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GNW - Q4 2012 Genworth Financial, Inc. Earnings Conference Call

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OVERVIEW:

GNW reported 4Q12 net income of $166m and operating income of $167m.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Genworth Financial's fourth-quarter 2012 earnings conference call. My name is Shannon, 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 towards the end of this conference call. As a reminder, the conference is being recorded for replay purposes. Also we ask that you refrain from using cell phones, speakerphones, or headsets during the Q&A portion of today's call.

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

Georgette Nicholas - *Genworth Financial, Inc. - SVP IR*

Thank you, operator. Good morning and thank you for joining us today for Genworth's fourth-quarter 2012 earnings call. Our press release, financial supplement, and fourth-quarter 2012 investor materials were released last evening, and this morning additional information regarding our 2013 business goals was posted to our website. We encourage you to review all these materials.

I would like to note that we have changed the financial presentation for divisions to align with the strategy announced in October 2012. We will now operate through three divisions -- U.S. Life Insurance, Global Mortgage Insurance, and Corporate and Other. There were no changes to the financial presentation for the segments, but the International Protection and Wealth Management segments are now part of the Corporate and Other Division.

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

In addition to our speakers, Pat Kelleher, President and CEO of our U.S. Life Insurance Division; Kevin Schneider, President and CEO of our Global Mortgage Insurance Division; Jerome Upton, Chief Financial Officer of our Global Mortgage Insurance Division; Buck Stinson, President of Insurance Products for our U.S. Life Insurance Division; and Dan Sheehan, Chief Investment Officer, will be available to take your questions.

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

This morning's discussion also includes non-GAAP financial measures that we believe may be meaningful to investors. In our financial supplement, earnings release, and investor materials, non-GAAP measures have been reconciled to GAAP where required, in accordance with SEC rules. Also, when we talk about International Protection and International Mortgage Insurance results, please note that all percentage changes exclude the impact of foreign exchange. Finally, references to our statutory results are estimates for the quarter due to the timing of the filing of the statutory statements.

Now I will turn the earnings call over to our new CEO, Tom McInerney.

Tom McInerney - *Genworth Financial, Inc. - President, CEO*

Thanks, Georgette, and good morning, everyone. Let me first say I am very excited to be joining you today for my first Genworth earnings call. Having just joined the Company about a month ago, I have been spending most of my time getting to know Genworth, its products and businesses, and the management teams in each of the businesses. I am looking forward to working with the Board and senior leadership to execute the strategy announced recently.

This morning I want to briefly cover four points. First, give you some perspectives about my decision to come to Genworth; second, comment on the strategy and priorities for the Company; third, tell you what I am most focused on as I start my tenure as CEO; and finally, offer a few comments regarding Genworth's fourth-quarter results. I will then turn it over to Marty to review fourth-quarter results and provide some detail around the specific financial goals for 2013.

So I'll start with what influenced my decision to come to Genworth. From my roles in the insurance industry I was familiar with and respected Genworth. After discussions with the Board and others over many months, I recognize the turnaround opportunity the Company had and wanted to be involved in that effort.

Genworth has a diverse portfolio of businesses that provide valuable products and services to customers that impact their lives. There is strong demand for many of our products, which provides future growth potential for the Company. We have a number of strengths that I believe we can further leverage, including our focus on the underserved middle market for life insurance, our leadership positions in mortgage insurance and long term care, strong distribution relationships, and our experienced and talented team of employees.

As you our shareholders know, the last two years have been very challenging for Genworth, and our business performance has suffered. A number of the businesses are in difficult markets with significant risks, and they face issues regarding the return on equity they are achieving. We must address these issues and improve risk-adjusted returns.

Because of the challenges we have faced due to the financial crisis and our constrained financial flexibility, we cannot pursue all the opportunities we have in our current businesses. I came to Genworth because I saw an opportunity to apply my broad experience in insurance, to work with the senior management team and the Board, to accelerate the turnaround of the Company and rebuild shareholder value. Together, our goal is to ensure that we only allocate capital to those products or businesses that meet our objective of earning an appropriate return over the required cost of capital.

