Credit Research Initiative
NUS National University of Singapore | RMI Advancing Risk Management for Singapore and Beyond
transforming big data into smart data
Weekly Credit Brief November 04 - November 10

Genworth's rating falls into junk territory after poor earnings

On 6 November 2014, the largest player in the US long term care insurance (LTC) market, Genworth Financial reported its worst quarterly loss on record. The loss was tied to an after tax USD 345mn charge related to an increase in its LTC claim reserves. The company was immediately downgraded to junk by a number of credit rating agencies, including S&P, which lowered the company's senior unsecured debt rating from 'BBB-' to 'BB+'. This was also reflected in the RMI 1-year probability of default (RMI 1-year PD), which surged past the upper bound S&P equivalent 'BBB' implied rating of 37.2bps to 119bps.

The RMI 1-year probability of default implied rating (PDiR) has been introduced to aid intuition about what different values of 1-year PD from RMI's default forecast model imply about a firm's credit quality. In short, the RMI 1-year PD for a firm is used to imply a credit rating based on historically observed default rates for credit rating agency ratings. The upper bounds for each PDiR are derived using S&P's historical default rates. These default rates were taken as the average one-year default rates from 2003-2013. The upper bounds (as of April 2014) for an S&P equivalent 'BB' rating and 'BBB' rating were 144bps and 37.2bps respectively.

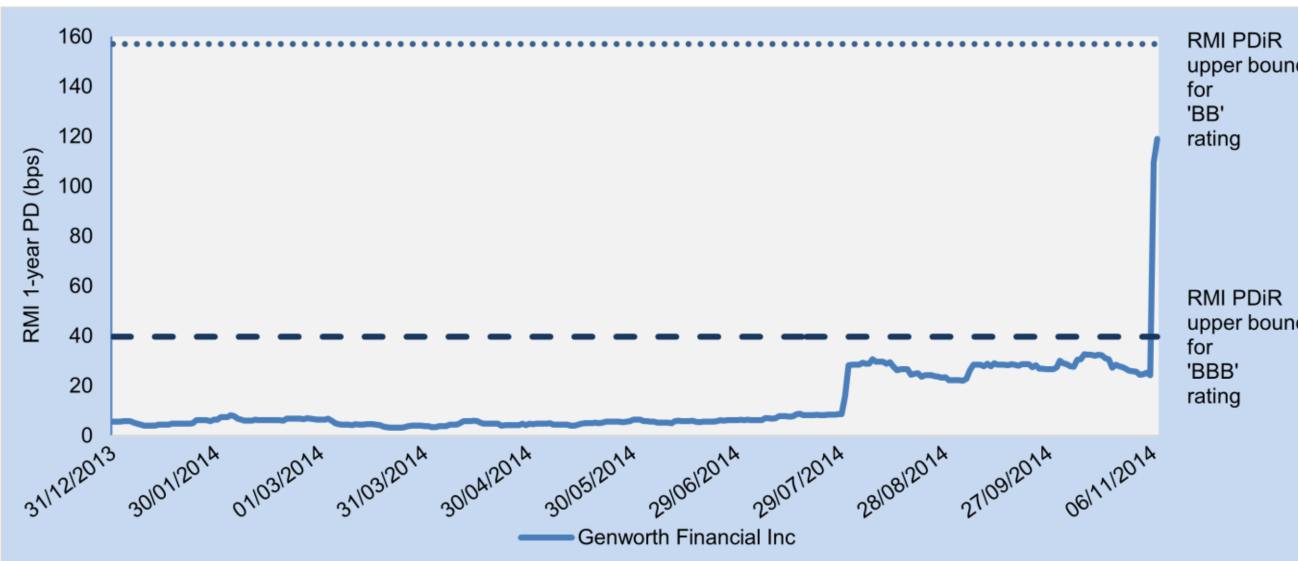

Figure 1: The RMI 1-year PD for Genworth with PDiR upper bounds. *Source: Risk Management Institute*

