FIIG | Factsheet

Genworth Financial Mortgage Insurance Pty Ltd

1 February 2022

Sector: Financials
Sub-sector: Insurance
Country: Australia
Ownership: Public

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Issuer Outline

Genworth Financial Mortgage Insurance Pty Ltd (the Issuer) is a wholly owned subsidiary of Genworth Mortgage Insurance Australia Limited (GMA).

GMA is a leader in the Lenders' Mortgage Insurance (LMI) sector in Australia servicing a diverse client base of lenders including banks, credit unions, building societies and mortgage originators. LMI covers a potential shortfall for the lender when the proceeds from the sale of a home are not enough to cover the outstanding amount owed by a borrower to their lender.

GMA is a listed entity on the Australian Stock Exchange, with a market capitalisation of approximately ~AUD1,015m as at 1 February 2022.

Key Financials (AUDm)

LTM (31 Dec)	2020
Gross written premium	562
Net earned premium	312
Net incurred claims	(289)
Underwriting result	(234)
Insurance profit	(174)
Net profit after tax	(108)
Delinquency ratio	0.58%
Loss ratio (%)	92.9%
Combined ratio (%)	175.0%
PCA multiple (x)	1.65x

Source: Company Reports

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3FN0054433	AUD 190m	Subordinated Unsecured T2	3M BBSW+5.00%	Quarterly	03 July 2025[2]	03 July 2030

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call
[2]And each interest payment date thereafter @100.00, subject to APRA approval

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Tier 2 Structure	
Interest Deferral/Cancellation	Interest will be deferred only in the highly unlikely circumstances that the payment would result in the insurer becoming insolvent. Any missed interest payment will accumulate.
Non-Viability Trigger	If APRA determines that the issuer requires capital support to prevent it becoming non-viable (a 'non-viability event'), it may be required to write-off some or all the face value of the notes.

Strengths

- Very strong capitalisation: GMA maintains a very strong level of risk-adjusted regulatory capital, with total capital as a multiple of its prescribed capital amount (PCA) of 1.74x (or 1.56x on a Common Equity Tier 1 (CET1) basis) as at 30 June, 2021, comfortably above company's targeted range of 1.32x-1.44x (or ~255m in common equity headroom above the lower bound of that range) and regulatory minimums of 1.0x. The high level of capitalisation provides a healthy buffer to absorb an unexpected increase in losses; because property and casualty reserves involve a greater degree of uncertainty than some other forms of insurance, such as health insurance, they typically hold larger equity buffers.

  Capitalisation also benefits from GMA's strong earnings generation capacity within its insurance operations, with an insurance margin (insurance profit divided by net earned premium) of more than 42% as at 30 June, 2021. As a listed entity, GMA does have the ability to raise additional capital if required.

- Sound balance sheet structure and good quality (low risk) investment portfolio to provide cover for losses: Property and casualty insurers, such as GMA, accumulate substantial funds due to the time gap between the receipt of premiums and the payment of potential claims. To ensure GMA has sufficient liquid funds available to meet payment obligations to policyholders and creditors, the company maintains a high proportion of high-quality liquid assets.

  As at June 30 2021, GMA had cash and investments of AUD3.6bn. Of this, ~80% is held in cash and highly rated fixed-interest securities ('A' rated and above). This compares with outstanding claims reserve (a provision for the future liability for claims which have occurred but which have not yet been settled) of AUD567m and unearned premiums (premiums written but not yet earned) of AUD1.6bn (the unearned premium reserve is a balance sheet reserve to cover the unearned portion of a policy in the event a policyholder or the insurer decides to cancel the policy during its tenure).

  GMA also has a reinsurance program in place with 20 different reinsurers (with a minimum credit rating of 'A-') providing AUD800m of additional loss cover.

- Well-seasoned in-force portfolio: Although LMI insurance is generally provided to borrowers with high loan to valuation ratios (see below), over time, increases in property prices and amortisation of debt reduces the effective loan to valuation. The total weighted average effective loan to valuation was most recently 49.9%, compared with an original (at time of underwriting) weighted average loan to valuation of 81.5%.

