarter 2014 earnings summary presentation, net operating income was up 28% over the prior year. The results were positively impacted by an improved housing market in the United States, driving lower losses, as evidenced by a loss ratio of 46% in our US Mortgage Insurance business. Similarly, Canada and Australia benefited from favorable loss performance, as reflected in low loss ratios of 20% and 17% respectively.

Mortality was higher in our US Life Insurance Division, and had a net unfavorable impact to earnings in the quarter, primarily in life insurance. In long-term care, we continue to see a favorable impact from the 2012 in force premium rate increases on earnings of $10 million versus the prior quarter, and $40 million versus the prior year. Overall, we are pleased with the results in the quarter, as we continue to improve the operating performance of our core businesses, to improve shareholder value.

Next, I wanted to provide an update on Genworth's top priorities for 2014. Slide 2 of the presentation details some of the highlights for the first quarter.

In 2014, our three key US Life Insurance Division priorities are one, execution of our long-term care insurance strategy, two, expanding the private long-term care insurance market, and three, developing innovative and more competitive Universal Life, Index Universal Life, and hybrid products, and balancing sales between term and permanent life. In long-term care, we continue to focus on securing state approvals for the 2012 premium rate increases on the three older generation of products written from 1974 through 2001, which we refer to as pre-PCS, PCS1, and PCS2, and on one a series of newer generation policies written from 2001 through 2007, which we refer to as Choice 1. During the quarter, the number of states approving the PCS and Choice 1 rate actions remained constant at 41 states.

Slide 13 of the earnings presentation is a new slide, that provides a summary of our 2012 long-term care premium increase projections, and how the rate actions impacted net operating income in 2013 and the first quarter of 2014. On the top of slide 13, we showed the 41 state approvals as of March 31, 2014. These states have approved gross incremental premiums of approximately $325 million. However, we know that the actual premiums we collect will be lower, because some policyholders will terminate coverage through death or policy decisions, accept lower benefits, or a non-forfeiture option, or make a claim for benefits. The $195 million to $200 million estimate that appears on slide 13, and that we have discussed before, is our projection of what the net annual incremental premiums will be by 2017, based on our internal projection models of policyholder behavior. Of course, the projected estimate could vary, depending on what decisions policyholders actually make.

We continue to work with state insurance departments to achieve additional 2012 rate increases, and remain confident that our ultimate annual net premium increases from the 2012 rate action will result in $250 million to $300 million of increased annual premium when fully implemented by 2017. As we have noted before, assuming we achieve our targeted net premium increase, this will only bring the PCS blocks closer to breakeven.

As shown on slide 13, we project that the pending rate increases in the 10 remaining states, that's 50 states plus Washington DC, that the 10 remaining states will result in incremental net premiums of $25 million to $45 million. In addition, for 30 states that have already approved some rate increases, we are making additional filings in these states, and project the net incremental premiums from these states to be between $30 million and $55 million.

The bottom of slide 13 shows the actual impact of the 2012 rate actions on earned premiums, reserve changes, and net operating income for the quarters noted. Given their relevance to results, we currently anticipate continuing to disclose these figures in our quarterly operating results.

In September 2013, we began filing 6% to 13% rate increases on long term care products issued beginning in 2003 and written through 2012. We refer to these policies as Choice 2 and Choice 2.1. Current premiums on these policies are in the range of $800 million. As of March 31, 2014, we have received approvals from 11 states, up from 4 states at year-end.

The Choice 2 and 2.1 approvals are important, because they represent the new approach that Genworth has been pursuing with state regulators. Rather than wait until actual loss ratios on Choice 2 and 2.1 policies exceed original assumptions well out into the future, we are asking regulators for smaller increases now, based on projected loss ratios. I am very pleased that regulators in these 11 states have agreed to the more modest 6% to 13% increases now.

It is our view that by implementing these more manageable rate increases now, to return the products to original pricing assumptions, we should mitigate the need for larger rate increases 10 to 20 years in the future. We believe this is a better way forward for consumers, insurance regulators, and the private long-term care industry.

Finally, in July, we expect to launch our Privileged Choice Flex 3.0 product which has a much improved risk profile, only marginal interest rate and lapse risk, and significantly less morbidity risk. We believe this new product is conservatively priced, which we feel is appropriate, given the risks inherent in long-term care insurance, and should generate returns of 20% or more.

In addition to meeting with insurance departments regarding long-term care premium rate increases, we have been spending significant time this year meeting with state regulators, legislators, and governors about the need to expand the private long-term care market. I also had the opportunity to represent the insurance industry in a panel discussion on long-term care at the Bipartisan Policy Center, and address key industry participants at the inter-company Long-Term Care Insurance Conference.

