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GNW - Q3 2010 Genworth Financial, Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen and welcome to Genworth Financial's third-quarter earnings conference call. My name is Melody and I will be your coordinator today. At this time, all participants are in a listen-only mode. We will facilitate a question-and-answer session toward the end of today's 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 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. - SVP, IR*

Thank you and good morning. Thanks for joining us for Genworth Financial's third-quarter 2010 earnings conference call. Our press release and financial supplement were released last evening and are posted on our website and we also posted some supplemental materials on our website that details loss experience in the US Mortgage Insurance business. Again, this quarter, we will also post management's prepared comments following the call for your reference.

This morning, you will first from Mike Fraizer, our Chairman and CEO and then Pat Kelleher, our Chief Financial Officer. Following our prepared comments, we will open the call up for a question-and-answer period. Kevin Schneider, President and CEO of US Mortgage Insurance; Jerome Upton, Chief Operating Officer of our International segment; and Ron Joelson, our Chief Investment Officer, 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 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 the Risk Factors section of our most recent annual report on 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 helpful to investors. In 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 International segment results, please note that all percentage changes exclude the impact of foreign exchange. In addition, we will today discuss the Canadian Mortgage Insurance business and it will 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 & CEO*

Thanks, Alicia and thanks, everyone, for your time today. We made important progress in a number of key areas in the third quarter while navigating a tough US Mortgage Insurance environment.

International earnings showed strong growth with improvement across our Canadian, Australian and European Mortgage Insurance platforms supported by better economic conditions in Canada and Australia. We also saw a turn in Lifestyle Protection earnings, reflecting lower losses and improved pricing.

US Mortgage Insurance had a disappointing quarter from the standpoint of the move we made to strengthen Florida reserves. At the same time, we continued to experience favorable trends across other areas led by delinquencies and loan modifications. Specifically, we saw improving trends in delinquencies, which outperformed expectations of a seasonal increase, demonstrating additional burn-through of exposures associated with the 2005, 2006 and 2007 books.

Turning to loss mitigation activities, the bulk of benefits now come from load modifications as expected with clearly improved rates of redefault. Looking ahead, we believe servicer-based loan modification programs should continue to ramp up as only a few servicers are hitting full stride here and we will work intently to support these.

And we are also seeing gradual improvement in the size of the private mortgage insurance market and competitiveness versus the FHA. However, the dynamic of late-stage delinquencies being tougher to cure with more going to foreclosure is real, so we have to keep working to deal with it and work to offset it. Pat will provide more color across these areas in his remarks.

Turning to Retirement and Protection, we had mixed performance. Sales were strong, particularly in life and Long Term Care insurance, along with positive net flows in Wealth Management. Earnings were solid in Long Term Care insurance, but remained lower in life insurance, impacted by the higher lapses we have been seeing on certain term policies, higher life reserve funding costs and sound mortality performance, but at levels not as strong as experienced in the prior periods.

This morning, I want to focus on four topics. First, highlight two examples of how we are driving growth and investing in targeted areas; second, update you on actions we continue to take to improve in force performance, most recently focused on our old block of Long Term Care insurance; third, provide an update on the housing regulatory front; and finally, provide perspectives on our medium-term return-on-equity targets.

Let's begin with where we are investing in key growth areas that support earnings and return expansion. As a reminder, we see organic growth from our existing business platforms as our biggest opportunity, complemented by two additional strategies -- targeted, small, bolt-on acquisition opportunities that fit with existing platforms and in particular at Wealth Management and collective entry into new international markets, which we think have strong future growth and profit potential where we bring established capabilities.

To drive organic growth, we focus on three fundamental agendas -- introducing refreshed or innovative products, driving distribution penetration and expansion, and improving value-added support services. Our new life insurance line, that is more capital efficient, has reflected all aspects of this organic growth agenda and it shows in the sales numbers. The productline has been totally redesigned with a few more additions to come. Producer penetration is up and we have supported this with improved application processing and underwriting approaches.

You also saw an example of how we are using targeted, small acquisitions to accelerate growth in our Wealth Management business. Here, we announced plans to acquire Altegris, a specialist in alternative investments, which will broaden our offerings to financial advisers. This is a great opportunity to enhance our competitiveness with advisers and their high net worth clients.

Turning to actions we take to improve in force performance, you saw the benefits come through more clearly this quarter of our repricing and contract restructuring actions in Lifestyle Protection. In addition, last week, we announced plans to increase rates on two of our older blocks of Long Term Care insurance policies, which would improve the overall earnings profile in that line. This is our second price increase on these blocks of business.

Similar to the actions we took in 2007, we plan to increase price responsibly, in this case by 18%, and are taking this action based on the lower termination experience we have seen in these older policies. The price increase will affect about 25% of the premium base, which will feather into earnings starting in 2011 with the full impact seen in 2012. Going forward, Genworth will continue to look for opportunities to improve the performance profile of our older books of business.

Turning to regulatory developments, the dialogue around housing policy reform in the United States picked up steam in the quarter and included what roles should exist for the GSEs and whether there are better designs for such entities, the importance of conservative mortgage underwriting, the role of first-time home ownership, the importance of securitization to the housing market and implementation of the qualified residential mortgage provision of the Dodd-Frank bill.

The Treasury Department regulatory bodies, including HUD and FHFA and the legislators, are central to this debate, the outcome of which remains open, but will determine the path forward for housing finance. The mortgage insurance industry and Genworth are participating actively in Washington providing important data and perspectives in this dialogue, as well as working to shape the policies that will be implemented in coming years. Throughout these discussions, the value of private mortgage insurance and the role of mortgage insurers were highlighted and clearly reinforced, which should be a positive for the industry.