Let me now turn to Genworth's strategy and objectives. I believe we have the right strategy and objectives, with a focus on improving business performance, simplifying the business portfolio, generating capital, and increasing the financial strength and flexibility of the Company. Executing these strategies and achieving our return on equity objectives will require us to continue to make some tough decisions, and we are prepared to do so.

We are working to overcome underperforming in-force portfolios, a relatively high cost of capital, and interdependencies among the individual businesses and with the Holding Company that impede flexibility.

Now, a few comments about my focus as I begin my tenure as CEO. My focus will be to improve operating performance, generate more cash and capital from the businesses, and increase return on equity. I am also spending considerable time understanding the risk profile of the Company better.

One area of immediate focus will be long term care insurance. The long term care business faces headwinds, given the low interest rate environment, long duration of the product, and changing healthcare trends. Therefore we must remain diligent on risk management, premium rate actions, understanding loss trends on the in-force portfolio, and working to design new products with much improved risk-adjusted returns.

I'd like to comment on how I view Genworth's fourth quarter. Genworth's operating results in the quarter were mixed. I am pleased that the signs of recovery in U.S. Mortgage Insurance continue and the International Mortgage Insurance results were stable. I was disappointed in the performance of long term care insurance, which hurt the results in the U.S. Life Insurance Division.

We have made progress on the strategy and objectives, and I am proud of what the Genworth Board and team have accomplished so far. Genworth met its 2012 goal for cash dividends paid to the Holding Company, positioned the US Life Companies to pay an ordinary dividend in 2013, and completed a debt tender. In addition, the Company designed and is now implementing a comprehensive U.S. Mortgage Insurance capital plan that significantly enhances our financial flexibility.

Genworth has a stronger balance sheet today, given these actions; and we will continue to build that strength as we execute further on our strategic priorities. We are prepared to face a challenging environment in 2013 and have built our plans accordingly.

We will manage the businesses and capital with discipline and with the goal of improving returns on equity and building shareholder value. We are challenging each business to manage the actions that are within its control, including assessing the pricing of products, improving risk management, targeting new product sales and new business opportunities where returns are above our cost of capital, and being more cost efficient.

We will continuously evaluate risk-adjusted returns on new business, seek to improve Genworth's underperforming in-force blocks of business, and make decisions as appropriate, no matter how difficult they may be.

I took the position of CEO for Genworth to accelerate the successful turnaround of the Company. The Company has products customers need, leadership positions in core businesses, strong distribution relationships, and has an experienced team of employees. Finally, Genworth has defined its strategy and objectives along with a strong commitment to execute that strategy and deliver better performance.

We are looking forward, and I am excited to be on the ground. I would also like to thank Marty Klein for his accomplishments as acting CEO for the second half of 2012. And now I will turn the call over to Marty to talk about the quarter and our 2013 goals.

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

Thanks, Tom, and good morning, everyone. Today I'll provide an overview of results for the quarter. As we move into a new year, I will also talk about our financial goals for 2013, as well as discuss how we did on our 2012 goals.

Let's begin with fourth-quarter results. We reported operating income of $167 million for the quarter and net income of $166 million. The results include a $78 million favorable adjustment from the finalization of a new Government Guarantee framework in Canada.

Overall in our businesses, we saw generally stable performance in Global Mortgage Insurance and mixed results in U.S. Life. In Global Mortgage Insurance, excluding the $78 million adjustment for Canada, net operating income was $53 million compared to income of $56 million in the prior quarter.

Let's discuss Canada first, where operating earnings were $36 million for the quarter when excluding the $78 million adjustment. Unemployment improved slightly sequentially, and home prices were flat to the prior quarter. The loss ratio increased 1 point sequentially to 31%, while improvement in the Alberta region continues.

Changes put into effect in July to the eligibility rules for Government Guarantee mortgages reduced the size of the high loan-to-value mortgage insurance market and, along with normal seasonal impact, drove our NIW in the quarter down 40%. We did complete several bulk transactions in the quarter of approximately $4.1 billion. We participate selectively in this market, and these transactions consist of low loan-to-value prime loans.

