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EDITED TRANSCRIPT

GNW - Q2 2009 Genworth Financial, Inc. Earnings Conference Call

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OVERVIEW:

GNW reported 2Q09 results.

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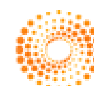

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Genworth Financial second-quarter earnings conference call. My name is Matt and I'll be your coordinator today. At this time all participants are in a listen-only mode. We will facilitate a question and answer session towards the end of this conference call. As a reminder, the conference is being recorded for replay purposes. Also, we ask that you refrain from using cell phones, speakerphones, or headsets during the Q&A portion of today's call.

I'd now like to turn the presentation over to Alicia Charity, Senior Vice President, Investor Relations. Ms. Charity, you may proceed.

Alicia Charity - *Genworth Financial, Inc. - SVP IR*

Thank you and welcome to Genworth Financial's second-quarter 2009 earnings conference call. We released our press release and financial supplement last evening and they're posted on our website, along with some additional detail regarding invested assets. Starting this quarter, we will be posting management's prepared comments following the call for your reference.

This morning, you'll first here from Mike Fraizer, our Chairman and CEO, followed by Pat Kelleher, our Chief Financial Officer, and then Ron Joelson, our Chief Investment Officer.

Following our prepared comments, we will open the call up for a Q&A period, and Pam Schutz, Executive Vice President of our Retirement and Protection segment, Buck Stinson, President, Retirement and Protection products, Tom Mann, Executive Vice President of our International segment, and Kevin Schneider, Senior Vice President of U.S. Mortgage Insurance, will be available to take questions.

With regard to forward-looking statements and the use of non-GAAP financial information, some of the statements we make during the call may contain forward-looking statements. Our actual results may vary materially from such statements, and we advise you to read the cautionary note

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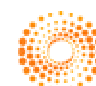

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regarding forward-looking statements in our earnings release and the Risk Factors section of our most recent annual report, Form 10-K, filed with the SEC in March 2009.

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

Finally, when we talk about International segment results, please note that all percent changes exclude the impact of foreign exchange. With that, let me turn the call over to Mike Fraizer.

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Thanks, Alicia, and thanks, everyone, for your time today. In the second quarter, Genworth executed well on our strategies to transition through this economic period and emerge even stronger, with a sharpened business focus. In particular, our specialist business model is on track. Investment performance improved, and we added significantly to our capital foundation and flexibility.

Looking ahead, we are seeing some encouraging market signs in the investment portfolio, our equity-related products, and in our International Mortgage Insurance businesses.

At the same time, a couple of areas remain quite challenging. The US housing market displays a mixed bag of positive and negative factors and has not yet seen the anticipated benefits of government modification programs. In addition, unemployment and related consumer impacts remain issues around the globe.

This morning I'll provide views on overall business positioning, progress on capital strategies, our strong liquidity position, and key risk management initiatives. Pat Kelleher will go deeper on business line performance, and Ron Joelson will share thoughts on key investment topics.

Starting with our business segments, we have tailored our strategy to leverage our strengths and reflect today's market realities. In Retirement and Protection, our specialist strategy around main street life insurance coverages, long-term care insurance, and independent advisor wealth management products and services is on track. And we remain opportunistic on the annuity front.

Sales levels in the quarter reflected this focus. Retirement and Protection sales, while lower, achieved our overall targets and were consistent with our capital plans. I am pleased with our sales results here, and we would expect these sales trends to continue during 2009; and we will see some additional product line level transitions as we introduce various new products later in the year.

In International, we've concentrated our efforts around mortgage insurance in Canada and Australia and Lifestyle Protection in Europe and select new markets. In addition, mortgage insurance in Europe remains small and well contained.

As world economies are going through different stages of slowdown and recovery, we are running these business lines with risk management and mitigation as a priority, while targeting new business production selectively and for good profitability. We see tangible success here during the quarter, and Pat will update you on our progress.

This brings us to U.S. Mortgage Insurance. Here, new business reflects a lower risk profile with much higher returns driven by products, guidelines, underwriting, and pricing changes. Our extensive focus on loss mitigation is delivering clear benefits, which are up considerably during the quarter. Finally, we are successfully executing our plan for this business to be self-contained from a capital standpoint.

Now let's turn to our capital strategies, where we made tremendous progress this quarter. Overall, we've increased capital flexibility substantially. Specifically, I'm very pleased with the improved flexibility we have at the Holding Company, as well as the capital positions of our operating companies.

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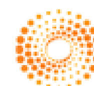

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We hit several important milestones since the last call. First, the IPO of Genworth MI Canada was well executed and achieved a sound initial valuation. Here we not only increased free capital by about $705 million, we did so with minimal shareholder dilution. We now have systemwide capital in excess of ratings and regulatory requirements totaling $2.3 billion.

Next, risk-based capital in our life companies remained at 390%. This is in line with our expectations. We are encouraged by the low level of investment impairments during the quarter and expect to end the year at the 350% level or higher.

This excludes downstreaming any proceeds from the Canadian IPO, which would be available to the life companies in the event the investment environment turned and deteriorated materially.

Finally in U.S. Mortgage Insurance, the risk-capital ratio remains well below the historical regulatory requirements supporting new business, as losses have been partially offset by a combination of loss mitigation activity, lower new business levels, and lower persistency. In addition, the US MI industry had an important public policy accomplishment in the State of North Carolina that reinforces our view that our business can be operated on a self-contained basis from a capital perspective under various scenarios. Specifically, a bill was passed in July that allows the regulator to approve well-capitalized MI companies to continue to write new business for a set period even if they exceed the 25-to-1 risk-to-capital ratio through mid-2011.