Finally, turning to ROE targets, we assess the progress we are making towards our medium-term operating return on equity targets on an ongoing basis and in view of the current environment. In that context, we are taking a more cautious view towards the timing of reaching our interim total business operating ROE goal of 10% initially targeted for 2012. We will provide a more detailed view into our earnings drivers and return targets at our December Investor Day.

At this point, we expect that achieving the overall 10% ROE level will take longer than previously estimated given the dynamics and trends to date in the US platforms with business segment level ROEs showing different ranges of performance.

We have seen good earnings momentum and growth in returns in the International segment supported by recovery or stabilization in these markets. International has certainly tracked our expectations. Retirement and Protection earnings have stabilized, but have not yet transitioned to the growth rate we want to see. The overall dynamics in US Mortgage Insurance remained reasonably within expectations, but there are several market dynamics outside our control that impact market recovery timing, including recent foreclosure trends, activity around foreclosure suspensions, softness in home prices and a sizable inventory overhang. We still view 2011 as a transitional year from an earnings perspective in US Mortgage Insurance, however, the specific timing of a return to sustained quarterly profits is less clear given these market dynamics, so we must see how these play out. In sum, we look forward to giving you a more detailed update in December.

Now before I turn it over to Pat, I wanted to comment on some management shifts we communicated during the quarter. As you know, Pam Schutz had announced her retirement earlier this year effective February 2011. So we were pleased to announce that Pat Kelleher will be transitioning to lead the Retirement and Protection segment. Pat has been instrumental as Genworth navigated the financial crisis and will bring his strong finance, product management and actuarial background to the segment at an important time.

We are in the midst of an external search for a new Chief Financial Officer and in the interim, Pat will remain in his current position and work with Pam on the Retirement and Protection leadership transition. We were also pleased to announce that Kevin Walker will join us as CFO of Retirement and Protection replacing Kelly Groh who will be leading our investment portfolio management as part of Ron Joelson's investment team. 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. This morning, I will focus on four areas -- first, sales and earnings growth in several businesses; second, loss trends in US Mortgage Insurance; third, the impact of a prolonged low interest rate environment on earnings; and finally, our capital management progress.

Let me start with sales growth. We are seeing good sales growth trends in several key areas, particularly in our leadership lines in Retirement and Protection and in Mortgage Insurance in Canada. In life insurance, sales of our new more capital efficient Colony Term UL and GenGuard UL products had strong sequential increases since the launch in late 2009. We remain number one in total life policies sold through the BGA channel and continued to make good progress expanding sales of larger face amount policies.

Turning to Long Term Care, individual Long Term Care sales increased 36% versus the prior year and here, we are seeing a rebound following declines in industry sales in early 2009. Growth has been driven by independent channels. And Wealth Management had its sixth straight quarter of positive net flows, which, combined with favorable market returns in the most recent quarter, brought assets under management to over $21 billion.

We saw a mixed sales growth in the International segment related to differences in market conditions in Canada, Australia and Europe. In Canada, flow new insurance written increased 45% year-over-year as overall mortgage market growth was robust. The market view is that originations have been loaded somewhat toward the first part of the year in anticipation of a rate increase and a sales tax increase, both of which occurred in July. Although sales continued at a stronger pace than we expected in the current quarter, they declined each month and we expect sales to continue to slow in the fourth quarter as normal seasonal patterns slow originations.

In Australia, flow new insurance written declined 36% year-over-year, driven by lower levels of government support to first-time homebuyers, a decline in high loan-to-value mortgage originations and increased interest rates beginning in the fourth quarter of 2009.

In Lifestyle Protection, we have seen the impact of lower consumer lending and have seen sales stabilize over the past three quarters. We do not see conditions improving this year and we are continuing execution of previously announced strategies to increase sales by broadening our distribution focus and more effectively mining in force books of business.

Finally in US Mortgage Insurance, we had sequential growth in new insurance written. Here, we are seeing clear indications that business has been gradually coming back to the private mortgage insurance market from the FHA, but at a slower rate than we would like to see.

Now turning to earnings growth, Long Term Care earnings were up 13% from a year ago. New business growth and improved investment income more than offset higher claims in the old block. As Mike mentioned, we are implementing an in force rate increase on a portion of the old block, which should improve future earnings.

Now given the Long Term Care market environment and recent competitor actions, we've been getting more questions in the area of interest rate exposure, new business, underwriting risk and reserving practices. And given this, I thought it might be useful to address these points.

First, regarding the interest rate exposure, we actively hedge forward cash flow reinvestment risks and about 70% of future cash flows on in force business over the next 10 years will receive yield enhancements from these programs if interest rates remain at low levels.

With respect to new business, we are planning to reduce interest rate yield assumptions in our next generation of products, continuing a trend that started several years ago. We believe our pricing and hedging strategies are appropriate for managing interest rate risk associated with our Long Term Care business.

Second regarding new business, despite near-term market disruptions, we believe the overwhelming consumer need and our approach to providing a robust portfolio of product solutions and broad distribution access will enable us to continue to grow sales.

And third, regarding underwriting, we have good practices in place, which, based on our deep experience, we evaluate and improve on a continuous basis. We have demonstrated stable trends in the interest-adjusted loss ratio and the loss ratio on the new block has been consistently favorable relative to pricing. In fact, we gave up sales to competitors to stick with our focus on preferred risks such as healthy couples.

