Genworth Financial	BL2103 – Protection Insurance	
EL0702 – Monitoring & Reporting	USD – 219,000,000.00 LOSS	USD – US Dollar
US – United States	North America	

Genworth Financial pays USD 219 million to settle class action over misleading financial statements

Contents

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Event	Published in Media	Date of Occurrence – From	Date of Occurrence – To	Discovery Date	Date of Recognition / Settlement
	11/Mar/2016	30/Oct/2013	05/Nov/2014	28/Feb/1997	11/Mar/2016

Loss Amount USD	Loss Amount EURO	Provision	Boundary Risk
USD 219,000,000.00	EUR 198,626,430.00	No	Other Risk

Industry Event	Scenario	Product	Process
N/A	D.QUAL – Data Quality	PD9999 – Insurance Product	PC9999 – Insurance Process

Parent Company	ORX Member	Role of Firm	AMA Status
N/A	No	LS0308 – Not Identifiable	N/A

Cause 1	Cause 2	Cause 3
CS0305 – Inadequate Data Quality	N/A	N/A

Counterparty	Jurisdiction / Choice of Law	Environmental Volatility
LS0212 – Not Identifiable	LS0101 – United States of America	LS0406 – Not Identifiable

1 General introduction

1.1 Executive summary

On 11 March 2016, Genworth Financial announced that it had agreed to pay USD 219 million to settle a class action lawsuit accusing the firm of making false representations to investors regarding the strength of its long-term care (LTC) insurance business.

Between 30 October 2013 and 5 November 2014, Genworth falsely represented to investors that it had reviewed the reserves that it had set aside for LTC claims, and that the reserves were adequate. However, on 5 November 2014, Genworth announced that it was materially under-reserved, that it would take a charge of USD 531 million to further increase the reserves, and would also undertake an extensive review of them. On the day of the announcement, the firm's share price dropped by 35 per cent.[1]

The class was led by plaintiffs Alberta Investment Management Corporation and Fresno County Employees' Retirement Association, who bought over 1.2 million shares and nearly 200,000 shares, respectively, during the period that Genworth made the false statements. The class action accused Genworth of using outdated claims data from 2010 which led to the firm underestimating the average claim duration and understating its reserves. The lawsuit sought to recover investors' losses caused by the dramatic subsequent drop in Genworth's share price.

In agreeing to the USD 219 million settlement, Genworth did not admit to any wrongdoing.[2]

[1] http://www.bloomberg.com/news/articles/2014-11-06/genworth-ceo-sees-tough-turnaround-from-844-million-loss
[2] http://www.orx.org/sites/news/Lists/PublishedLossEvents/DispForm.aspx?ID=5278

1.2 Background

LTC Insurance in the USA

Genworth Financial is the largest provider of LTC insurance in the USA.[3] LTC insurance policyholders pay regular premiums over a number of years in return for coverage against the costs of LTC services provided in the insured's home or in assisted living or nursing facilities. Insureds become eligible for covered benefits if they either become incapable of performing two activities of daily living or severely cognitively impaired.[4]

According to Forbes, "the typical policy today covers nursing homes, assisted living, and home care. It may also cover other needs like homemaker services, hospice care, adult day care, international coverage, respite care, bed reservation, care coordination, caregiver training, and supportive equipment."[5]

LTC insurance has been the subject of increasing interest in the USA as the baby boomer generation reaches 65 years of age.[6] The LTC insurance market expanded rapidly during the 1990s[7], but the challenges of declining interest rates and lower than expected lapse rates[8] have since caused many providers to exit the market.[9]

Genworth's LTC insurance business and reserves

Genworth holds money in two types of reserves to cover LTC policies it has issued:

1. For active claims, the "disabled life reserve" (DLR); and
2. For issued policies where the policyholder is not on claims, the "active life reserve" (ALR).

According to court documents, for the DLR, when a policyholder submits a valid claim, Genworth establishes a DLR representing its best estimate of the present value of what it expects to pay out on that claim over time, accounting for the policy's daily benefit amount, the benefit period, and diagnosis of the claim.

