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GNW - Q1 2013 Genworth Financial, Inc. Earnings Conference Call

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OVERVIEW:

GNW reported 1Q13 net income of $103m and operating income of $151m.

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PRESENTATION

Operator

Good morning ladies and gentlemen, and welcome to the Genworth Financial's first quarter 2013 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 your 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 Holdings Inc - SVP of IR*

Thank you, Operator, and good morning, everyone. Thank you for joining us for Genworth's first quarter 2013 earnings call. Our press release and financial supplement were released last evening. Earlier this morning, our first-quarter earnings summary presentation was posted to our website. We encourage you to review all these materials. Today, our speakers will be our President and Chief Executive Officer, Tom McInerney, followed by Marty Klein, our Executive Vice President and Chief Financial Officer. Following our prepared comments, we will open the call up for question-and-answer period. In addition to our speakers, Pat Kelleher, President and CEO of our US 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, 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 the forward-looking statements in our earnings release and the risk factors of our most recent annual report on form 10-K as filed with the SEC.

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

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

Thanks, Georgette and good morning, everyone. Overall, I'm pleased with the progress in our results in the first quarter of 2013. Operating income increased to $151 million, representing a significant improvement from last year's first quarter and the fourth quarter 2012, excluding the favorable adjustment from the new Canadian Government Guarantee framework last quarter, and the Australia reserve strengthening and life block transaction impacts from last year. We made headway on several of our strategic priorities, including improving operating performance in our businesses driven by the continued recovery of US Mortgage Insurance and some improvements in our US life Insurance division.

Our focus continues on our strategic objectives to improve business performance, simplify the portfolio, generate capital, and increase the financial strength and flexibility of the Company. Our priority remains to rebuild shareholder value. This morning I want to focus first on steps we are taking to improve business performance, which is where I've been spending most of my time. Second, comment on progress made on other strategic objectives. And third, offer a few additional comments regarding Genworth's first-quarter results. I will then turn it over to Marty to review first-quarter results in more detail.

So I'll begin with where I am spending most my time, improving business performance. As we move forward, we are working to offer valuable products and services that help consumers plan for their financial security. We must balance demand for products through strong distribution relationships, with the objective of earning an appropriate return over the required cost to capital for shareholders. A prime example of where we are working to obtain this balance is in our approach to managing the long term care insurance business. I have been meeting with a number of insurance commissioners and state representatives to discuss our rate increase actions and approach. We also recently issued our study on the cost of care for long term care. From these discussions, it is clear that long term care is a social and economic issue that will impact consumers and states as the population continues to age.

Federal and state budgets are already strained by obligations under entitlement programs. In many states, long term care absorbs a substantial portion of Medicaid budgets currently, and this is before the bulk of the 76 million baby boomers retire. We believe there is an important role for private insurance in helping consumers plan for their long term care needs and an opportunity for Genworth to be part of the solution given our market position. Our approach is to first stabilize the in-force portfolio through rate actions and then introduce new products attractive to both consumers and shareholders. Given the poor experience on certain older blocks, the significant price increases requested are necessary to bring them closer to a breakeven point and reduce the strain on earnings and capital.

Some of the newer blocks, or policies issued on forms introduced since 2004, may need price increases at some point in the future given the current level of interest rates, low lapses, rising long term care costs, and historical mortality and morbidity experience seen on long term care. These newer blocks will be proactively managed, and our approach going forward will be to closely track emerging experience and as warranted, file for smaller rate increases sooner and more frequently. We believe filing for smaller rate increases more frequently is a better approach for consumers, regulators and shareholders, and we want to work with state insurance regulators to discuss options to achieve this result.

We are also working hard to obtain approvals to introduce new long term care insurance products that are more tightly underwritten and use more conservative assumptions and benefits, including shorter benefit periods, smaller daily benefit options and fewer riders. We will seek to balance the commercial and risk considerations as we move forward through this process, but we are prepared to take actions such as suspending sales in states and ending new sales through distribution channels where we cannot offer products within an acceptable risk-adjusted return. Our announcement to temporarily suspend sales in California, and our announcement today to end sales through our AARP relationship, are examples of this approach. Throughout last year and continuing into 2013, we are introducing new product offerings and pricing changes throughout the US life Insurance Division. These changes have caused sales to decline significantly overall, with long term care transitioning as expected, but life declining more than anticipated.

In life insurance, we increased prices and introduced a new term product, and made changes to our universal life product in the fourth quarter of last year. Given some of the market changes on pricing, we have been less competitive on certain products. We are re-evaluating the term product and pricing to be more competitive in the market, but still maintain acceptable risk-adjusted returns. We expect to introduce the new indexed universal life product in the second quarter. That will be less capital intensive and have a better return profile.

In long term care insurance, we introduced our new product, Privileged Choice Flex 2, on April 15, which incorporates underwriting changes such as a blood and lab work and gender-based pricing. We also anticipate reentering California in the third quarter of this year, given the approval of the Privileged Choice Flex product. We do anticipate long term care insurance sales to increase in the second quarter ahead of the new product implementations. As we continue to transition this year to new product offerings, we would expect to see sales rebound and the sales mix shift over time towards life from long term care insurance.

These new products, and the decisions we are making on distribution, are examples of bringing a better discipline to the products we want to sell and the returns we want to achieve. Over time, along with our in-force actions, we are seeking a steady improvement in the operating performance of our US life insurance division. I focus my time today on long term care insurance because we know shareholders and others are concerned about the business. But we are bringing this same return and risk discipline to all our products and businesses. The recent price increase we are implementing in our Australia mortgage insurance business is another good example of this discipline.