As I mentioned earlier, our results included $78 million this quarter from a new Canadian Government Guarantee framework which took effect on January 1, 2013. While there is no change in the 90% level of the Government Guarantee to the business under the new legislation, it does eliminate the Government Guarantee fund along with its related exit fees, in favor of a higher regulatory capital target set by Canada's Minister of Finance. The elimination of the Government Guarantee fund will increase the business's regulatory capital available; but that increase is expected to be predominantly offset by an increase in its required capital. Our capital positions remain solid in Canada.

Turning to Australia, operating earnings were $62 million versus $57 million in the prior quarter. Unemployment was down slightly, and home prices were down about 1%. While lower interest rates have improved affordability, consumers are still cautious.

The loss ratio for the quarter dropped significantly to 36%, down 11 points sequentially. Overall, delinquencies were down 14%, with new delinquencies improving across all major states. While paid claims remained elevated, reserves continue to be largely in line with the trends we had anticipated when we implemented the first-quarter reserve strengthening.

During the quarter, we further expanded our reinsurance coverage, adding a total of AUD350 million of external reinsurance for the year. Many of you know about the January floods in Queensland, which are not anticipated to be as bad as the floods of 2011. While we do not cover property damage caused by the flooding, if it has an economic impact on the area we could see new delinquency development, as we did after the last flood.

We will continue to assess the impact and provide updates as the situation develops. Currently, we estimate less than 1% of our portfolio is in the affected areas, or 300 million in effective risk in-force.

Also, earlier this week, Moody's downgraded the mortgage insurance industry in Australia and reduced our rating 2 notches to A3. We do not expect this to impact us significantly, given our customer relationships as well as the impact on the industry ratings overall.

Moving to the Other Countries in International Mortgage Insurance segment, the operating loss is up sequentially to $11 million driven by losses primarily in Ireland. Slow growth in 2013 is expected in the Canadian and Australian markets, where unemployment and home prices are stable. A moderate decline in the high loan-to-value markets and the seasoning of older vintages will pressure revenue, but generate capital.

Dividends for the segments in 2013 are expected in the range of $150 million to $200 million, while we maintain capital targets which currently are in excess of 190% for Canada and 135% for Australia. These capital targets are dynamic and based on several considerations such as the economic environment, business performance, and ratings.

We maintain prudent buffers above regulatory requirements for the possibility of unforeseen events or weaker than expected performance. Other International MI is expected to generate operating losses in the range of $30 million to $40 million during 2013 as pressure in Ireland continues.

In January, we contributed $21 million in additional capital to the European Mortgage Insurance business, in line with our expectations laid out last February. We do not currently anticipate the need for additional contributions to the business this year, but may do so if the experience deteriorates more than expected.

Executing a partial sale of our Australia MI platform remains a key goal; but given our liquidity at the Holding Company and the other levers we have to generate cash and capital, we want to execute a transaction when it makes the most sense for shareholders. Execution of an IPO is subject to market, the valuation, and regulatory considerations, and we continue to not expect an IPO to occur until the fourth quarter this year or later.

Moving now to U.S. MI, we had net operating loss of $34 million in the quarter, slightly improved over the prior quarter from favorable taxes. We are seeing a slow recovery in the housing market, along with strong growth driven by a larger mortgage origination market and higher mortgage insurance purchase and refinance penetration in the quarter. For the full-year 2012 the origination market is up approximately 24%, and overall mortgage insurance penetration is up about 2.5 points.

Total losses were up slightly from the third quarter, as lower loss mitigation savings and modest changes in aging were offset by a lower new delinquency development with a favorable mix. Our total flow delinquencies fell by 21% from the prior year, with new delinquencies down 4% sequentially and down 23% year-over-year, reflecting the continued burn-through of the 2005 to 2008 books as well as the new better-performing books becoming a larger portion of our overall portfolio.