Our main point in these meetings and industry presentations is to emphasize the need for the private sector and public sector to work together, to dramatically expand the number of Americans that address their long-term care needs. There are about 10,000 people turning 65 everyday from now until 2030. Based on government projections, 70% of people who live to 65 will need to fund long-term care costs sometime in the future. There are 115 million Americans between the ages of 40 and 75, and only 7.4 million Americans today have coverage.

Our message to federal and state policymakers, particularly given the pressures on federal and state budgets, is that we all should be focused on expanding the private long-term care market dramatically, so that as many of these 115 million Americans as possible are insured. We know that most Americans have not saved enough through 401(k) programs. The median savings is approximately $100,000, and few are covered by defined benefit plans.

Therefore, if most of these Americans do not own private long-term care policies, and become disabled in retirement, they will ultimately need to rely on Medicaid to cover their long-term care services, after effectively exhausting their assets. And we all know that Medicaid and other internal programs are going broke, even before the bulk of the 78 million baby boomers reach retirement age, another compelling reason for a more robust long-term care insurance market.

Moving to our life insurance business, our product offerings protect people during unexpected events, and help address the needs of the uninsured and underserved middle-market. It is estimated that there are 70 million households in the United States that either do not own or do not have enough life insurance coverage. This creates a compelling opportunity for the life insurance industry.

Based on the latest available market data for the year ending 2013, indexed Universal Life, or Indexed UL, has grown from a $330 million market in 2006 to a $1.7 billion market in 2013. Indexed UL sales increased 13% in 2013, representing 42% of total UL premiums, and 17% of all individual life insurance premiums. Additionally, overall industry sales of hybrid products are estimated to have increased approximately 10% in 2013 versus 2012.

With our 2013 entry into the index Universal Life market, we expect to capture a small portion of the overall market in 2014, which will increase sales moderately, as our indexed UL products gain momentum. Additionally, we also have competitive hybrid products that we expect will gain momentum this year, particularly as we leverage our experience in long-term care insurance. We are in the early stages of this transition in life insurance sales, and are looking to Jim and his team to help accelerate this transition and position us for growth.

In our Global Mortgage Insurance Division, we have two major priorities this year. First, continued execution of the US mortgage insurance business's return to profitability, and second, execution of the initial public offering of up to 40% for Australian mortgage insurance, which allows Genworth to reallocate capital and reduce risk.

Our earnings in USMI improved to $33 million in the quarter. The loss profile continues to improve, as the 2005 through 2008 books burn out, and the 2009 and forward books become a larger percentage of the portfolio, now at 47% of risk in force. The commercial strategy of the business continues to take hold, as we believe we have seen modest share gains over the last several quarters.

Turning to Australia, completing a partial initial public offering of up to 40% of our Australian mortgage insurance business is a strategic priority for Genworth in 2014. On April 23, Genworth's Australia MI business filed a prospectus with the Australian regulator. The execution of the IPO is subject to market conditions and valuation considerations, including business performance.

Due to Australian and US security law restrictions, we are very limited to what we can say at this time, and I know that you understand that we cannot provide additional information regarding the IPO on today's call. We will provide an update in due course.

We have continued to make headway on our turnaround in the first quarter of 2014. And while there is much more work to do, Genworth is strong and getting stronger, as we focus on continued execution of our strategic priorities to improve shareholder value. And now, I'll turn the call over to Marty to talk about the first-quarter results in more detail.

Marty Klein - *Genworth Financial, Inc. - CFO*

Thanks, Tom, and good morning everyone. Today I'll give an overview of results for the quarter, and an update on our 2014 goals. I'll be referencing our associated first-quarter earnings summary, which was posted on our website this morning.

Let's begin with first-quarter results, starting with slides 3 and 4 of the earnings summary. We reported operating income of $194 million for the quarter and net income of $184 million. Net operating income was up 28% versus the prior year, and up $1 million sequentially.

Although we saw higher mortality versus the prior quarter in US life insurance, results were helped by the long-term care rate action, as well as lower losses in Australia, Canada, and the US. The results also reflect $16 million of unfavorable foreign exchange versus the prior year, and $5 million of unfavorability versus the prior quarter. Results in the current quarter included $15 million of tax benefits, while results in the prior quarter included $29 million of tax benefits.

Turning to slide 5, in global mortgage insurance, reported net operating income was $132 million, up $25 million from the prior quarter. Let's cover Canada results first on slide 6, where operating earnings were $41 million for the quarter.

Unemployment in Canada at the end of the quarter was 6.9%, down slightly from December 2013, and there was a modest sequential increase in home prices. Premiums were down sequentially from the maturing of the larger 2007 and 2008 books of business and unfavorable foreign exchange.

Flow NIW in the quarter decreased 40% sequentially, with the normal seasonal variation we see in the first quarter each year exacerbated this year by the March severe winter weather. We anticipate housing demand will shift to later in the year. The loss ratio remained low at 20%.