While Genworth does not anticipate exceeding a 25-to-1 risk-to-capital ratio, we believe this law provides flexibility to continue writing new business in about 35 states, with opportunities to do so in additional states if we encountered scenarios where we would exceed this level, enabling a transition to a better economic environment.

So overall, we're comfortable with our current capital levels and have sound plans in place as we look forward to 2011 and 2012 debt maturities. That said, we will remain opportunistic as we see approaches that can optimize our capital structure.

In terms of liquidity, we have successfully moved through a period of disrupted capital markets and uncertainties around liability surrenders. We're currently reducing excess cash levels at our operating companies in stages, to reflect a return to a more normal environment.

Moving to risk management, loss mitigation is playing an increased role in our financial results. This is particularly true in our U.S. Mortgage Insurance business. We have saved over $330 million in the first half of the year and see that number growing in the second half of 2009. We also see loss mitigation benefits emerging in our International mortgage insurance businesses.

In the investment portfolio, we continue to benefit from risk management strategies, where we took aggressive steps to defensively reposition the portfolio and reduce or exit certain positions, which Ron will touch upon in more detail.

In closing, as I look back at the past several quarters, the market and Genworth went through a period of significant dislocation. As we sit here today and look ahead, the picture is quite different and is more positive.

We're comfortable with our excess capital which gives us good flexibility. Our Retirement and Protection business is demonstrating successful execution of our specialist strategy with our distribution partners, and we expect to improve sales levels in life, long-term care, and wealth management as markets improve and questions about capital flexibility dissipate.

In U.S. Mortgage Insurance we continue to execute a sound transition strategy, delivering on our plan to keep the business self-contained from a capital perspective while benefiting from loss mitigation efforts and positioning ourselves to capture attractive new business.

We're seeing early signs of a recovery in Canada and Australia on top of sound performances in these two markets. New business levels increased nicely in Australia, and we see an opportunity to gradually increase share in Canada.

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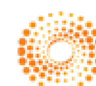

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And finally, investment portfolio performance has improved dramatically and we believe we have put the worst losses behind us. In short, we laid out our strategies and are doing what we said we would do. We will remain focused on rigorous risk management, keeping our financial foundation strong, and positioning Genworth for long-term profitable growth.

With that, let me turn it over to Pat.

Pat Kelleher - *Genworth Financial, Inc. - SVP, CFO*

Thanks, Mike. Genworth's operating results in the quarter reflected important progress towards achieving financial strength objectives, improving business performance trends in our Retirement and Protection segment, some good business results in Canada and Australia, and challenges due to the housing market and economic pressures in Europe and in U.S. Mortgage Insurance.

On a sequential quarter basis, increased operating earnings in our Retirement and Protection segment more than offset a decline in International segment earnings; and the loss in U.S. Mortgage Insurance was in line with the first-quarter results. Strong improvements in credit spreads contributed to improved asset valuations.

All-in, Genworth's book value per share increased by over 20% from first quarter to $23.

This morning, I'll focus on three areas -- our capital plans, liquidity, and business performance, including some views on trends impacting outlook for 2009.

Beginning with capital. As of June 30, Genworth had a total of $1.6 billion of capital in excess of regulatory and rating agency targeted levels, a level consistent with our first-quarter results. In July, we completed the IPO of Genworth MI Canada and received about $705 million in net proceeds, bringing our total amount to about $2.3 billion.

In our US life insurance companies, the consolidated risk based capital ratio remained unchanged from the first quarter at approximately 390%, as improving earnings funded declining levels and investment losses and higher capital requirements relating to credit migration during the quarter.

Our International segment saw sequential increases in capital ratios in Canada and in Europe, as earnings and declines in unrealized losses combined to improve capital ratios, while Australia's capital ratio came down a bit from increased levels of new insurance written.

The U.S. Mortgage Insurance risk-to-capital ratio increased moderately to 14.8-to-1, and this increase is well within our expectations for the US MI standalone capital plan.

As I say, we closed the Canadian IPO transaction, generating about $705 million of net proceeds. This provides considerable flexibility as we move through the year and would be available for the life companies if the favorable trends we have seen in the investment portfolio performance reversed.

Moving to liquidity. We retired our 2009 long-term debt maturities in the quarter and do not have any long-term debt maturing until mid-2011. We've seen only scheduled maturity outflows in our institutional portfolio. We have been opportunistic in retiring some of these obligations early and at attractive discounts. And fixed annuity surrenders continue to trend down and are at or below pricing assumptions.

With this in mind we are decreasing the cash at the operating companies in stages and putting an initial amount of about $1 billion of excess cash to work at more attractive yields. This is in addition to our normal investing activities.

Now let me review the operating performance this quarter. Overall, underlying business performance was good in light of the challenging economic conditions around the globe. Given this, some areas remain soft; and in these areas we are taking actions on price and loss mitigation which will impact trends going forward.

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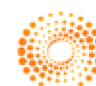

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Let's look at segment results starting with Retirement and Protection. In our US life insurance companies, we experienced favorable trends across the board through the quarter. New business was in line with our expectations. Life insurance mortality and long-term care morbidity were both favorable and in line with expectations. Lapses on the individual annuity portfolio were lower than expected, again.

Expense reductions and improvements in equity markets contributed to improved operating and capital plan results. And investment income results improved measurably, and more active markets provided us with opportunities to trade and reduce credit risk exposure in some key areas.

In Wealth Management, gross flows increased 40% from the first quarter as markets improved, and net flows became positive at $160 million after two quarters of negative net flows. Wealth management assets under management increased by $1.7 billion during the quarter, with positive flows continuing into July.