Let me now turn to the progress made on other strategic objectives. We continue to make progress in simplifying the business portfolio, generating capital, and increasing the financial strength and flexibility of the Company. First, on March 27, we announced an agreement to sell the Wealth Management business including Genworth Financial Wealth Management, an Alternative Solutions provider, the Altegris companies, to a partnership of it Aquiline Capital Partners and Genstar Capital. The sale price is expected to be approximately $412.5 million, with an after-tax loss of approximately $27 million related to the sale recognized in the first quarter, offset by approximately $7 million of income. We anticipate an additional loss of up to $10 million to be recorded upon closing. The sale is expected to close in the second half of 2013, subject to customary closing conditions including required regulatory approvals.

Second, the Company announced that the comprehensive US Mortgage Insurance Capital Plan received all necessary approvals and was fully implemented on April 1, 2013. The capital plan, announced in January, consisted of several actions including transferring ownership of the European Mortgage Insurance subsidiaries to Genworth Mortgage Insurance Corporation, or GMICO, on January 31 of this year. On April 1, we implemented an internal legal entity reorganization which created a new public holding company structure that removes the US Mortgage Insurance subsidiaries from the companies covered by the indenture governing Genworth's senior notes. Also as part of this plan, $100 million of capital was contributed to GMICO on April 1. After the contribution, GMICO's risk to capital is expected to be approximately 23 to 1.

Our longer-term goal is to manage the business to a 25 to 1 or below risk to capital level, being mindful the competitive landscape and the perspectives of the regulator's, GSEs and rating agencies. We think it is prudent risk management and good for the mortgage insurance industry to have all market participants moving back below the regulatory threshold over time. We are also pleased that in January, Moody's reaffirmed the of the holding company and revised the outlook to stable. In addition, last week, S&P reaffirmed the rating of the holding company but maintained a negative outlook. On US MI, S&P maintained their rating and revised the outlook from negative to stable, reflecting the improved performance and impacts from the capital plan. We believe the execution of our strategic priorities will help to improve our ratings over time. And finally, the Company completed the sale of home equity access for $22 million on April 1. All of these transactions are steps forward in executing our strategic objectives. Before turning things over to Marty, I would like to make a few more comments on how I view Genworth's first quarter. Again, Genworth's operating results in the quarter were improved, with operating income of $151 million.

I am pleased that the signs of recovery in US Mortgage Insurance continue, as new delinquencies continue to decline and new business remains very profitable. Of course, all of us at Genworth are encouraged by the operating profit achieved by US MI in the first quarter. After 21 consecutive quarters of losses, achieving an operating profit of $21 million is a welcome milestone and confirmation that the business is on the right track. However, we remain cautious regarding US MI, given the continued sluggishness in the US economy, and therefore we are not changing our view that US MI will be breakeven or modestly profitable in one or two quarters of this year. International Mortgage Insurance results were down versus the prior quarter, but we are satisfied with how the businesses are performing.

The US Life Insurance Division's results in the first quarter of 2013 improved versus the previous quarter. Mortality was favorable in the quarter, but we continue to experience pressure from low interest rates. We continue to make progress on our long term care insurance in-force rate actions, with approvals received as of March 31, 2013, representing approximately $60 million to $65 million of the targeted per annum premium increase of $200 million to $300 million when fully implemented. As we move forward in 2013, we continue to challenge 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 to capital, and being more cost efficient and effective. And now I will turn the call over to Marty to talk about the quarter results in more detail.

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

Thanks, Tom and good morning, everyone. Today I'll provide an overview of results for the quarter, update you on the holding company, and provide some perspectives on 2013 earnings expectations. Let's begin with first-quarter results. We reported operating income of $151 million for the quarter and net income of $103 million. The prior quarter included a $78 million favorable adjustment from the finalization of a new Government Guarantee framework in Canada. Excluding the favorable adjustment in the prior quarter, operating income increased 84% this quarter. In Global Mortgage Insurance, reported net operating income was $102 million compared to income of $55 million in the prior quarter after excluding the favorable adjustment in Canada.

Let's cover Canada results first, where operating earnings were $42 million for the quarter. Unemployment in Canada rose slightly to approximately 7.2%, and there was modest sequential increase in home prices. Premiums were down slightly from the maturing of the larger 2007 and 2008 books of business. Changes put into effect in July of last year to 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 flow NIW in the quarter down 25% sequentially. We did complete several bulk transactions in the quarter of approximately $2.4 billion. We participate selectively in this market, and these transactions consist of low loan-to-value prime loans. The loss ratio was flat sequentially at 31%, and improved seven points from the prior year from lower new delinquencies, net of cures, and continued improvement in Alberta. For Australia, operating earnings were $46 million versus $62 million in the prior quarter, which included a favorable tax impact. Unemployment in Australia rose slightly to 5.6% and home prices rose approximately 3% sequentially.

Premiums are up from the prior year as the larger 2012 book matures and more premium is recognized. The origination market was down 15% sequentially from normal seasonal variation, the flow NIW down 18%. The loss ratio for the quarter increased to 47%, which is up 11 points sequentially but still within the targeted range of 40% to 50%. Overall, delinquencies were flat to the prior quarter, with seasonally higher new delinquencies and lower cures. A partial sale of our Australia MI platform remains a key priority, and we want to execute a transaction when it makes the most sense for shareholders. Of course, execution of the IPO is subject to market, valuation and regulatory considerations, and we do not expect it to occur until the fourth quarter of this year or later. We will provide updates on our IPO plans during the year. Regarding other countries in the international mortgage insurance segment, the operating loss was down sequentially to $7 million driven by lower new delinquencies, primarily in Ireland.

