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CORPORATE PARTICIPANTS

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

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

Marty Klein *Genworth Financial, Inc. - CFO*

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

Pat Kelleher *Genworth Financial, Inc. - President & CEO of US Life Insurance*

CONFERENCE CALL PARTICIPANTS

Nigel Dally *Morgan Stanley - Analyst*

Geoffrey Dunn *Dowling & Partners Securities - Analyst*

Sean Dargan *Macquarie Research - Analyst*

Joanne Smith *Scotiabank - Analyst*

Suneet Kamath *UBS - Analyst*

Craig Perry *Panning Capital - Analyst*

PRESENTATION

Operator

Good morning, Ladies and Gentlemen, and welcome to Genworth Financial's second-quarter 2013 earnings conference call. My name is Allie, and I'll be your coordinator today. At this time all participants are in 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, speaker phones or headsets during the QA portion of today's call. I'd 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 of IR*

Thank you, Operator, and good morning, everyone. Thank you for joining us for Genworth's second-quarter 2013 earnings call. Our press release and financial supplement were released last evening and earlier this morning, our second-quarter earnings summary presentation was posted to our website. We encourage you to review all these materials. Today you will hear 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 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 forward-looking statements in our earnings release and the risk factors of our most recent annual report on form 10-K and form 10-Q 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 the 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'll turn the call over to our CEO, Tom McInerney.

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

Thanks, Georgette. Good morning everyone. Thank you for joining us today for our second-quarter earnings call. I would like to spend my time today briefly discussing second-quarter results, outlining the significant actions we are taking to improve the US Life Insurance division's performance and providing an update on the progress we are making on our strategic objectives and goals. We are working hard on our four strategic priorities to improve shareholder value and we are beginning to see some early progress. As a reminder, our four strategic priorities for 2013 are -- first, improve the operating performance of the businesses; second, simplify the portfolio; three, generate capital; and four, increase the financial strength and flexibility of the Company.

I am pleased with the results in the second quarter of 2013 as we reported operating income of $133 million, up $66 million compared to the prior year with improved performance in both the Global Mortgage Insurance and US Life Insurance divisions. US Mortgage Insurance continues to improve with a second profitable quarter and the combination of a larger originations market and the improving private mortgage insurance penetration rate is driving growth in new business which remains very profitable. Based on the first half of 2013, we now project that USMI is on a path to be modestly profitable in 2013 and we expect that its 2014 results should improve over 2013. We expect seasonality in the US mortgage insurance market in the remainder of 2013, which could cause the second half of the year to return to a marginal net loss profile. I'm satisfied with the Global Mortgage Insurance businesses are performing well with significant momentum coming from the ongoing recovery in the US mortgage insurance business. Driven by improvement in USMI and the expectation that Canada and Australia will continue to perform well, we are optimistic that Global Mortgage Insurance division will continue to show a trend of improving results in 2014.

The US Life Insurance division's operating profit in the second quarter was up compared to the prior year. We are taking strong and decisive action to improve the operating performance of the division. Our non-core businesses struggled, given the less favorable equity markets impact on the run-off business versus the prior quarter and the continued pressure from the European economy on the International Protection business.

Let me now turn to an update on our strategy to accelerate the turnaround of the US Life Insurance division, starting with our Long Term Care Insurance business. We are conducting an intense, very broad and deep review of all aspects of our LTC Insurance business. As you know, we are a leader in this business and several of our major life insurance competitors have exited from this business. We continue to believe there is an important role for private insurance in long term care. Since last quarter, I've been meeting with more insurance commissioners and state representatives as well as the NAIC to discuss our approach to managing the Long Term Care Insurance business. In my meetings with state regulators and public policy experts in long term care, there are different perspectives on the options that should be pursued.

Most observers realize that 30% to 50% of state Medicaid budgets are already allocated to paying for long term care for individuals, and with a looming challenge of 76 million baby boomers retiring at a pace of 10,000 per day, government entitle programs will become even more strained than they are today. Therefore, long term care experts believe there is an important role for private long term care insurance. At Genworth, we believe this creates a significant opportunity for us if we can substantially improve how we manage the business. In our view, there are three main priorities to improve our Long Term Care business. First, obtain significant premium rate increases on the older generation of LTC blocks written before 2002 to bring them closer to a breakeven point over time and reduce the strain on earnings and capital. Second, request smaller rate increases more proactively on newer blocks as needed. And third, introduce new products that are more tightly underwritten with appropriately priced benefits using more conservative assumptions.

In long term care insurance, we are seeking significant price increases on three older generations or series of products written from 1974 through 2001. We also are currently seeking price increases on one series of newer generation policies written from 2001 through 2007. We continue to make good progress on these four blocks, with approvals received as of June 30, 2013 representing approximately $115 million to $120 million of the targeted per annum premium increase of $200 million to $300 million when fully implemented. This compares to approvals representing $60 million to $65 million as of March 31, 2013.

