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GNW - Q1 2010 Genworth Financial, Inc. Earnings Conference Call

EVENT DATE/TIME: APRIL 30, 2010 / 1:00PM GMT

OVERVIEW:

GNW reported 1Q10 results.

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PRESENTATION

Operator

My name is Bill and I will be the 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, this conference is being recorded for replay purposes. (Operator Instructions). I would 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. - VP, IR*

Thank you and good morning. Thank you for joining us for our Genworth Financial's first-quarter 2010 earnings call. Our press release and financial supplement were released last night and are posted on our website. Again, this quarter, we will post management's prepared comments following the call for your reference.

This morning, you will hear first from Mike Fraizer, our Chairman and CEO and then from Pat Kelleher, our Chief Financial Officer. Following our prepared comments, we will open the call up for questions and we will be joined by Kevin Schneider, President and CEO of US Mortgage Insurance; Pam Schutz, Executive Vice President of Retirement & Protection; Jerome Upton, Chief Operating Officer of our International segment; and Ron Joelson, Chief Investment Officer, will all be available to take your questions.

With regard to forward-looking statements and the use of non-GAAP financial information, some of the statements we make during this call may contain 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 Risk Factors section of our most recent annual report in Form 10-K filed with the SEC in February of 2010.

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

And finally, when we talk about the international segment, please note that all percent changes exclude the impact of foreign exchange. In addition, the results we will discuss today for the Canadian Mortgage Insurance business reflect total Company results, including the minority interest, unless otherwise indicated. And now, 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. We took another important step forward in the first quarter, executing our strategy and delivering improved financial results. I was especially pleased with the progress we made across five areas. First, building new business growth momentum in several lines and launching additional new products. Second, improving investment results, which included substantial cash reinvestment and ongoing risk reduction and diversification.

Third, transitioning US Mortgage Insurance towards profitability with substantial progress in the quarter supported by broad-based market efforts regarding loan modifications plus other loss mitigation efforts. Specifically, I am encouraged about the prospects for US Mortgage Insurance where we are seeing continued favorable trends in new delinquencies, cure rates and our new business share position.

Fourth, optimizing Genworth's capital structure. We made good progress in the quarter with optimization strategies continuing as we move through the remainder of 2010 and the next two years. And fifth, delivering solid performances across our Australian and Canadian Mortgage Insurance platforms where overall market conditions continued to improve nicely.

Stepping back, I have said to many of you that we were coming out of this economic downturn more focused than ever with stronger business models. Indeed we are. And you saw that in a number of areas in the quarter.

But we still have some work to do. And I would highlight three areas where we remain actively focused. First, European markets remain in various stages of recovery and some parts, like the Nordic region, are now experiencing the impact from unemployment that was seen earlier in Western, Southern and Eastern Europe. This continues to pressure our Lifestyle Protection business on two fronts -- claim durations and new business levels. The latter because of reduced levels of consumer borrowing.

I spent some time in Europe during the first quarter and was very pleased with the benefits we are seeing from actively repricing products and restructuring distribution relationships to enhance profitability across areas like profit and loss sharing, as well as commissions.

We are also focused on selling our Lifestyle Protection products in new ways. For example, rather than primarily selling Lifestyle Protection at the time of a new lending transaction, we are broadening programs with our distributors to market Lifestyle Protection to their clients with various types of outstanding financial obligations using the appropriate coverage types.

In addition, we are broadening distribution channels to support Lifestyle Protection sales with our larger dedicated team to do so. Importantly, the stressed economic environment reinforces our value proposition and provides new opportunities to grow the business. In sum, Lifestyle Protection's recovery is coming along, but their profile will remain choppy as we move towards a stronger recovery in Europe.

Second, in US Mortgage Insurance, I am very pleased with the trends in losses, loan modification and gains in marketshare. However, we would like to write more new business in aggregate. We have strong capacity for additional growth because of our risk profile and disciplined capital planning. But we have encountered a much smaller market than anticipated with the large role currently being played by the FHA.

So we are taking steps to increase sound new business. During the quarter for example, you saw us add markets where we will cover up to 95% LTV business for high FICO borrowers where loans come to us through retail channels, which have strong underwriting. We do feel the market is slowly starting to shift back towards private mortgage insurers and we will continue to do so as the FHA reassesses its standards and re-prices for risk management purposes.

In addition, there is a clear opportunity for GSEs to review loan level pricing that has steered new business to the FHA. Both these opportunities are accelerated by the fact that the industry, using various strategies, has improved its capital strength and capacity. This helps policymakers feel confident about private mortgage insurers taking on an expanded role in the housing finance system.

Finally, we will continue to focus on improving profitability and further accelerating sales growth in the life and long-term care lines. Along these lines, we were very pleased with the market acceptance of our new term life value proposition product called Colony Term UL and the new UL offering, both of which incorporate more capital-efficient designs.