Last month we announced a comprehensive capital plan for our U.S. Mortgage Insurance business. The plan reduces Genworth Mortgage Insurance Corporation's, or GMICO's, risk-to-capital levels and, along with our continued GMICO waivers and use of Genworth Residential Mortgage Assurance Corporation, or GRMAC, ensures our continued ability to write profitable new business and generate additional capital. The plan not only greatly decreases the likelihood that the U.S. Mortgage Insurance subsidiaries will require additional capital for the foreseeable future, it also removes those subsidiaries from the companies covered by our senior notes indenture.

As part of this capital plan effective January 31, 2013, we completed the transfer of ownership of the European Mortgage Insurance subsidiaries to GMICO. Given the effect of this transaction, U.S. MI risk-to-capital ratios should decrease by approximately 12 points.

We expect to complete the legal entity reorganization during the second quarter, subject to various regulatory approvals. Our expectations of performance for this business in 2013 are based on the continuing improved trends in the US housing market; and we remain focused on executing loss mitigation strategies, maintaining our distribution network, and writing profitable new business.

For 2013 we expect loss mitigation savings to be between $250 million and $350 million; new insurance written to be between $15 billion and $20 billion; and new delinquencies to decline between 15% and 20%. There are, of course, various possible outcomes to performance, depending on new delinquency development, cures, modifications, and levels of new insurance written.

Assuming no significant deterioration in the US housing market or material global economic downturns, we continue to believe these trends enable the ongoing improvement in earnings for U.S. MI, with a potential return to breakeven or modest profitability in one or two quarters of this year. We expect overall performance for this year to be much improved over 2012, given the 2009 and forward books of business are expected to comprise 40% to 45% of the risk-in-force by the end of the year.

Moving to the U.S. Life Insurance Division, reported operating earnings were $76 million. Life Insurance earnings were $49 million for the quarter. We saw significantly improved term life mortality experience in the quarter, which is also better than pricing assumptions, following three straight quarters where mortality had been elevated.

Life Insurance sales were down sequentially and year-over-year, consistent with the pricing and product actions taken this year as they manage sales volume and improve statutory performance. In October, we introduced a term product that replaced the term universal life insurance product, and we are redesigning certain universal life insurance products and repricing others.

We completed our second life block transaction in the fourth quarter with a capital benefit of about $175 million. This benefit was larger than initially estimated due to refined estimates of the associated tax benefits. With the completion of this transaction, our life block deals have generated approximately $345 million of benefit to unassigned surplus. We will look opportunistically for such transactions going forward.

Long term care earnings of $7 million were down for the quarter. Two factors hurt results this quarter.

First, during the quarter we increased claim reserves slightly to more fully reflect the slow interest rate environment. While this had a significant earnings impact of about $5 million for the quarter, it represents only a small increase to the actual claim reserve.

The other factor impacting earnings is a higher reserve build on new claims, which negatively impacted earnings versus the prior quarter by $5 million. The reported loss ratio was 76%, 10 points higher than the prior-quarter reported loss ratio of 66%. The prior quarter had several favorable reserve refinements; and without those refinements the loss ratio in the third quarter was approximately 74%.

The new-generation product loss ratio is 58%, up 4 points from the prior quarter, after excluding the third-quarter reserve requirements refinements, due to a higher average reserve build on new claims. The loss ratio on the new-generation policies reflects the new claims methodology introduced in the prior quarter, which we believe better reflects ultimate paid claims.

With respect to the recently initiated in-force price actions, we have filed in 49 states and have received approvals representing approximately 20% of the total anticipated annual premium increase of $200 million to $300 million, which we expect to achieve when all the price actions are fully implemented. In 2013 we anticipate an increase of $20 million to $30 million in premiums for the year from the price actions, with the increases being implemented over time in line with the regulatory approvals.

Fixed annuity earnings were $20 million, with sales down from the third quarter as we continue to take actions to maintain margins in a low interest rate environment.

Turning to capital, the U.S. Life Companies' risk-based capital ratio is estimated to be about 430%, up from the prior quarter. The ratio benefited this quarter from a second life block transaction and also reflects the extraordinary $25 million dividend paid to the Holding Company in the quarter from the Medicare Supplement sale proceeds.