Although it is very early in the process of communicating the long term care approved premium rate increases to Genworth policyholders, some very early trends are interesting. So far, approximately 81% of our policyholders are deciding to pay the approved rate increase; approximately 18% are deciding to pay their current premiums amounts and take reduced benefits, or they are taking the non-forfeiture option and 1% are choosing to lapse their policies. These are very early trends with only limited numbers of policyholder decisions and they may not be indicative of what other policyholders decide to do in the future. We believe it is possible that policyholders view the benefits provided on these older generation policies as a good consumer value despite the significantly higher prices. In addition, for those policyholders who would be overburdened by the large premium increases, they have the option to continue to pay the same premium by reducing their benefit. Policyholders that decide to take more limited benefits still retain policy terms of pricing, but are more favorable than new LTC products currently offered in the market.

We have substantially completed a review of long term care insurance policies introduced since 2003. These policies are still profitable but we believe the experience on these policies could be somewhat worse than assumed when originally priced, given low lapse rates and historical mortality-morbidity experiences. For certain Genworth long term care products issued since 2003, there is a need for more moderate rate increases now so we potentially avoid the need for much larger increases in the future. The approximate current annual premium for these products in aggregate is in the $600 million to $700 million range. We intend to begin filing for moderate rate increases on these policies in the second half of 2013.

The third part of our long term care strategy is to develop and introduce new generations of LTC policies that are priced using the latest information and expectations for interest rates, lapses, morbidity-mortality, and better underwriting and screening procedures. In April, our new product, Privileged Choice Flex 2, was introduced which incorporates underwriting changes such as blood and lab work and gender-based pricing. The Flex 2 product was approved by 31 states when launched and we continue to work with other states to obtain their approval on the new product. In addition, we are currently working on a refinement of the Privileged Choice Flex 2 product and expect to file this updated product in the fourth quarter of 2013. Our intention is to provide investors and analysts with a detailed review and update regarding our Long Term Care Insurance business in the Fourth Quarter of 2013.

In addition to our long term care actions, we have been introducing significant new product offerings as well as underwriting and pricing changes throughout the US Life Insurance division, with a focus on offering a range of products to consumers, managing the risk profile, and ensuring we are writing new business that is earning an appropriate return over the required cost of capital for shareholders. In Life Insurance, we have increased prices, introduced a new term product and made changes to our universal life product, including the introduction of a new indexed universal life product in the second quarter. We are working to expand the product portfolio offerings in universal life later this year. Given some of the market changes in life insurance, we are finding ourselves less competitive on pricing in certain products, and we continue to reevaluate product pricing, especially in term, where we are working to become more competitive in the middle market we serve but still maintain acceptable risk-adjusted returns.

Fixed annuities have had slower growth than expected as we have worked to maintain our target returns in the low interest rate environment. With the increase in market interest rates and some fixed annuity pricing changes, we have seen sales move higher this quarter and we continue to meet our return target. All of these changes taken together are significant for distributors, consumers and many of our employees. The breadth of these changes has caused sales to decline significantly overall through the first half of the year as we work through all these changes and continue to make adjustments with our product portfolio. We are working very closely with our distribution channels to address their questions. As we continue to transition this year and through 2014, we expect to see sales rebound.

Let me now turn to the progress made on other strategic objectives and goals. First, the sale of the Wealth Management business is expected to close in the third quarter with proceeds dedicated to paying down the 2014 debt maturity. Second, we are making good progress in achieving our 2013 goals laid out in February, especially around payment of dividends to the Holding Company which totaled $273 million in the quarter, including $100 million from the US Life companies and $133 million from International Mortgage Insurance. And finally, as we previously stated, we are targeting the fourth quarter of this year or later for our Australian IPO. The timing is based on when we could get the best results for our shareholders.

We are of course working through the numerous tasks to put ourselves in a position to execute an IPO of up to 40% of the Australian Mortgage Insurance business in this time frame. Overall, the Australian IPO market has seen some improvement but uncertainty regarding recent outlooks in the mining sector and from China make us cautious about the Australian IPO market. We will continue to monitor the market as we move through the second half of the year and we would intend to proceed with the IPO if it makes sense for shareholders, based on Australian equity market conditions and valuation and regulatory considerations. Our capital and liquidity plans did not anticipate the execution of an Australian IPO and therefore, we will execute when it makes the most sense for shareholders. Now I will turn the call over to Marty to talk about the quarter results in more detail.

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

Thank you, Tom and good morning, everyone. Today, I'll provide an overview of results for the quarter, give an update on our 2013 goals and provide some perspectives on our use of reinsurance and captives. Let's begin with second-quarter results. We reported operating income of $133 million for the quarter and net income of $141 million. Net income in the quarter included a $13 million after-tax charge related to our previously announced expense reduction plan, which ultimately should realize about $80 million to $90 million in annual pre-tax expense savings related to these actions. In Global Mortgage Insurance, reported net operating income was $102 million, flat to the prior quarter and up $51 million over the prior year.