Turning to slide 7, operating earnings in Australia were $62 million. Unemployment in the country was unchanged at 5.8%, and overall home prices rose modestly from the prior quarter. Taxes were less favorable in the quarter, but expenses were lower sequentially.

Foreign exchange was unfavorable versus the prior quarter and prior year. Excluding the impact of foreign exchange, premiums were up from the prior year, as the larger more recent books mature, and more premium is recognized. Flow NIW was down 9% sequentially from normal seasonal variation.

The loss ratio for the quarter decreased by 4 points sequentially to 17%, the lowest level since 2005, as we saw favorable aging and in stage delinquencies. We now anticipate the loss ratio for 2014 will be at the low end of our 30% to 40% range.

Moving to USMI on slide 8, net operating income was $33 million for the quarter. NIW slowed in the quarter from a seasonally smaller purchase origination market.

As in Canada, the severe winter on the East Coast and in the Midwest contributed to lower NIW, as did a lower refinance market. Our NIW expectations for 2014 reflected a stable origination market, and although the first quarter originations were low, we still think 2014 NIW will be up modestly from 2013. We will continue to assess potential headwinds in the origination market.

Our total flow delinquencies fell by 27%, and new flow delinquencies dropped 18% year-over-year. The new better performing books from 2009 forward are 47% of risk in force, and we expect this percentage to continue to increase throughout the year.

We modestly increased reserve factors in the first quarter to reflect higher severity expectations, primarily for late stage delinquencies, driven in large part by the extension of the foreclosure timeline. This is partially offset by a reduction in our frequency expectations for early stage delinquencies, which we now expect to roll the claim at a rate of approximately one out of every six new delinquencies. We believe the revised loss reserve factors are appropriate for the ultimate claim development on our existing delinquencies.

The reserve strengthening had a net unfavorable impact of approximately $11 million after-tax for the quarter. Overall, we were pleased with results in our global MI division, and we continue to expect the division earnings to be relatively flat to 2013, given factors including lower US tax benefits and foreign exchange rate headwinds I've mentioned before, that we expect this year.

Turning to capital in the division on page 9, the prescribed capital amount, or PCA ratio, in Australia was estimated at 147%, down from the prior quarter from the termination of an affiliate reinsurance treaty in January, as I had mentioned last quarter, partially offset by continued strong statutory income. For Canada, the MCT ratio was estimated at 229%, compared to our minimum target of 190%, and the business continues to evaluate opportunities to optimize capital.

As previously announced, effective May 1, Canada will increase premium rates by an average of 15%, due in part to the increased regulatory capital requirements. Additionally, yesterday, Genworth MI Canada refiled the shelf registration for our normal course issuer bid, which gives the Company the flexibility to buy back shares in the future, should it make sense to do so. If the buyback did proceed, Genworth Financial would currently plan to participate in the stock buyback, ultimately benefiting holding Company cash, while keeping our overall ownership percentage at its current level.

In US MI, at quarter-end, the risk to capital ratio for GMICO was approximately 18.4 to 1, improved from the prior quarter from positive statutory earnings. We still anticipate that the $300 million at Genworth Mortgage Holdings from the December 2013 debt transaction will be deployed to benefit GMICO to the extent needed, after the new GSE requirements are finalized. If the $300 million had been contributed to GMICO, its quarter-end risk-to-capital ratio would have improved by approximately 4 points under the current risk-to-capital framework.

Turning to the US Life Insurance Division on slide 10, operating earnings were $94 million, down $25 million from the prior quarter, as the division was impacted by higher mortality sequentially across all three of its business lines, hurting results in life insurance, but benefiting earnings to a lesser extent in fixed annuities and in long-term care. Earnings in the life insurance were $21 million for the quarter. We saw unfavorable mortality experience in both term and universal life insurance versus the prior quarter from higher frequency of claims, while versus the prior year, we saw both higher frequency and severity of claims.

As shown on slide 11, actual to expected mortality for term remains favorable to pricing, and in line with our 2014 expectations at 92%. However, we estimate that the actual to expected mortality for Universal Life was over 110%. Mortality experienced certainly can vary from quarter to quarter, so at this point, we do not have any indications of a change in underlying trends, but we will continue to watch experience closely.

Long-term care earnings were $46 million. The in-force rate action continues to impact earnings, benefiting results by $40 million versus last year, and $10 million versus the prior quarter.

Moving to slide 12, the reported loss ratio for the current quarter was approximately 63%. The improvement sequentially and year-over-year is largely driven by the increased premium and reduced benefits from the rate action. The increased premium, of course, adds to the denominator of the loss ratio, while reduced benefits have the effect of releasing associated reserves, which gets reflected in the numerator.

We saw an incremental $24 million of premium in the first quarter from this rate action. We still anticipate that the incremental premium that we will recognize in 2014 will be between $150 million and $175 million, and that after-tax earnings should benefit by $120 million to $150 million from the rate actions.