Also, long-term care sales have rebounded nicely in our independent channels. We did see some underwriting and other fluctuations in the quarter that should naturally balance out and Pat will touch upon these.

As we look ahead, I view our performance and strategic transition as being right on track. We are intently focused on executing the transitions in our business segment and enterprise-level returns on equity that we laid out at our December investor day, along with continued improvements in earnings and new business sales.

We also remain very engaged on the public policy and regulatory fronts in the US and around the world given the dynamic environment where multiple aspects surrounding financial services are being assessed and debated. With that, let me turn it over to Pat for a deeper look at the quarter. Pat?

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

Thanks, Mike. We made good progress in the first quarter executing our plans to grow earnings and enhance returns. We remain focused on efficiently managing capital and demonstrated that in several key areas this quarter.

This morning, I will focus on three areas. First, business and earnings growth; second, investment results; and finally, our capital management activities. Let me start with Retirement & Protection. Here, we are seeing sales growth in several key areas setting the stage for future revenue and earnings expansion.

In life insurance, our new, more capital-efficient products continue to gain traction. The combined term and Colony Term UL production premiums of $24 million for the current quarter is up over 25% from prior year and is also up 9% from fourth quarter 2009. This is well above our expectations.

We are also pleased with the initial acceptance of our new GenGuard UL product where sales nearly doubled sequentially and were almost 90% of submitted UL policies in the first quarter. Overall, Universal Life sales are down, primarily reflecting lower excess deposits in the current interest rate environment.

In addition, we have intensified our focus on increasing average face amount per policy targeting policies in the $500,000 to $1 million range. Overall, we are encouraged by first-quarter life insurance sales results.

Long-term care sales improved both sequentially and year-over-year. We are seeing improvement in long-term care sales following declines in industry sales in early 2009. First-quarter individual LTC sales were $31 million, up almost 30% from prior year. Group and linked benefit sales combined are at an all-time high of $19 million for the quarter. We are pleased with the group sales momentum, including the recent addition of employees from the Commonwealth of Virginia. Given the nature of group enrollment, we'd expect quarterly sales levels to be a bit uneven.

Over in wealth management, we saw a fourth straight quarter of positive net flows and an 85% increase in sales year-over-year. Assets under management are just shy of pre-global financial crisis levels. Here, we are investing in capabilities to penetrate new markets and are seeing the earnings growth we would expect as our assets under management increase. We are pleased with the progress adding new advisers due in part to the differentiated service we provide to them.

From an earnings perspective, first-quarter Retirement & Protection results improved significantly year-over-year. Wealth management and retirement income earnings benefited from a combination of improving markets and cash reinvestment while life insurance and long-term care were relatively flat year-over-year.

Looking at results sequentially, earnings growth was muted by a few factors. While we saw expected levels of earnings accretion from cash reinvestment, this was offset by expected real estate limited partnership losses. We also had some pressure from less favorable life mortality and lower persistency as certain term policies reached the end of their level term periods.

In long-term care, old block claims increased and we saw the usual seasonal increases in Medicare supplement claims. However, across Retirement & Protection, mortality, morbidity and persistency experience were all within a normal range of statistical variation.

Looking at the international businesses, the Canadian economy and housing markets overall continued to improve. Unemployment declined modestly from 8.4% in December to 8.2% in March. Housing affordability remained solid with mortgage interest rates ending the quarter at approximately 4.4%, up about 50 basis points from year-end. Home prices in our target markets remain stable, up 3% from year-end. Most regions have now recouped the declines experienced during the recent downturn.

Flow sales in Canada were up more than 40% versus the prior year, primarily from growth in the mortgage origination market. On a sequential quarter basis, flow sales were down a bit reflecting normal weather-related seasonality and homebuying. The flow delinquency rate in Canada has remained stable now for the past three quarters at about 34 basis points, down from 36 in the second quarter and reflecting improved economic trends. The loss ratio decreased by one point to 38%, marking the third consecutive quarter of improvement.

As we look at loss performance across book years in Canada, our 2006 book has passed its peak delinquency period while the 2007 book is showing signs of peaking. The delinquency rate for the large 2007 book has been in a relatively narrow range for the last three quarters, which leads us to conclude that it may have peaked and should decline in the second half of 2010.

Turning to Australia, you have a similar story to Canada with the economy at home prices continuing to recover. Unemployment rates declined modestly from 5.5% at year-end to 5.3% at quarter-end. National home prices have stabilized following an increase of approximately 5% on average in 2009 with most areas having recouped the home price declines experienced during the recent downturn.

Following strong sales in 2009 that were driven by the combination of low mortgage interest rates and government stimulus programs, we saw a decline in flow new insurance written as we expected as the government stimulus was reduced in late 2009 and as interest rates increased. We are pleased that the total delinquency rates improved and loss ratios have continued to improve.