At the end of the fourth quarter, I am happy to report that unassigned surplus is approximately $345 million, exceeding the unassigned surplus target of $250 million to $300 million that we had laid out in February of 2012.

The focus in our Life businesses in 2013 is improving the financial performance of the division through pricing, rate actions, and new product introductions. As we transition this year to new product offerings in both life and long term care portfolios, we would expect to see the sales mix start to shift over time towards life from long term care.

With the return of the Life Companies' ordinary dividend capacity at the end of 2012, we expect 2013 dividends from the division to be $150 million to $200 million. Net of dividends paid, we anticipate unassigned surplus to be $200 million to $250 million at the end of 2013.

We do anticipate statutory earnings will be lower this year, as 2012 included tax benefits from the life block transactions and also benefited from improved variable annuity results from better equity markets. Our long-term goal continues to be to manage the consolidated RBC ratio to levels of at least 350%. However, given factors such as the low rate environment and potentially volatile equity markets, in the near term we anticipate holding the RBC ratio in the range of 375% to 400% and would expect the ratio to fluctuate quarterly.

Shifting to the Corporate and Other Division, the net operating loss for the quarter was $40 million. International Protection earnings were $8 million for the quarter. The business continues to navigate the tough European environment and is working to reduce its footprint there through pricing and expense actions.

As part of the plans to increase value through growth in new markets, we continued to make progress in our relationship with MAPFRE in Latin America. The business paid dividends to the Holding Company of $119 million in 2012.

Wealth Management had earnings of $8 million and continues to provide steady dividends, paying $39 million of dividends in 2012. The business continues to develop new solutions for advisors and their clients.

The runoff segment experienced less favorable market performance compared to the prior quarter and prior year, but benefited from favorable taxes in the quarter. We expect dividends from our non-core businesses to be between $30 million and $50 million in 2013.

Turning to investments, the global portfolio continues to perform well, as the core yield remains stable and total impairments remain low. We wanted to provide an update on the impact from an extended low rate environment on operating earnings per share.

If market investment yields and asset allocation strategies remained unchanged through 2015, the impact on the total operating earnings per share run rate from after-tax spreads would be approximately $0.07 per share lower in 2013, and $0.11 per share lower in 2014. The largest impact would be in the U.S. Life Insurance segment, give its mix of products, particularly long term care and universal life insurance, although hedging of interest rate risk exposure helps mitigate the impact significantly.

Let me now cover some topics at the Holding Company. We are pleased with the outcome of the Moody's review and the reaffirmation of the Holding Company rating with a stable outlook. The rating resolution and execution of the comprehensive capital plan for U.S. MI should increase our financial flexibility at the Holding Company, which is a primary goal for us.

We continue to generate and maintain significant liquidity at the Holding Company. At the end of the fourth quarter, cash and highly liquid securities at the Holding Company totaled about $1 billion, in line with our expectations and greater than our target of 2 times debt service plus a buffer of $350 million for stress scenarios.

We anticipate continuing to maintain cash and highly liquid securities of at least 2 times debt service plus the $350 million buffer, and we will evaluate the level of the buffer as circumstances change.

During the quarter, we successfully completed a debt tender of $100 million of the 2014 senior notes, reducing the amount of outstanding 2014 debt maturities to $500 million. We plan to address that remaining $500 million later this year, well in advance of its maturity date.

Our overall leverage goal for 2013 is approximately 25%, with a medium-term goal of 20% to 22%.

As we close out 2012 I want to comment on how we did against our financial goals for the year. Regarding dividends to the Holding Company, the operating companies paid $457 million in dividends in 2012, in line with our target of $460 million. The U.S. Life Insurance Division, International Protection segment, and the Wealth Management segment exceeded the 2012 goal of $300 million, having paid $336 million. In Global Mortgage Insurance we received $121 million of dividends, in line with the revised target we laid out in the second quarter of 2012, although short of their initial target.

With respect to the Holding Company, we met our targets for Holding Company cash levels as well as for leverage.

Heading into 2013 we expect that overall earnings for Genworth will improve as our U.S. Mortgage Insurance business recovery continues. International Mortgage Insurance earnings should be stable, and the U.S. Life Companies will continue to take actions to improve their performance over time.