Tom spoke earlier about slide 13, which we hope enhances our communications around the 2012 in-force rate action. This slide illustrates the various components of the rate action, and how they impact earnings.

For fixed annuities on slide 14, earnings were $27 million, above our expectations, primarily from improved mortality sequentially. In aggregate, US Life Insurance Division results were in line with our expectations, and have not changed our views for its earnings for 2014.

Turning to a review of statutory results on slide 15, as part of our year-end 2013 filings, we completed annual cash flow testing, which at the end of 2013, resulted in a $40 million decrease to the additional cash flow testing reserves of $120 million that we had held in our New York company for long-term care. Unassigned surplus for the first quarter was flat to the prior quarter, at approximately $440 million.

Statutory income was positive, but down from the prior quarter, which included benefits from the restructured life insurance transactions, inter-company dividends, and the partial release of the New York cash flow testing reserve I just mentioned, partially offset by increased reserves for Universal Life products for the secondary guarantees in the New York Company. The current quarter statutory operating income was impacted by lower equity market growth, which reduced statutory variable annuity earnings. We continue to expect to achieve our 2014 unassigned surplus and dividend goals for the US life division.

The risk-based capital ratio for the quarter in the US life companies is estimated to be approximately 480%. We have commenced work on the repatriation of the long-term care business, reinsured the Brookfield Life and Annuity Insurance Company Limited, or BLAIC, to our US-domiciled companies. We expect to execute the repatriation in the second half of this year.

Shifting to the corporate and other division on slide 16, the net operating loss for the quarter was $32 million. This result included $17 million of favorable taxes, primarily from a release of the valuation allowance and state and federal true-ups from the prior-year return.

International protection earnings were $7 million for the quarter. The business continues to manage through a challenging environment in much of Europe, although reported after-tax earnings were higher than our expectations this quarter, because of $4 million of favorable tax adjustments. Runoff earnings were $12 million in the quarter, as equity market growth was lower this quarter, compared to the prior year and prior quarter.

Turning to investments on slide 17, the global portfolio core yield declined modestly to 4.4%, and we continue to experience a very low level of impairments, down to only $1 million after tax in the quarter. Let me now cover some topics at the holding company on slide 18. We continue to generate and maintain significant liquidity, with cash and liquid assets of approximately $1.3 billion at the holding company.

After deducting the $485 million that we have been holding to address the remaining 2014 debt maturity, we hold approximately $780 million of cash and liquid assets, essentially in line with our target of 1.5 times debt service, plus a buffer of $350 million for stress scenarios. These numbers exclude the proceeds from our December debt offering, with $300 million of cash at the USMI holding company after contributing $100 million to GMICO.

As Tom mentioned, the completion of the Australia IPO is a strategic priority for us. Should we complete the IPO, which is subject to market conditions and valuation considerations, including business performance, important priorities for us for the proceeds include ensuring our operating businesses remain appropriately capitalized, and seeking opportunities to accelerate progress on our medium-term leverage targets.

Let me wrap up. We continue to make good headway in executing our strategy and improving our business performance. We are on track to achieve all of our 2014 goals, but we have much work ahead of us to achieve those goals, deliver on our strategic priorities, and continue to rebuild shareholder value. With that, let's open it up for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Sean Dargan, Macquarie.

Sean Dargan - *Macquarie Research - Analyst*

I have a question about the life statutory capital. So we're essentially, in terms of unassigned surplus, where we were at the revised number you gave out for the end of 2013. How should we think about the run rate for statutory operating income over the next three quarters? So you identified some discrete items that negatively impacted the stat earnings this quarter, I was just thinking of how we should think about it, going forward.

Marty Klein - *Genworth Financial, Inc. - CFO*

It's Marty. Let me take a crack at that.

First of all, I'd say that I do think we are on track for our unassigned surplus goals for the year growing at about $100 million to $125 million for the year. As you probably recall from the last year or two, the increases on unassigned surplus certainly aren't linear over the year, they move around quite a lot year-to-year. I think what you also see is that statutory income is pretty lumpy, and moves around quarter-to-quarter.

I'd say that this quarter for our core businesses in US life, for annuities, long-term care, and life insurance, that the statutory operating income was pretty much in line with what we expected. Variable annuity income was a little bit off, given some of the reduced growth in equity markets, and the lower interest rate environment, so we did see a little bit of tepid variable annuity results, but the core results in the other businesses were basically on track.

When it comes to the unassigned surplus walk though, it's not just a matter of net income, there some other items that go into it. This quarter, we saw a couple items in particular, that basically offset that positive net income.

One was lower reinsurance credit, which is frankly an item that we expected, and it does tend to have a larger negative impact in the first quarter than it does subsequent quarters. The other item was a tax reserve adjustment that we made, that was not expected, that also impacted the walk on unassigned surplus, so those two extra items basically offset net income for the year.