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[3] http://www.bloomberg.com/news/articles/2015-02-10/genworth-posts-760-million-loss-as-ceo-tackles-long-term-care
[4] http://webcache.googleusercontent.com/search?q=cache:6HdtKwNrI20J:securities.stanford.edu/filings-documents/1052/GFI00_02/201551_r02m_14CV00682.pdf+&cd=2&hl=en&ct=clnk&gl=uk
[5] http://www.forbes.com/sites/wadepfau/2016/01/19/potential-concerns-and-risks-for-traditional-long-term-care-insurance/#69a271b81a61
[6] http://tinyurl.com/hdgro5n
[7] http://www.forbes.com/sites/wadepfau/2016/01/19/potential-concerns-and-risks-for-traditional-long-term-care-insurance/#201337301a61
[8] http://www.forbes.com/sites/wadepfau/2016/01/19/potential-concerns-and-risks-for-traditional-long-term-care-insurance/#5804b8f61a61
[9] http://www.forbes.com/sites/financialfinesse/2012/10/04/insurers-are-getting-out-of-long-term-care-is-it-time-for-you-to-get-in/#277eaab48c67

The ALR is established when Genworth issues new LTC policies. It represents the liability for future claims from the active lives, that is the policyholders who are paying premiums and not currently on claim. When a policyholder goes on claim, a DLR is set up at that time and the corresponding ALR for that policyholder is released.[10]

The financial health of LTC insurance companies depends on the adequacy of their reserves; if an insurer's reserves are inadequate, funds must be reallocated from elsewhere in the firm's finances.[11]

Misrepresentation of the adequacy of Genworth's reserves

Between 30 October 2013 and 5 November 2014, Genworth executives made statements in investor conferences, presentations and regulatory filings about the adequacy of Genworth's LTC insurance reserves that later turned out to be false or misleading.

On 30 July 2013, Genworth's CEO, Thomas McInerney, responded to investor concerns over the health of the firm's LTC business during an investor conference by saying that Genworth was "conducting an intense, very broad and deep review of all aspects of its long-term care insurance business". He said, "We're particularly looking at long-term care and we're looking at all aspects of that".[12]

Then, on 30 October 2013, McInerney reiterated to investors during another conference that the review was "largely completed", and that the review had been ongoing for approximately 4 months. McInerney specifically said to investors that the firm was focussing the review on the strength of its reserves. "We're more confident than we've ever been that the reserves are adequate, with a comfortable margin" ,[13] he said.

On 4 December 2013, the firm gave an investor presentation, in which McInerney alleged that Genworth had completed the review of its LTC insurance business and reserves. He said, "We believe we have adequate long-term care reserves, with a margin for future deterioration."[14] McInerney and Genworth's CFO, Marty Klein, went on to explain the methodology and assumptions used to calculate the reserves, which they claimed were sound.

The executives continued to mislead investors until mid-2014, when, on 30 July, they announced that a review had not in fact been conducted since 2012, and that that assumptions made during that review were based on information from pre-2010, and so may not be accurate. McInerney also incorrectly said that the review would only impact DLRs, not ALRs. This later turned out to be false. The firm said that, due to disappointing quarterly results, it would conduct an actual review of its LTC insurance business. McInerney said, "We are

[10] http://tinyurl.com/zl79f4j
[11] http://tinyurl.com/zl79f4j
[12] http://tinyurl.com/zl79f4j
[13] http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2013-10-30T12_00_rev.pdf
[14] http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2013-12-04T14_00.pdf

conducting a detailed review of the associated claim reserve assumptions, methodology, and process to determine what changes are needed and we do not currently know whether or not these changes will have a material effect on our reserves."[15]

On 5 November 2014, the firm posted a quarterly loss of USD 844 million and announced that subsequent to a comprehensive review of its long term care insurance claim reserves conducted over the past few months, it would have to increase its reserves by USD 531 million.[16] The firm said that this was due to an increase in the amount of time that claims went on for compared to the historical data which they had previously used to calculate the reserves. The announcement caused a substantial drop in the price of Genworth shares.[17] According to Bloomberg, the stock lost 35 per cent of its value in a single day, erasing USD 2 billion from the company's market capitalisation.[18]

A class action lawsuit, led by plaintiffs Alberta Investment Management Corporation (AIMCo) and Fresco County Employees' Retirement Association (FCERA), was launched in late 2014[19] to recover investors' losses. Between 30 October 2013 and 5 November 2014, the period during which Genworth had misrepresented the adequacy of its LTC insurance reserves, AIMCo and FCERA had bought over 1.2 million and nearly 200,000 Genworth shares, respectively.