Moving to US MI, we achieved an important milestone as the business had a profitable quarter with net operating income of $21 million. During the quarter, we made a change to the way we account for premium refunds wherein a delinquent loan goes to claim. We have restated the financial information in our earnings reports to correct this error for all periods presented. The cumulative decrease to retained earnings was $46 million as of January 1, 2012, and the impact to GMICO's statutory capital position in the first quarter 2013 was a reduction of about $55 million or an increase of two points to its risk to capital. We are seeing strong NIW growth over the prior year from an increase in both refinance and purchase private MI penetration, a larger origination market, and stable market share.

Total losses were down $96 million from the fourth quarter from lower new delinquencies, seasonally better cures, and favorable changes in aging. Our total flow delinquencies fell by 22% from the prior year, with new delinquencies down 12% sequentially and down 18% 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, now at 34%.

Turning to capital in the division, Canada and Australia remain sound. The MCT in Canada was approximately 216%, compared to our minimum target of 190%. The business paid its ordinary dividend in the quarter, and we are pleased that the Canadian Board authorized a share repurchase through a normal course issuer bid. Genworth Financial will participate in this normal course issuer bid, ultimately benefiting the holding company cash and will keep our overall ownership percentage at its current level. In Australia, the prescribed capital, amount or PCA, was 144%, in line with our target of 135% or greater. A new set of capital standards went into effect in January 1 of this year that the minimal impact on our capital position in the first quarter. Also during the quarter, the business terminated AUD100 million of affiliate reinsurance.

In US MI, at quarter end and the combined risk-to-capital ratio was approximately 24.2 to 1, and the risk to capital for GMICO was approximately 26.4 to 1. The combined risk to capital ratio improved about six points from year end from the transfer of Europe MI that added approximately $230 million of capital and was partially offset by the premium refund accrual change. Finally, we are pleased to have completed the US MI capital plan. As part of that plan, on April 1 the Company contributed $100 million to GMICO, which should have a favorable impact to its risk to capital of approximately three points.

Now let's discuss the US Life Insurance Division, where reported earnings were $85 million. The results in the quarter reflect favorable mortality and life insurance, long term care insurance, and fixed annuities. Life insurance earnings were $36 million for the quarter. Total revenues were down sequentially, driven by two factors, lower bond call and other investment income, and lower sales. Sales were down both sequentially and year-over-year as we made product and pricing changes in the second half of last year to improve profitability and capital utilization. As Tom mentioned, we continue to make product and pricing changes, including launching a new index UL product, as well as repricing our term products in the second quarter to improve competitive position. Term Life mortality experience was better than pricing assumptions, but less favorable than the prior quarter.

Long term care earnings of $20 million were up from $7 million in the prior quarter, benefiting from higher claim termination rates due to higher mortality. During the quarter, we made several adjustments to actuarial reserves and premiums that had a net favorable impact of $6 million after-tax. Individual long term care sales were down this quarter as the accelerated sales ahead of the previously announced pricing and portfolio actions subsided. With the launch of a new long term care product insurance last month in 31 states, we may see a temporary increase in long term care sales as a result of people purchasing the old product prior to regulatory approval of the new product, which has higher prices. With respect to the recently-initiated in-force price actions, we have filed in 49 states and are making good headway so far. We have received approvals representing approximately $60 million to $65 million against the total anticipated premium increase of $200 million to $300 million when fully implemented.

In 2013 we anticipate an impact of $20 million to $30 million in premiums for the year from the price actions. The reported loss ratio was 69%, seven points lower than the prior quarter figure of 76%. Excluding the actuarial reserve and premium adjustments in the quarter, the loss ratio would have been 72%. After excluding the reserve and premium adjustments, the new generation product loss ratio is up two points from the prior quarter to 59%, while the old generation product loss ratio is down 12 points for the quarter to 103%. We believe reserves for both GAAP and STAT were adequate. We completed our annual statuary cash flow testing process in the quarter, and this work indicates across the group of life companies, that there is margin for future deterioration. We recognize there are significant interests from our investors around our long term care balance sheet, and we plan to provide more details on it, including the reserves, later this year.

Fixed annuity earnings were $29 million, with sales down from the fourth quarter as we continue to maintain spread margins in the low interest rate environment. SPIA mortality was very favorable to both the prior year and prior quarter, but we do not expect such favorability to continue.

Turning to capital, the US life company's risk based capital ratio is estimated to be about 450%, up from the prior quarter from improved equity markets, favorable credit markets, lower new business strain, and sales in our investment portfolio which reduced required capital. At the end of the quarter, the unassigned surplus was approximately $335 million, down slightly from year-end as an increase in non-admitted reinsurance and variable annuity hedge losses from the favorable equity markets, more than offset statutory operating income. Relative to prior quarter, our after-tax statuary operating income was down due to lower subsidiary dividend and NOL utilization, partially offset by favorable market impacts, helping variable annuity results.

Shifting to the Corporate and Other Division, the net operating loss for the quarter was $36 million. International Protection earnings were $6 million for the quarter. The business continues to navigate the tough European environment, and is working to reduce its footprint there by exiting certain distribution relationships and by expense actions. The business is making progress on its plans to grow in new markets in reinsurance, such as through our relationship with MAPFRE in Latin America. The run-off segment experienced less favorable tax benefits compared to the prior quarter and prior year that benefited from favorable equity markets versus the prior quarter.

Turning to investments, the global portfolio of core yield decreased slightly and total impairments remain low. The low rate environment does continue to pressure reinvestment rates and we saw some spread tightening in the quarter. We continue to take a conservative approach in our portfolio to balance yield, credit quality, and duration matching in our investment decisions. In the prior quarter, we provided an update on the impact from an extended low rate environment and operating earnings per share. Our current view of the EPS impact of an extended low rate environment is still in line with that analysis.