- Market leading position: GMA's domestic market share for LMI is strong at 37.0% (as measured by gross earned premiums), unchanged in recent years (despite the loss of key relationships in recent years), making it the largest provider of LMI in Australia. The number of LMI providers in Australia has declined over a number of years, with four providers actively operating.

Risks

- Limited business diversification as a monoline insurer: GMA's earnings are almost entirely generated through its LMI underwriting business. As a result, its earnings are largely reliant on a relatively limited customer subset and favourable residential property market dynamics (primarily house prices and employment--see below).

- High exposure to unemployment and falling property prices: GMA is primarily associated with providing LMI insurance to high loan-to-value (LVR) mortgage holders, generally considered those with an LVR > 80% (see below), although three quarters of policies (insurance) in-force are to owner-occupiers and a high proportion have considerable seasoning (also see below).

Figure 1: Insurance-in-force by original LVR band

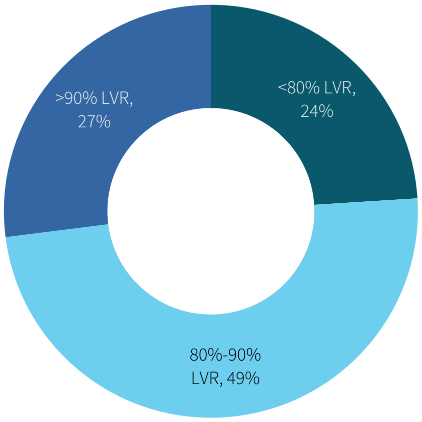
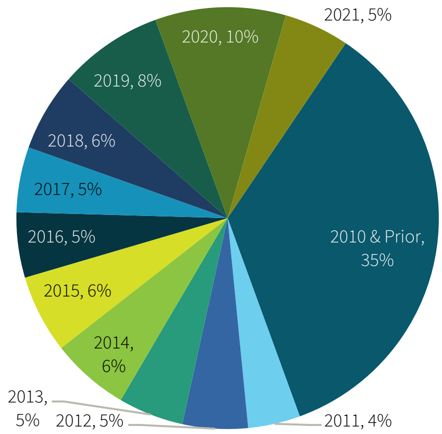


Figure 2: Insurance-in-force by book year



The primary association with LMI leaves the company exposed to rising unemployment, and, to a lesser extent, falling property prices (recall that LMI covers a potential shortfall for the lender when the proceeds from the sale of a home are not enough to cover the outstanding amount owed by a borrower to their lender). To the extent a broad-based rise in unemployment or falling property prices forced a number borrowers to sell their property, GMA may be required to satisfy that potential shortfall, leading to a substantial rise in losses (see the PCA scenarios above as an example).

- Single client concentration: Although GMA has LMI relationships with over 100 lenders (bank and non-bank), it generates a high proportion of gross written premiums from a handful of clients (albeit, unchanged in recent years). In particular, the Commonwealth Bank of Australia (Australia's largest mortgage lender) accounted for 57% of FY20 GWP (although less of the total in-force book). GMA has provided LMI services to CBA for more than 50 years--and on an exclusive basis since 2006, which was to expire on December 31, 2022.

  GMA has recently announced that its exclusivity arrangement with CBA will be extended for a further three years (excluding its BankWest subsidiary) through to 31 December 2025. As such, while the concentration risk does exist, it is largely mitigated for a period that is likely to extend beyond the point at which GMA's subordinated notes are expected to be redeemed (based on market convention, which typically sees subordinated notes called at their first opportunity; albeit, subject to regulatory approval [see further below for optional call risks]).

  For completeness, although the loss of CBA would clearly be a negative development for GMA, it is unlikely to be terminal. Firstly, GMA earns the GWP it writes from its LMI policies over a 12 year period (this is the net earned premium [NEP]), with the overwhelming majority recognised over a six year period [inclusive] subsequent to the writing of the relevant policy. Therefore, assuming the arrangement with CBA is not renewed, GMA will continue to earn the premiums on existing in-force policies for a number of years thereafter. While this assumes no unforeseen circumstances, the lower capital requirement will reduce the refinance task for GMA's subordinated notes.