All-in, these trends contributed to a substantial sequential increase, doubling Retirement and Protection operating earnings from first quarter.

We remain committed to meeting our year-end target of a 350% or better risk-based capital ratio. We've seen improving operating results and declining levels of investment losses, combined with moderate levels of adverse credit migration as key trends to watch and manage. We do have the flexibility, if needed, to contribute capital to the life companies, but we don't expect that this will be necessary.

Turning to the International businesses, mortgage insurance in Canada and Australia had good results in the quarter and are performing well, given the economic pressures in those markets. This demonstrates the inherently more stable financial model that results from the single premium product and favorable regulatory frameworks which help manage risks in mortgage markets in both Canada and Australia.

The decline in home prices has been much less pronounced than in the US. And while unemployment pressures exist in each market, these housing markets have been much more resilient, in part due to effective government programs to improve housing affordability. So let's take a closer look at the underlying trends.

In Canada, unemployment rates have increased from 6.2% to 8.6% through the past year as the economy slowed. During this period, mortgage interest rates declined from approximately 5.2% to 4.1%, increasing housing affordability. And home prices declined by only 5% from early 2008. In recent months, home prices have begun to recover, and the delinquency rate on our portfolio has been stable for the past two quarters at 30 basis points.

On a sequential quarter basis, earnings declined from $66 million to $58 million, due primarily to increased loss severity in the Western Provinces.

In Australia, unemployment rates increased from 4.2% to 5.8% through the past year, and the economy has seen a slowdown. Through this period, the central bank has reduced interest rates, and mortgage rates have declined from 9.4% to 5.8%.

These rate changes greatly improved housing affordability, as most mortgages carry floating-rate terms. And in recent months, home prices have begun to recover. Here we've seen our delinquency rates stabilize for the past two quarters at 45 basis points.

On a sequential quarter basis, earnings were flat, and we've seen a more significant 15% increase in the flow new insurance written as mortgage originations are stronger and we increase share.

As we look ahead, we remain focused on losses, associated loss mitigation efforts, and we will monitor the trends we've seen in recent months in both Canada and Australia and would expect continued solid performance in this environment.

Turning to Europe, high unemployment levels have negatively impacted lifestyle protection earnings, and we have reported several sequential quarters of earnings declines. In particular, we've seen increases in unemployment-related claims, most notably in Ireland and Spain, where unemployment rates are in the mid-teens. It is important to note that following a full year of increases, new claim registrations peaked in March and have since declined. Accordingly, we have been aggressively repricing and modifying our contracts on both new and in-force policies, where

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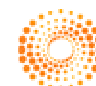

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applicable, to take into account these circumstances and to improve profitability. We expect these actions will help mitigate the loss trends we've seen and improve results as they take hold in the fourth quarter.

In U.S. Mortgage Insurance, we've seen our net loss decline only modestly from first to second quarter, which is disappointing. However, several emerging trends are encouraging.

First, on a sequential quarter basis, gross flow losses declined approximately $100 million or 20%. After taking into account captive benefits, which are declining as some of the large lenders have exceeded coverage limits, flow losses declined approximately 15%.

Second, bulk losses increased $25 million quarter-over-quarter due primarily to GSE Alt-A deductible erosion. However, recent investigation activity has yielded excessive rescission rates on this business. Accordingly, loss mitigation resources are appropriately allocated to this area.

Third, we are encouraged by the modification plans that we see on the state and federal level and are optimistic that this could decrease delinquency rates. But we do not currently expect any meaningful impacts until the fourth quarter.

And finally, we have again increased our own loss mitigation resources and efforts and expect the financial impacts of this activity to build through the second half of the year. I will note that on a sequential quarter basis loss mitigation savings, net of policy reinstatements, have increased to $188 million from $145 million. We've added disclosure on this metric to our financial supplement this quarter to enable you to track what we view as an important measure.

From a capital perspective, we are confident that the business can operate with its current capital plan, even if the housing market experiences more severe stress than we are seeing currently. As Mike indicated earlier, the new law passed in North Carolina this month increases flexibility beyond what we would anticipate needing.

In sum, we are seeing improving operating results across our Retirement and Protection segment; good results in Canada and Australia; and we are addressing the difficulties in lifestyle protection via pricing and contract actions. In U.S. Mortgage Insurance, losses remain a challenge. While there are some early signs of stabilization, we are taking actions now, addressing this with effective loss mitigation activity.

We achieved increased financial flexibility, as we outlined in the capital plan we articulated last year. And we are pleased to have put liquidity concerns behind us. Capital management has always and will remain a continuing effort and a key priority.

As we turn our attention to the second half of 2009, we are keenly focused on positioning Genworth for future growth. Now I'll turn it over to Ron.

Ron Joelson - *Genworth Financial, Inc. - SVP, Chief Investment Officer*

Thanks Pat. We are pleased to see improved results in the investment portfolio for the quarter. Favorable market conditions as well as the impact of risk management actions we're taking to defensively position the portfolio are evident in our results.

This morning my comments are focused on three areas -- impairments in unrealized losses, both in the quarter and some emerging trends; risk-reducing actions we have taken; and performance of the commercial mortgage-backed securities portfolio and the commercial mortgage loan portfolio.

Of the $117 million of net investment losses taken during the quarter, $18 million relate to asset sales and $99 million are impairments. The impairments consist of $5 million from corporate holdings; $71 million from structured securities; and $23 million from our retained interest in a single securitized transaction.

Trends in corporate impairments are slowing. For example, the $5 million in the second quarter compares to $205 million in the first quarter and $217 million taken in the fourth-quarter 2008. We believe that improved market conditions and active risk selling has contributed to this positive trend.