2012 was certainly a year of challenges and changes for our Company. As we move into 2013, we have new leadership as well as a strategy to take our Company forward. We remain focused on our goal to rebuild shareholder value by improving our performance as well as our financial strength and flexibility.

With that, let's turn it over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Sean Dargan, Macquarie.

Sean Dargan - *Macquarie Research - Analyst*

Thanks and good morning. I have two questions. My first question is about long term care. Given the reserve refinement and the reserve build, reflecting new assumptions, it sounds like there had been a change in assumptions. Why was that not reflected in a DAC charge?

Pat Kelleher - *Genworth Financial, Inc. - President & CEO - U.S. Life Insurance*

This is Pat Kelleher. I will take that. When you look at our reserves in long term care, about 15% of the reserves or $3 billion is our reserve for current open claims. What we did in third quarter of last year was we updated all of our experience studies and made adjustments, which in total were not material to the claims reserve balance reflecting our experience. Then in the current quarter, we looked at the relatively stable portfolio yields we have seen. But anticipating some modest declines in the low current interest rate environment, we made a modest negative adjustment, reducing the interest rate that is used in the calculation of those reserves.

So since it is a current claims or FAS 5 reserve, and it had just an impact in the current period, and we have taken into account all the costs of the currently open claims and future periods, it really had no impact.

Sean Dargan - *Macquarie Research - Analyst*

Okay, thank you. Shifting to U.S. MI, how do we get from a loss of $26 million this quarter to breakeven or modestly profitable quarter? What quarter should we be thinking about? And how would we make that jump?

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

Hi, Sean; this is Kevin. I think we need to start with just a little bit of a caveat that speaks to -- there is a range of possible outcomes that could occur, based on the continued uncertainty in the macroeconomic environment. But with that said, if you go back to the trends that we identified, really last February when we began talking about the improving performance and our expectations for this business, our trends largely remain in line with those expectations and continue to head towards the potential for really significant improvement in the overall U.S. MI earnings and a potential, again, for breakeven or modest profitability in one or two quarters.

When I start to more directly address your timing question, I think about it this way. First off, we do have the benefit of seasonality in this business. And taking account the usual trends one sees in the seasonality of delinquencies and cures, you could expect that that would point towards that breakeven or return to profitability sometime in the first half of the year, either Q1 or Q2.

At the same time, we also have another dynamic that continues to play through our portfolio. And that is, as the older books, the unprofitable legacy books of business, continue to burn out, and the further you get into the year in that burnout dynamic. Adding to that, the benefit we continue to realize of incremental new, well-priced and highly performing production, you get to a tipping point that conceivably could be more in the later part of the year, Q3 or Q4.

So it is really -- and we're not going to do a pick point right now. But that is really, I think, the dynamics that are at play. Continued burn off of the books, continued addition of new profitable production, getting to a point, as I think Marty identified in the goals, where you could be at 40% to 45% range of new, profitable, new books of business in the overall portfolio -- that starts to drive that tipping point later on in the year.

And then lastly, this is just an additional item and it doesn't really help in nailing down your question, but we also do benefit from some dividends from affiliate investments we have in our portfolio. And those come in Q1 and Q3. So again, could help drive it in the first quarter, it could also help drive it potentially in the latter part of the year.

Sean Dargan - *Macquarie Research - Analyst*

Okay, great. Thank you very much.

Operator

Mark Palmer, BTIG.

Mark Palmer - *BTIG - Analyst*

Yes, thank you. Quick follow-up question on Australia. You mentioned in your comments that the flooding this year, at least the impact of the flooding is not as bad as it had been in 2011. I believe you said that it would impact an estimated less than 1% of the portfolio.

Last year as I recall, the issue really stemmed from one lender in particular. I want to get a sense of -- with regard to the exposure in question, what the composition of that might be. Is it one lender? Is it more than one lender? What more can you tell us about that?

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

Yes, Mark, first of all, just let me revisit Marty's directional comments on it. Our early assessment, it is going to be low to modest impact.