Let's cover Canada results first where operating earnings were $43 million for the quarter. Unemployment in Canada was down slightly to approximately 7.1% 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. Flow NIW in the quarter was up 45% sequentially from normal seasonal impacts. NIW is lower than a year ago given the changes last year in eligibility rules for government-guaranteed mortgages. We completed several bulk transactions in the quarter of approximately $6.4 billion. These transactions consist of low loan-to-value prime loans and we participate selectively in this market. The loss ratio improved sequentially by 6 points to 25% and improved 7 points from the prior year from lower net new delinquencies as a result of an improving economic environment and the strong credit quality of recent books.

For Australia, operating earnings were $55 million versus $46 million in the prior quarter. Unemployment in Australia rose slightly to 5.7% and home prices were flat sequentially. Premiums are up from the prior year as the larger 2012 book matures and more premium is recognized. The low interest rate environment drove the origination market up approximately 10% sequentially with flow NIW up 13% from the prior quarter. The loss ratio for the quarter decreased to 35%, down 12 points sequentially. The year-to-date loss ratio is 41%, at the low end of our expected range of 40% to 50%. Overall delinquencies were down 1% from the prior quarter, driven primarily by seasonally higher cures. Regarding other countries in the international mortgage insurance segment, the operating loss was up sequentially to $9 million, primarily from higher losses.

Moving to USMI, the business had another profitable quarter with net operating income of $13 million. 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. Our total flow delinquencies fell by 23% from the prior year with new delinquencies down 11% sequentially and down 22% year over year, reflecting the continued burn-through of the 2005 through 2008 books, as well as the new better performing books becoming a larger portion of our overall portfolio now at 37%. Turning to capital in the division, the MCT in Canada was approximately 216% compared to our minimum target of 190%. In addition to paying an ordinary dividend in the quarter, the business generated proceeds to us related to its normal course issuer bid share repurchase program in which Genworth Financial participated to maintain our ownership at 57.4%. For Australia, the prescribed capital amount or PCA was 134%, just under our target of 135% but above regulatory requirements. In the quarter, the business paid most of the planned full-year dividend and had strong new business volumes, factors which impacted the ratio. We anticipate achieving our PCA target by year end.

In USMI at quarter end, the combined risk-to-capital ratio was approximately 22.4 to 1 and the risk-to-capital for GMICO was approximately 23.8 to 1. GMICO's risk to capital improved almost three points from the prior quarter and reflects both positive earnings as well as the $100 million capital contribution made to GMICO on April 1 as part of the comprehensive capital plan. In June, the FHFA announced strategic priorities for the GSEs and indicated there could be changes to GSE eligibility standards. These changes could increase capital or asset requirements for mortgage insurers. We don't know what these standards will be or when they would be implemented. As we get more specific information, we will assess the impacts on our business and approaches to meet the standards.

Turning to the US Life Insurance division, reported operated earnings were $79 million. Results in the quarter reflect less favorable mortality in Life Insurance and a favorable impact from our current rate actions in Long Term Care. Life Insurance earnings were $27 million for the quarter. Sales were down sequentially when you combine flat sales in our term product and a decline in universal life sales, and down significantly year over year as sales in our new products are not yet at levels seen in our discontinued term universal life product. As Tom mentioned, we will continue to make product and pricing changes to improve our competitive position and increase sales while meeting our return goals for the business.

Term life mortality experience is better than pricing assumptions and while more favorable than the prior year, it was not as favorable as the prior quarter. We also experienced less favorable mortality sequentially in other Life Insurance product lines that drove earnings lower. Long Term Care earnings of $26 million were up from $20 million in the prior quarter, benefiting from stable incurred loss performance, improved bond call and limited partnership performance, and the impact of our most recent rate action, which increased premiums and reduced benefits. The reported loss ratio for the current quarter was approximately 67%. This ratio declined two points from the prior quarter and is four points lower than the prior year when adjusting for the impact of a refined methodology in allocating components or reserve changes that we implemented as part of the system conversion and also when excluding reserve and premium adjustments in the prior quarter.

With those same adjustments, the new generation product loss ratio improved 2 points from the prior quarter to 55%, while the old generation product loss ratio improved 6 points for the quarter to 95%. Individual Long Term Care sales were up sequentially as sales accelerated ahead of the implementation of pricing and product portfolio actions that we took in the first half of the year. As Tom said, we are making good progress on the recently initiated in-force rate actions with approvals representing approximately $115 million to $120 million against the total anticipated annual premium increase of $200 million to $300 million when fully implemented. We continue to anticipate an impact of $20 million to $30 million in premiums for 2013 from the price actions.

As part of our strategic goal to improve financial strength and flexibility, receiving ordinary dividends from our US Life Companies has been an important objective. I'm pleased to say that the Life Companies paid an ordinary dividend of $100 million during the quarter. The risk-based capital ratio is estimated to be about 445% and unassigned surplus is approximately $200 million, both down from the prior quarter primarily from the ordinary dividend payment. Fixed annuity earnings were $26 million as SPIA mortality was unfavorable to the prior quarter. Sales were up from the first quarter from both pricing changes and the rise in interest rates. This new business is expected to meet or exceed targeted returns.