Let me now cover some topics at the holding company. We continue to generate and maintain significant liquidity, with cash and highly liquid securities of $955 million at the holding company, in line with our target of two times debt service, plus a buffer of $350 million for stress scenarios. We anticipate maintaining cash and highly liquid securities of at least two times debt service plus the $350 million buffer, although the buffer may dip temporarily below that level within quarters due to timing of cash inflows and outflows.

As I said earlier, on April 1 we contributed $100 million of holding company cash to US MI as part of the comprehensive capital plan. We expect holding company cash to remain in line with our targets, including the $350 million buffer, at the end of the second quarter. We will evaluate the target level of the buffer as circumstances change. Some considerations that may impact the buffer target include near-term debt maturities, the stability and predictability of business dividends, and access to credit lines.

In March, we announced that we had reached an agreement to sell the Wealth Management business for $412.5 million. This sale represents an important step in our strategic plan to rebuild shareholder value. As a result of that agreement, we are realizing a loss of $27 million on the sale this quarter, and are reporting the business' discontinued operations, with prior periods also represented to reflect this change. We expect the transaction to close in the second half of this year, subject to customary closing conditions, including requisite regulatory approvals.

Net proceeds from the transaction, after transaction costs and the Altegris earn-out payment, are estimated to be approximately $360 million. These proceeds will be held at the holding company and used to address the $500 million of 2014 debt maturity, with the remaining $140 million of the 2014 debt already provided for in our cash plans. As part of our goal of increasing financial strength and flexibility, we will continue to look for ways to extend our debt maturities and to pay down debt towards our medium-term leverage goal of 20% to 22%.

Before I wrap up, I wanted to provide some perspectives on 2013 earnings expectations. We still expect that annual overall earnings for Genworth will increase this year over 2012 as our US Mortgage Insurance business recovery continues. Assuming no significant deterioration in US housing market, or material economic downturns, overall performance in US MI should be much improved over 2012, given the 2009 and forward books of business, should comprise 40% to 45% of the risk in force by the end of the year. International Mortgage Insurance earnings should be generally stable as those businesses operate in steady economic environments with quality portfolios and continue to maintain margins.

While the US Life Insurance Division faces headwinds such as the low interest rate environment, it is taking actions which should improve performance in future years, such as the long term care insurance rate actions and the rollout of new long term care and life insurance products. After adjusting for last year's life block transactions, we expect that overall US Life Insurance Division earnings in 2013 will comparable to those of 2012. Finally, we expect that the Corporate and Other Division quarterly results for the remainder of this year should be down slightly from the first quarter result, given the good equity market performance we saw in the quarter. While we expect overall results to improve this year, we recognize that we have much work ahead. We are very focused on improving performance as we continue to execute our strategic plan and rebuild shareholder value. With that, let's turn it over for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Sean Dargan, Macquarie.

Sean Dargan - *Macquarie Research - Analyst*

I have a question for Kevin regarding the outlook for US MI. Just when I look at the results this quarter, I understand there's some favorable seasonality in the first quarter. But when I look at the results of some of your MI competitors have put up in their outlook for the year, and I see your reserves in Florida, which I know will be a trouble spot this year. It seems to me that perhaps the outlook is a bit cautious?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes, Sean. I -- obviously we are quite pleased with our results in the first quarter. We are encouraged by the direction that we're seeing and what's going on with our business performance. As you said, we do benefit from seasonality in the first quarter, in particular -- and you really in the first half of year, but in particular in the first quarter. And we just think the environment has enough uncertainty that remains in it. There is still a sluggish job growth, and that really hasn't taken off, even though home prices are generally trending up, which is very positive for us. We just think at this point in time, our best course is to remain cautious, and we will certainly update you as we progress through the year, as we continue to observe our development, and we will be back at the next quarter with -- to see if we need to revise or change that outlook going forward.

Sean Dargan - *Macquarie Research - Analyst*

Okay. And I have a follow-up. I think it was said that the target risk to capital level and US MI would be 25 to 1, but it seems that the NAIC and the GSEs will be looking for more stringent capital requirements going forward, maybe in the range of 20 to 1 or 18 to 1. I was wondering what your thoughts are around that, and if something like that went through, how would you get there?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes, great question. Tom observed in his comments that we are committed to managing down our risk-to-capital level below the 25 to 1 statutory requirement. And I would say ultimately in line with other outcomes that may come out from either the NAIC or the GSEs. There is many ways one can get to that and to achieve that reduction in risk-to-capital. And just to highlight a few besides the obvious, one is profitability and ongoing improvement in our statutory income. Second possibility with some reinsurance. Another way we might -- that might help us further get down to those type levels is the ultimate realization of some of our DTA benefit over time as profitability improves. So we got a number of different ways to get after that, and we will consider all of our stakeholders over the long term as we get more clarity on what those levels are ultimately going to be. I think it is a little premature to make that call, but we are talking with all those same folks, as you can imagine, on an ongoing basis. And we do think it is prudent get that number back down over time to below the 25 to 1 level.

Operator

Steven Schwartz, Raymond James & Associates.

Steven Schwartz - *Raymond James & Associates - Analyst*

A couple of number questions, if I could. First on long term care and the actuarial assumption changes. Maybe Marty, you can go through how that affected the revenue line and the expense line. I think it changed both.

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

This is Pat, I will take that question. The first quarter adjustments favorably impacted reserves, a net of $20 million on an after-tax basis. And there was a unfavorable impact to reduction to premium -- reported premium revenue of $14 million after-tax. And that's the net of six.

Steven Schwartz - *Raymond James & Associates - Analyst*

And that's the net of what?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

Of six.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. All right. And then looking at page 8 of the presentation, at the bottom, am I looking at these percentage numbers for life insurance? Is that A-to-E, is that with those numbers are? 96, 97, 93, 80, 88?