When you look back on last year, the current flooding compared to what we experienced in 2011 in Queensland, is far smaller. It is really primarily isolated in the rural areas. Again, our master policy really specifically excludes physical damage, including floods. And so when we talk about this range of output, we said it is really primarily linked to the economic impact to the environment.

Stepping back from that, related to your question, it is really spread over all of the lenders that we have that we have done business in that area. It is not specifically just identified to one lender. We do have some lenders we do more business with than others.

But again at this point in time, early assessment. Still early. We will update as you continue to see the trends development, but we expect a low to modest impact.

Mark Palmer - *BTIG - Analyst*

Okay, thank you. And one other question, with regard to the U.S. Mortgage Insurance business, we have seen the US government pulling back from the mortgage insurance space, or at least announcing that they intend to pull back. To what extent are you seeing that pullback translate into increased opportunities to write new business?

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

Yes, great question. When you talk about the US government, I will specifically highlight we are talking about the FHA, which is the government's mortgage insurance arm. Just from a trend perspective, if you look at the way our penetration, which the mortgage insurance penetration into the market has developed over the year, we are really coming out of 2012 at a fairly high penetration rate of 8% overall. That is starting from a point going into the year that was about 5%.

Our refinance penetration, which is usually lower than our purchase penetration, has almost doubled over the year as we have gone into the year. And our purchase penetration, which is really the bread and butter of our business, exited the year as an industry at almost 17% -- sort of back to pre-go-go-year type levels is the way I would characterize it, sort of 2002 or 2003.

So you see the government raising prices on the FHA's business. You see them getting more restrictive in terms of their underwriting policies, and that business is beginning to flow back into our markets.

We hear it from our customers. You can see it in our production. Even with a sort of stable share growth this quarter, our production was up on a BPQ basis about 9%. You compare that to where we were on a prior-year basis, we are up over 50%.

So the market is getting bigger. It is a market we think is an attractive market to play in, and we continue to be very disciplined in our pricing approach to going after that business.

Mark Palmer - *BTIG - Analyst*

Okay. Thank you very much.

Operator

Geoffrey Dunn, Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Good morning. A couple questions. First, on the MI side, can you qualify your '13 expectations for new default development with some commentary on how you think cures are going to trend? Because at the end of the day, that change doesn't overly matter without the impact on net new notices. So what do you think cures are going to do relative to that 15% decline?

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

We gave you a range, I think, of 15% to 20% new delinquency decline next year. That is a range that we think the overall business will perform within. We did a similar thing this year, targeting about a 20% decline and that played out at, I think, close to 23%.

New, as it relates to modifications and cures, I think they are going to go down. Directionally they are going down.

Number one, we have less inventory to deal with. So just based upon the amount of inventory, delinquent inventory we have, it should go down.

But as we continue to see some improvement in overall economic development, I think that is going to continue to help that, as more jobs -- that will help with the self-cure line. So at the end of the day, I think although modifications will be down, they will be down and will continue to help support the overall new delinquency development, which we also think is going to be down.

And I think the trends are -- we don't expect any major falloff, Geoff, in our overall cure expectations. And it's really -- it's in line with the way we think about our overall reserves and the way we have them set.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. Also, the risk-to-capital this quarter, you only saw about a 0.6 increase sequentially. Outside of some modest realized gains in the P&L, were there any other balance sheet adjustments which aided that ratio this quarter?

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

Well, we got some -- a little bit of benefit from some deferred tax asset realization, and so that comes through the stat line, gives us a little bit of help there. And you mentioned that we did have some modest gains in terms of the overall portfolio, but nothing else -- no other major drivers.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. Then just on the long term care side, a couple questions Ryan asked me to pass on. Related to the year-end, did you add any stat reserves as a result of your cash flow testing?

Pat Kelleher - *Genworth Financial, Inc. - President & CEO - U.S. Life Insurance*

Yes, this is Pat. I'll take that. On long term care, we have done a thorough review, loss recognition testing, and we are comfortable with the results there in terms of our provisions being adequate. We have completed, of course, the Q3 stat, loss recognition testing. We are finishing up the process in Q4.