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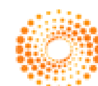

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Turning to structured securities, the $71 million of impairments is down significantly from the two prior quarters, where we recorded losses of $183 million and $298 million. More than half of structured impairment, totaling $44 million, were from Alt-A and subprime securities versus $131 million in the prior quarter. $19 million came from prime securities and $6 million came from CMBS.

Looking ahead, we see continued pressure in the structured markets, but would not expect impairments to increase significantly from current levels.

Moving to unrealized losses, the total net unrealized losses on fixed maturities after tax and other adjustments improved significantly to $3 billion from about $4.1 billion in the first quarter, as a result of declining spreads and certain risk-reducing actions. We anticipate this trend will continue, given the improved market conditions. And this decrease is despite a $382 million aftertax write-up in book values due to the FSP accounting changes. Excluding this writeup, net unrealized losses were $1.5 billion lower in the second quarter after tax; and we have seen further market improvements since the quarter closed.

We continue to reduce our weighting in banks, financials, certain higher-risk assets, and have sold over $800 million of securities through the first half of the year. We have also significantly reduced our holding in CIT, some of which was during the quarter, and were able to do so at attractive prices relative to today's values. Our CIT holdings are currently about $90 million, down from $186 million in the first quarter.

Turning to our CMBS portfolio, the CMBS portfolio continues to perform well despite a significant uptick in delinquency rates for the CMBS market. Our $3.6 billion portfolio was minimally impacted by downgrades, with 87% currently rated AAA or AA, unchanged from the prior quarter. Approximately 70% of our holdings are from 2005 and prior vintages.

To give further detail on our $2.9 billion AAA CMBS, approximately $2 billion is conduit; about $500 million is guaranteed agency bonds; and about $400 million is large loan and other. 75% of our conduit positions are in 2004 and prior vintages, which have performed very well. In more recent 2005 to 2007 vintages, 94% are super-senior, with an average original enhancement of 27%.

As Alicia mentioned, we posted some invested asset slides on our website, and one shows the ability of the CMBS portfolio to withstand stress losses as forecasted by a number of Street firms. Stress losses are calculated assuming an average 40% drop in commercial real estate values, depending on rent and vacancy forecasts by property type.

In the second quarter, the stress loss assumptions were updated to be even more severe, reflecting primarily higher vacancy and loss severity assumptions. 71% of our portfolio can withstand at least 4 times these revised stress losses; and 95% can withstand 2 times. By contrast, the actual losses on this portfolio have been less than 1%.

Turning to commercial mortgages, our $7.9 billion portfolio, with a low average loan size of $4 million, has continued to perform well during the quarter. We had only two delinquent loans through July, totaling $8 million. And our loan loss reserve stands at $33 million, a level more than sufficient to withstand the full amount of expected losses. This represents a $4 million pre-tax increase and is driven by overall market conditions for commercial property. In the second half of the year, we would expect only a slight uptick in commercial mortgage loan losses.

Average loan-to-value is about 57%, up from 55% at year-end based on current valuations. We would expect this number to grow modestly in the second half, up to the low 60s as we complete our annual loan review process.

Average loan occupancy remains at about 91%, and our average debt service coverage ratio is 1.82 times.

We also have little refinance risk in our portfolio, as only 2% of the loans are scheduled to mature in 2009; 3% in 2010; and only 6% in 2011. In short, the portfolio is well positioned to withstand significant further property declines.

Turning to reinvesting cash, as Pat mentioned, we have come out of a period where we thought it prudent to hold higher cash levels and we are starting to put $1 billion of cash back to work at yields that will loose investment income at our operating companies going forward. In sum, we

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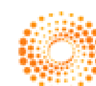

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are seeing early signs that the worst is behind us in terms of impairments, and we expect impairments in the third and fourth quarter to be more consistent with what we saw this quarter.

We are pleased with the trends in most of our asset classes and our ability to continue to the defensive repositioning of the portfolio, both with sector sales and with new investments. And with that, we will open it up to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Darin Arita, Deutsche Bank.

Darin Arita - *Deutsche Bank - Analyst*

Thank you and good morning. On the U.S. Mortgage Insurance business, can you give a little more color on the recissions? What are you seeing now that the initial underwriting process did not pick up?

And on the loan modifications, what changes to the loans are being made?

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Thanks, Darin. Let me turn that over to Kevin Schneider.

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Morning, Darin. As it relates to rescissions, we continue in this recent environment. There was a fair amount of loans that were originated that we're seeing didn't comply with our underwriting guidelines and the guidelines that we had approved and said under which we would ensure production. We've also continued to see increasing amounts of misrepresentation and fraud in some of the files when you actually get a chance to look at them and investigate them.

So we've continued routines that we've always done in our business, in terms of looking and investigating this. But frankly with the development in our delinquency pipeline, we just have a lot more loans to look at. So that's really what's driving the increase in that investigation activity.

On the modification side, I'm not sure if I got your question exactly. But modifications, specifically as they relate to the government announced programs, have really not gotten a lot of traction yet at this point. We are beginning to see a lot of pickup in that from the servicer side. There's been intense proactive cooperation between the mortgage insurance industry, the servicers, the lenders, and in fact Treasury and the administration to knock down all the barriers to trying to make these modifications work.

So we've begun to see that start to pick up in terms of modifications that are approved to be processed. And we would see that feathering in and accelerating hopefully over the second half of the year.

Darin Arita - *Deutsche Bank - Analyst*

On those modifications, would those be reductions of the interest rates and reductions at the principal? Just wondering what changes will be made, so that we don't see these borrowers re-default.