Genworth Financial Inc	Sep 2013	Dec 2013	Mar 2014	Jun 2014	Sep 2014
Total quarterly net income	108	208	184	176	-844
US life insurance net operating income (NOI)	54	56	21	39	13
US LTC insurance NOI	41	42	46	6	-361
RMI 1-year PD (Nov 7: 119)	**9.73**	**5.71**	**3.88**	**6.50**	**30.1**
RMI DTD (measured in standard deviations)	3.77	4.45	4.78	4.30	2.81
Cash / TA (RMI Adjusted)	3.36%	3.29%	3.90%	3.97%	3.71%
International revenue	730	2147	574	626	573
International net income	1	565	151	90	-6

Table 1: Financial and risk performance metrics for Genworth. Figures are in USD mn, unless stated otherwise. Source: *Risk Management Institute, Bloomberg, company reports*

Genworth said that the Q3 loss was mainly due to an unfavorable adjustment of LTC claim reserve calculation and goodwill impairments in the life insurance and LTC businesses. LTC is a type of insurance that provides monthly payout used to offset the cost of hiring caregivers when the insured is unable to perform their daily routine tasks such as bathing and eating. The operating climate for LTC insurance companies has been tough. Competitors like Prudential, Metlife and Allianz had already exited the LTC insurance sector during 2000 and 2012 due to economic uncertainty, unattractive rate margins and inaccurate actuarial assumptions which failed to foresee longer life expectancies and fewer policy lapses.

Even though, Genworth is well positioned in the LTC industry now, recent figures suggest that sales has been sluggish for Genworth. The firm's NOI as shown in Table 1 has been on the decline in the last few quarters. Market revenue in the first half of 2014 declined 30% YoY. The company's new LTC product – Choice Flex 3.0 commands a higher premium and offers lower maximum benefits, and will take a considerable time for the market to gain momentum in its distribution channels. Last year, Genworth terminated its distribution partnership with the Association of American Retired Persons and also tightened its underwriting standards for LTC policies.

In July, the Federal Housing Finance Agency (FHFA) announced plans to lower the Private Mortgage Insurer Eligibility Requirements in 2015. The new and stricter rules set by the FHFA could require Genworth's US mortgage insurance business to raise more capital. The company previously estimated that it would need additional capital of between USD 450mn and USD 550mn by June 2015 to conform to regulatory demands. However, their Q3 guidance was increased to between USD 500mn and USD 700mn due to a change in estimates of their available assets as well as unsettled disputes with Bank of America.

The riskiness of Genworth's life insurance arm can be seen in the fluctuating nature of its NOI through the recent periods. This is partly due to constant adjustments to loss reserves and capital management initiatives. Life insurance NOI increased from USD 21mn to USD 39mn in Q2, but subsequently declined to USD 13mn in Q3. Moving forward, the company hinted that the firm could take further charges as it completes its active life margin review in Q4. As part of the company's portfolio analysis, the management expects that the results of the review will materially reduce the margins of its life insurance business.

Although Genworth's latest earnings loss reduced its liquidity position from 3.97% to 3.71% (see Table 1), the company is still in a healthy state with USD 3477mn of cash, that is measured on a consolidated basis (Genworth's holding company has USD 1.1bn of cash). The same measurement of liquidity for Prudential Financial - the second largest US life insurance firm, was 3.46% and lower than Genworth. The downgrades by the rating agencies may have placed the company in junk territory, which could increase its funding cost of the insurer in the future. However, the company seems to be able to fend off its problems as it managed to raise USD 400mn through long term debt issued at a coupon of 4.8% in 2013 and raise capital by selling its Australia mortgage unit for USD 545mn via IPO. In the near term, Genworth could still sell its overseas units as earnings from international markets have been falling and turned negative in September, in tandem with its revenue downward trend between Q1 and Q3.