And fourth, we actively review emerging loss ratios and trends as part of our reserving process. And supplement this with independent third-party reviews. As a result, we reflect emerging trends as they are identified. Our reserving process provides for appropriate adjustments and refinements on a timely basis. The point is, this is not something we only do every few years.

Now let's turn to Retirement Income, including fee and spread annuities where earnings also improved, reflecting the benefits of improving markets and better asset liability matching. I should note that, in this quarter, fee earnings were reduced by $6 million due to a valuation refinement impacting DAC amortization and death benefit costs.

And in our life insurance business, we have seen lower year-over-year earnings for the past few quarters. Here, three factors are influencing results. First, mortality, while below pricing, is above the very favorable levels we saw in 2009 and specifically, the term insurance mortality ratio was 94% of original pricing levels in the current quarter compared to 85% in the third quarter of last year. This reduced quarterly earnings by approximately $14 million compared to the prior year.

And second, we faced continued pressure from higher funding costs for the XXX securitizations and while this did not materially impact the year-over-year comparison as funding costs increased back in 2008, it has muted overall earnings levels and we will look opportunistically to improve the funding costs of these programs over the longer term.

And finally, consistent with the second quarter, term lapse-related costs were up compared with prior year. This is primarily related to the higher lapses at the end of the level premium period on 10-year term insurance. But as we look ahead, we would expect the near-term run rate for quarterly earnings to remain in the low to mid-$30 million range subject to normal quarterly fluctuations with the new business gradually lifting the earnings profile.

International earnings growth was strong, aided by improved market conditions in Canada and Australia and an improved earnings profile in Europe. Sequentially, market conditions in Canada and Australia were stable. As we look ahead, we are mindful of the earnings patterns associated with the single premium financial model. Specifically that premium recognition parallels the timing of loss emergence with most premiums recognized in years two through five. In Canada, we will see the premium recognition on the large 2007 book decline in 2011, which will pressure next year's revenues. This will rebound over time as larger books of business are underwritten.

In contrast, we anticipate moderate premium growth in Australia during 2011, which is aided by a larger 2009 book.

In Lifestyle Protection, earnings improved nicely for three reasons. First, loss experience has improved with the loss ratio declining to 17% in the quarter compared to 27% a year ago. Second, the in force pricing and distribution contract changes we made in 2009 and earlier this year are providing the lift we expected. And finally, Lifestyle Protection earnings benefited from about $7 million of lower taxes in the quarter. Looking ahead and excluding the favorable tax item, we would expect earnings improvement overall with some quarterly choppiness.

Turning to US Mortgage Insurance, as we expected and discussed last quarter, earnings were below the levels we saw in the first half of the year and we expect that to continue in the fourth quarter. Let's take a closer look at third-quarter loss development starting with the biggest driver. $85 million pretax of reserves strengthening on delinquent loans in Florida, a few dynamics contributed to this result -- aging in delinquencies, lower loss mitigation savings from lower loan modifications versus the rest of the country and higher foreclosure starts and paid claims during the quarter. As Alicia mentioned, we posted some supplementary materials on our website that walk through these business dynamics in more detail.

I will offer two observations relating to these developments. First, Florida has a relatively high percentage of investor-owned properties, 16% versus 6% in our overall portfolio in the US. As a result, these loans can be more difficult to modify.

Second, there are two servicers in Florida where we saw a more dramatic increase in foreclosure starts during the quarter. These servicers in general are having relatively low success rates in completing modifications and therefore, more of these loans have proceeded to foreclosure. We are actively working with the servicers to improve modification results.

Looking past the Florida reserve strengthening, we saw results that were overall consistent with expected trends, particularly given the seasonal developments that we anticipated. Total flow delinquencies decreased 3%, primarily from growth in paid claims and lower new delinquencies. Modifications increased and this was offset by earlier-than-expected declines in rescission activity. And as a result of these dynamics and an overall shift in the delinquency inventory from early-stage delinquencies to later stage. We added a schedule to the financial supplement this quarter which illustrates this trend.

We now expect the delinquency aging to gradually increase the average reserve per delinquency as the late-stage delinquencies move through the claims process over the next several quarters and we expect paid claims to trend up as they did this quarter.

In total, loss mitigation savings declined to $158 million in the quarter, bringing the year-to-date amount to $608 million. Looking at the full year and considering the lower level of new delinquencies, we now expect to be at approximately $750 million below the $847 million in 2009.

We continue to expect savings to be more heavily weighted to loan modifications from rescission and we are seeing encouraging trends in redefault rates on modified loans with current redefault experience of around 30% compared with much higher historic redefaults on modifications.

To wrap US Mortgage Insurance, while we are encouraged by trends and new delinquency development and early signs of improved new business, some clear headwinds remain. Our self-contained capital plan remains within expectations. The risk to capital level is right in line with our capital planning assumptions as these plans were based on a relatively conservative outlook. We will continue to manage prudently through a challenging mortgage market.

Next, I wanted to review the potential impact to Genworth of a prolonged period of low interest rates. For context, our mix of housing and Protection and Retirement business positions us well to manage a period of low interest rates on a relative basis. Within our Protection and Retirement businesses, our product mix has relatively small exposures to interest-sensitive deposit-type liabilities. The largest exposure to deposit-type liabilities is our single premium deferred annuity portfolio with approximately $11 billion of account values.

Here, our assets are matched with our liabilities from a duration perspective with less than one quarter mismatch. This means that we are well-positioned to preserve spreads and protect against the impacts of lower lapses in a low interest rate environment.