Genworth agreed to settle the lawsuit on 11 March 2016, without admitting to any wrongdoing.

[15] http://s2.q4cdn.com/240635966/files/doc_downloads/GNW%20Q2%202014%20Earnings%20Transcript_v001_j8fq69.pdf

[16] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true

[17] http://www.prnewswire.com/news-releases/aimco-secures-219-million-recovery-in-genworth-571964161.html

[18] http://www.bloomberg.com/news/articles/2014-11-06/genworth-ceo-sees-tough-turnaround-from-844-million-loss

[19] http://www.modernhealthcare.com/article/20160314/NEWS/160319952?template=print

1.3 Timeline of incident

- **30 October 2013 – 5 November 2014**: Total period during which Genworth misrepresents in financial reports and executive statements at investor presentations that its LTC insurance business is adequately reserved for.
- **30 July 2013**: In response to investor concerns, Genworth's CEO says in an investor conference that the company is conducting a deep review of all aspects of its LTC insurance business.[20]
- **30 October 2013**: Investors are told that the LTC insurance review is "largely completed", and that the firm is confident that its reserves are adequate.[21] Class period begins here.
- **4 December 2013**: Genworth executives claim during an investor conference that a review of reserves is complete, and that the firm has adequate reserves for its LTC insurance business. Investors are shown presentation slides showing how the review was allegedly conducted to calculate the necessary reserves.[22] The stock price reaches a 40 month high.[23]
- **5 February 2014**: Genworth repeats claims that its LTC insurance reserves are adequate.[24]
- **30 July 2014**: After posting disappointing results, a Genworth executive admits at an investor conference that the last in-depth review by the company was in 2012, and that this review was conducted using data from until 2010. Genworth says it will now conduct a thorough review of its LTC insurance reserves methodology.[25]
- **5 November 2014**: Genworth announces the results of the comprehensive review of its reserves. The review finds Genworth to be materially under-reserved, and the firm is required to increase them by USD 531 million.[26]
- **11 March 2016**: Class action settlement agreement.[27]

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[20] http://tinyurl.com/zl79f4j
[21] http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2013-10-30T12_00_rev.pdf
[22] http://s2.q4cdn.com/240635966/files/doc_events/GNW%20LTC%20Insurance%20Review%20Dec%204%202013.pdf
[23] http://tinyurl.com/zl79f4j
[24] http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2014-02-05T13_00.pdf
[25] http://s2.q4cdn.com/240635966/files/doc_downloads/GNW%20Q2%202014%20Earnings%20Transcript_v001_j8fq69.pdf
[26] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true
[27] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/e9b6725e-a2c0-4fd3-b39d-0f0ff124a26b.pdf?noexit=true

2 Internal risk factors

Factors over which the bank had control that directly or indirectly caused the event, increased the severity or duration of the event, or increased the loss amount.

2.1 Use of outdated claims data for calculating necessary reserves

According to a former professor of insurance at Indiana University, LTC insurance providers have historically made several mistakes when selling the products. "They underestimated how long people would live and how long they'd need nursing home care, but overestimated how many people would drop their policies and how much interest insurers could earn on the premiums they banked."[28]

Specifically, Genworth used outdated claims data from before 2010 when estimating reserves. This caused the firm to underestimate how long people would continue to claim for, thinking that it would be on average 2.2 years when in fact it was closer to 3 years.[29] The firm also underestimated lapse rates, thinking that more customers would drop their policies before claiming on them than actually did.

When Genworth announced the need to increase its reserves, it stated that "claimants are staying on claim longer and utilising more of their available benefits in aggregate than had previously been assumed in the company's reserve calculations."[30]

2.2 Inadequate controls for calculating the reserves

Even after identifying the weakness in its reserve calculation methodology, Genworth's controls failed to ensure that a methodology reasonably designed to assess the necessary reserves was implemented.