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

Yes, those are actual-to-expected ratios for term mortality where the expected is pricing.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. And then going back to US MI, I'm wondering about maybe an update on anything regulatory going on?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes. I see, no, I don't think there's any real breaking news on anything from a regulatory standpoint. We continue to actively participate and watch what may happen as it relates to any changes regarding the FHA. The government certainly watching that closely and trying to protect the taxpayer, so there is certainly an opportunity for some changes in terms of the regulatory framework around FHA. The QRM standard has still not come out and been published and finalized, so that remains something that we watch and are actively involved in, particularly as it relates to the potential for some down payment requirements to be QRM qualified. I think, based upon where I see that heading right now, it is more likely that QRM is -- could end up being broadly defined similar to QM.

We think that's a reasonable outcome for us, and then the last thing really is -- or two additional things. One is, where does Basel end up, particularly for portfolio holders of mortgages where they have mortgage insurance on them. There remains some discussion around whether those folks will get credit for the credit enhancement provided by the mortgage insurance, but that's still up in the air. And then -- we got a busy regulatory agenda. The final thing is, just where do we stand on GSE reform? And there's a lot of dialogue underway on that. I just don't see any big changes coming in calendar '13.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay, great.

Operator

Joanne Smith, Scotia Capital.

Joanne Smith - *Scotia Capital - Analyst*

Yes, I just had a quick numbers question and then a broader question. I was wondering, what is the private mortgage insurance market share numbers, currently? And then just secondarily, I was just wondering if you could talk a little bit about additional asset sales, going forward? You've announced the wealth management and the home equity portfolio. I'm just wondering if there are other non-core assets that you're thinking about maybe disposing of?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes, Joanne. I will start off on the market share question as it relates to private mortgage insurance. Our penetration as an industry in the first quarter was around 8% in aggregate, and that includes both the refi and the purchase penetration levels. The most interesting percentage, I think, is really the growth in our purchase penetration. As you know, we have a much higher -- out of every 100 loans we get a lot more MI loans from the purchase side than we do on the refi side, and that's been held steady over 16% for both Q4 and for Q1. So we are really back to -- certainly back to pre-crisis levels, and actually back to pre-early 2000s-type levels.

So we are getting back into a range where we have a nice purchase penetration outcome, and now we're just waiting for that purchase market to really start to come through. And I think home prices have, and the combination of both home prices, where they are, and interest rate environment right now makes it very attractive for people to get back into the purchase market. If we had a little bit more, I think, improvement in what's going on from the job creation side, we think there's a lot of buyers that will come back into the market even as rates may trend up a little higher. So about 16% refi is about 5% total, 8% on the quarter.

Joanne Smith - *Scotia Capital - Analyst*

Just a quick follow-up before we move onto the other questions. It seems to me that there's some regional strength in the housing market where there might be weaknesses that continue in other regions. Can you talk a little bit about what you are seeing the strengths and the weaknesses and the market currently?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Yes, as you probably read yourself, a lot of the markets that had been seeing the most significant stress are really starting to see some strong comeback in terms of their home price numbers. So you have good home price appreciation going on out in the West Coast, even due in Florida to some extent, much more -- not recovering quite as strongly because of the drawn-out foreclosure environment down there. Phoenix and Nevada are even improving. So all the places that suffered the biggest declines are seeing some strong growth. We do continue to see some weakness in the Northeast, in particular in New York and the New Jersey area. Just not quite as strong, and so we're monitoring that closely, but overall across-the-board, we think we've got a firm bottom and things are headed in the right direction.

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

This is Tom. I will take your question on sales and other strategic priorities. First, as you know, the Australia IPO is still a priority for us. But keep in mind that our 2013 cash and capital plans didn't include it, so we are not under pressure from overall capital cash position to do anything. We have said a few times before that we think that better timing for the IPO will be later this year in the fourth quarter, maybe even to next year, and there is two reasons for that. First, while we are pleased with the results of the last four quarters in Australia, we do expect continued good performance, and so therefore we think that helps the value over time. And second, we haven't seen a lot of IPO activity in Australia, and so we'd like to see over the next few months a little bit more evidence of a good IPO market, so we are really watching those two things quite a bit, and we will have more to say on that later in the year.

The other business that's non-core is LPI, and we did -- we have looked and continue to look at three options. Running off now, sell it now, or position it for sale in the future. And when we've done our work on that, we think from a shareholder value perspective, of the three scenarios, the best is to position the business for sale in the future which -- and what do we mean by that? Next two to three years.

And I make a few additional points about LPI. It is still profitable, despite very tough markets in Europe. We believe management is doing a good job given the challenges they face. They are focused on reducing the footprint in Europe, and you know we said that we want to reduce the number of strategic distribution partners by half, which we think will strengthen the business. We are also reducing expenses in line with the reduction in sales. We are selectively expanding in new markets outside of Europe, and we are tightly managing the capital and still expect to see LPI pay dividends as planned to the holding company. So looking at all of that, we are still convinced that the best strategy for shareholder value is to wait, hopefully see some improvements in Europe in time for the other platforms to develop for value later on. Obviously, we will keep you updated as the year progresses. And then finally on the variable annuity business, they are having a few transactions that have happened. From a value perspective, we don't think the value yet is there to do anything, so we will continue to look, but nothing imminent there.

Operator

(Operator Instructions)

Mark Palmer, BTIG.

Mark Palmer - *BTIG - Analyst*

Just a quick question for Marty. And following up on the Australian IPO discussion. On the last conference call, the fourth quarter call, I believe you made the remark about there had been some signs of improvement in the Australian capital markets, such that a fourth-quarter IPO could potentially be more feasible. Just want to get a sense of if you're seeing those same signs now, or if there's been any change since that comment?