Shifting to the Corporate and Other division, the net operating loss for the quarter was $48 million. International Protection earnings were $1 million for the quarter. The business continues to navigate the tough European environment and is working on refocusing its footprint there, centered on key clients and on expense actions. Assuming the economies and the lending environment in Europe are stable and don't improve in the near term, we expect the business to produce only slightly positive earnings for the remainder of the year. The run-off segment experienced less favorable equity Markets versus the prior quarter but more favorable versus the prior year.

Turning to investments, the Global portfolio core yield was flat at 4.5% while total impairments of $4 million were low. An increase in interest rates from the depressed levels we've seen is a positive for us as it is for most other insurers, but the rise this quarter did of course impact the unrealized gain balance. We continue to take a conservative approach in our portfolio to balance yield, credit quality and duration matching in our investment decisions.

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 approximately $1 billion at the Holding Company, in line with our target of two times debt service plus the buffer of $350 million for stress scenarios. We continue to anticipate maintaining cash and highly liquid securities of at least two times debt service plus the $350 million buffer. As I've said before, we will evaluate the target level of the buffer as conditions change, such as the stability and predictability of business dividends, access to credit lines, and near-term debt maturities.

We're making good headway towards closing the sale of our Wealth Management Business, which is an important step in our strategic plan to rebuild shareholder value. We expect to complete the transaction in the third quarter of this year. Netting transaction costs and the Altegris earn-out payment from the sales price of $412.5 million produces proceeds estimated to be approximately $360 million. Net proceeds from the sale, along with cash already held in the Holding Company will be used to address the remaining $490 million of 2014 debt maturities. 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%.

Next, I want to give an update on our 2013 goals. We continue to make good progress towards achieving the goals that we laid out back in February. Our US Life companies are on track to meet their full-year dividend and capital goals and the business remains focused on the Long Term Care Insurance rate actions. Our Canadian and Australian Mortgage Insurance platforms are on target for the full-year dividend and capital goals and their loss performance has improved. USMI has benefited from a continued housing market recovery driving lower new delinquencies, stronger new insurance written and improved operating results, and has already met its full-year loss mitigation goal. And finally as I mentioned before, Holding Company cash is in line with our target.

I want to turn now to our use of captives in our US Life Insurance division, a topic which we know is of interest to investors. I will focus on how captives are used by our US Life companies and describe some of the corresponding financial details. Later this year, we also plan to provide more details on our Long Term Care balance sheet, including reserves and important underlying assumptions. Our US Life division has used captives almost entirely for its Life Insurance and its Long Term Care businesses. We do not use reinsurance or captives for our Variable Annuity business which is in run-off and we've used captives only on a limited basis in our Fixed Annuity lines.

For our Life Insurance business we use captives primarily to finance excess reserves from Regulations XXX and AXXX. Here I would make the following key points. All economic reserves are fully funded by our US life Companies; excess reserves are financed by various diversified third-party funding sources and are non-recourse with only one exception. In that one case, Genworth Holdings provides no more than $400 million of capital support with respect to our Term Life business, less than 10% of our financed reserves overall. I should also note that Genworth Holdings provides to our Universal Life captive structure a limited auxiliary guarantee, which was valued at $1 million at the end of 2012. All of our entities are structured to meet the requirements of, and are approved by, various US domestic regulators.

I will now move from XXX and AXXX structures and provide more details behind our Bermuda captives and relationships with our Long Term Care business, but first let me provide some context on our organizational structure. Our Bermuda-based subsidiary, Bookfield, owns our Australia MI entities, approximately 41% of Canada MI, and the Brookfield Life and Annuity Insurance Company, Ltd., or BLAIC, which in turn owns the International Protection group of companies. This organizational structure when it was created, helped us more efficiently manage capital across our operating entities.

For our Long Term Care business, in recent years we've been reinsuring 40% of our business to a third-party reinsurer. Of the business that we retain at Genworth Life Insurance Company, or GLIC, one of our US domiciled life companies, 50% has been reinsured on a proportionate quota-share basis to BLAIC. Here I would note the following important points. The BLAIC treaty is co-insurance with funds withheld, which means that US statutory reserves are backed by a high-quality portfolio of assets that are held by and are under the exclusive control of GLIC, giving it direct access to all the assets that back the statutory reserves. Long Term Care reserves represent approximately 75% of BLAIC's reserve exposures. Reflecting only the close to $900 million of capital made up of hard assets in BLAIC, consisting predominantly of cash and investment-grade bonds, the corresponding RBC ratio was approximately 390% at year-end 2012. We estimate the RBC ratio at the end of the second quarter to be in line with the year-end 2012 level.

Given the capital levels that we were holding at BLAIC at the end of 2012, if we were to repatriate the Long Term Care business from BLAIC into GLIC, we would anticipate a minimal impact to the US Life Company RBC ratio. This reinsurance relationship in our LTC business goes back many years and had originally been set up to mitigate the capital strain created by our growing Long Term Care block. The reinsurance had also provided capital benefit as we use to manage to a minimum of RBC ratio to 250% in Bermuda for our Long Term Care business versus our current minimum of at least 375% in our US life Companies. However, capital levels in BLAIC have been significantly higher than its 250% management threshold for the last couple of years, as we book capital levels more commensurate with long term care insurance risks to increase our financial strength and flexibility.