On 2 March 2015, in the firm's 2014 results, Genworth stated that "a material weakness exists in the controls over the implementation of our long-term care insurance claim reserves assumption and methodology changes."[31]

2.3 False statements made to investors

The main cause of the class action lawsuit was the fact that Genworth and Genworth executives repeatedly misled investors over the course of over a year, in quarterly reports and investor presentations, regarding the adequacy of the firm's LTC insurance reserves. Investors in Genworth stock relied on accurate statements from Genworth and its executives

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28 http://khn.org/news/long-term-care-insurance-less-bang-more-buck/

29 http://www.forbes.com/sites/howardgleckman/2014/11/19/what-does-genworths-bad-news-mean-for-the-future-of-long-term-care-insurance/#3dca20e05fd1

30 http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true

31 http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/800f3773-6978-409d-8643-e472262dc246.pdf?noexit=true

with regards to the firm's financial position in order to make sound judgements when making investment decisions.

Some of these misleading statements included:

- On 30 October 2013, Genworth's CEO told investors that the firm was confident that it was adequately reserves for its LTC insurance business, "with a comfortable margin for future deterioration"[32];
- On 4 December 2013, investors are told that Genworth has completed a review of its reserves and that the reserves are adequate[33]; and
- On 5 February 2014, Genworth reiterates claims that its LTC insurance reserves are adequate.[34]

The plaintiffs in the class action argued that "Genworth's risk disclosures failed to warn investors that in calculating reserves, the company used stale data from 2010 and the company did not conduct the 2013 reserve review that they touted. Moreover, [Genworth] knew that the risks identified in their cautionary language had already materialised, but were not accounted for by the company in calculating its reserves."[35]

3 External risk factors

Factors over which the bank did not have control that directly or indirectly caused the event, increased the severity or duration of the event, or increased the loss amount.

3.1 Decline in the Long-Term Care Insurance industry

Genworth is not the only company to have experienced problems in its LTC insurance business. According to Forbes, the entire LTC insurance industry is going through difficulties, with sales of new policies dropping by 75 per cent in ten years, and 90 per cent of LTC insurance providers withdrawing from the business.[36] This is the result of three factors:

3.2 Aging population

According to InvestmentNews, almost a quarter of Americans are part of the baby boomer generation, which comprises those people born between 1946 and 1964.[37] People are also living longer, which means that insurance companies are more likely to have to pay for care for a longer period of time once an insured begins to claim on their policy. When announcing

32 http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2013-10-30T12_00_rev.pdf
33 http://tinyurl.com/zl79f4j
34 http://s2.q4cdn.com/240635966/files/doc_events/GNW-Transcript-2014-02-05T13_00.pdf
35 http://tinyurl.com/zl79f4j
36 http://www.forbes.com/sites/howardgleckman/2015/04/09/the-long-term-care-insurance-industry-ponders-its-future-seven-trends-to-watch/#228ed212783c
37 http://www.investmentnews.com/article/20150303/FREE/150309971/genworth-financial-struggling-under-the-weight-of-long-term-care

that it would have to increase its reserves, Genworth said that the number of people claiming on their policies for 4 years or more had increased by “a steep 10-13 percentage points”,[38] an increase that will have harmed the firm’s profit margins and changed provisioning assumptions.

3.3 Falling interest rates

Insurance companies make their money by investing the income from premiums. Historically low interest rates since 2008 have cut into insurers’ profits from re-investing premiums.[39] According to a 2014 report by the US Society of Actuaries, LTC insurers have been subjected to increased reinvestment risk because interest rates have been low for so long.[40] Genworth was unable to anticipate this and, as such, its LTC insurance policies were under-priced.

3.4 The rising cost of elder care

According to Genworth, the median costs of a private room in a nursing home in 2015 was over USD 87,000 per year, having increased by 4 per cent annually over the previous five years.[41] The rising costs of long-term healthcare will have damaged Genworth’s profit margins, especially when combined with increased the trend of increased claims durations caused by rising life expectancies and medical advancements.

[38] http://www.forbes.com/sites/howardgleckman/2014/11/19/what-does-genworths-bad-news-mean-for-the-future-of-long-term-care-insurance/#541042195fd1
[39] http://www.forbes.com/sites/howardgleckman/2012/08/29/whats-killing-the-long-term-care-insurance-industry/#1b625dada77e
[40] http://tinyurl.com/jjruga4
[41] http://www.investmentnews.com/article/20150303/FREE/150309971/genworth-financial-struggling-under-the-weight-of-long-term-care

4 Remedial measures

Measures taken inside or outside the bank to correct the failures that led to the event and try to prevent a reoccurrence of the event.