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

Yes, Mark, I would say we really haven't seen any change. I think the markets -- equity markets over there are generally in the public markets, working okay. But one thing that really hasn't happened, as Tom just mentioned, is a really continues -- there really not being any significant IPO activity. We do see that, maybe a few months ago, perhaps a pipeline that's building, but nothing's really come to market yes, so we want to watch that pretty closely.

Mark Palmer - *BTIG - Analyst*

Okay, fair enough.

Operator

Ed Shields, Sandler O'Neill.

Ed Shields - *Sandler O'Neill & Partners - Analyst*

I think I've got a question for Marty here. With the proposed NAIC model changes for our RMBS and CMBS, can you just comment on anticipated impacts this may have on your RMBS, CMBS, or the RBC ratio, either in whole dollar amounts or RBC points?

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

Sure. Let me actually turn that over to Dan Sheehan, our CIO, who has been tracking that pretty closely.

Dan Sheehan - *Genworth Holdings Inc - SVP, Chief Investment Officer*

Yes. A couple things. Most importantly, I just want to note that that proposal is still in the comment period. As recently as yesterday, there were discussions around potential implementations and there -- certainly a number of questions that still need to be answered. So at this point, I think it is preliminary. I will follow it closely to make sure that, as we move closer to implementation, we are aware of the changes and the impact on the portfolio. I think there are two real changes that are being discussed. One is to broaden the inclusion to be all cash flows and not just principal-based. The second is to change to a risk-free discount rate versus the coupon rate. I think both of those are potentially negative for capital at the QSF level on a case-by-case basis.

I think one positive coming out of the discussion, though, is that there is a lot of talk about finalizing assumptions much earlier in the year, which is a positive for the industry. At this point, our expectation is that we would manage any impact from this change within our existing capital plan. And I say that for number of reasons. First off, we have not been an active buyer of these legacy positions, which have benefited from the recent capital changes. Secondly, our Legacy portfolios have continued to decline, and that decline has actually accelerated in the last few quarters. And so we believe that we have a manageable book, and you've seen that come through in a steady improvement in the level of impairments over the last few quarters.

And then finally, there's also another proposal on the table to change the risk-based capital rules for commercial mortgages, and that was actually approved at the capital adequacy task force yesterday, and so it is actually ahead in the process and more likely to be implemented in 2013. That proposal is actually going to change the model to be based on a combination of loan-to-value and debt service coverage ratios, and to model more closely the way bonds are modeled from a capital basis. Based on the overall quality of our portfolio and the historical strong performance, we would expect that change to be positive. And so I would say the net effect, if both of these changes go into effect this year, I would probably be neutral to slightly positive.

Ed Shields - *Sandler O'Neill & Partners - Analyst*

Okay, great.

Operator

Conor Ryan, Saba Capital

Conor Ryan - *Saba Capital - Analyst*

What sort of NIW are you guys trying to target in the 2014 and 2015 context?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Conor, we haven't really -- this is Kevin. In the US, We haven't really provided any expectation on '14, '15. I would think of it as an origination market that should be growing from the points we are at this year, where what we provided for this year is, we think we will be in the 15% to 20% range. I think we will probably be in the middle to upper end of that range. Think about it, then, as we talked about earlier in response to Joanne's question about a 16% purchase penetration market going forward. I think that gives us an opportunity for some expansion, and our NIW going forward and a little bit of share progression potentially. So I think growing marginally over time into '14 and '15 back into some more traditional and sustainable levels of NIW delivery.

Conor Ryan - *Saba Capital - Analyst*

Okay. And then, do you guys feel confident that your long term care reserves are more than adequate? And most of the issues associated with that segment are largely behind you?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

With respect to the reserves, I would say that, as Marty indicated, we completed our year-end regulatory cash flow testing and across the US Life companies, the reserves were adequate. And with sufficient margin inclusive of provisions for adverse deviation that we provide for in that testing. We also completed and continue to regularly monitor our GAAP long term care reserve adequacy testing. And the results, again, of our most recent testing indicate the aggregate reserves are adequate with sufficient margin under current assumptions and expectations. In addition, in the third quarter of last year, we updated, fairly comprehensively, our assumptions around our long term care claim reserves, and did a thorough review of claims history.

Since implementing those changes in third quarter, our emerging experience is indicating our claim reserve levels are just slightly more than needed in aggregate, which is appropriate given that they're claims -- best estimate claims reserves and relatively short duration. With respect to the performance of the long term care business, I would say that, as Tom indicated, we've got a lot of work to do. Our progress to date on the re-rating of the older blocks is in line with our expectations. But there's a lot more work to be done there, as well as repositioning the new business portfolio from a risk and profitability perspective. We have taken a series of actions, and you can expect more on that front. So more work to do, but good progress to date, I think.

Conor Ryan - *Saba Capital - Analyst*

Right. And so, just tying into that, obviously you guys have done a great job of addressing some of the credit market's concerns associated with some of your subsidiaries. And given that you think you have more than adequate reserves levels, is it possible that you are being conservative with holding company cash? And at what point in the future, or what level of profitability would you want to be at before you started really focusing on potentially shifting your attention from improving ratings and improving your credit worthiness to focusing on shareholders?

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

Conor, let me just give you a little bit of a perspective on my view on long term care. Certainly we think the improvements we are making there are very important from a shareholder value perspective. I want to make it clear that I think it will be a challenge to turn the long term care business around. There are three key priorities from our perspective. The first you know about, and we are well along the path, which is large in-force rate increases on the older books, which given a lot of issues and low interest rates lapses, things that you've heard about, we need significant increases on to bring those back to a breakeven. And that's real hands-on work. It requires us to meet with each of the 50 state regulators. I'm personally involved, as is Pat and others. And so there is progress to be made, but that's an ongoing challenge for us.