We haven't really talked about our net income goals. We have really talked in terms more of unassigned surplus goals. Certainly one of the goals of the business with Jim Boyle and the team to really organically grow statutory income, so that it can support dividends over time, so we have a lot of work to do with the long-term care rate actions and introducing increased life product portfolio, life products into our portfolio and things like that, to improve statutory income over time.

But this quarter was basically what we expected, with respect to statutory income, because variable annuities were a little bit tepid, and then we did have that tax reserve adjustment, that was really something we didn't expect.

Sean Dargan - *Macquarie Research - Analyst*

Okay. Thanks. And one question on USMI. You noted today that there was some reserve strengthening for later stage delinquencies and yet you still reported a loss ratio of 46%. Does the full-year guidance of a loss ratio of 60% to 70% still stand?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Sean, this is Kevin. You broke up a little bit in the middle of your question. If you could take another shot at that, I really couldn't hear the basis of your question.

Sean Dargan - *Macquarie Research - Analyst*

Yes. Sure. Can you hear me now?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

I can.

Sean Dargan - *Macquarie Research - Analyst*

Sure. So your loss ratio was 46% USMI.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes.

Sean Dargan - *Macquarie Research - Analyst*

That reflected some reserve strengthening on the later stage delinquencies. Is your full-year guidance still 60% to 70% loss ratio?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. I think that's the best way to think about it. We should be on track with that, which we provided back in February, in the 30% to 60% range.

Just to give you a little bit more color on it, our incurred losses were down in the quarter. Almost 40%, or about $45 million VPQ.

But of that new delinquencies, we're down about 8%, and usually you look at new delinquencies are really what drives your incurred loss. The difference we had in the quarter is really primarily driven by the seasonal benefit for next cures and aging, and the -- plus the reserve factor that you referenced.

Sean Dargan - *Macquarie Research - Analyst*

Okay. Thank you.

Operator

Geoffrey Dunn, Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Kevin, I wanted to follow-up on that topic. So it looks -- I think you mentioned that you dropped your incidence expectation of early-stage delinquencies to 1 in 6. This quarter, ex the charge, it looks like the seasonal benefit might have pushed that towards 1 in 10. Where do you think that the incidence expectation on new notices trends over the course of the year?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. Geoff, when you said the incidence benefit would have been 1 in 10, I think it feels a little bit like you're making the connection from frequency to actual paids, and the amount of paids we made, paids were down certainly on the quarter, but that's really not the full story on our frequency. It's really how you think about the transition rates through various stages of delinquencies, and ultimately what will go to claim.

You can have a good seasonal benefit, like we did here in the first quarter, and it looks like it was high, if you are just drawing that comparison to your paid claim level, in terms of units. But I think, overall, we would expect over time to be in that 1 out of 6 range, in terms of the road forward, and perhaps we get a little bit of a benefit as the economy continues to improve.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. I was actually referencing the provision in the quarter, not paids, but that still answers the question.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Okay.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

And then could you -- for Australia, what are you seeing that is driving the improved incidence on the late stage delinquencies? Is this Queensland stuff that you took a charge for a couple years ago, and now isn't turning out as bad, as you get positive HPA? What the development there?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. Number one, our reserves that we posted back in that quarter have held up pretty well over time. Additionally, you continue to have decent home price appreciation in Australia, and so, on some of these later stage delinquencies, you can almost think back to the pre-crisis days in the United States, even when you are having paid claims, or when you're having claims, you are getting good disposition values on the houses when they're sold, and the houses are being sold, reducing the net impact of the claim. That's the biggest driver, I would say, in terms of what's driving that performance.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. And then the last question, can you confirm if the NCDOI has received capital proposals yet?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

I guess based upon our understanding of the process, which is probably about as good as yours, at this point, Geoff, we believe that certain regulators have received it, but I can't confirm whether North Carolina is or not -- has or not.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. Great. Thank you.

Operator

Suneet Kamath, UBS.

Suneet Kamath - *UBS - Analyst*

A couple questions, just first to follow up on unassigned surplus. I just want to be clear in terms of how we are benchmarking this, because I think at the end of last year, or earlier this year on the conference call, you talked about $100 million to $125 million increase on a base of $400 million. But now at the end of the year at $440 million, and you're actually -- seems like you're keeping the same increase, which increases the overall target for year end so I just wanted to make sure -- should we be focus on the $100 million to $125 million improvement or should we be focusing on an absolute level of unassigned surplus by the end of the year?

Marty Klein - *Genworth Financial, Inc. - CFO*

Suneet, it's Marty. Yes. You're right. The goal is really the change -- the $100 million to $125 million growth so it really would be off that $440 million level.

Every quarter end, we are estimating where we think unassigned surplus was. It was our estimate that it would be $400 million, and it turned out to be $440 million, as we had a release of a reserve in New York Company with cash flow testing. So it's really -- our goal is to grow $100 million to $125 million off of the $440 million.