We had expected some modest uptick in the loss ratio as we moved through the year primarily for two reasons. First, we added $250 million Australian Dollars of external reinsurance coverage as part of our capital plans, which reduced premiums by $6 million. Second, while the national unemployment rate has improved, we are still seeing underemployment, as well as pockets of high unemployment in certain regions of Australia. This can lead to variation in quarterly loss performance. In sum, we view performance in Canada and Australia as solid and would expect earnings to trend gradually up from current levels.

Turning to Europe, we had a choppy quarter in our Lifestyle Protection business following strong results in the fourth quarter that had some additional lift from tax and loss mitigation benefits. Three factors contributed to the choppiness. First, loss performance in Southern and Western Europe has improved as new claim registrations slowed in the last nine months, reflecting a decline in the pace of unemployment growth. In addition, repricing and restructuring of distribution relationships completed to date in these areas contributed to the improved performance.

Second, in the Nordic region, losses increased generally, reflecting unemployment pressure, which had been running below levels seen in the rest of Europe. And as we look more closely at losses in the quarter, we have identified a concentrated source of these additional losses and we are currently taking steps to address the situation, much as we did in Western and Southern Europe during the past year.

Third, we are seeing the impact of lower consumer lending and Lifestyle Protection sales across Europe and this is pressuring revenue growth. As outlined earlier, we are taking steps to improve sales as the new initiatives take hold. In sum, we continue to take decisive actions to improve earnings in Lifestyle Protection addressing the economic challenges in Europe. As we execute our plans and as these European economies recover, you should expect overall earnings improvement with some choppiness reflecting this transition.

Now looking at the US Mortgage Insurance business. Here, we are seeing clear earnings improvement, primarily from lower losses and continued loss mitigation benefits. In the flow business, we saw improved loss trends from normal seasonal declines in new delinquencies and from increases in cures from the various modification programs and continued loss mitigation benefits.

In addition, I am pleased to report that delinquencies from the 2005, 2006 and 2007 books peaked in early 2010. Flow delinquencies decreased to about 102,000 from about 107,000. We saw the return of normal seasonal patterns with a sequential delinquency decline of 5%, slightly ahead of the 4% we have seen historically in the first quarter. This was the result of a decline in new delinquencies, as well as higher cures.

Modification programs such as HAMP have been effective, particularly at curing earlier stage delinquent loans. The flow average reserve per delinquency increased a bit this quarter given higher-than-expected loan modification activity on early-stage delinquencies. While we continue to see a shift to a more national distribution of delinquencies across traditional loan products and this shift continues to put downward pressure on the reserves, in this quarter, that impact was more than offset by the mix of delinquent loans being more weighted to late-stage delinquencies since the modifications are curing more of the early-stage delinquent loans.

I should note that although we saw significant loss mitigation benefits during the quarter, rescission activity was in line with our expectations and we did not make further adjustments this quarter to our reserve factors for cures due to rescission activity. In addition, we have not yet factored in the potential impact of increases in modifications, including HAMP.

In the bulk business, losses declined to $4 million down from $36 million in the fourth quarter. This decline was expected due to the January settlement previously announced, which resulted in a reduction of approximately 10,000 delinquent loans and reduced total bulk RIF to $523 million in the first quarter.

Finally, I would also note that we still have a shadow inventory to work through in the marketplace, which will dampen home price recoveries. In addition, as we think about the remainder of 2010, we expect normal loss trend seasonality to continue.

Now briefly turning to the investment portfolio, the actions we have taken to reinvest cash and derisk the portfolio are having the desired impact on investment income, as well as on impairments. We will continue these actions and further diversify the portfolio. We will broaden our exposure to corporate bond sectors like utilities and industrials and in private placements, taking advantage of areas where credit spreads remain attractive.

Cash reinvestment strategies since the third quarter of 2009 contributed $18 million to investment income in the quarter. We reinvested $1.1 billion of excess cash and are marking good progress toward our goal of deploying $2.5 billion to $3.5 billion of excess cash by midyear. Most of this impacts the Retirement & Protection segment.

I should also note that, since these funds were deployed throughout the quarter, we do expect some incremental lift to investment income into the second quarter. However, first-quarter reported real estate limited partnership performance was weak, which was expected, and offset the quarter impact of cash reinvestment, total LP losses were $22 million after-tax, $8 million in the Retirement & Protection segment and $14 million in corporate and other. As we have seen in the past, limited partnership investment losses experienced a catch-up in the first quarter when the 2009 year-end financial information became available.

Now looking ahead, we would expect the run rate on after-tax investment income to be about $24 million higher than first-quarter levels, both from the cumulative benefit of cash reinvested to date and from stabilized limited partnership valuations.

The final point that I would make regarding the investment portfolio is that we have limited exposure to European sovereign credit. For example, we hold just $3 million of sovereign debt in Greece and another $2 million in Portugal.