Credit News

European banks returning to Asia with fresh capital

Nov 10. Banks in Europe are re-capitalising and flocking back to trade finance and syndicated loan deals in Asia, a market they retreated during financial crisis in 2011. In October, the stress test by ECB showed that Europe's biggest banks looked healthier than they did several years ago. Bankers in Asia thought of the test as a sign that quantitative easing in Europe could find their way back into the market. Nevertheless, in the first half of 2014, European banks had made somewhat of a comeback, with about 30 per cent of the trade finance market. (SCMP) (Subscription required)

European banks' riskier debt deals nearly double

Nov 9. European financial institutions have nearly doubled volumes of riskier debt deals as yield-starved investors are prepared to snap up racier assets in their struggle to generate a return. The issuance of subordinated debt has risen by 80% YoY up to date. Much of the increase has come from banks in eurozone periphery countries, which struggled to access market funding due to sovereign debt crisis in 2011-12. In addition to subordinate debts, investors' yield lust has also given a boost to other risky but lucrative debt instruments sold by banks, including lower-rated pieces of asset-backed securities. (FT)

OW Bunker bankruptcy and questions of corporate governance

Nov 9. OW Bunker, a Danish marine fuel supplier with revenues of USD 17bn in 2013 and 7% global market share, filed for bankruptcy after it revealed a USD 125mn fraud at its Singapore subsidiary Dynamic Oil Trading, This could be one of Singapore's largest financial frauds in the last 10 years. The full extent of the fallout of OW Bunker's sudden bankruptcy will most likely take years to unravel the actual cause. However, the incident has resulted in the firing of OW Bunker head of risk management Jane Dahl Christensen. (Seatrade Global)

Minsheng bank unveils capital raising plans (Risk.Net) (Subscription required)

UK banks face break-up threat as competition probe launched (Reuters)

Citic and its peers bear brunt of NPLs (SCMP) (Subscription required)

China names ICBC for Yuan clearing in Canada (WSJ)

Regulatory Updates

Higher capital buffers: the new rules big banks will hate

Nov 11. Financial Stability Board (FSB), a global regulator, has proposed new rules that would push mega-banks to double their financial buffers in order to shield economies and taxpayers if they collapse. The new rules require 30 such giant lenders, including UBS, Citigroup and HSBC, to increase their capital reserves to at least 16 to 20% of their risk-weighted assets. (news.com.au)

"Too big to fail" bank rules unveiled by global regulators

Nov 10. Financial Stability Board (FSB) plans to set up new global rules to prevent banks that are "too big to fail" from being bailed out by taxpayers. According to FSB chairman, Mark Carney, it had been totally unfair for taxpayers to bail out banks after the financial crisis. The new system would ensure that bank shareholders, and lenders to banks such as bondholders, would become first in line to bear the brunt of future losses if banks could not pay out of their own resources. (BBC)

Liquidity rules tightened in Taiwan

Nov 5. Local banks in Taiwan are required to report liquidity coverage ratios to the Financial Supervisory Commission (FSC) and central bank on a monthly basis from Jan 1, 2015. The requirement aims to enhance risk management and gear towards international standards. Taiwanese banks will have to maintain a liquidity coverage ratio of at least 60% beginning next year, and the ratio is to be raised by 10% each year, reaching 100% by 2019. (TaipeiTimes)

Fed completes rule limiting banks' size

Nov 5. U.S. Federal Reserve released a final rule that prohibits banks and certain large financial firms from acquiring another company if that merger would cause their liabilities to exceed 10 percent of the total consolidated liabilities for all financial firms. The rule takes effect beginning 2015 and aims to prevent financial firms from becoming too big and thus affect the U.S. financial market if they fail. (Reuters)

G20 agreement on banking regulation will end bailouts (Guardian)

Regulators must treat insurers differently from banks (RiskNet) (Subscription required)

Regulators fault banks on leveraged loans (WSJ)

Dealers fret over NSFR impact on equities (RiskNet) (Subscription required)