Suneet Kamath - *UBS - Analyst*

Okay. And then I guess on -- I think it was slide 13 on the long-term care pricing, if I heard you correctly, I think in that first bar you said that you had gotten $325 million of approvals, and you're haircutting that to $195 million to $200 million based on expectations for policyholder behavior.

It strikes me that the haircut seems pretty big, especially given your prior commentary, I think, that 86% of the folks that you've approached with respect to the price increases have agreed to take the price increases. So I just want to get a sense is the 86% a high number, or is the 40% haircut a low number?

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Just to be clear, because I don't think we had mentioned this before, if you look at the actual approvals from those 41 states, if everything stayed the same, we would see $325 million. That in effect is how the regulators would look at what's been approved, but we know that because these increases will be implemented over the next five years, because in some cases some of the states spread it out, that things will change. We won't have all of the policyholders we have today. Some will terminate coverage for whatever reason. Some are taking the reduced benefit, and so we have to factor that in. We do pay some incremental commissions to agents.

So we have an internal model that takes the $325 million and then pro formas that going forward, so that when we get 2017, it's our best estimate of what we think we'll actually realize when it's all said and done from the increase. So it's an estimate. It's based on our models, I think our models are good. We can't predict with certainty exactly what policyholders will do, and certainly what the mortality with policyholders will be, but I think so far we feel pretty good about those estimates, and I think that's a pretty solid number. And again, when we look at for when it's fully implemented, the $250 million to $300 million, that again is not based on our internal model.

So I think it's something we can rely on, it's not exact. But the one thing we are also doing on slide 13 on the bottom is -- so the top is, and the $195 million to $200 million and $250 million to $300 million are our estimates projections. The bottom shows the actual impact on our US GAAP reporting numbers, so we are trying to give you both.

And obviously we'll see how the model works out and what policyholders do. I would say, because we didn't specifically comment on this, but we are still sitting at about 85% take the full rate increase, about 10% are taking a reduced benefit, and 5% are still taking a non-forfeiture option.

Suneet Kamath - *UBS - Analyst*

And how big is that sample size? When you give those percentages?

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

I think we've notified several hundred thousand policyholders, and of course, the other thing you have to keep in mind is that the increases go in policy by policy on the anniversary date, so it will build going forward.

Suneet Kamath - *UBS - Analyst*

Got it. And then just the last question -- I just want to come back to Australia for a second. Just in terms of use of proceeds, I asked the question on last quarter's call, if capital management could be a possible use of those proceeds.

And I think Tom, you said you want to delever and do some other things, but it certainly is a possibility. I just want to make sure the comments in the prepared remarks on this call -- I want to see if there is a change in that, because you didn't mention capital management, or if you are thinking about it pretty consistent -- in a consistent way as you did last quarter.

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Yes. While I appreciate all of you not asking questions on the actual IPO process, because we can't comment on that. On use of proceeds, we still have the same priorities, and I'll just ask Marty to review those with you, since he's the one that's focused on looking at the various options for what we could do, working with me, and also ultimately with the Board.

Marty Klein - *Genworth Financial, Inc. - CFO*

Suneet, there's still a number of things we don't know. Obviously, one of the things we don't know is if we are going to be able to execute the IPO. The other is what the amount of proceeds is going to be. We also have yet to really understand what that GSE requirements are going to be, so there's a number of things that are yet to be determined.

I would say that if we do execute the IPO, which is subject to a number of contingencies, as we've discussed, that our primary areas of focus, not necessarily our only areas of focus, but our primary areas of focus are really first making sure our businesses are appropriately capitalized, so in the case of USMI, we want to make sure it's ready to go under the new GSE guidelines. And then we also want to begin to make some good headway on, if we can, accelerating our deleveraging goals.

So those are our primary areas. We will also look at other things that we might do, depending on how much we have in our way of proceeds, and what those business needs might be. Capital management is something that we certainly think about and talk about, but we'll have to assess that later in the year working with our Board.

There's other things that we are obviously also looking at in that process. We wanted to be making continued headway in improving our ratings, so we want to think about that. We also want to think about the dividend flows and capital generation within our businesses, as we think about things like dividends, and things like that. But those are the things we're looking at and discussing with our Board, and we'll have updates later on in the year.

Suneet Kamath - *UBS - Analyst*

Okay. Thanks.

Operator

Nigel Dally, Morgan Stanley.

Nigel Dally - *Morgan Stanley - Analyst*

First question, just on Australia, you came up with guidance of 30% loss ratio, and clearly the loss ratio was well below that this quarter. So a couple of questions. First is the 30% a full year, or is that like a loss ratio that we should expect for the balance of the year, and if it is just for the full year, would that mean that we're likely to see the loss ratio somewhere above 30% for the remaining course of the year?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Nigel, 30% would be a full-year type average so think about it that way. And then -- that's how we think about it. And then in order to get there, to your point, you would need to have some incremental pressure in some of the later quarters of the year.