Before closing, I would like to comment briefly on capital. The Retirement & Protection segment capital is right on its plan. The consolidated risk-based capital for the US life insurance companies ended the quarter at approximately 385%. Regulatory capital ratios in Canada, Australia and Lifestyle Protection increased sequentially and remains in excess of targeted levels.

In Canada, our majority-owned subsidiary announced a new plan to optimize its capital structure with two components. First, adding debt to the capital structure as current market conditions are favorable with an initial debt to capital target in the 10% range. Second, subsequent to the debt deal, returning up to $350 Canadian dollars to its shareholders in the current year. As a majority shareholder, Genworth will receive a significant portion of those proceeds.

In Australia, we increased our external reinsurance program by $250 million in the quarter, which provides additional capital flexibility and diversification of exposures to high-quality reinsurance counterparties.

In US Mortgage Insurance, the consolidated risk to capital ratio remains strong at 14.9 to 1 as losses moderated reflecting improved market conditions and loss mitigation benefits. In sum, our operating businesses are well-positioned to support operating and parent holding company capital plans going forward.

To wrap, this quarter marks solid progress executing plans for growth in earnings and in setting the stage for ongoing improvement in return on equity. We remain focused on four levers to reach these targets -- profitable new business growth, optimizing investment performance, ongoing risk management including loss mitigation and finally, effective capital management. All in, first-quarter results mark progress towards the 2012 return-on-equity targets announced in December. With that, I will open it up to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Eric Berg, Barclays Capital.

Eric Berg - *Barclays Capital - Analyst*

Good morning. Two questions, one related to Mortgage Insurance and the other to Europe. I want to sharpen my understanding and this question, I guess, would be best directed to Mike or Kevin if he is on the phone. As you pointed out, you have a business that is much more profitable or losing significantly less money than it was just a short while ago, but it is shrinking; the risk in force continues to come down. What is going to happen looking forward here that will reverse that trend? What will allow you to grow, especially given the fact that some of these changes that you referenced? Opening up more markets, I believe, were introduced a while ago. That is my first question and then I will have a second. Thank you.

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

Eric, let me hand that off to Kevin for the first part.

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

I think where you need to start thinking about is what is going on with the overall insured market. When I say the insured market, you should think about it in terms of the private mortgage insurance market plus the government or FHA market. So when you think about the market drivers that have impacted that market, first of all, we start at the top level. Originations been down a little bit, so our overall business levels at the pricing that we have talked about so many times and higher returns have been affected by that small origination market. As we come through the cycle and the economy further strengthens, I would expect that to further recover. So that is a top-line level of the market change.

Then you think about what has happened between the FHA and the private mortgage insurance sector and it has really been something that is part of this normal cycle. When we go through a cycle like this, the FHA steps in as private capital has to be husbanded more to take care of the losses that we see in the marketplace.

So what we have seen is the FHA has had more expansive guidelines. The government raised their loan limits back in late 2007, I believe. The GSEs increased their pricing, which has driven more business away from the conventional market towards the FHA. The GSEs have had extensive repurchase activity with their lenders. I think that has further driven lenders to choose FHA execution and frankly, we adjust our guidelines as an industry. And in particular, some of the declining -- from a declining market standpoint, where we saw serious price declines back through the early stages of the cycle.

Now to your point, transitioning and going forward, the private mortgage insurance industry has significant more capacity. The last week or so has reinforced that further with some of the capital raises across the sector. Our industry has begun to expand guidelines and do market expansions. We did do that at Genworth. As you reported back in the fall, we had two moves back in the fall. We also announced, at the end of March, an additional move that was referenced in some of the preliminary comments. That will bring business back to us.

There will be -- the FHA is very focused right now on increasing their pricing to manage their risk exposure, as well as some of their own capital challenges. The first round of that has already been implemented in early April where they increased their upfront pricing. The second level of that is going through Congress right now and requires statutory approval where their plan right now and their design is to increase their annual rate.

When those two things happen, as an industry, just FHA to private mortgage insurance, we will be very competitive with the FHA. I would then ultimately expect, as the government begins to transition to an exit strategy away from being the only liquidity in the sector, that you will see gradual returns to the previous loan limits, possibly through the FHA, again driving more business back into the conventional market.

And then lastly, the GSEs, I believe, have been a big influence on what, as I mentioned earlier, in terms of the business going to FHA and also as mentioned earlier on in our call, the capital improvement in the industry really sets up an opportunity for them to reassess their pricing so they can participate in some of this improved credit quality business available.

So I think those are the big pivot points that we are going to see as we go forward and this is exactly what happens in this industry when you go through these cycles. You can look back on it historically and that is what we have seen in the past. It is operating the way it is currently constructed.