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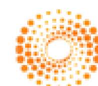

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Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

That's a great point, Darin. When you think about re-defaults, a loan that has resulted in a reduced monthly payment to the borrower and in fact improves their cash flow and their ability to maintain their payment going forward has a far lower likelihood of re-default. We've begun to see really in the fourth quarter, first quarter, and second quarter some of the modifications that we're seeing now and participating in, you're having an increasing number of reductions in borrower payments.

What that does is gets them down so they can cash flow the loan. So we're encouraged that those modifications -- with that type of reduction in payment -- will drive down a lower default rate going forward. Re-default rate, excuse me.

Darin Arita - *Deutsche Bank - Analyst*

Right. Thank you.

Operator

Mark Finkelstein FPK.

Mark Finkelstein - *FPK - Analyst*

Hi, good morning. Pat, I think you made the comment in your opening remarks that you don't expect to put more capital in the life company. I guess firstly, is that a 2009 assumption? Or is that an assumption, I guess, looking out beyond 2009?

Then secondly, I guess, can you just share with us whatever assumptions, whether it's losses or whatever, that kind of gives you the comfort in making that statement?

Pat Kelleher - *Genworth Financial, Inc. - SVP, CFO*

Sure, Mark, I would be happy to do that. It is 2009 but it's also forward-looking beyond that. Frankly, what we've seen over the course of the past couple of quarters is good statutory core income growth increasing our -- I will say operating earnings within the life companies.

And that's been offset by credit migration and investment losses that we've experienced. But what we are seeing is a declining trend in the investment losses. And what that is generating, we think, going forward is more earnings power from a statutory perspective, to the point where as -- if things continue on the path that they're on, we should be starting to look at dividends from the life companies over an extended period of time. Does that address your question?

Mark Finkelstein - *FPK - Analyst*

I think so. I may follow-up. But I guess what were stat earnings in the life company in the second quarter? Do you have an estimate on that yet?

Pat Kelleher - *Genworth Financial, Inc. - SVP, CFO*

I don't have the earnings number, but I would say from the perspective of core income growth, with some help from the equity markets, we saw our risk-based capital ratio lift from the starting point of 390 by a little over 50 percentage points. And that was really offset by the combination of investment losses as well as credit migration that we saw impacting required capital for the period.

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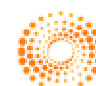

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Mark Finkelstein - *FPK - Analyst*

Okay. That's actually helpful. I guess on the MI business, it seems like the flow business is starting to show some stabilization, but the bulk business I guess deteriorated a bit in the quarter.

I guess, can you just give more color on the bulk business? And I guess just what are the remediation efforts and rescissions, etc., that you are able to I guess perform in that block?

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Kevin, would you take that please?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

I'd be glad to. Just to reemphasize your comment relative to gross -- to flow losses, we did see some stabilization in our delinquency and reserve development on flow losses in the second quarter, which is really largely driven by some stabilization in the Specialty Products and sand states development of those flow losses.

On the bulk side, we do have continued deterioration in the bulk loss development. It's really driven largely by these loans were structured in a way that -- or these pools were structured in a way that had deductibles. As those deductibles have been filled up and fulfilled, then the additional losses and delinquency development beyond those deductible levels are pressuring our bulk loss development.

Same reaction to the previous caller's question regarding what we're seeing in those loans. We're continuing to see loans that did not comply with our underwriting guidelines and loans that have fraud and misrepresentation in those. And those are the type of loans that we're pursuing from an investigation standpoint.

We pay all of our claims that we're owed -- per our master policy requirement, and will continue to do so, but we are not obligated to pay claims that are associated with fraud and misrepresentation.

Mark Finkelstein - *FPK - Analyst*

Okay. Thank you.

Operator

Eric Berg, Barclays.

Eric Berg - *Barclays Capital - Analyst*

Thanks very much. I joined the call a little bit late so I'll apologize in advance if you've touched on this; just tell me.

In the narrative of your news release -- and what I would like to do is to build on a discussion I had with Alicia last night. You mentioned a logjam with respect to the movement of homeowners who are in trouble from delinquency to foreclosure. I'm not sure if this has anything to do with the economics as much as with timing. By that I mean that if a person is in trouble and his foreclosure is delayed, that's really all we are talking about. That is to say, when that person loses his home rather than if.

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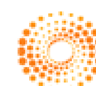

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So my question is, how is this logjam at all -- how is it affecting the economics of the business? Now there's whether there will or will not be a loss; and how is it affecting the financial results? Why are you telling this? Why is this important for us to know in terms of understanding the financial results of the domestic mortgage insurance business? That's my first question. Thank you.

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Eric, I'll take that. This is Kevin. As you think about what we're seeing in the marketplace, in a normal environment loans that were ultimately going to go to claim, once they hit foreclosure there is a time period that they make it through the process and come out the backside. And you see that claim presented to you.

In the environment we're in right now, there is an increasing amount of loans that are in the system that are delinquent, that once they hit the foreclosure process are not coming out the backside of the process on the normal pace that one would expect them.

For us, the importance of that to our economic performance or our income performance is those are loans now that continue to age, that are in our delinquency population, that we continue to reserve against; and those reserves build over time. We're seeing a delay -- and in fact, somewhat below our expectations -- in our actual paid claim population at this point in time. So paid claims are actually running a little behind where one would expect them to be.

But the continued development of loans that are delinquent, they are sort of stuck in the system. I think the implications in the marketplace right now are that a lot of these modification programs that have been introduced in the marketplace, specifically the administration's programs, have probably slowed some of this development and transition through the system down, while the servicers get their arms around them and are able to better implement them.