That said, all longer duration insurance products have exposure to changes in interest rates over time. Our biggest such exposure is in our Long Term Care insurance products, which I touched on earlier where the duration of the liabilities is around 25 years, making it impractical to match closely with appropriate assets. Here, we have enhanced our asset liability matching strategies using derivatives to lock in future reinvestment rates that are consistent with our pricing requirements. In total, these positions are worth approximately $2.1 billion as of September 30. They reside in the balance sheet in accumulated other comprehensive income.

Given this, it is clear that a portion of future cash flows in Long Term Care are unhedged and a prolonged low interest rate environment would impact GAAP earnings. If rates and credit spreads were to remain at current levels, I would not expect a material impact on Long Term Care earnings this year or next. The impact would build over three years to about $20 million to $30 million after-tax impact to GAAP earnings in year three.

Turning now to capital management, we are pleased with the sound capital ratios at our operating companies. We are successfully executing our plans to meet and provide for obligations at the holding company. We currently have $1.3 billion of holding company cash and short-term securities. We received $182 million in dividends from our operating companies during the quarter. In total, we expect about $350 million in operating company dividends during 2010. As we look to 2011, we see multiple sources and good flexibility for holding company dividends from our operating companies. In sum, our operating businesses remain well-positioned to support operating and parent holding company capital plans going forward.

Looking ahead, we remain focused on four levers to drive improvements in our returns -- profitable new business growth, optimizing investment performance, ongoing risk management, including loss mitigation, and finally, effective capital management. We look forward to providing you with a more detailed update on our business and financial targets at our December Investor Day. With that, I will open it up to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Finkelstein, Macquarie.

Mark Finkelstein - *Macquarie Research - Analyst*

Good morning. I guess I just want to explore the Florida a little bit more. I guess it feels like we are kind of catching up to a deteriorating experience. And I guess can you just walk us through how you feel comfortable that the reserve levels have fully caught the emerging trend and that you are comfortable that this shouldn't be a quarterly issue that we have to deal with?

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

Good morning. This is Kevin Schneider. In Florida, as you are aware, we strengthened reserves by $85 million to account for the specific characteristics of loan inventory that we saw there. What we really saw happening in Florida is the reserve strengthening was based on a recent observed experience that we witnessed in the quarter. And basically, we more heavily weighed and reflected our provisioning for that recent observed experience.

Unlike the rest of the country where, as modification and cure development in earlier stage delinquencies based on our recent experience and then the aging challenge of loans throughout the rest of the country, those largely offset themselves from the rest of the country. In the state of Florida, that was not the case. Florida had a much higher level of foreclosure development we saw in the third quarter. And we saw rescission activity trailing off in Florida that had, in fact, been quite strong in the first two quarters of the year.

Our foreclosure development in Florida in the second quarter, for example, actually had declined from what it had been in the first quarter and so we saw a reversal of that in the fourth quarter.

So I would say what we did is we reflected the actual experience we saw. Rescissions declined more than we expected. Modifications across the rest of the country were generally very consistent with what our expectations were, but you didn't get the same level of modifications in the state of Florida.

So when I think about further pressure, to your question, to reserve development in Florida, again, we actually strengthen our reserves to more heavily reflect that recent experience, so we think we are adequately reserved there. But we are going to need to watch the observed experience in the quarters ahead and see how this continues to play out. For this point in time based on our best estimate, we think we are right on point and we don't really see any other states right now that have any similar characteristics.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, that's very helpful. I guess how should we think about the reserve per delinquency generally? It went up about $900 sequentially. Obviously, this had an impact. I guess how do you think -- how should we think about that trending going forward?

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

I think you should think about the reserve per delinquency trends very similar as they continue to -- as loans age and ultimately go through to claim, those that go through to claim, there will be some pressure to that reserve per delinquency level. You could see that continue to trend upward until those losses come off the back end of that inventory and you start taking down the heavily, more heavily reserved delinquent loan population. So I would expect to see some incremental pressure to that number over time.

The modifications and the work on that is having a higher impact on loans that are in earlier stage and therefore, have less reserves per delinquency up against them and so that will continue to pressure the lower delinquency levels. And so on a mix basis, you are going to have some pressure to that number until we get over the hump on this paid claim basis.

Mark Finkelstein - *Macquarie Research - Analyst*

Okay, all right, thank you.

Operator

Steven Schwartz, Raymond James and Associates.

Steven Schwartz - *Raymond James & Associates - Analyst*

Hey, everybody. Two questions. One, a follow-up. Kevin, looking at the burn-through of the delinquencies, when they should pay out, when do you think that hump is?

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

I do believe that we have seen, as we have talked before, a peak in the new delinquency development for the tougher books of business that we have been working through. The experience we are seeing right now, as we work into the fourth quarter in a period where normally you would have a lot more seasonality headwind, we are seeing that it looks like that kind of burnout exists there and those delinquencies, while the new delinquencies while still up are not up at the level we would expect them to be up.

So I think a lot of it is based on, in this burnout, is really going to be dependent on what happens with this foreclosure issue we are looking into, whether that holds things up a little bit in terms of ultimately playing through and all the claims curing. I would expect that to be somewhere in early 2011, but there is a lot of uncertainty in the market right now in terms of when are all these foreclosures going to be perfected? Are we going to have to restart some of them and run through it again? I think that is really the level of uncertainty that we are facing into.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. I tried to get at this last night and couldn't. The way the reserving works -- I mean the delinquencies I guess didn't cure or not curing as fast as you thought in Florida. The reserve per delinquency is obviously up. You took a hit this quarter. I guess the question is, just looking at the Florida book of business, how does that affect loss recognition going forward compared to what you were thinking before, all else equal? Do you take it now and then you go back to a normal pattern or does the reserve indicate that the losses in Florida are going to be higher going forward even without the (multiple speakers)?