Eric Berg - *Barclays Capital - Analyst*

That was very comprehensive. Thank you. My second and final question relates to Lifestyle Protection. I think, Pat, you described an environment of sort of crosscurrents with a sharply improved environment in parts of Europe, but a still challenging environment in the Nordic countries and problems with a particular product. How is all this going to, in coming quarters, play out? You mentioned it in passing. I didn't quite get it. With many moving parts, new distribution relationships, problems in some places, success elsewhere, how do you see results playing out, however specific you would like to be, in Lifestyle Protection in coming quarters? Thank you very much.

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

Eric, it's Mike. I will take that, give you a couple perspectives. First of all, going a little deeper on what are the trends we have seen, you saw things like the factors from unemployment pressures sort of move from West to East and then from East to North. So you have seen some staging of that overall.

Specifically, maybe one way to help you think about this is sort of what is the run rate of the business and you had a strong fourth quarter as far as improvement direction; I should point it out that way. There were some one-timers in there that aggregated about $7 million, including some tax favorability. So then you would say, well, help me get from sort of where we are, about a 12 to a run rate and you would have sort of a one positive influence and you had two negatives and the negatives will see some shifts in them. The positive has been repricing. We have done extensive repricing for risk purposes. As I mentioned, that has moved through most of our major relationships and that will remain a positive.

On the negative side, volume has been slow because consumer lending has been slow. And as I pointed out in my prepared remarks, that is something that we are working on very actively on multiple fronts and then we did have one block of business where, by the nature of the design, we saw some adverse selection. And one thing that, as we drilled into that, identified that, certainly you use various levers, including certainly a price change lever to deal with that, which will improve that performance as that's monthly premium product and you can re-price that immediately and get a lift.

So you put all of those, sort of the positive and the negative factors together, and that gives you about a $3 million to $4 million benefit on your run rate there off of the $12 million you saw in the first quarter and that is the way to think about the recovery profile of the business as you look at 2010.

Now as we move into 2011, we expect further improvement because you are seeing that hitting that peak of claims that impacts specifically your unemployment product and to a lesser extent the accident and sickness product. And you have the benefit of all the price increases and we expect a number of our growth initiatives will more fully kick in as that unfolds through the rest of 2010 and you have more of a full-year 2011 impact. So I expect that improvement to continue as we move on into 2011.

Eric Berg - *Barclays Capital - Analyst*

Very helpful as well. Thank you.

Operator

Mark Finkelstein, Macquarie Securities.

Mark Finkelstein - *Macquarie Research - Analyst*

Good morning. A few questions; I think they are all quick. Firstly, Kevin, what is your outlook on severity in flow in USMI? Sequentially, it went up a little bit, which is kind of a change in the trend. I guess what is your severity expectation going forward?

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

Yes, Mark, as we calculated, our severity moved up slightly, as you indicated, in the quarter to 109%. If you think about it on an average claim paid standpoint, it was really rather flat in the flow business and some of the bump in that severity was driven by the bulk settlement that we announced both at the last quarter and it's also talked about in our press release.

I continue to feel, as we have stated, that our severity is operating --it hasn't trended up significantly and is operating well within the range of our expectations and the further away from the cycle we get, I think the more potential favorable benefit you might have to that as the economy begins to cycle and as home prices further strengthen.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, just on Canada and the recap in Canada, is the $350 million that you talked about, is that above and beyond a normal dividend or does that incorporate a normal dividend for Canada?

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

This is Pat, Mark. That $350 million is above and beyond the normal dividend from Canada.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, great. And then finally, Pat, US life company RBC at 385%, I guess what is your current view on whether the Company will be self-funding or you may want to put capital into the Company from the holdco?

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

I will go back to our December investor day. Our capital plan, which we are right on, does anticipate dividends starting in 2011 and in 2012 from the US life companies and we are making nice progress towards that result.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, so your current expectation is not putting any capital into it in 2010?

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

That's correct. We made the change that -- or the capital contribution we did last year-end and we feel and still feel that that was sufficient to fund the incremental growth opportunities associated with our plans going forward.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, thank you.

Operator

Steven Schwartz, Raymond James & Associates.

Steven Schwartz - *Raymond James & Associates - Analyst*

Hey, good morning, everybody. A few also, I hope to be quick. Actually, the first one may not be. I am looking at the Lifestyle Protection and you are talking about the Nordic countries and the loss ratio heading up and maybe I am just not understanding the accounting here, but the loss ratios itself for the entire business were pretty much in line with what they were in the fourth quarter. If I was to point to something that would be a shortfall, it is what you have got allocated for interest expense. So I was hoping somebody could possibly explain that to us.

I was also interested in the Aussie reinsurance and whether that was being put on in order to have the capital there to do more business or is that being put on because you are thinking things may be as good as it gets?

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

Pat, do you want to start out on the first one, please?