We had a -- I'm very pleased with the first-quarter results. But we are -- we do anticipate some potential pressure as it relates to unemployment, some modest unemployment increase, that could pressure our loss ratios going forward. We're very cautious in watching the impact on Asia, that it might have on Australia.

And then finally one quarter -- it's one quarter results and we may see some variation through the balance of the year, some seasonal variation. But overall you would have to be above where we are at this point to achieve that 430% average mathematically.

Nigel Dally - *Morgan Stanley - Analyst*

Right, thanks. And then just second on long-term care. I know you're confident that the outlook should improve going forward, but I guess we've heard your confidence that sales should begin to improve performance, and sales remained somewhat weak. What -- do you have some color as to why the attraction is taking longer on some of these products?

Jim Boyle - *Genworth Financial, Inc. - President & CEO, US Life Insurance Division*

Yes. Nigel, good morning. Jim Boyle talking here.

Long-term care sales for the quarter were off, as we had indicated in the fourth quarter they would be, really due to pressure from some pricing, product and distribution changes we made in 2013. And clearly, from some headwinds that exist in the marketplace, relative to pricing and product and rate increases.

On a positive note, as Tom highlighted in his opening remarks, the market opportunity continues to be stronger than ever. What we're hearing from our distributions partners is the need to include a long-term care solution in their financial planning schemes is higher than ever. And so for us, we expect to see higher sales in each quarter, throughout the year.

Our early indicators, which are submits, were up in every month, January, February, and March, in the first quarter, and so, as we really expected, we expected to have some headwinds. We're investing significantly in product marketing and distribution, and we fully expect to have more favorable results as the year progresses.

Nigel Dally - *Morgan Stanley - Analyst*

Great. Thanks a lot.

Operator

Joanne Smith, Scotia Capital.

Joanne Smith - *Scotiabank - Analyst*

Kevin, I just had a question going back to the big reserve strengthening that you did at USMI back in -- I think it was late 2012. I'm just curious to see if the reserve strengthening -- the small reserve strengthening you took this quarter, how does that relate to the remaining balance of that strengthening that you did back then?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. Joanne, if you go back to that period of time, and I would rather you not take me back there anymore, but I will go because you asked. We -- it's really difficult to compare it to what happened back there.

The cohorts, the loans that were available at that point in time -- some of those are gone. We don't have all those. We've paid claims. We've had a lot of loss improvements, so I really don't -- I wouldn't relate it quite as much to that reserve strengthening we did at that point in time.

But directionally, the way you could think about it is, as foreclosure timelines have been stretched out, and ultimately, loans are going to claim, you got increased interest rate and expenses associated with that elongated timeline, and that's pressuring your severity levels bottom line. That's the biggest piece of what drove the reserve build.

The offset for that was, as performance improves, we got better product in the marketplace, we got economic recovery going on, unemployment is improving, home prices are improving. We are seeing some improvement in the frequency of the early stage delinquencies that go to claim. Net-net we put up about $11 million, on a $1.3 billion reserve base, don't really think it's very material.

Joanne Smith - *Scotiabank - Analyst*

Okay. All right. That's good enough, thanks. And then just on the overall PMI industry penetration in the quarter, it was flat. Can you talk a little bit about what's going on with the industry dynamics overall?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. I think penetration -- when you say it was flat, on a purchase penetration basis, we think it's maybe up a point. And purchase penetration is really the biggest driver of our business. Overall, we probably, out of 100 loans, at this point we're probably doing -- 19 of them are going to the MI industry, so that's a big driver. The volume of the market did go down, and that's driven primarily, I would say, off the top line origination number -- originations were down quite a bit. They were down predominantly because refinances have fallen off dramatically.

We could expect that to continue. We are just not going to have the big refinance market we've had in the past. A lot of people are talking about weather. No doubt weather impacted the Northeast and parts of the Midwest. But they were also down in other parts of the country where you didn't have weather, and that's probably being driven by both the increase in interest rates and some further affordability challenges that are being driven by home prices going up.

On balance, when I sit back and look at it, and say what is going to happen with the market for the year? We've got some -- you've got the headwinds of slow labor market recovery, wage growth is not going up dramatically, I talked about the home prices and the interest rate. And then on the other side, there are some really positives, I think, that are still out there, and we're going to have to see how it ultimately plays out.

Even though the labor market isn't improving dramatically, it is improving every single quarter. There's pent-up household formation demand, that I think is ultimately going to have to play into the market. It may not be in Q2 or Q3, but over time, those that have been on the sidelines are going to reenter the market, and I think that's going to be the biggest driver for us.

Joanne Smith - *Scotiabank - Analyst*

Great. Thanks Kevin.