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

Yes, thank you. The way we think about it is this further strengthening of reserves here has not impacted our ultimate expectation of overall losses. Our trends across the rest of the country continue to be very in line and very consistent with what our expectations would be on this development right now. In fact, news are running a little favorable to what our expectations have been.

So just to get back to it, this further provisioning and this further strengthening could largely be a timing issue and we will have to see how that plays out if there is further development in the fourth quarter. But I don't see it as further eroding our ultimate claims expectation, rather further strengthening based upon the observed experience in Florida.

And then the other thing we are really focused on is working with these servicers to work on making sure we are getting after the modification strategies and helping them support their modification strategies because what we saw in the quarter was simply a real significant acceleration of foreclosures, particularly in Florida.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. Doesn't it -- if you think -- what am I missing here? If you think the losses -- the ultimate losses you are going to have to pay haven't changed and you took a reserve hit now, does it follow that losses going forward would be less than they would have been, all else equal?

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

I don't think it has any real impact at this point in time on our overall loss expectation. What we had been seeing in our observed experience in Florida was we were getting significant benefit in Florida from rescission activity. We were getting significant reasonable benefit overall for modifications across the country. What we saw, a transition in Florida, was some reduction in -- the foreclosures went up, the rescission activity did come down more than what we had expected. We had expected that to taper off over the course of the third and fourth quarter. We got a little bit of acceleration on there and now we are -- we just feel like we are more adequately provisioned based upon that emerging experience that we saw in the quarter.

So there were some changes in Florida. Foreclosures were up there more than they were anywhere else in the country and we think we have modeled for that in our provisioning.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. And then if I may, just a quick switch to the life insurance and the DAC issue, the DAC amortization issue. The DAC amortization is being fed by the '99 and 2000 books, the fire sale pre-XXX books. As we move into 2011 or maybe it's 2012, does that shock lapse kind of wear off, that people who have those policies who haven't lapsed kind of there is going to be inertia there and they just kind of hold onto them and we are done?

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

This is Pat. I will take that question. The way to look at it is, for the 10-year term policies sold in year 2000, that was the largest book that we sold through this period. The original sales were about 50,000 policies. If you look out over the next few years, the sales declined to a range of 30,000 to 40,000 policies per year. So we would expect that we would see the impacts that we are seeing in terms of elevated lapse rates, but they would migrate over time, reflecting the relative sizes of the books.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, all right. I got it. Thank you, guys.

Operator

Steven Eisman, FrontPoint.

Steven Eisman - *FrontPoint Partners - Analyst*

Yes, hi. I think it is pretty clear this was a very poor quarter, but there are larger issues here that I think you need to address. Frankly, the only accomplishment that this management team can truly point to is the survival of this Company, which I don't mean to minimize, but otherwise, this management team has overseen a massive destruction of shareholder value. In fact, at the current price to book, Genworth is selling at a steep discount to both MGIC and PMI, the pure play MIs and this is probably because this Company does not meet its cost of capital in any of its businesses.

In other words, the market currently is ascribing negative value to your non-MI businesses. It's a pretty astonishing statement and I don't get any sense of urgency from this management team as to how this is all going to be addressed. I think going down the current road seems to me a complete waste of time. Clearly, the best use of capital for this Company is to buy back stock when it is at a discount, less than 40% of book value. The ROE on that activity is multiples higher than any new business you can write.

So it seems we can go down a couple of roads. Number one, you could shut down businesses and use resulting excess capital to buy back stock or you can give us a roadmap and a time schedule, which we are going to hold you to as to when each of your businesses will achieve at least its cost of capital.

I want you to understand that my patience and the patience of your shareholders is not infinite and my patience is just about done. And I would like a response to my comments. And one other thing, at the beginning of this conference call, Mr. Fraizer said that they might do bolt-on acquisitions. Do not do that. Your stock is selling at less than 40% of book value. You do a bolt-on acquisition and I will wager a proxy battle immediately to throw you out of here. And I would like a response.

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

Steve, you've touched upon a number of areas, so let me walk through those. Clearly, we are in a transition with different other business segments at different stages of that transition. As we look at the International segment, a much clearer path, a much clearer performance trend. You can also see the path to not only earning your cost of capital in International, but in fact exceeding that cost of capital. And we will reinforce that as we lay out both where we are and where we are going in that as we walk through the Investor Day. But I think you can see that in the numbers.

Steven Eisman - *FrontPoint Partners - Analyst*

Actually, I can't. But go ahead.

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

Okay. And we will make sure we give you -- if you look at International and where we have targeted in that segment, 15% ROE by 2012, we are tracking right to that. So we will try to make sure that, in that forum, we can show all the details and levers that you and other investors can see behind that one.

Number two, if you get to the Mortgage Insurance business, clearly the transition we are going through is a frustrating one, and I share your frustration on that. But I think we are doing all the right things to bring that business back.

Now, I can't explain for you the difference in valuation if I look at that on the segment versus some other public comparables and I am happy to have that deeper discussion on the reasons for that, your perspectives on that separately. But there is a business where we did move early and others followed to deal with loss mitigation activities, to reprice business for the risk so that, as you put on new business, you can turn that business. We currently have seen a very choppy, to say the least, third-quarter set of data come in as Kevin outlined. That, as I said, is a business we will, again, see transitioned back to earning more than a cost of capital. I think we have a timing issue there given some of the factors I highlighted specifically in the market.