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

First, with respect to interest expense, I should explain that some of the Lifestyle Protection contracts we have are reinsurance of captive business from banks. It's a mechanism for getting it and some of those reinsurance contracts are sufficiently risk remote, that they are accounted for on a deposit accounting basis. So when interest expense rises, it also means you are seeing increases in investment income as the margins come through as the difference between the two. So if you see interest expense rise in that business, that is generally a good sign we are seeing more profitability or more business coming through on the contracts that do not qualify for risk transfer.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay.

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

From a loss perspective, I will go back to last year and look at the situation that we had in Ireland and Spain and the repricing that we did starting in the second quarter. From my perspective, I am very pleased with the results. In fact, by the first quarter, post repricing and given the situation in Ireland, we have returned underwriting margins to positive for Ireland. So the approach that we are taking is certainly producing good results and I believe it will also produce good results, similar results in the Nordics.

When you look at the loss ratios by themselves, it is hard to just look at that and draw a conclusion because the different contracts that we have have different degrees of profit sharing, so we generally look at it in terms of how well we are doing from an underwriting perspective, which will include the cost of profit sharing and when that is factored in, even though the losses appear stable, they were higher in some areas and lower in some other areas, then when you factored in the cost of profit sharing, what flowed through was the claims in the Nordics that Mike described. Does that cover your question?

Steven Schwartz - *Raymond James & Associates - Analyst*

So if I can follow-up, Pat, would we see that then in --? Would we see that? Would we see that in the expense ratio?

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

That is correct.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, all right, so that explains that. And then on the Aussie reinsurance, the reasons for that?

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

It's Mike. Just think of it on two fronts. One is it does contribute to optimizing your capital structure. We think there is a lot of growth, attractive growth still to go. The market will slow this year given the pullback of stimulus on the rise of rates, but there is still good growth opportunity in the market as there is a lot of housing demand. In fact, some of the construction is trying to catch up to the demand.

And secondly, it is just good discipline from a risk standpoint, having a diversified reinsurance base. And remember reinsurance and mortgage insurance on a global basis is relatively new. So when you think longer term, it is attractive to develop a whole set of reinsurers, introduce them to a market in various layers and forms so that as you look out over the next 5, 10, 15, 20 years, you have much more of a reinsurance participation in managing both risk and capital for our various platforms.

So this is just the first one that I think people can quite clearly get their arms around, but I would expect that to broaden out in other platforms over time and I think we will be a leader in helping that happen given our global experience.

Steven Schwartz - *Raymond James & Associates - Analyst*

If I can ask one more. On the persistency on the life side of the business, my presumption here is that this was a fire sale business written before XXX came in. Would that be correct?

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

Yes, it's 10-year policies at the end of a level term period. We did see it last year. We tended to see a little bit of a spike in the first quarter and it improved through the year. And I am kind of expecting it again this year. So from my perspective, an expected a normal statistical variation.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, great, thanks.

Operator

Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Hey, guys. Question, the House Financial Services Committee passed a bill a couple days ago basically letting the FHA increase their premiums up to 1.5%. Can you comment on that because one of the reasons you guys have been losing share is they have been underpricing both on the level of risk they are willing to do and the price. If they increase their price, and it seems like there is pretty broad support for that, would that give you further justification to increase your pricing as well?

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

Kevin, why don't you take that, please?

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

Good morning, Jordan. I would not, to begin with, I would not about it as further justification for us to increase our price. Basically what is happening is -- this is what I alluded to a bit earlier. They have had the ability to raise their upfront pricing, which they have done. They need statutory approval to raise their annual fee, which is what this bill is designed to accomplish, so that they can both adequately price for the risk and support their own challenged capital levels right now.

So the way I see this is this will make us very competitive with the FHA if this gets passed and ultimately implemented. It has still got to go through and get Senate support. Still got to get Senate support, but I think what it really does is it reinforces the price point that we are at in the marketplace today. The FHA is acknowledging essentially that they are underpriced for the risk and once they drive and get this annual fee introduced, again, we will be largely competitive.

The biggest driver between the business though continues to also -- the additional big driver of why they have gotten more business continues to be the GSE's pricing and again, as alluded to earlier, now that capital is more visible and there is capacity in this industry beyond our own to support these writings, we think there is opportunities for both of these to really move in the right direction. The GSE back down a little bit, the FHA, as you described, heading up and we will get back to a more sufficient market size to take advantage of the share levels and the relationships that we have today.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Do you see any opposition in the Senate? It seems like it is passing the House pretty strongly?

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

Too soon to call, Jordan. The issue is the Senate has got a lot going on right now. There is a few other things they are focused on. So this ultimately once this makes it through the top of the list, we would expect support there as well.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Okay, thank you very much.

Operator

Bill Drew, Harbinger Capital.

Bill Drew - *Harbinger Capital - Analyst*

With all the GSE putbacks taking place, have you had any large mortgage lenders cease using private MI?

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

Cease using private MI?

Bill Drew - *Harbinger Capital - Analyst*

Right.

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

Is that the question?

Bill Drew - *Harbinger Capital - Analyst*

Yes.