And from my standpoint where we are currently, we are comfortable that our reserves are adequate and that our capital position is strong and as stated.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay. Then his other question was you gave the income statement impact from the low interest rate environment. Would you anticipate any kind of GAAP or stat balance sheet impacts from the same analysis?

Pat Kelleher - *Genworth Financial, Inc. - President & CEO - U.S. Life Insurance*

In doing the work relating to loss recognition and cash flow testing, we are taking into account all of our experience; and we have reflected the reserves where they should be on our balance sheet. I would say, just to add a little bit of clarity to the performance as we go forward, if I look at the quarterly performance over the last couple of years, I would say that we have had pretax margins on the long term care business between 5% and 10% of premiums, some quarters larger, this quarter a little bit less.

But on an annual run rate basis, the earnings level has been a little bit more stable, around $100 million in each of the last two years. The important thing to recognize in terms of what Marty announced before in terms of the rate actions, on $2 billion worth of in-force annual premium we are expecting at this point to get about $200 million to $300 million of additional premium through those rate actions over time with only, I guess, 20% of it actually realized to date based on approvals that we have got.

When we look at the impact of that on our statements over time, it is probably important to recognize from a process perspective the rate increases are implemented after notice on the next policyholder anniversary. So we are only seeing a portion of the approvals that we have got already and over the course of 2013, with the rest recognized in 2014.

And given the size of these rate increases, we are offering a range of options that allow policyholders to elect to reduce benefit options. I would say overall, most of the policyholders -- it has been our experience that they would go along and pay the rate increase. Although this time, since it is larger, we would probably see more policyholders electing reduced benefits.

So as a result, we will see those increases coming into our results and strengthen our earnings and our balance sheet over time, with about $20 million to $30 million, as Marty said, of the impact being felt in the current year.

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

I would just add, Geoff -- it's Marty -- that as we show in the analysis on the impact of low rates, that analysis is really just the impact on after-tax net spreads and does not include the impact of any DAC or reserve unlocks, which is a little bit harder, more speculative thing to model in this type of analysis given the number of factors involved.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, great. Thank you.

Operator

Tom Gallagher, Credit Suisse.

David Motemaden - *Credit Suisse - Analyst*

Hi, this is David Motemaden asking on behalf of Tom Gallagher. I see on page 5 of the slide deck that you guys put out that stat earnings were $275 million for the year. Could you tease out how much of that is due to the life block transactions and the tax gains or the tax benefits that you had?

Pat Kelleher - *Genworth Financial, Inc. - President & CEO - U.S. Life Insurance*

This is Pat. I'll take that. The stat earnings that we report on page 5 I believe are the Genworth Life Insurance Company statutory earnings, which are really the earnings of the Parent Company and the Group that generate the dividend capacity to the Holding Company. If you look at the stat earnings of I will say all of the entities in the Group, it would certainly have been larger than that in the current period.

The one thing that I would say is from the life block transaction perspective, we have a capital benefit of $175 million; but a significant portion of our capital benefits are not actually from statutory earnings. So it would only be a portion of that that would be reflected in the earnings of the US entities. Does that help?

David Motemaden - *Credit Suisse - Analyst*

Yes. Then I think you guys had mentioned that you expected lower tax benefits in 2013. Just wondering how much that impacted 2012.

Pat Kelleher - *Genworth Financial, Inc. - President & CEO - U.S. Life Insurance*

I can give you a general idea. When we did the life block transactions and the work that we did to generate and bring capital on to the statutory balance sheet, we were able to -- through those transactions and our other operating results -- utilize some previously non-admitted tax loss carryforwards in the statutory balance sheets. And when those are filed you can -- I don't have a precise number, but you can look at those and see how that position changed.

And that generally was directly accretive to our capital position and was part of our intended result.

David Motemaden - *Credit Suisse - Analyst*

Okay, great. Thank you.

Operator

Thank you. There being no further questions, this will conclude Genworth's fourth-quarter 2012 earnings call. Thank you for your participation. At this time, the call will end.