In Bermuda, we complete annual regulatory filings and are required to provide an annual appointed actuarial opinion. The laws and regulations of Bermuda do not specifically require that US asset adequacy analysis be performed as in the US, however we have always applied the same valuation and analysis techniques as asset adequacy analysis used in GLIC as required by US regulations, to validate that the assets supporting the reinsurance obligations of BLAIC are adequate. We believe the reserves held in BLAIC for both GAAP and STAT are adequate, as is the case for the reserves in our US Life Companies.

Finally, I would note the ACLI and NAIC have stated they believe captive reinsurance transactions represent an important and positive element of a competitive life insurance market while also supporting greater transparency through disclosure. We agree with the ACLI and the NAIC on those points, and as our use of captives evolves, we will continue to work closely with regulators and seek to provide relevant information to investors as well. Let me wrap up by saying that we have made good progress on our goals for 2013 as we cross the half-way point, but we have much work ahead of us 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

Ladies and gentlemen, at this time we will begin the Q&A portion of the call.

(Operator Instructions)

Nigel Dally, Morgan Stanley.

Nigel Dally - *Morgan Stanley - Analyst*

Great, thanks. My question is on Australia. We are seeing significant weakness in commodity prices impacting the mining sector, potentially threatening the Australian economy. First, have you seen any preliminary signs of this impacting your operations, like more pronounced move in early delinquencies in those regions more levered to the mining sector like Western Australia? Second, any steps that you're taking to potentially mitigate that risk? And third, does it perhaps make sense to increase your PCA target, given that uncertainty? Thanks.

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

Nigel, this is Kevin. You're spot on in that China does have a fairly significant export portion of their GDP, or excuse me, Australia does. China makes up about 30% of Australia's exports. And really the two commodity-rich regions that we're very focused on in monitoring are Western Australia and to a lesser extent, Queensland. In terms of performance there, Western Australia continues to perform very, very well. Our delinquencies are improving there.

Queensland, I would characterize as stable to improving, so both of those markets are holding up pretty well at this point. We have seen some reduction in capital expenditures related to infrastructure around mining, but overall commodity prices are actually holding up and have stabilized there. Exports in terms of trade remain pretty solid, and at this point it really hasn't generated any impact on those regional areas that we've seen. We will continue to monitor those regions. We do have some, I would say, credit policy levers to pull, if we see some deterioration there. And we're cautiously monitoring that going forward.

Overall, the economy could be impacted by the slowing in China. We're very cognizant of that. I think it's one of the reasons the RBA has moved over time this year to lower cash rates and we think they have more flexibility around that to do that. They are really focused on making sure some of the other sectors of the economy can recover and perhaps grow and offset some of the pressure related to commodities. The Aussie dollar is also weakened, which could help some of those other sectors recover, both specifically manufacturing and tourism which could have an impact on Queensland.

I think the real pressure we're cautious of, as we monitor China and the impact on Australia is, would further slowdown have some further impact on consumer confidence? And how might that play into performance in the marketplace? But overall, at this point, our underlying delinquency development, performance development, is holding up pretty well.

I think the next question, whether you stated it or not, is what's the implication that might have to what's going on with the equity markets. And we think so far, they have held up pretty well and shouldn't have a material impact based upon what we've seen so far, as we think about and evaluate the IPO going forward. Although we'll continue to monitor because further deterioration could create some risks to the market.

I guess the last question you had in there, if I remember the order, was something around our capital ratios. The PCA, it's a little bit lighter than what we had, off a point just marginally from the target we set for the year, primarily driven by some strong production growth in the quarter, as well as the dividends that we got out of the business. We have paid most of the dividends that we expect for the year out of the Operating Company and we would expect over time to get back within our targeted range.

Nigel Dally - *Morgan Stanley - Analyst*

Great. Thanks a lot.

Operator

Geoffrey Dunn, Dowling & Partners.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Thank you, good morning. On the USMI front, can you give a little bit more color around the loss provision this quarter? First, was there any favorable development in the prior-year book or first quarter? And then second, can you comment that to the incidence level at which you're providing for on new notices and how that compares to pre-crisis levels?

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

(technical difficulty) -- believe broadly that our reserves for our existing delinquencies going into this year are adequate and sufficient for future loss expectations. And really, I think to get to your point, future performance and loss experience is really going to be largely based therefore, on delinquency development going forward. In this quarter specifically to your question, our incurred losses were driven primarily by current-year new delinquencies. And we also, but we did experience some modest favorability in the development on the prior-period delinquencies. So in terms of net cures and aging, we have some favorability there, driven by work-out, self cures and probably seasonality supported.

But to answer your last question, we have not made any changes to our frequency or roll-rate factors based upon those new delinquencies and we're going to continue to watch the emerging experience on there until we have a little more confidence in the trends. Overall, where we are currently reserved, think of it as terms between one and four and one and five type roll rate development. And historically, if you revert back to what this was pre-crisis, I think of that as about 50% of the current levels we're at right now.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, great and then on Australia, obviously a very good loss ratio development this quarter. I'm guessing it's not a sustainable item and you probably see some of it revert back into the 40% to 50% range. Can you talk a little bit about what drove such a positive result this quarter? Is it really the impact of working through some of those Queensland built-up claims or is there anything else going on affecting the quarter?