So what I would expect to see is some freeing up of that logjam going forward as more and more borrowers get access to these modification programs.

Eric Berg - *Barclays Capital - Analyst*

But since you set reserves based on delinquencies, not based on foreclosures, once a person's home mortgage is severely delinquent, you are going to reserve for that irrespective of whether that person gets -- foreclosure proceeds at a normal pace or not. So in terms of -- maybe this question is better addressed by Pat, I don't know.

But is this affecting the financial results, the income of the mortgage insurance, this logjam?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Again, we reserve on a case basis when a delinquency is reported to us and as that delinquency ages through its normal delinquency life up to foreclosure, and then ultimately to claim, we reserve against that.

What you're seeing right now, I think, is a higher development of overall incurred on a reserving basis and a lower than what we would expect loss on a paid claim basis because of what's being held up in the system. But it is being appropriately reserved for.

Pat Kelleher - *Genworth Financial, Inc. - SVP, CFO*

Eric, this is Pat. One thing just to clarify. Our reserves are based on emerging experience as we see it. As we haven't seen the impact of these modification programs in our actual results, we basically ignore them in setting reserves.

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So to the extent that the modification programs have a beneficial impact, that will benefit financial results.

Eric Berg - *Barclays Capital - Analyst*

Last question. What would be an example of a type of modification, Kevin, that you would consider to be -- what is the nature of modifications that clearly are not working? As opposed to -- that do lead to re-default? How should we think of the different types of modifications, those that work versus those that don't?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

That's a great question. When I think about those that are having more difficulty working today in this environment, those are modifications where arrearages -- the borrower gets behind. They get behind in their payment. And historically in a more normalized environment, you could take those arrearages that they are behind on, perhaps add them into the principal amount of the loan, and extend the amortization period.

So you stretch out their payment requirement over a longer period of time. That doesn't necessarily do anything to lower the borrower's monthly payment. So those type of modifications are having higher re-default rates.

I contrast that to a payment -- or a modification, excuse me, where the borrower's monthly payment is lowered. And that can be achieved through a number of ways. It can be achieved through a reduction in the interest rate. It can be achieved through a reduction in principal.

By doing that you get the borrower into a better cash flow position, a cash flow position that in fact substantiates that they can maintain their monthly payment going forward. And as long -- those type of modifications Eric are having a lower re-default rate.

We would expect to see more of those going forward because that's really where the administration's modification efforts are focused.

Eric Berg - *Barclays Capital - Analyst*

Actually, one last quick one for Ron. Does rating migration -- this will be real quick. Does rating migration downgrades, on a GAAP basis, does that affect the likelihood or the need to impair a bond?

If a bond is downgraded, obviously it's going to affect its price. It's going to be statutory capital. But what about in terms of the likelihood that you will impair a bond? Is that likelihood affected by ratings changes?

Ron Joelson - *Genworth Financial, Inc. - SVP, Chief Investment Officer*

The downgrade per se doesn't have that impact. But if the downgrade is suggestive or so severe that we actually think there would be an economic loss in the future and we wouldn't receive a full return of principal, then yes, it would be -- it would result in an impairment.

Eric Berg - *Barclays Capital - Analyst*

Thank you.

Operator

[Blake Phillips], Philadelphia Capital.

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Jordan Hymowitz - *Philadelphia Capital - Analyst*

It's actually [Jordan Hymowitz]. Thank you for taking my question. Two quick questions.

One is the average paid claim in dollar went down substantially. What caused that? Is it because your California is getting less prevalence, or --?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Yes, Jordan, it's largely driven by the mix of paid claim development, where it's coming from right now, as well as we are also getting the benefit of some offset from our captives on the ceded loss side of the income statement.

In other words, the captives now are also benefiting to the claim payment; and so our actual paid claim amount is being impacted.

Jordan Hymowitz - *Philadelphia Capital - Analyst*

Okay. Second question is, you said you raised rates in the US. Can you say the absolute amount in basis points that the new rate is versus before, versus the percentage increase for prime?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

I'm trying to remember off the top of my head. I can tell you the way you need to think about the rate increase is we did a 20% basis -- 20 percentage point increase. So I believe it took us from the 50-some basis point level up into the 60-some basis point level, say for a typical 90% loan-to-value loan.

I'd contrast that with a 95% loan-to-value loan, which is in fact priced like 30% higher than a 90% LTV level.

So from that, you've got a baseline price increase of about 20%. Then on top of that, we're also benefiting from a reduction in the captive ceded premium levels, because were not doing captives going forward; and that picked up an additional 15% of price increase for us on a comparable mix basis.

Jordan Hymowitz - *Philadelphia Capital - Analyst*

So when I try and extrapolate that increase in pricing and assume a 50% loss rate, would I assume that you are writing new business close to a 20% ROE today?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

I think you could safely assume that our new business model, with the reduction in the volatility driven by our underwriting standards and our price increase, is going to be sufficiently north of 20% ROE.

Jordan Hymowitz - *Philadelphia Capital - Analyst*

Okay. Thank you very much. I'll get back in the queue. Appreciate it, and congratulations on an excellent quarter.

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Operator

Steven Schwartz, Raymond James.

Steven Schwartz - *Raymond James - Analyst*

Hey, good morning, everybody. A couple of questions if you would. Mike, maybe you could talk about something I've been wondering about.

CLASS, Teddy Kennedy's program for long-term care, what's your thoughts on that, how that might affect you if that came to eventuality?

Ron, maybe you could talk about CIT. It seemed to me that maybe you're still holding that at cost. That would be a little bit different from everybody else I think so far who has reported.