  Secondly, as a result of slower policy-count growth, GMA's capital requirements will in-theory reduce over time. Basically, as the number of in-force policies declines, so too does GMA's capital requirements.

- Market risk within investment portfolio: GMA is exposed to market movements (interest rate risk) within its investment portfolio, which is marked-to-market each quarter (the duration within GMA's investment portfolio is approximately four years).

  Movements in interest rates can result in material losses (or gains), albeit, generally unrealised (to the extent losses do not need to be crystalised (realised) to support the company's ability to meet its claims, losses should generally unwind).

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Risks relevant to Subordinated Unsecured Tier 2 instrument

- Basel III compliant structural features: The Notes are classified as Basel III compliant Tier 2 capital instruments. As such, they contain the following features:
    - Non-viability trigger event: If APRA, the Australian Prudential Regulator, determines that GMA requires capital support to prevent it becoming non-viable (a 'non-viability event'), the insurer may be required to write-off some or all the face value of the notes. Whether a non-viability trigger event will occur is solely at the discretion of APRA. APRA does not define what constitutes a non-viability event and there are currently no precedents under Basel III to determine non-viability.

      For context, however, we estimate GMA would need to lose about half their tier one capital base to reach minimum capital standards, which in-itself is not likely to be considered by APRA as a point of non-viability (indicating further headroom to absorb additional losses before APRA would consider taking more punitive action).
    - Optional call dependent on regulatory approval: The Notes include an early call feature where the face value of the Tier 2 notes may be repaid early in cash at a pre-defined call date and each subsequent interest payment date up the Maturity Date. The optional redemption requires regulatory approval, which may not be provided.

      In general, regulators are unlikely to provide approval for a Tier 2 instrument to be called if it results in a reduction in the issuer's capitalisation; regulators are unlikely to provide approval for a redemption or resale unless the issuer has, or is expected to, issue an instrument of similar size to replace the instrument subject to that call. To the extent the optional call was expected not to be exercised, it is likely that the price of the notes will be negatively affected, with this negative price movement being potentially material.

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Summary Financials

The financial summary below represents the consolidated operations of Genworth Financial Mortgage Insurance Pty Ltd.

FYE December 31 (AUDm)	2016	2017	2018	2019	2020
Profit and Loss					
Gross written premium	382	369	460	433	562
Net earned premium	**453**	**370**	**281**	**298**	**312**
Net claims incurred	(159)	(142)	(146)	(151)	(289)
Acquisition and other underwriting costs	(117)	(108)	(96)	(106)	(74)
Underwriting result	**178**	**120**	**41**	**42**	**(234)**
Investment income on assets backing insurance liabilities	40	28	39	66	60
Insurance profit	**218**	**148**	**80**	**108**	**(174)**
Investment income on equity holders' funds	86	75	43	77	30
Net profit after tax	**203**	**149**	**76**	**120**	**(108)**
Balance Sheet					
Cash and investments	3,523	3,392	3,224	3,131	3,426
Deferred acquisition costs	142	152	167	181	42
Total assets	**3,836**	**3,766**	**3,590**	**3,447**	**3,681**
Outstanding claims reserve	356	340	339	361	540
Unearned premium	1,178	1,109	1,214	1,281	1,461
Interest bearing liabilities (tier two debt)	196	197	198	199	188
Total liabilities	**1,868**	**1,844**	**1,853**	**1,950**	**2,293**
Net assets	**1,967**	**1,922**	**1,737**	**1,528**	**1,388**
Credit metrics					
Delinquency rates	0.46%	0.47%	0.54%	0.56%	0.58%
Loss ratio	35.1%	38.3%	51.9%	50.6%	92.9%
Expense ratio	25.7%	29.3%	33.6%	35.3%	82.1%
Combined ratio	60.8%	67.5%	85.4%	85.9%	175.0%
Insurance margin	48.1%	40.0%	28.3%	36.2%	(55.8%)
PCA multiple	1.57x	1.93x	1.94x	1.91x	1.65x

Source: Company

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