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

Yes, we certainly have worked down dramatically our claims pipeline. It's running at a pretty historically low level right now, so we've gotten that worked down. Overall, 35% is a strong loss ratio performance. I think we're going to be well within the 40% to 50%. We benefited some in the quarter, as we mentioned last quarter, from an expectation that resulted in pretty strong seasonal improvement in cures.

So we had strong cure performance. The 2000-2008 books, they're burning through, we're working through those. But you should probably expect the second half of the year to have a little bit more variability, a little more seasonal movement. But I still think we're going to be well within our expectation on the 40% to 50%.

Geoffrey Dunn - *Dowling & Partners Securities - Analyst*

Okay, thank you.

Operator

Sean Dargan, Macquarie.

Sean Dargan - *Macquarie Research - Analyst*

Thank you. I have one question about USMI and one on LTC. The risk-to-capital ratio came in more favorably sequentially. But as new insurance written picks up, I suspect there will be some capital strain. Your competitors are talking again about an expectation of the risk-to-capital limit moving to the neighborhood of 18 to 1 and last quarter, Kevin mentioned that you had some options of how you might be able to get there. I was just wondering if you could expand on what those options might be.

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

Yes, Sean, first of all what I said last quarter, and I don't think its changed, is as a Company we remain committed to managing down our risk to capital, keeping it below the 25 to 1 and ultimately to get it to whatever levels with some management cushion, depending on whatever the outcome is of some of the GSE eligibility decisions. We don't have great visibility into what that's going to be at this point. I don't think anybody does. We've certainly seen and had discussions around an 18 to 1 type threshold.

But as those guidelines come out, I think there are practical ways one could deal with it. One of the ways is, based on improvement in profitability, that just generates for us basically generic capital, we generate our own internal capital off of that. We've got some potential for some of the DTA to start to play back into our P&L. That will give us some increases.

We're certainly evaluating and looking at reinsurance-type opportunities that might, if cost effectively could help us manage that. The other thing is, we have no idea what the implementation timeline is going to be for these type of things. So we think we're going to have a reasonable period of time to deal with whatever the reality is, at which that point it finally becomes disclosed.

The other thing I would say is, we're pricing our business today at a risk-to-capital level that's basically in line with where we think this thing is ultimately going to get to. We don't think it's going to have a deterioration in terms of our returns, so we feel good about that. And the business is very, very, very profitable. It's a good return on capital and we think it's a good place to consider. There's a number of different ways to do it and when we get to that point in time we'll evaluate what we need to do to make it happen.

Sean Dargan - *Macquarie Research - Analyst*

Okay, thank you. And then on Long Term Care, Marty mentioned if the reserves held in the Bermuda captive were repatriated, the impact to RBC would be minimal. I was wondering if you would quantify what minimal means?

Pat Kelleher - *Genworth Financial, Inc. - President & CEO of US Life Insurance*

This is Pat. I'll take that. The reinsurance treaty, as Marty indicated, is a funds-withheld co-insurance treaty, so we basically are already funding 100% of the ceded reserve, the assets withheld and invested by the ceding Company. We do hold a slightly lower Bermuda STAT reserve. But ignoring that difference, if you just look at what I'll call the hard capital in Bermuda, that's equivalent to a 390% RBC level. And when we look at the impact of repatriating the business, let's say back into the United States, and putting it together with the business in the originating Company, the impact on RBC ratio is expected to be in the neighborhood of five percentage points.

Sean Dargan - *Macquarie Research - Analyst*

Thank you.

Operator

Joanne Smith, Scotia Capital.

Joanne Smith - *Scotiabank - Analyst*

Yes, can you hear me?

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

We can.

Joanne Smith - *Scotiabank - Analyst*

Okay, good. I have a couple of questions on the level of profitability regarding the post-2008 USMI book and how we should think about the development of that over time. I understand that you've talked a lot about the returns being quite attractive on the stuff that you've written since the crisis. I'm just wondering about how we should look at the development of those earnings as we go through and we start to see more of that burn-through of the pre-2008 books.

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

Okay, Joanne, this is Kevin. For starters what we've said in the past is on the long term pricing expectation, we think those books of business are priced to perform at a mid teens-type level. The actual experience we're seeing on that business, based upon what I would describe as very, very favorable loss development, is very much more closer to the high teens to 20%-type level.

So going forward we think it's a very profitable business. When you think about how you should start to expect that to transition in through our P&L in terms of impacting earnings going forward, I think you just think about this year, 2013 is a transition year for us. The older books of business, we've gotten to the point where, as of this quarter 37% of our book is based upon business that was written after 2008.

We told you that we expect that to be between 40% and 45% of our overall portfolio by the end of 2013, and I think we're on track to be within that range. That new business, layering on at those high return levels are, as delinquencies come down and our overall loss performance continues to improve, I think that's the turning point. And we're very optimistic about what that will mean for us in terms of 2014.