Then Kevin, could you remind us what your rating is on the MI companies? What the GSEs are currently thinking about ratings and weighting ratings, and maybe touch upon the MGIC restructuring and what that -- your thoughts on that vis-a-vis the Genworth business?

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Steven, let me start in handling your first question. I'm also going to hand it over to Buck Stinson, given his long and deep experience in the long-term care front and all of our active engagement on the CLASS topic.

I'll just observe that I think CLASS as a proposal is just bad public policy. Does not achieve a helpful goal for the consumer specifically. And that there is an education effort underway to help people understand the flaws in this area, coupled with the importance of the -- or ongoing importance I should say, of the private long-term care market.

So, Buck, could you take that apart for us and walk through?

Buck Stinson - *Genworth Financial, Inc. - President of R&P Insurance Products*

Yes, Steven. Just to add some more color to what Mike is talking about, I was in Washington in fact all day Wednesday. Genworth has been actively involved in the broader healthcare reform debate, keeping track of what implications all of the various movements might have on our business. We've watched a very fluid process as it's moved through the House and the Senate.

In terms of impact on Genworth's overall business model, our current view is that whatever comes out the backend in a broader form will have limited impact on our business model. But specifically, we are watching the CLASS Act and have analyzed that particular bill in detail. As you know, the bill would provide a voluntary federal long-term care insurance program that would provide a very minimal level of benefits for participants.

While we believe that if passed that bill could temporarily disrupt the long-term care private market, our broader concern is what Mike has mentioned, which is the lack of actuarial sound fundamentals backing the public policy.

Just recently, the Academy of Actuaries has released an analysis of the CLASS Act, and that's part of this education program that we're actively participating in. But that concluded that the proposed structure and funding approaches would not only be unsustainable within the foreseeable future, but very unlikely to cover more than a very small portion of the intended population. In essence creating another underfunded government entitlement program.

So we believe it's bad public policy. We don't think that there is going to be wide participation even if it is passed. We think the private market could compete favorably against it.

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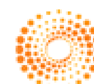

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But we're concerned about the additional confusion that that bill might introduce into the public, so we stay actively involved monitoring that bill.

Steven Schwartz - *Raymond James - Analyst*

But I hear, Buck, maybe temporarily people might think that that's a replacement for private coverage until they figure out maybe it's not.

Buck Stinson - *Genworth Financial, Inc. - President of R&P Insurance Products*

Our concern, our battle today when we sit down with consumers is we have to convince them that Medicare isn't designed for long-term care. So we think yet another entitlement program over the top would just create additional confusion.

Again, when the facts get explained, we think again the private products are going to compete very favorably. But it just would add additional confusion.

Steven Schwartz - *Raymond James - Analyst*

Got you. Thanks, Buck.

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Ron, want to pick up on CIT, please?

Ron Joelson - *Genworth Financial, Inc. - SVP, Chief Investment Officer*

Yes, on the CIT question, as I mentioned in our remarks, we hold roughly $90 million of those securities. They were not impaired because of the events which occurred were subsequent to the quarter-end. However, consistent with everyone else, we do carry the bonds at the market value, which is in the mid 60s. It's about $64 million of the $90 million.

Steven Schwartz - *Raymond James - Analyst*

Okay. Got you.

Mike Fraizer - *Genworth Financial, Inc. - Chairman, President, CEO*

Kevin, do you want to pick up on the MI, please?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Yes, Steven, as I understood, you had two questions. One was relative to the GSE ratings and eligibility. The GSEs have continued to support individual mortgage insurers, even with rating agency ratings that have been reduced below the AA rating level. I think the comfort level they have there is with the strength of the state regulatory regime and the comfort the state regulators have with our ongoing claims-paying capability as well as ability to write new business.

As it relates to MGIC --

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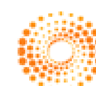

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Steven Schwartz - *Raymond James - Analyst*

Kevin, one second. What's your rating these days?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

What is our rating? Sorry, I don't have it.

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

It's BBB minus, I believe.

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

BBB minus, excuse me.

Steven Schwartz - *Raymond James - Analyst*

Okay.

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Historically, it's been a AA eligibility requirement by the GSEs. And as we went through 2008, a number of the mortgage insurers had ratings reductions below the AA level. The GSEs have continued to operate and allow those mortgage insurers -- and the entire industry, in fact -- to continue to be eligible insurers and support and write new business for them at this point.

On the second question regarding MGIC's proposed approach to stacking of legal entities. We haven't had any detailed discussions like that with the GSEs regarding this issue. We believe we can continue to run our business on a self-contained basis, but we're always going to continue to evaluate smart options for additional capital flexibility.

In fact, when we think about the production that we're writing today, with that increased pricing that we talked about with an earlier questioner, and those increased underwriting guidelines, that's good production that we believe is going to generate profitable margin. And it is an attractive place to deploy capital.

So we will continue to evaluate all options and we will update you going forward on additional plans we choose to execute with our capital plan.

Steven Schwartz - *Raymond James - Analyst*

Okay. Thank you, Kevin.

Operator

Mike Zaremski, Credit Suisse.

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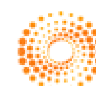

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Mike Zaremski - *Credit Suisse - Analyst*

Hey, guys. Thanks for taking the question. I'm going to exhaust the conversation on US MI, if that's okay. Have you guys given a base and worst-case estimate of US MI operating losses in 2010 if things stay on the (multiple speakers)?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

No, we have not.

Mike Zaremski - *Credit Suisse - Analyst*

Okay. So the sequential losses were down in the segment, but it seems to be due to loss mitigation trends. Do you think the loss mitigation trends are sustainable given that delinquencies are probably still going to rise on mortgages?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Yes, as I said, we continue to have, through the combination of both our loan modification efforts and loan workout efforts, as well as continued opportunities on the investigation side, I do believe we will continue to benefit from loss mitigation going forward.