Thirdly, then you come back to Retirement and Protection and we have put a number of lines, such as our institutional area, into runoff to basically harvest capital from them. And what we do, if you look at capital there, is maintain capital to support the ratings and the sound level of growth, not too much, not to little, maintain appropriate risk buffers, and now I am jumping to a bit of an enterprise comment, optimize the capital structure as we look through the maturities we have in 2011 and 2012.

And then it comes -- so let me just finish then on the life business. We have to continue, at the line level, taking the actions we are. We will show the progress in Long Term Care and you have seen us move with pricing actions there and the dynamics of the old book versus the new book. The old book is about 35% of the book. The new book is now at 65% and the path of those dynamics.

The life area, because of the two factors that Pat has touched upon, has certainly been below our performance expectations, but that is also why we totally changed the nature of the product to not make it capital-consumptive as the old and to have very different margins.

Now let's get to your point on use of any excess capital and what is the appropriate use of that. First, if I look at the math, for example, and use $100 million to repurchase shares, you would get about a 5 basis point lift on today's ROE and I look at that quite carefully. I would agree with you that, first of all, acquisitions should not be a major priority or any subsequent priority for the Company beyond what it is executing with organic growth and optimizing our capital structure and maintaining appropriate risk buffers.

The one you did see this quarter was a small, tuck-in one. There is not a pipeline of those per se, but in the Wealth Management business that is the one area I pointed towards, along with where we have selectively put less than $25 million of capital looking at a few new markets in International Mortgage Insurance that we think can be the next Canada and Australia. But it has to be very modest because, after that, I would agree, as I look at any excess redeployable capital, the math is compelling on a share repurchase when you look at the book valuation.

So right now, if you step away and you look at our capital versus rating agency requirements or regulatory requirements, you would see about $1.2 billion level over those hurdles. We would hold basically -- if you look at US Mortgage Insurance, we would hold the portion associated with that to navigate this period as a risk buffer. We would hold what we have in the life businesses similarly for both risk buffers and just to operate the business appropriately at a single A rating. And the rest of that capital sits in International and as Pat has noted, there will be dividends that come in from International through the holding company, but some of those dividends will be used to address the 2011 and 2012 maturities. And you will see our debt to capital structure come from sort of the mid-20% range right down to the 20% to 21% range, which is in line with targeted coverage ratios and where we need to be.

So if there is capital that we generate beyond that as we go forward, your point is noted and accepted that, if you have that excess capital, buying shares is a compelling way to deploy that capital and you should run your other businesses for recovery. So as we get to the December Investor Day, we will certainly endeavor to walk you through with good visibility, not only each of those segments, but also the holding company, walk you through the levers and continue to take your views, as well as other investor views and execute.

Operator

Eric Berg, Barclays.

Eric Berg - *Barclays Capital - Analyst*

Thanks very much. Kevin, it seems to me that the reason that we had this issue in Florida, and quite frankly across the whole country, is that a development occurred that surprised you. You have said repeatedly, thank you for being clear on this, that rescissions came in lower than expected in Florida, indeed lower than expected across the country and it is only because you have the offset, I suppose, in the form of higher-than-expected modifications that you didn't have an earnings hit elsewhere.

Now, I can understand why this is going to happen. This is not a perfect science. I appreciate that, but you guys have been in this business for decades and reserves will be short, reserves will be redundant, no different from a bank having a shortage in redundancy of reserves, property/casualty company and so forth.

What I am interested in knowing, my question is what specifically are you doing with your team to increase the probability that, in the future -- I don't have a problem with you are not getting it right. What I would like to know is what are you doing in the future, what have you learned from this and what are you doing in the future with your guys to increase the probability, not guarantee, but increase the probability that you won't be surprised in another way? This takes us back to the question I think from Mark. Thank you and then I have one follow-up.

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

Good morning, Eric. I think the way I think about what we are doing is, as you can imagine, this is clearly an environment where we don't have total and clear visibility into all the the pipelines and what is going on with the various servicers. We endeavor to continue to try and improve upon that and that is one area specifically where we will continue to work as a management team at improving our visibility into that.

Secondly, we are working very closely with those same servicers on working to improve the modification benefits and the outcome on the various workout programs that those servicers are working on. As you can imagine, sort of across the board and across the country, if you look at overall servicing performance, different servicers have a different level of traction they are getting against this overall modification effort. And so we are working very hard to target the opportunities for loss mitigation and for loan modifications, in particular with those servicers that are a little bit below the average.

Additionally, Eric, one of the things we did here in particular is we more heavily weighted in our provisioning the actual reserve experience that we saw in this quarter. Across the entire country, you are seeing improvements in the earlier stage delinquencies. So we are very comfortable with what we are seeing there from a development standpoint. The new delinquencies are generally flat to trending better to experience.

The cures in those earlier stage delinquencies continue to develop both through self cures, as well as modifications. You will continue to have aging as things age through this population and so I think one of the real challenges here is really having clear visibility and as loans move from each successive stage of delinquency pattern. And that is something we are endeavoring to try and get a better handle on with servicers.

So I don't look at this as some huge mistake on the quarter. Clearly, we are disappointed with the results in the quarter. But when I look back on what we had been observing in Florida in the first two quarters of the year, our provisioning was consistent with what we had observed in those quarters. And so we are trying to modify it now. We think we have addressed that with what we did in the fourth quarter.

If you look at the supplemental investor materials that we shared on our website, you can see how Florida truly does stand out as an outlier compared to the rest of the states on there. Nobody has that same unique level of circumstances that we have seen in Florida. Florida has got some unique characteristics. It is a big state. It has got -- it is one of the most problematic states in the entire mortgage industry. It has got a higher investor level of content in terms of the loans and those are more challenging to modify. And so as a team, we will look to continue to address that and incorporate that into our expectations going forward.