The other thing we see is that our production levels have continued to improve. Our NIW level in the USMI business in the second quarter was up roughly 30% over the first quarter. It was up I believe, 75%-ish over the same period in 2012. So we got bigger markets coming through, bigger books of business, highly profitable, with delinquencies declining, I think that's how you should think about what the future looks like going forward.

Joanne Smith - *Scotiabank - Analyst*

And Kevin, is there any regional concentration to the business that you've been writing over the past year or so?

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

I don't think anything that's outside of the traditional market. In fact we're probably under concentrated in some of the bigger origination markets compared to the overall origination levels.

Joanne Smith - *Scotiabank - Analyst*

And have you seen any impact on volumes, given the rise in interest rates. That's my final question. Thank you.

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

Yes, I think the biggest impact the interest rates are going to have, and it's a great question, is it's going to be on the refinance market. We have seen refinance activity certainly start to trail off dramatically. The nice thing that is going on for the industry though, at the same time, is as refinances start to get pressured, we're also seeing some recovery in the purchase market.

Our penetration in the purchase market is at a very high level in the second quarter. Our purchase penetration is over 16%, about 16.5%. That's very strong for this business. And so even though you might have a decline in overall originations, driven by the reduction in the refinance market, the pick-up we're seeing in the purchase mix is driving us to higher markets and higher production levels.

Joanne Smith - *Scotiabank - Analyst*

Great, thank you very much.

Operator

(Operator Instructions)

Suneet Kamath, UBS.

Suneet Kamath - *UBS - Analyst*

Thanks and good morning. Couple questions on Long Term Care. First, I guess on past calls you've indicated that the reserves are adequate both on a GAAP and a STAT basis, before the impact of the recent price increases that you filed for. I just want to make sure that that's still the case.

Then in your prepared remarks, you talked about a Long Term Care review, the findings of which you'll show us in the fourth quarter. Wondering what is this review? Is it incremental to what you guys have already been doing? Or is this just part and parcel with what you guys have been doing for a while now?

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

This is Tom. Let me take that one first.

Regarding reserves, we do believe that both a GAAP and a STAT basis, the reserves are adequate as we've said before. I think what I have said since I arrived in January, is that we were taking a comprehensive look at all of the businesses. We're particularly looking at Long Term Care, it's a challenging business. We've laid out our strategy but we are looking at all aspects of that.

As I have been out with Marty Klein and others, there's a lot of interest from analyst investors on Long Term Care. It's a very challenging business to understand. We do expect late in the fourth quarter, after reviewing the business laying out for all of you in a comprehensive way, the details of the business in a way where you can have a much better understanding of how the business works, how the reserves work, how we do the testing, and what the business looks like. Our projection on the timing would be some time late in the fourth quarter.

Suneet Kamath - *UBS - Analyst*

Okay. I guess based on what you just said though, and considering how the stock trades, it seems to me that you're implying that we should not be expecting -- that one of the conclusions of this review is a statutory or GAAP charge. Is that an incorrect assessment?

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

What I would say there is that we believe the GAAP and STAT reserves are adequate.

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

Suneet, it's Marty. I would just add as we've said before, and again if you think about the factors that have gone in the marketplace, business is really, obviously -- very little has changed over the last few months, except perhaps you might say interest rates are higher than where they were a quarter or two ago. So, it's obviously a positive development. The reserves, as we have been computing them, are adequate we think, with margin for further deterioration.

You did ask the question I think earlier, which I don't think we talked about yet, are the rate actions embedded in those calculations or not? We do have margins that are very sufficient without including those rate actions. We did this past year at the end of December, when we were doing our cash flow testing for statutory purposes, as well as for GAAP, did reflect our assumptions with perhaps a little bit of hair cut, for what we might get in the rate actions. But even of you exclude that impact, we think the margins are adequate. And again, those are assumptions that we'll provide more detail later on in the year.

Suneet Kamath - *UBS - Analyst*

Okay. And then a question about Long Term Care in terms of the quarter. There is some moving pieces, I guess, with the change in the methodology you guys were using around the interest rate and tabular interest. Wondering if we strip that stuff out and we just look at the incidents on a claims underlying underwriting trends of the business, have you noticed any changes one way or the other in terms of how the block is performing? Again, away from the accounting adjustments that you made.

Pat Kelleher - *Genworth Financial, Inc. - President & CEO of US Life Insurance*

This is Pat, Suneet. I'll take that. The tabular interest change actually didn't impact the net operating income at all. It really just resulted in a reclassification of how we're looking at the cost of claims for purposes of calculating the loss ratio. The loss ratio with a more precise calculation of tabular interest declined about three percentage points. We think that's a better measure, so we've restated all the prior-periods to reflect that.

If we look at the quarter, especially compared to the prior quarter, the overall claims results were pretty consistent. We did see, if you look at trends, we've had the pretax operating income fluctuating for a period of time between 5% and 10% of premiums. We've seen the loss ratio fluctuating over the last six quarters between, I guess, about 64% or 65% and 73%, with an average in the middle of that on a restated basis. The only thing I'd point out in the current quarter is we did start to see a little bit of lift relating to the recent rate action, which we pointed out in the earnings release. I think that's probably the most important comments to mention.