I think we mentioned earlier in one of the prepared remarks that we had over $300 million of benefit in the first half; and we would see that growing in the second half of the year.

If I could come back to your first question and just expand upon it a little bit, while we haven't provided loss level outlook for 2009 or 2010, what we have done is in operating our business, assuming we're going to be in an environment where unemployment grows to a little over 10%, 10.3% in early 2010, and we ultimately have a peak-to-trough decline of 35%. So that's the way we've been running the business.

But we've also said, given the uncertainties of this environment we're in, we think it's prudent to stress that even further. So we've looked at stress scenarios that would drive the peak-to-trough housing price decline down to 47%, and looked at unemployment levels up to 14%.

Clearly outside of any ranges that anybody is really forecasting today or even that we believe today, but we're very comfortable that we continue to have sufficient claims-paying resources and capabilities under even those type of dire stress scenarios.

Mike Zaremski - *Credit Suisse - Analyst*

Okay. Some of the major lenders -- I think including JPMorgan -- ended their foreclosure moratoriums recently. Should we be thinking about a backlog of foreclosures potentially picking up losses in the coming quarters, then? I don't know. I'm not sure if there is an element of IBNR in your reserves. How should we think about that?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Yes, first, there is absolutely an element of IBNR in our loss reserves.

Secondly, while we do have -- in some individual moratoriums that have been lifted, they are largely continued throughout the system right now. And there are also continued calls for even additional moratorium from Congress right now.

So I think the way to think about it and the way I think about it is today there is some clogging in the system of loans that haven't gone on from foreclosure on to claim. And we should see more of that beginning to work itself through the system.

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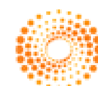

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But at the same time, we should also see the pickup in some of the modification programs, which are really extensive. Those should help benefit some of those loans that are held up in the process.

Mike Zaremski - *Credit Suisse - Analyst*

Okay. Then, on the captive benefits, they've declined for the third quarter in a row. I mean I guess should we be concerned that potentially -- does that mean you're piercing through lots of the benefits and then we're not going to see the captives mitigate as many losses in the coming quarters?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Well, the way we have expected and have talked on previous calls that we would expect the amount of captive benefit to decline throughout the year. I think our expectation for 2009 is probably somewhere in the range of $250 million worth of captive benefit. We got $119 million in the first quarter, $76 million-ish I think in the second quarter. And that would continue to trickle down.

What you're going to see is a shift in the mix of the benefit coming from a reserve offset and starting to see more benefit from the captives in terms of the actual paid claims benefit side of it on a cash basis, when claims ultimately are presented.

As it relates to captives going through the loss tiers, with the type of development in the marketplace and the type of economic outlooks and stress scenarios that I've described and the way we're managing the business, we would absolutely expect some of the captives to come out the top end of the tier.

They will, particularly for those captives that had lower backend attachment points. So we would expect that and are planning that in our -- those are actually planned in our internal loss forecast. And again you are going to continue to get benefit from increased loss mitigation which will develop over time.

Mike Zaremski - *Credit Suisse - Analyst*

Okay. Very helpful. Thanks, guys.

Operator

Ed Spehar, Bank of America Merrill Lynch.

Ed Spehar - *BAS-ML - Analyst*

Thank you. Good morning. Kevin, I guess on the topic of captives, if we look at the benefit that you think you're going to get from all the loan modification efforts, could you help us in terms of the relative significance of that, versus the benefit that we have seen from captive reinsurance? Can you sort of size it on a relative basis?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Ed, last year I think we got the benefit of about $500 million from captive recoverables. This year, as I just said, I believe we'll get roughly $250 million.

Over time I would expect you are going to see a total of over $1 billion worth of total offset from the captives multiyear as they run out over time. So that's the way I think about that in a multi-period time frame.

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On a loss mitigation and loan modification standpoint, I really think you could see similar type relief over a multiyear period. We're having realized over $300 million worth of benefit in the first half of this year, if you just expand that out over time I think you could be in similar type buckets. And I really think a bigger portion of them going forward is going to come from modifications.

Ed Spehar - *BAS-ML - Analyst*

How should we think about -- at what point do we see the turn in sort of the quarterly results? I'm not looking for specifics. But if we're just trying to model out, when do things start to look better from a bottom-line standpoint?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Yes, the way I'm thinking about it right now is at the point at which our new delinquency development starts to decline and you start to actually see some improvement in the cure rates. And right now, in the first half of the year we did actually see some favorable development in new delinquencies. Much of that may be seasonal; but we didn't get the benefit of that seasonality in 2008. So I find that encouraging in 2009.

But I don't think we're -- I'm not sure that trend is going to manifest itself all the way through the year. What is more important right now is we are not seeing any improvements yet in the cure rate. And once you start to see that turn the corner, that's when I think we'll be able to talk more specifically about improvement on the bottom line.

Ed Spehar - *BAS-ML - Analyst*

Historically, if we think about the relationship between delinquencies, stats improving or declining, and improvement in cure rates, just historically what kind of a lag is there? Or is there a lag?

Kevin Schneider - *Genworth Financial, Inc. - SVP, President & CEO of USMI*

Ed, I honestly don't know the answer to that question. I'll be glad to do some further research on it and get back to you.

Ed Spehar - *BAS-ML - Analyst*

Okay. Thank you.

Operator

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

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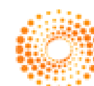

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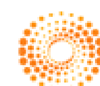

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