We -- I also said in my prepared remarks that on the newer products, and let's roughly define those as products issued on forms since 2004. Right now those products are profitable, but just given that rates are lower now than they were, they may require some rate increases going forward. And so the second part of our strategy is on the newer products to continue to proactively manage them, look at the results and experience, and be prepared to go sooner and perhaps more frequently to regulators to the extent we think that's necessary. And then finally, I think the team -- Pat's team have done a good job on new products. We just launched a new product on April 15, which we call Flex 2, which has a significant number of improvements from an underwriting perspective, reducing benefits. And we hope that that will be a very successful product. We will see. It has been launched in 31 states.

We will continue to look at those products going forward. So I would say, on long term care, we are making progress, but there's a lot to do going forward. And coming back to the question on shareholder value, we have four priorities. I think among the most important priorities from improving shareholder value is to improve the operating income ROEs of all the businesses. US MI, getting that to sustain profitability, and fix these legacy issues we are talking about in long term care and other businesses. I think that is very important to do. As we make progress on the operating income, we will look at other options from a shareholder perspective and returning capital. And Marty may have a few comments on the capital and cash plans as they are today.

Conor Ryan - *Saba Capital - Analyst*

Yes, I guess quickly interject and then I'll let Marty follow up is that, I'm not disagreeing that improving operating efficiency, improving ROEs are going to be the single biggest driver of shareholder value. But I'm just curious what are -- what is your thought process around when you would feel comfortable potentially returning capital to shareholders and/or what would have to happen for that to occur?

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

Look, as I say, I think we -- if you look at our ROEs today and operating performance, it's not where we want it to be, and we want to continue to improve it. We of course continue to look at options to unlock shareholder value, and some of those are on the transactions we've done. We are also -- there is the Australia IPO and other actions that we will take over time. And clearly we do understand the need to run the businesses well, manage capital tightly, focus on selling products above the cost of capital, and returning capital to shareholders when we can. We need to continue, though, to make improvements and improve our financial flexibility, I think before I would be comfortable with doing a lot there. And Marty, I will let you add your point of view.

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

Yes, and I would just add that getting more stability in our operating company dividends is important. And as I think you know, the life company, for the first time this year in a number of years, is now -- has the ability to return an ordinary dividend. But it is early days. We want to watch that closely. We feel like, early in the year, we are pretty good stead in that, but we have to watch that as a place through the year. We also, I'd also point out, while our ratings outlook with Moody's stabilized, we still have a negative outlook, as Tom mentioned in his remarks with S&P at BBB minus. So we -- that was a negative outlook, and so we really feel like we want to continue to get some increased financial flexibility and hopefully clear that up.

I would say that we -- I think that the holding company cash targets of two times debt service is an absolute minimum threshold for us, and this $350 million target buffer we have in excess of that is to make sure we are always able to have that two times debt service. And as we get some more stability and certainty in our dividend flows, as we take care of some of their nearer-term debt, for example the 2014 bonds, we are going to dedicate the wealth management proceeds towards that, but we haven't closed the wealth management transaction yet, so we need to do that. Then also, if we are able to get credit lines in place at some point and get some form contingent liquidity, those would all be considerations as we might think about revising the buffer, but we have to get through some of those things first before we would do that.

Conor Ryan - *Saba Capital - Analyst*

Yes, no. I'm not trying to assume any of this happens tomorrow. I'm just curious. It sounds like, to the extent that you can generate some of the operating performance that you are looking to achieve, we could be in '14 -- let's say we are in the '14, '15 timeframe. And now any earnings that you are generating could theoretically be more solely focused on shareholders, is that fair?

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

Yes, I think that's very fair. And we will look at, when we get there. And we are working hard to get there on all the options that we would have to return capital to shareholders, including dividends and share repurchases. And obviously an important event to go this year is the Australia IPO, which we hope to do later in the year.

Operator

Craig Perry, Panning Capital.

Craig Perry - *Panning Capital - Analyst*

Congratulations on the quarter. Just very quick question. I was just curious -- somewhat related to Conor's question. Would you also consider, similar to what you've done in Canada, a partial IPO of the US mortgage businesses, assuming a return to profitability? Obviously, there are certain groups of investors who have a particular interest in owning that asset. And so just curious to get your thoughts on that.

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

You know, Craig, it is interesting. When I came to Genworth in January, I don't think I got that question.

Craig Perry - *Panning Capital - Analyst*

You would have gotten it from me, I promise.

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

Yes. I don't think I did receive that, but with the actions that some others have done in the industry, and I think particularly this quarter with the profit for US MI, that question is starting to appear. But let me say where I am on that. First, we are focused on continuing to improve the business performance in US MI. Once US MI is consistently profitable, and the 2005 and 2008 books on no longer an issue, we will look at evaluating various options for US MI, but I think it is premature now to be looking at or talking about those options.

Craig Perry - *Panning Capital - Analyst*

Got it. Please include my name in the book when you do float it.

Marty Klein - *Genworth Holdings Inc - SVP & CFO*

(laughter) We will think about that. And I would just add that we are very focused on -- for thinking about IPOs, the Australian IPO, as Tom mentioned. So we will look to see if we can do that in fourth quarter. It may come later, but we want to focus on that. And we think actually, as you compare the two, that would have a better return profile for shareholders at this point in time versus the US MI IPO.

Craig Perry - *Panning Capital - Analyst*

Got it.

Operator

Jimmy Bhullar, JPMorgan.