Operator

Steven Schwartz, Raymond James.

Steven Schwartz - *Raymond James & Associates - Analyst*

Just a couple. Johnson-Crapo, Kevin, any thoughts on that and how that might affect the business?

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Yes. I think that --

Steven Schwartz - *Raymond James & Associates - Analyst*

Assuming anything happens.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Pardon me?

Steven Schwartz - *Raymond James & Associates - Analyst*

Assuming anything ever happens.

Kevin Schneider - *Genworth Financial, Inc. - President & CEO, Global Mortgage Insurance*

Assuming anything happens. Number one, I have no idea when anything is going to happen. I think it's been, as you know delayed, and we'll see when it ultimately comes back and gets voted on.

In general, I think it's good for the MI industry. It contains some, as it is currently constructed, contains some explicit language relating to credit enhancement on above 80% loan-to-value loans, and I think that's very supportive of private MI. And so, net-net I see it as a positive.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. And then if we can go back to slide 13 -- I appreciate the attempt, but I'm still not getting it. So you've got approvals $325 million, you think that's going to wind up $195 million to $200 million. And when I look at the bottom here, and earned premiums, the benefit is $24 million reserve changes are $46 million, and that's $70 million. You annualized that, that's $280 million -- how do these fit together?

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Well Steven, you have to keep in mind that the $195 million to $200 million that we've received so far, that gets implemented over time, policy by policy. In some cases, the states didn't give us a one-time approval, but said spread it out over three years or five years. So then on each anniversary of the policy, we add the incremental approved amount.

So it just takes time for the premiums to flow through. We ultimately think in 2017, and we also think we are going to get some more approvals on the remaining 10 states, and we are going back, as we said, to other states. We do think we will see by 2017, as we roll all those increases through all the policies, and people -- policyholders decide what they do, that we'll end up with -- versus no increases, that we'll end up with annual premiums going forward of per year between $250 million to $300 million.

Steven Schwartz - *Raymond James & Associates - Analyst*

No. What I'm not getting is, I'm getting the $195 million to $200 million, and I understand that's over time through 2017. What I'm not getting is that the 24 plus 46 is 70, and you multiply that by 4 to annualize. That's 280, and that looks like a very big number. It's the bottom half of that looks too big to me relative to the top half.

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Again, keep in mind that you have two things going on. One is premiums.

Steven Schwartz - *Raymond James & Associates - Analyst*

Right.

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

And they roll in over time. But if someone, and there is 10% of policyholders take a reduced benefit, and 5% take the non-forfeiture option.

So for those people, we aren't going to get the increased premium going forward, but because they've reduced their benefits or they've taken the NFO, the claims that we might have to pay to them are significantly lower than what we originally assumed. So you do see that -- you get more of a one-time benefit from the reserve release from the NFO, the RBO, so that hits one-time, whereas the premiums continue year after year. So you will certainly get more of a short-term benefit to earnings, the more people take the reduction in benefits or the NFO.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. That was good to know. And then one more -- this has been -- you mentioned a couple of times in various presentations, higher tax rates in international MI. The tax rates that we saw in the first quarter, international MI, are those good for the year?

Marty Klein - *Genworth Financial, Inc. - CFO*

It's Marty, Steven. I think that basically our forecast for the full year, we gave some indication of that in our prior quarter, and I'd say that we still have those same expectations. Some of these are really not so much tax rate changes as tax adjustments, as we look at some of the things in our return, and adjust it into our financial statements. But the guidance that we gave on our prior quarter call is still the guidance we would have for the full year.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. Thank you very much.

Operator

Ladies and gentlemen, with there being no further questions at this time, I will turn the call over to Mr. McInerney for closing comments.

Tom McInerney - *Genworth Holdings, Inc. - President & CEO*

Thanks operator, and thanks all of you for your time and good questions today. I also want to thank Amy Corbin, because Amy stepped in, as you know, in the new role of IR, and I want to thank her on behalf of the whole team for planning this meeting, and everything she's doing, so pleased with that.

I also want to say that on behalf of the senior team and myself, I think we are pleased with the progress we are making in the first quarter. I think we're building on the turnaround. I think you'll continue to see those benefits going forward.

We are focused on those five priorities I mentioned. I think we now have a new senior team in place, and I think it's working well, so I'm very pleased with them. And obviously we have a very talented group of employees. I think they're much more excited going forward, given the progress that we're making. We remain focused.

We have, I think, two strong missions. One is to help families at those moments of truth, when they need to rely on life or long-term care policies, and then obviously on the mortgage side, helping families maintain the dream of home ownership.

So we are -- I think we are making progress. Thanks for being on the call, and we'll look forward to the second-quarter call later this year.

Operator

And ladies and gentlemen, this concludes Genworth Financial's first-quarter earnings conference call. Thank you for your participation. At this time the call will end.