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

I think over time, there has been a shift from the conventional market to the FHA market that I have seen. I don't have anybody in particular that I am aware of that is not doing any MI loans.

Bill Drew - *Harbinger Capital - Analyst*

Okay.

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

No.

Bill Drew - *Harbinger Capital - Analyst*

Okay, thank you.

Operator

Donna Halverstadt, Goldman Sachs.

Donna Halverstadt - *Goldman Sachs - Analyst*

Good morning. Most of my questions were asked, but I did have one small question related to your investment portfolio. You told us how much exposure you have to the sovereign debt of Greece and Portugal. Do you have any exposure to the debt of banks in any of the southern eurozone countries?

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

Let me turn that over to Ron Joelson.

Ron Joelson - *Genworth Financial, Inc. - CIO*

Hi, thanks for your question, Donna. We do have some exposure to banks, primarily in Spain, but where we have that exposure, it tends to be with banks that have global operations. In fact, the way we look at exposure when a parent company is located in Spain, it kind of gets included in that bucket, but in the particular case I am talking about, the operations are actually all over the world. So it is really not significant in terms of the pure credit exposure.

Donna Halverstadt - *Goldman Sachs - Analyst*

Okay. And just so we know, what is the par amount of that exposure?

Ron Joelson - *Genworth Financial, Inc. - CIO*

So the par amount of that exposure is about $150 million. To give you a sense for our overall exposure to some of these countries that are in question, the overall unrealized loss on all of our exposures to Portugal, Greece, Italy and Spain, the unrealized loss number is only about $16 million. So it's pretty small.

Operator

[Chris Owens], Trafelet.

Chris Owens - *Trafelet - Analyst*

Good morning, everyone. My question is now that 28% of your delinquent loans in your MI business are under some sort of HAMP modification, what are the internal tests that you guys are looking at to decide if you want to book any future benefit for those delinquencies?

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

Let me turn that over to Pat.

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

Thanks for your question. What we look at is we look for, I will say, persistency as trends change. So for example, we saw a significant increase in the cure rates relating to both HAMP modifications and other modifications generally. And from a reserving perspective, until we see that, I will say, persist for at least another quarter, we wouldn't let that influence our reserves, but we would contribute it or we would consider it at an appropriate time. I'll turn it over to Kevin Schneider for his perspective on this.

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

Yes, Chris, this is just a -- your question is around an issue that is still in its very early stages. Based on -- when you think about traditional modifications and traditional modifications did not lower borrowers' payments. And in fact, sometimes they increased their payments because they took arrearages and threw it into the size of the mortgage and then maybe extended the amortization. So traditional modifications based on our experience have redefaulted at a rate of 55% to 60%.

What we are seeing now is these HAMP modifications and importantly -- we haven't really talked about it -- but importantly, growth of some additional alternative modification programs, new programs that basically are operating very much like HAMP, also driving the same type of borrower, average monthly payment reduction, really designed to get the borrower to be able to cash flow the loans. We are seeing those have a lower redefault experience and I know it is really early right now, but I would say, our early reads right now are in the 20% to 25% range. Longer-term expectations are that could trend up to 30% to 40% type range, but at this point in time, we just need to see the experience. Once we see it, once we observe it, we will address it at that point.

Chris Owens - *Trafelet - Analyst*

Okay, great. The other question was you had mentioned that your cures on average are coming from earlier delinquency buckets. So what is your average reserve release on a cure look like relative to your average total reserve?

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

I think you just need to, as a rule, look back to our average reserve per delinquency that is reported in our findings today. And I think our reserve per delinquency on the quarter was about 18.9 in total. The earlier ones might be a little less than that on the cures if they are hitting the earlier stage cases.

Chris Owens - *Trafelet - Analyst*

It is roughly in line, maybe like 15, 16. Would that be a fair number, 15,000, 16,000?

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

I think it might be a little higher than that, right in that range.

Chris Owens - *Trafelet - Analyst*

Okay, thank you very much.

Operator

Suneet Kamath, Sanford Bernstein.

Suneet Kamath Thanks and good morning. Two questions. One for Kevin on comments about the FHA and the expectations that this cycle is going to play out similar to past cycles in terms of them stepping up and then pulling back. And I guess my question is why are you so confident that that will be the case? It just seems to me that everything about this mortgage cycle has been different, more severe, much faster than anything that at least I have seen or we have seen in the past. So why are you so confident that this is not the cycle that sort of changes historical patterns that we have observed? And then I will have a separate question.

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

To clarify, between the -- the dynamic between the private market and the government market?

Suneet Kamath Exactly.

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

Well, I have no crystal ball. My opinion is that the government is beginning to get focused on beginning to put together an exit strategy where they are not the only liquidity in town for mortgages. In our early -- you are also beginning to -- number one and secondly, we are beginning to see early indications on our application trends and -- we call them our commitment trends and the FHA's application trends.