Jimmy Bhullar - *JPMorgan Chase & Co. - Analyst*

I just had a question on your -- on the MI business. So it did pretty well this quarter, and it's even better if you take out the charge, so I was a little surprised that you didn't change your guidance for profitability for the year. I think you are expecting a profit one to two quarters, and a modest profit for the year. So just wondering how you expect MI margins to trend. I recognize there is a little bit of seasonality in the first half versus second half, but is there some built-in conservatism in your numbers? Or was there something this quarter that you saw that might not repeat in the next few quarters?

Kevin Schneider - *Genworth Holdings Inc - President & CEO of Global Mortgage Insurance*

Jimmy, this is Kevin. As I responded to Sean's first question this morning, there's nothing new we are seeing at this point in time that would either cause me to guide you up or down from the guidance that we provided at the beginning of the year. Our news continue to come down. We have seen the seasonality that you see in the first half. You've got to recognize that that means you don't always have it in the second half. And so you can have some upward pressure on your cures and things in the second half of the year.

We do expect, as the economy continues to mend and heal, the second half could have some economic improvement that could be favorable to you. And as I have referenced before, we have a -- the benefit of some interest dividends that run through our investment line that we get in the first quarter and the third quarter of the year. So there is a little bit of timing issue on that was favorable in the first quarter. But other than that, we just think, at this point in time, we're going to remain cautious. It is still an uncertain environment, and just as soon as we are prepared to update you either direction, probably next quarter call, we will be back to provide you that progress and our views at that point in time.

Jimmy Bhullar - *JPMorgan Chase & Co. - Analyst*

Okay.

Operator

Joanne Smith, Scotia Capital.

Joanne Smith - *Scotia Capital - Analyst*

Yes, I just wanted to go back to your comments about the long term care rate increases. And I think the comment was that, on the older book, that the rate increases are enough to get you in a breakeven or slightly above. And that the strategy going forward is that you would like to go back to regulators for smaller rate increases more frequently. And I'm just wondering how these conversations are going to go with regulators once you're at a premium deficiency mode on that book? Is it going to become more difficult to get those more frequent rate increases?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

This is Pat, Joanne. I will take that question. When we make the reference to smaller and more frequent rate increases, we are looking really of the policies issued on forms introduced since 2004, which are different groups of policies from those older blocks, where we are looking for the rate increases to get back to say a breakeven or modestly better than that. And the approach -- the rationale for the approach there is that we need to stay on top of the emerging experience, and we've learned from the old books of business that acting early and preemptively with smaller increases is more manageable for policy holders. We think it is something that's more doable and approvable from a regulatory perspective because of the implications of large increases. And also from the point of view of the Company and shareholders, in terms of managing to a target pricing result. As -- if we are reacting quickly to emerging circumstances and making adjustments, it really lowers the overall risk profile of the book. And we think that learning from the lessons of the past, as we look at the newer books and business, that's the right way to approach it.

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

And Joanne, it's Tom. I just want to reference back to my earlier prepared remarks, because I think the language I used is a little bit different than what you said. What we think is the significant price increases that we are requesting bring the older business closer to a breakeven point and also helps to reduce the strain on earnings and capital.

Joanne Smith - *Scotia Capital - Analyst*

Okay, thanks for clarifying.

Operator

Ladies and gentlemen, we have time for one final question. Jordan Hymowitz, Philadelphia Financial.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

You have a big AOCI gain on the bonds. Can any of those bonds be sold and that gain locked in at this point? I know a number of them are attached to longer-term contracts. I guess, what portion of that approximately $7 in book value could be logged in today and replaced with lower yielding bonds if you wanted?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

Okay, this is Pat. That's -- thank you for asking that question. Our accumulated other comprehensive income is comprised, of course, of the unrealized gains on the bond portfolio, but it is also comprised of realized and unrealized gains on our hedging portfolio. And if you think about -- I will say outside the long term care business, in life insurance and annuities, where we have a lot of investments, we really matched cash flows, assets to liabilities. So while some of those bonds are in a gain position, we actually need the aggregate of the cash flows to match future claims and expenses and provide for future profits on the book.

But I will point out that, with respect to the long term care portfolio where we've used derivatives, hedging strategies to extend the maturities of our assets, the accumulated other comprehensive income includes, on a pretax basis, about $2.8 billion of realized and unrealized gains, which effectively are gains which, in the low interest rate environment, would be available to offset and to provide funding for claims and expenses on our long term care book. And that is something that I think distinguishes Genworth from a number of the other long term care carriers in terms of how we provided for protecting the downside associated with lower interest rates. And perhaps why some of our reserve adequacy calculations are producing different results.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

So $2.8 billion of the -- I think it's $3.7 billion, if I remember correctly, could hypothetically be realized and replaced with other at-market rate bonds, so to speak, and actually lock in those gains?

Pat Kelleher - *Genworth Holdings Inc - President & CEO of U.S. Life Insurance*

I wouldn't put it that way. First of all, in accumulated other comprehensive income, it is an after-tax number. So it would be more like $1.7 billion there, but effectively that includes the benefit of the $2.8 billion in realized and unrealized accretion of the value of those hedging positions. And that value will ultimately release through net investment income as the revenue to fund future claims and expenses.

Jordan Hymowitz - *Philadelphia Financial - Analyst*

Got it.

Operator

Ladies and gentlemen, I will now turn the call back over to Mr. McInerney for closing comments.

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

Thank you, Shannon, and thanks to all of you for your time and questions today. Just to sum up the quarter, I'd say that further execution on key strategic objectives moves us further along the path to a successful turnaround in the Company. The focus remains on accomplishing the 2013 goals that we laid out in February, and we are on track to do so. We feel the Company has products customers need, leadership positions in core businesses, strong distribution relationships, and we have an experienced team of hard-working employees and all of us have a strong commitment to execute Genworth strategy and deliver better performance for shareholders.

Operator

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