4.1 Backtracking on previous statements and restatement of reserves

Genworth began to backtrack on previous statements regarding the adequacy of its reserves on 30 July 2014, when its CEO said that, contrary to what had been said earlier, the firm had in fact not conducted an in-depth review of its LTC insurance business since 2012, and that that review had been conducted using out-of-date data from a period until 2010.[42]

The results of an actual review of the firm's LTC insurance reserves were announced on 5 November 2014, with Genworth needing to increase the reserves by USD 531 million.[43]

4.2 Re-evaluation of methodology for calculating reserves

Along with re-stating its reserves, Genworth announced that it had revised its methodology and assumptions for pricing policies and calculating reserves. This included revising internal assumptions related to claim terminations and benefit utilisations which had caused the firm's LTC insurance business to be under-reserved.[44]

4.3 Raised premiums and toughened underwriting standards

Genworth has aggressively raised premiums on existing policies and toughened underwriting standards for new policies in order to improve the profitability of its LTC insurance business. According to Forbes, the firm has also limited coverage under new policies to a maximum of five years, to reduce the risk of increasing claims durations. Genworth has also requested permission from state regulators to raise premiums on existing policies, and has received approval to raise premiums by as much as 47 per cent. The firm has stopped selling LTC insurance in Massachusetts, New Hampshire and Vermont, where it was not granted approval to increase premiums.[45]

4.4 Improvement to internal controls

In its 2014 annual report, Genworth stated that it was improving its internal controls over the implementation of improved reserves calculations methodologies.

It said, "We have reviewed the design of our current 'review control' over implementation of assumption and methodology changes to our long-term care insurance claim reserves to determine appropriate improvements and implement enhanced procedures. As part of these

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[42] http://s2.q4cdn.com/240635966/files/doc_downloads/GNW%20Q2%202014%20Earnings%20Transcript_v001_j8fq69.pdf
[43] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true
[44] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true
[45] http://www.forbes.com/sites/howardgleckman/2014/11/19/what-does-genworths-bad-news-mean-for-the-future-of-long-term-care-insurance/2/#2fce9011441c

enhanced procedures, our actuarial team responsibilities will be separated to provide that one team will develop and implement all significant assumptions and methodology changes to the long-term care insurance claim reserves while another team will determine the nature and scope of the review required as a result of the changes, and then execute the review process."[46]

The firm also said that it would expand the scope of its controls over the implementation of assumption and methodology changes to "include testing of claim reserves calculations, on an individual basis, from the point at which the claim record is included in our policy administration system through the point at which our reserve is reported in our consolidated financial statements."[47]

The controls improvements were targeted to be completed during 2015.

5 Impact

5.1 Financial impact

The size of the financial impact on the institution's P&L and share price, if applicable.

5.1.1 Direct financial impact

On 11 March 2016, Genworth announced that it would pay USD 219 million to settle the class action lawsuit, inclusive of all plaintiff's attorneys' fees and expenses. The firm said that USD 150 million of this would be covered by its insurers and that it would pay the remaining USD 69 million.[48]

For comparison, Genworth's US life insurance division recorded a loss of USD 253 million, from revenues of USD 6.5 billion, in 2015.[49] The USD 219 million settlement therefore equates to 87 per cent of the size of the loss of Genworth's US life insurance business in 2015.

Genworth also said that it "expects to incur additional legal fees and accruals related to the litigation over amounts previously accrued and expenses of approximately USD 10 million pre-tax in the first quarter of 2016.[50]

[46] http://www.sec.gov/Archives/edgar/data/1276520/000119312515072748/d840962d10k.htm
[47] http://uk.businessinsider.com/genworth-financial-material-weakness-disclosure-2015-3?r=US&IR=T
[48] http://newsroom.genworth.com/2016-03-11-Genworth-Announces-Settlement-Of-Securities-Class-Action-Lawsuit
[49] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/72a99065-09f3-4fd0-ad33-b2599aed22b7.pdf?noexit=true
[50] http://newsroom.genworth.com/2016-03-11-Genworth-Announces-Settlement-Of-Securities-Class-Action-Lawsuit

The class action settlement is in addition to a USD 531 million charge which the firm announced on 5 November 2014.[51] This amount has not been included in the total loss amount for this event because it is considered a pure insurance risk loss.