So we are beginning to see the impact of some of the early price increases they have instituted that went into place at the beginning of this month. They are tightening up their risk parameters. They are very engaged and focused on the additional price increases that they need to get to. And I just think at the end of the day, there is a need to have private capital in the system. And the only capital in the system, from a taxpayer perspective, have it be public capital is not a good outcome for the country.

Our model, in fact, has worked through this cycle. It has worked exactly as it was designed to work and I think ultimately policymakers are beginning to understand that. So that is the nature of my confidence there. I do think longer term one of the other things that this cycle may provide for us is an opportunity to think about a longer public-private type solution to Mortgage Insurance in this industry and we have begun to have some of those discussions in Washington as well.

Suneet Kamath - *Sanford Bernstein - Analyst*

But is it just impossible to think about a situation like I guess in Canada where you have one or two players and then the government is a big player as well?

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

It's Mike. I just want to give you a little color on this. First of all, the observations that we have shared are not theoretical in nature. We spend an awful lot of time on the ground in Washington at a very granular level. So we are not just dreaming perspectives up. We are reflecting a mosaic of discussions. So that would be observation number one.

Observation number two is when something works, you usually try to do more of it and the private mortgage insurance industry worked. I mean if you look at the reserving methodology, if you look at the claims paying ability, first dollar loss coverage, it did exactly what it was supposed to to absorb an enormous amount of losses and that perspective is not lost on policymakers.

So more of the dialogue is shifting to capacity is we want you back in, we don't want to take all of this risk, demonstrate the capacity because that is a timing consideration of adding private and public capacity to the housing financial system so it doesn't constrain the capital that needs to come and support a housing, continued stabilization and recovery.

So as I noted and Kevin noted, it has been quite positive to see all of the strategies that have been pursued in the industry to bring that capacity. But there is an education step to remind all of the policymakers of how much that capacity add up to and therefore, if the government programs step back, that then indeed you are coming into that and that is a very active education process.

Finally, going back to your specific point, I do think that we learn things through cycles, both companies, as well as folks on the governmental side learning things. And there can be some neat opportunities to look at of hybrids of having the private industry upfront and having the government more in a public-private partnership providing additional reinsurance capacity in the back that is a little different than, but has some very clear analogies to Canada, but it doesn't replace a private industry. It lets it do what it does best, be on the front lines, do the second underwrite, support mortgage lending, but make sure that there is enough capacity through up and downcycles and that is the way you need to think about it.

Suneet Kamath - *Sanford Bernstein - Analyst*

Very helpful. Thank you. My second question again goes back to the Lifestyle Protection business. We've talked about bank exposure to the overall European troubled sovereigns, as well as direct exposure. Does the Lifestyle Protection business have a lot of exposure in those countries? Thanks.

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

The answer is it doesn't have a lot. We have a small, but very profitable business in Greece specifically. But as far as -- think about it on a percentage basis. Maybe 1% of your exposure would be in Greece and low single digits like 8% around Portugal, but we monitor that very closely, but that is not the risk factor that I would focus on if I were in your shoes.

Suneet Kamath - *Sanford Bernstein - Analyst*

Appreciate the answers.

Operator

Mike Grondahl, Northland Securities.

Mike Grondahl - *Northland Securities - Analyst*

Thanks for taking my question. On the marketshare, last September, you were about 9% in the US MI business and I think now you are around 17%. Where do you see that going? And then secondly, the opportunity or the potential savings from HAMP modifications was 28% of your delinquent loans in that program. I mean is that still a big opportunity for savings? Could you just kind of scope that a little bit for us?

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

Let me hand that off to Kevin.

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

From a share perspective, I think you should think about us operating in an industry that currently has six players moving to seven and a 20%-ish type range, something like that. I think when you start heading too far beyond that, you are doing things -- it drives you to bad practices. So I think that is directionally where you should expect us.

And just to recall, that low point last year was in part a conscious decision while we managed through the execution of our capital plan, as well as to gain greater transparency into really what was the stability of the housing market. So once we got more comfortable with that, got the capital plans in place behind us, saw the markets beginning to improve, that has allowed us to expand up to the levels we have seen today.

Secondly, as it relates to HAMP and as I mentioned earlier, other modification programs that are emerging, again, I can't give you a good handle on the number. I will tell you, as we said back in December at our investor day, ultimately this year, we expect our overall loss mitigation benefits to be sort of consistent with the range we had last year. Increasingly, we are seeing more and more of that come from loan modifications as we get more of the investigation and rescission activity behind us. So I continue to be cautiously optimistic about the opportunities for modifications going forward.

And the government continues to lean in and provide new changes to the type of modification programs that are available that are really designed to get at people that the initial HAMP programs didn't touch.

Mike Grondahl - *Northland Securities - Analyst*

Great. Sounds good. Thank you.

Operator

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.