Eric Berg - *Barclays Capital - Analyst*

I want to switch gears and ask a second and final question regarding Long Term Care. I am going to presume -- I certainly haven't interviewed a significant number of older people who are buying your policies and I know that while the age group has been coming down, it is still a policy Long Term Care insurance that is bought by older people. I am going to presume that, like anyone who buys insurance, these older people are buying them to be relieved of risk, to get an issue off their hands.

So here is my question. What is your sense of what these repeated multiple price increases are going to do for the demand of the product? I mean isn't it possible that the senior population, looking at these across-the-board repeated increases, will say this isn't helping me. If I buy this product and the industry is repeatedly hitting me with price increases, I am really not taking an issue off the table here. What is going to happen to demand for this product and sort of how are those conversations going at the agent/customer level right now?

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

Eric, let me turn that over to Buck Stinson.

Buck Stinson - *Genworth Financial, Inc. - President, Long Term Care Insurance*

Eric, a couple perspectives on that. I think that is certainly something that we are concerned about at the industry as you watch some of the original carriers and some of their pricing actions. But a couple of perspectives just on -- as we adjust premiums on these in force blocks, certainly we are taking an approach to take a responsible increase -- the increase in that that we announced back in 2007 was a range of 8% to 12%.

What we saw in that was a shock lapse of less than 1%. We would expect -- again, this increase is the second round on two of the four older blocks that we addressed in 2007. The amount again that we announced is 18% that we will be requesting with the Department of Insurance. We would not expect that that shock lapse to be, again, much more than 1% or so.

The discussions with the customer, when you are looking at a comparable set of benefits of the price of the product that they are buying today, even with that 8% to 12% that we announced back in 2007, the additional 18%, that same package of benefits that is purchased on the market today is roughly 20%. What they are paying on the older blocks would be roughly 20% cheaper than the new priced product.

So as we think about the in force rate increases, we are looking at this in a responsible way. We think that the seniors that purchase the products historically still get great value in that product and the products that we are selling on the market today, again, as we look at our assumptions, we believe are priced for relative stability.

One thing I would point out that, in 2001/2002, the NAIC model regulations required a level of rate stabilization so all carriers that are filing products today are approaching their pricing with, I think, a more conservative stance. So we are seeing that the in force rate increases announced are being accepted by the consumers. They are paying a higher premium and still have good value.

Eric Berg - *Barclays Capital - Analyst*

All right, thank you.

Operator

Colin Devine, Citi.

Colin Devine - *Citigroup - Analyst*

Good morning. I guess following up on Steve's comments, in one sense with respect to strategy. I am just going to leave USMI alone. It is really not much more you can say about it. It seems to me that you are in a lot of businesses where Genworth is at best a second-tier player, if that, whether it is variable annuities, I am not sure why you continue to do it, I am not sure what the incremental benefit long term is going to be as a credit insurance business where the earnings are a third of where they were two years ago.

Isn't the real strategy here that you need to shrink this Company and focus on your key lines, whatever you decide those are, rather than playing in things like Wealth Management where Genworth is never going to be a material player or it is never going to contribute a material amount to earnings at least over the next five years?

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

Colin, we have taken some important steps I think to focus the Company and you're going to see that transition continue. Let's just walk through. If you look at the life and Long Term Care area, as we declared, we have leadership in both the middle or mainstream market in life insurance. And if you look at the bulk of our policies, they are under a $1 million face size. In fact, the vast majority are under $500,000 and we are penetrating in both segments. So we have made a very clear call there and we have made a very clear call in making sure that we leverage our long Long Term Care experience to have appropriate and profitable business there.

The Wealth Management business has actually grown nicely. I understand we have kind of different views, but that is the third area that we concentrated on because of the shift to advisers. And we have seen a lot of adviser dynamics moving to independent platforms that we serve.

We have taken a much narrower stance and continue to evaluate the optimum from participation in the annuity area, recognizing that some of our distribution values selling more than one product. And that is a dialogue with distribution and we are able to leverage our distribution expense and spread it because of those multiple products as opposed to if you were a monoline in that area.

But there will be the appropriate capital given to the leadership areas and that capital is being taken away from the other areas as we work through the US life strategy, which is playing out, but for the drag in the older blocks that Pat talked about lapsing off and the dynamics around that.

Internationally, in Mortgage Insurance, enough said when you look at Canada and Australia and the way those platforms not only performed, but the move through and we have pulled back from a number of markets we were starting to explore to concentrate on those leadership areas while selectively planting some seeds.

I guess we probably have a different view on the Lifestyle Protection business because of how we see the market. And it sounds like we should make sure that we do a good job of laying that out. I view that over time as more of a complement to a protection value proposition when you look at the nature of the risks, the underwriting, the actuarial support that we leverage. And I like the diversification it gives you in the protection area versus the US market. So I think it is more than just being classified as a credit and credit insurance business.

But we will, as we move through executing our strategy, of course, look at our portfolio and make sure that our portfolio mix evolves so that not only are we trying to rebuild value, but we optimize it over time. So we will try to bring certainly I will say a diligent screen to where we put capital and where we don't as we move ahead.