Suneet Kamath - *UBS - Analyst*

Got it. One quick one for Kevin. I think in response to Sean's question, you had indicated that your pricing, your USMI business, already assuming a lower risk-to-capital ratio. But then you also said that you're not even sure what the new guidelines might be.

So what are you assuming? Are you assuming that 18 to 1 that you mentioned earlier? Or something close to that? Just so we get a sense of what you're pricing at.

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

I would say we would do it at a stronger capital level than 18 to 1. And when you think about our overall portfolio, we do it at on a risk-adjusted basis so the riskier the loan type gets a higher capital charge but think of it in terms of south of 18 to 1.

Suneet Kamath - *UBS - Analyst*

Okay, thanks.

Operator

Ladies and Gentlemen we have time for one final question. Craig Perry, Panning.

Craig Perry - *Panning Capital - Analyst*

Thanks for taking my question and good quarter. I guess it's really a question for Pat, Marty and Tom. You guys quickly, I know you're going to provide additional clarification in Q4, but could you help me understand, it was a little unclear to me, is the new set of rate increases on the 2003 block of, and onward block of business in the LTC, is that a incremental set of premium increases above the $200 million to $300 million that you've outlined? And then separately, could you remind us how we're supposed to think about those increases coming and flowing through into earnings over time?

And then lastly, could you remind us what the internal IRR hurdle is for new business that you're writing in Long Term Care today? I think in prior conversations, or at least in prior earnings calls, you'd spoken about mid to high teens-type return on new product underwritten to today's standards. So would you mind clarifying all three of those? And again I appreciate you guys taking the time to provide additional color for this business in Q4, thanks.

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

Craig, its Tom. Let me take the first cut at that and I'll ask Pat or Marty to add in. First, we had, starting late last year, filed for rate actions on about $1.1 billion of blocks, four blocks. Three of them were blocks that were written prior to 2001 and one in 2001 and 2007 and that's the $200 million to $300 million when fully implemented in five years. And as we said through June 30, we received approvals from regulators for $115 million to $120 million, in that range on that block.

In addition to that, there's another around $600 million to $700 million of premiums. Those are blocks that have been written post 2003. And on those, looking at those, they are still profitable. However, while lapse rates assumptions were lower than on the old blocks, we still believe that there needs to be some modest increases. So we are incrementally beginning to look at that, analyzing that.

We've concluded that we want to file moderate increases in the second half of the year on those. So that is a second set of blocks, policies written since, say, 2003, so incremental to and separate from the other increase. In terms of how we're pricing the business today, a new business and a new product, the new Flex 2 that we launched, we're looking for, we believe, mid-teen returns, is the cost of capital and we're pricing and we expect receiving, better than that mid-teen level.

Craig Perry - *Panning Capital - Analyst*

Great. And I'm sorry, in terms of you said, moderate increases in the 2003 block. Is moderate $50 million to $100 million, is that the right way to think about it? I just don't really know what moderate would be.

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

Moderate would be in the 10% to 15% range.

Craig Perry - *Panning Capital - Analyst*

Got it.

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

And again that is not something that we would all have to get in one year.

Craig Perry - *Panning Capital - Analyst*

Yes, totally understand. And I'm sorry, and then I didn't quite get quite clarification on the timing of the $200 million to $300 million, how does that get booked into your earnings stream over time?

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

So as we've said, when we receive the approval from the regulators, we then notify the client 30 days prior to the anniversary date. They have some options to take the increase or not. We've told you that about 80% are taking the increase. That is, that increase is effective on the anniversary date, so that will roll in over time.

In some cases the regulators have approved the increase at one time. In many cases it is spread out over three years, sometimes five, and so that will roll in over that period of time. So the $200 million to $300 million we've talked about is, when fully implemented, factoring in all of the rate increases, including where they've been spread. In the second quarter, after-tax about 8 million after-tax have been the benefit of those rate increases. And that comes both from the increased premium, as well as for those policyholders who have taken lower benefits, that does have an impact on the reserves.

Craig Perry - *Panning Capital - Analyst*

Got it. Okay, so it wouldn't be unrealistic to think that two-ish years from now, you would be closer to the 10% plus ROE target for the Long Term Care business, based on the combination of new business written and assuming those rate actions actually take hold?

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

Certainly, we would expect to see as those roll in the ROEs on the business continue to improve.

THOMSON REUTERS

Craig Perry - *Panning Capital - Analyst*

Great. Okay, thank you, guys. Thanks.

Operator

Ladies and Gentlemen, I'll now turn the call back over to Mr. McInerney for closing comments.

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

Thank you, operator. Thank you all for your time and questions today. As we move forward in the second half of 2013, we're going to continue to focus on the actions and execution of our key strategic objectives needed to turn around the Company. We will also continue to work on improving our products and our relationships with our customers and distributors. And we look forward to seeing and talking to you all again to update you next quarter. Thank you very much.

Operator

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