Genworth Exits the VA Race

By Kerry Pechter *Tue, Jan 11, 2011*

“They’re editing their lineup,” said Eric Berg, an analyst at Barclays Capital. “They’re getting out of the businesses where they lack meaningful size." (Above, Genworth CEO Mike Fraizer.)

Less than three months after a celebrity hedge fund manager lashed into Genworth Financial’s CEO during a quarterly conference call, the Richmond, Va.-based company said that it will stop selling new variable annuities, group annuities, and hybrids of long-term care insurance and annuities.

The hedge fund manager, FrontPoint Partner’s Steve Eisman—a central figure in Michael Lewis’ best-selling *The Big Short*—criticized CEO Mike Fraizer over Genworth’s performance and threatened to lead a proxy fight against current management if the company started making acquisitions.

In a January 6 press release, Genworth announced that it “is discontinuing new sales of retail variable annuities and group variable annuities. Genworth continues to provide fixed annuities as well as other leading offerings, including life insurance, long-term care insurance and wealth management.

“In addition, Genworth is suspending sales of one type of linked benefit offering—which combines annuities and long term care insurance—until that market develops further. The company continues to offer linked benefit products that combine life and long term care insurance.”

Genworth’s shareholders lost a lot of value in the third quarter, with some recovery since then. The stock price, which closed as high as $36.70 in early 2007, reached a post-financial crisis peak of $19.36 last April. It took a sharp dive at the end of July 2010 after a disappointing earnings report, falling by a third, to $10.59 on August 30 from $15.79 on July 29. (During August 2010, the S&P Index fell 6.6%, to 1,048 from 1,125.) Yesterday, Genworth shares closed at about $14.

Analysts’ views

Wall Street analysts weren’t surprised that Genworth was getting out of the variable annuity business, which has consolidated significantly since the financial crisis and where just four companies—Prudential, MetLife, Jackson National, and Lincoln Financial Group—account for a huge share of the individual product sales.

“They’re editing their lineup,” said Eric Berg, an insurance industry analyst at Barclays Capital. “They’re trying to focus on their areas of real competency and getting out of the businesses where they lack meaningful size and where the cost of being an expert—i.e., hedging—is becoming increasingly complex and costly. Genworth has never been a leader in the annuity business. This has always been a product that complemented but never really led their sales.”

“They had shown interest in continuing in [the variable annuity] business and had said as much in the past. But in retrospect this latest decision isn’t not particularly surprising,” said Steven Schwartz, a Raymond

James analyst in Chicago. “They are not a major player in the variable annuity business, and it is a business where the big tend to get bigger.”

At the same time, annuity industry watchers weren’t surprised that Genworth would suspend sales of long-term care/fixed annuity hybrids, which can make long-term care insurance more affordable.

The aging of the Boomers is expected to drive demand for that type of product, which was not feasible until January 1, 2010, when tax laws changed. But the hybrid’s sales appeal relies on the appeal of its fixed-rate deferred annuity component, and fixed-rate annuities aren’t offering attractive rates in today’s interest rate environment.

“The current market for [hybrids] is still relatively small,” said Cary Lakenbach, of Actuarial Strategies, Inc., in West Hartford, Connecticut. “But our market research has indicated a desire by annuity producers to enter this market.”

Recently, Genworth was also hurt by the exposure of its mortgage insurance business to real estate foreclosures in Florida. This situation was described in the firm’s most recent 10-Q statement filed with the Securities and Exchange Administration.

Genworth was not willing to offer RIJ direct interviews with its executives about the announcement. In response to questions about the fate of Genworth’s ClearCourse 401(k) group variable annuity, company spokesman Tom Topinka sent the following message in an e-mail:

“Many factors were taken into consideration in making these decisions including which Genworth markets, distributors and products were the strongest areas for growth, profitability and reliability of earnings. We also looked at which markets Genworth has the strongest value proposition and leadership position and finally, which markets align best with our customer and consumer needs,” Topinka wrote.

“Variable annuities did not fit into those plans including ClearCourse,” he continued. “That said, we continue to accept new participants to existing group plans. In addition, the terms and conditions of existing ClearCourse contracts—including add-ons—have not changed. Genworth will continue ClearCourse implementations that are ongoing with our clients.”

“The variable annuity business doesn’t really fit in with where they’ve gone since the crisis,” said Schwartz. “Due to ratings changes, they’ve shifted their sales effort to more of an insurance agent-type distribution and away from the high-end registered reps like Raymond James. That would make their distribution on the VA side very different from the rest of their business. That doesn’t make a whole lot of sense.

“As for getting away from the [LTC/annuity] combination business, I don’t understand that. They said they’re not seeing demand. I would think that they would continue in that market because of its long-term prospects. But maybe they decided to let somebody else, like Lincoln Financial, do the initial development.”

“This may be the first indication of their desire to get serious about restructuring,” Berg said. “I felt during the [third-quarter] earnings call that Mike Fraizer was not only listening to but hearing what the dissidents had to say. It doesn't mean he would do what they wanted, but he was listening and seemed empathetic to the idea, i.e., that Genworth might be in too many businesses. Genworth has had a history of being in businesses where it lacked leadership positions, and they've shown a consistent insistence on remaining in those business. My hope is that they'll change, and that they'll edit the lineup."

The Big Short

Steve Eisman, Genworth's lead critic, was blunt to Fraizer at the third quarter earnings call, saying about its mortgage insurance business:

"Genworth is selling at a steep discount to both MGIC [Mortgage Guaranty Insurance Corp.] and PMI [Private Mortgage Insurance], the pure-play MIs [mortgage insurance]. This is probably because this company does not meet its cost of capital in any of its businesses…"

More generally, Eisman added, "To keep going down the current road seems to me a complete waste of time." Later, he added, "And one other thing, at the beginning of this conference call Mr. Fraizer said that they might do bolt-on acquisitions. Do not do that. Your stock is selling at less than 40% of book value. You do a bolt-on acquisitions – and I will wage a proxy battle immediately to throw you out of here."

Eisman made an estimated $1.5 billion for a Greenwich, Conn.-based, Morgan Stanley-owned hedge fund firm, Front Point Partners, by betting against the sub-prime mortgage market in 2008. His lucrative exploits and those of others were chronicled by Michael Lewis in *The Big Short: Inside the Doomsday Machine* (W.W. Norton, 2010) and described by Lewis in an interview published on The Motley Fool website.