Colin Devine - *Citigroup - Analyst*

Mike, I think you are still missing the point Steve made is you have got a lot of capital tied up in frankly what I would refer to as many hobby businesses that just result in a complete lack of focus. I mean managed money Genworth is never going to be a player in, okay? In variable annuities, you are not and I guess it is very difficult -- I mean the market perceives you as a specialty writer if it is in Long Term Care, perhaps life. I don't see why you need to offer variable annuity to complement that and even in Long Term Care, that is a sector where most of -- in fact, pretty much all the majors have pulled out. And if we look at the in force block, it is clearly not earning target profitability. Since the day you brought Genworth public, every analyst meeting you have talked about getting it repriced right. We are still here with having to put rate hikes up. If Long Term Care is your core line, maybe it needs a lot more attention and you need to get out of some of these other businesses, pay down the debt and strengthen this balance sheet.

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

We will continue to focus, Colin, in the US and honing on where we have leadership and taking capital out of areas where we don't. But beyond that, I think you have shared your views and I appreciate those.

Colin Devine - *Citigroup - Analyst*

I wish you would look at where the stock price is, Mike.

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

And we will continue executing and sharpening where we allocate capital.

Operator

Andrew Kligerman, UBS.

Andrew Kligerman - *UBS - Analyst*

Yes, sorry about the technical difficulties earlier. Let me start by saying it is unfortunate that the Florida MI or just MI in general in the US has performed so poorly this quarter because it looks like you actually made pretty solid progress in a number of your other businesses, whether they be MI-related or Retirement and Protection.

That said, let me just kind of take a look at what happened in the quarter at this 263% loss ratio. If you back out Florida, you are still at 205% and I know, seasonally, you see a pickup, but in the prior two quarters you were at 138%, 141%. So seasonality wise, at worst, I would've expected maybe 150% or 160%.

And then you mentioned that the two services, they were inefficient. I would have assumed that you would have been aware of that inefficiency. And secondly, you mentioned foreclosures came down earlier in this call in the second quarter. Maybe that was a sign that things could actually get worse, not that your provisions were spot on.

So my question is I want to have confidence in Genworth going forward. I want to make sure that you guys have the ability to get it right. And I know Eric was kind of getting into that, but what can you provide to give us a sense that, all right, you just took a massive reserve in the second quarter. How do we know you are going to get it right going forward?

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

Kevin, do you want to take Andrew's comment?

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

Andrew, this is Kevin. When you think about what happened in the quarter, you sort of have to walk through a number of different items. Number one, our gross paid claims increased in the quarter about $133 million. The total gross change in reserves from the quarter was $51 million. Offsetting that, we had some benefit, continued benefit from captives of about $12 million in the quarter and another $3 million or $4 million of some bulk losses that were totally within our expectations.

That, in aggregate, is what drove the overall change. When I think about Florida, Florida was a strengthening of provisions in Florida while the rest of the country actually was largely performing in line with what our expectations were. Overall cures in the third quarter were downward pressured consistent with what you'd think from overall seasonality and we, on our last call, we said we were cautious about what was going to play out in the fourth quarter as cure rates generally are pressured during that quarter.

The acceleration in foreclosures was something that these loans are going to eventually have to move through to further claim. Foreclosure accelerations were up in total about 35% across our entire book. So there were certainly issues with that. Now we have the further cloudiness over the overall foreclosure activity and that is something we are simply trying to parse through to get our best handle on it so that we can provide better clarity, better visibility to everybody in terms of our expectations.

But at the end of the day, we saw expectations in the quarter that were generally in line with what we would have thought. We are seeing the benefit on the earlier term delinquencies. We are seeing some aging pressure on the older, but nowhere near what we saw in the state of Florida. So we believed, based upon our best estimate of where we are at right now, that we have that addressed. We do not see that we have another hot state issue like that out there based upon expectations. We are going to certainly have to continue to work on modifications with the servicers because that is still a key focus of our loss mitigation effort.

And then the last point I just want to remind you of is we, as we have declared throughout this cycle, went after our investigation and rescission process fairly early on. We received the benefit of that in previous periods. We put most of that behind us as we worked through it and eventually, as we expected, that is going to trail off towards the balance of this year. That came in a little faster than what was expected, but we don't have a lot of expectation for significant benefit from that going forward into 2011. So that is very in line with where we are right now.

Florida is a unique animal. Florida is a unique animal and the size of the RIF there adjusted and compared to other states is higher. 65% of the loans there are in a later stage of delinquency versus a much lower level of about 45% or 47% in the rest of the country. We think we have accounted for it and we will continue to do our best job to continue to give you clarity and hopefully provide more comfort to you that this won't be a repeat performance.

Andrew Kligerman - *UBS - Analyst*

So Kevin, the objective I guess in recent quarters, management has said that by mid-2011 you expect to get under the 100% benefits ratio. And I have also heard on this call a word that '11 is a transition year. I just heard you used the word cloudiness. Do you still think by mid '11 under 100% benefit ratio is conceivable?

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

If what we saw here in the quarter, Andrew, was an acceleration of this development and not a further growth in the overall loss expectation. Right now, what we are looking into right now was some things accelerated into this quarter. You could have a little bit more of that erosion in the fourth quarter. All other things equal, because we are making a number of progress on some other fronts, that still positions us for a turn in 2011.

Andrew Kligerman - *UBS - Analyst*

Okay, and then just one quick one regarding the fee-based $6 million after-tax negative DAC unlocking. We thought, just given the equity markets, maybe the DAC unlock would be more positive. Perhaps someone could just give me a little color around that $6 million after-tax DAC unlock negative.

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

Andrew, this is Pat. I can do that. Looking at the current experience and the impact of the markets, we would have reported earnings which were $6 million higher than reported, but for a technical change to reserve calculations, which cost the $6 million. Is that clear?

Andrew Kligerman - *UBS - Analyst*

Yes. Thanks a lot.

Operator

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