5.1.2 Indirect financial impact

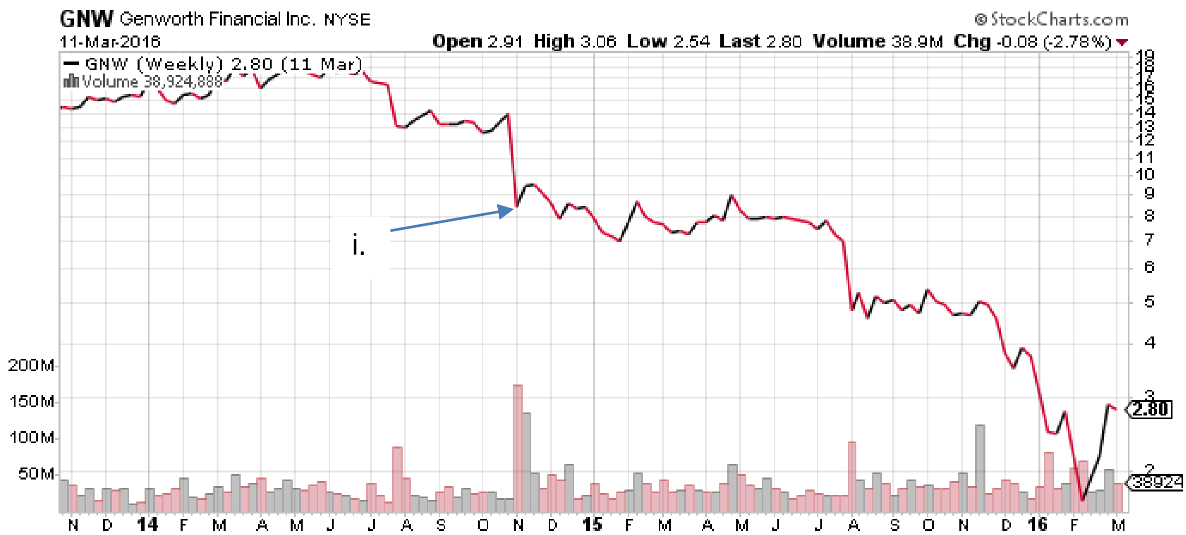

Fig 1. Genworth Financial share price chart for between 30 October 2013 and 11 March 2016 (source: stockcharts.com)

The chart above shows Genworth's share price movement between 30 October 2013, which is when the firm first stated that it was adequately reserved for its LTC insurance business, and 11 March 2016, which is when the firm settled the class action lawsuit. Point i. shows the drop in share price on 5 November 2014, when the firm announced that it would restate its reserves with an additional USD 531 million. This does not necessarily imply causation, but it was the sharp drop in share price that caused investors AIMCo and FCERA to file the class action lawsuit.

5.2 Non-financial impact

Impacts on reputation, senior management, and changes in regulatory environment.

5.2.1 Corporate restructuring

Before the class action settlement was announced, Genworth had already said that it would suspend sales in traditional life insurance and fixed annuity products in the first quarter of 2016 so that it could focus on moving its LTC insurance business towards profitability.

[51] http://d1lge852tjjqow.cloudfront.net/CIK-0001276520/b7a6f96e-0214-47af-b30f-12a2f639bec1.pdf?noexit=true

On 4 February 2016, Genworth announced in its Q4 2015 results that it would "initiate a series of internal restructuring actions aimed at separating and isolating its LTC business."[52] The firm said that the restructuring would be "focused on addressing LTC legacy block issues that continue to pressure rating across the organisation."[53]

5.2.2 Reputational impact

A high-profile loss of such magnitude may have caused some shareholders and other stakeholders to lose faith in the firm, especially as the loss related to prevarication on the part of executives.

According to Bloomberg, Genworth's CEO issued an apology during an investor conference over his misleading statements, but an investment analyst said that "Genworth's credibility has already clearly been damaged."[54]

[52] http://newsroom.genworth.com/2016-02-04-Genworth-Financial-Announces-Fourth-Quarter-2015-Results
[53] http://newsroom.genworth.com/2016-02-04-Genworth-Financial-Announces-Fourth-Quarter-2015-Results
[54] http://www.bloomberg.com/news/articles/2014-11-06/genworth-ceo-sees-tough-turnaround-from-844-million-loss