

Consolidated Financial Statements of

**GENWORTH MI CANADA INC.**

Years ended December 31, 2010, 2009 and 2008

## **MANAGEMENT STATEMENT ON RESPONSIBILITY FOR FINANCIAL REPORTING**

Management is responsible for the preparation and presentation of the consolidated financial statements of Genworth MI Canada Inc. (the “Company”). This responsibility includes ensuring the integrity and fairness of information presented and making appropriate estimates based on judgment. The consolidated financial statements are prepared in conformity with Canadian generally accepted accounting principles.

Preparation of financial information is an integral part of management’s broader responsibilities for the ongoing operations of the Company. Management maintains an extensive system of internal accounting controls to ensure that transactions are accurately recorded on a timely basis, are properly approved and result in reliable financial statements. The adequacy of operation of the control systems is monitored on an ongoing basis by management.

The Board of Directors of the Company (the “Board”) is responsible for approving the financial statements. The Audit Committee of the Board, comprising directors who are neither officers nor employees of the Company, meets with management, internal auditors, the actuary and external auditors (all of whom have unrestricted access and the opportunity to have private meetings with the Audit Committee), and reviews the financial statements. The Audit Committee then submits its report to the Board recommending its approval of the financial statements.

The Company’s appointed actuary is required to conduct a valuation of policy liabilities in accordance with Canadian generally accepted actuarial standards, reporting his results to management and the Audit Committee.

The Office of the Superintendent of Financial Institutions Canada (“OSFI”) makes an annual examination and inquiry into the affairs of the insurance subsidiary of the Company as deemed necessary to ensure that the Company is in sound financial condition and that the interests of the policyholders are protected under the provisions of the Insurance Companies Act (Canada).

The Company’s external auditors, KPMG LLP, Chartered Accountants, conduct an independent audit of the consolidated financial statements of the Company and meet both with management and the Audit Committee to discuss the results of their audit. The auditors’ report to the shareholders appears on the following page.

Brian Hurley  
President and Chief Executive Officer

Philip Mayers  
Senior Vice-President and Chief Financial Officer

Toronto, Canada

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## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the accompanying consolidated financial statements of Genworth MI Canada Inc., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, the consolidated statements of income, changes in shareholders' equity, comprehensive income and cash flows for each of the years in the three-year period ended December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Genworth MI Canada Inc. as at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2010 in accordance with Canadian generally accepted accounting principles.

Chartered Accountants, Licensed Public Accountants

February 17, 2011  
Toronto, Canada

# GENWORTH MI CANADA INC.

Consolidated Balance Sheets  
(In thousands of dollars)

December 31, 2010 and 2009

	2010	2009
<b>Assets</b>		
Invested assets:		
Cash and cash equivalents (note 8)	\$ 351,136	\$ 377,512
Short-term securities (note 8)	6,988	253,527
Bonds and debentures:		
Held-for-trading (note 8)	38,290	34,485
Available-for-sale (note 8)	3,897,936	3,743,867
Equities (note 8)	195,186	423
Government guarantee fund (note 9)	645,733	576,417
	<u>5,135,269</u>	<u>4,986,231</u>
Other:		
Accrued investment income and other receivables	32,270	28,869
Income taxes recoverable (note 11)	7,505	–
Subrogation recoverable	40,393	13,646
Deferred policy acquisition costs	152,618	146,840
Goodwill (note 18)	11,172	11,172
Intangible assets (note 17)	14,119	16,307
Premises and equipment (note 16)	2,836	3,844
Other assets	2,019	3,017
	<u>262,932</u>	<u>223,695</u>
	<u>\$ 5,398,201</u>	<u>\$ 5,209,926</u>

# GENWORTH MI CANADA INC.

Consolidated Balance Sheets  
(In thousands of dollars)

December 31, 2010 and 2009

	2010	2009
<b>Liabilities and Shareholders' Equity</b>		
Policy liabilities:		
Loss reserves (note 10)	\$ 206,611	\$ 236,181
Unearned premium reserves (note 5)	1,902,164	1,971,396
	<u>2,108,775</u>	<u>2,207,577</u>
Other liabilities:		
Accounts payable and accrued liabilities	45,872	27,811
Due to parent and companies under common control (note 12)	260	775
Income taxes payable	—	116,230
Long-term debt (note 21)	421,566	—
	<u>467,698</u>	<u>144,816</u>
Net future income taxes (note 11)	215,428	203,218
Accrued benefit liability under employee benefit plans (notes 14 and 15)	17,075	11,088
	<u>17,075</u>	<u>11,088</u>
Total liabilities	2,808,976	2,566,699
Shareholders' equity:		
Share capital (note 20)	1,552,043	1,734,376
Retained earnings	912,813	811,927
Accumulated other comprehensive income	124,369	96,924
	<u>2,589,225</u>	<u>2,643,227</u>
Commitments (note 13)		
	<u>\$ 5,398,201</u>	<u>\$ 5,209,926</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Brian Hurley" \_\_\_\_\_ Director

"Brian Kelly" \_\_\_\_\_ Director

# GENWORTH MI CANADA INC.

Consolidated Statements of Income  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

	2010	2009	2008
Gross premiums written	\$ 564,415	\$ 373,954	\$ 722,057
Net premiums written	\$ 551,603	\$ 359,679	\$ 706,126
Net premiums earned	\$ 620,834	\$ 609,804	\$ 517,561
Initial impact of change in premium recognition curve (note 5)	–	100,144	–
Fees and other income	95	62	320
Underwriting revenue	620,929	710,010	517,881
Losses on claims and expenses:			
Losses on claims (note 10)	206,410	255,756	159,985
Sales, underwriting and administrative	103,823	91,291	78,153
Initial impact of change in premium recognition curve on change in deferred policy acquisition costs (note 5)	–	6,370	–
	310,233	353,417	238,138
Net underwriting income	310,696	356,593	279,743
Investment income:			
Interest	173,512	177,136	185,730
Dividends	2,816	–	–
Net realized gains on sale of investments	3,735	2,984	40,470
Change in unrealized (loss) on held-for-trading securities	3,806	8,625	(21,748)
Equity in earnings of government guarantee fund (note 9)	3,692	4,981	(533)
General investment expenses	(4,442)	(4,552)	(3,799)
	183,119	189,174	200,120
Interest on long-term debt (note 21)	(8,322)	–	–
Interest on related party debt	–	(1,463)	(2,857)
Income before income taxes	485,493	544,304	477,006
Income taxes (note 11):			
Current	124,776	160,372	107,850
Future	11,991	5,192	32,465
	136,767	165,564	140,315
Net income	\$ 348,726	\$ 378,740	\$ 336,691
Earnings per share (note 22):			
Basic	\$ 3.09	\$ 3.31	\$ 3.02
Diluted	3.06	3.30	3.02

See accompanying notes to consolidated financial statements.

# GENWORTH MI CANADA INC.

Consolidated Statements of Changes in Shareholders' Equity  
(In thousands of dollars)

Years ended December 31, 2010, 2009 and 2008

	2010	2009	2008
<b>Share capital (note 20)</b>			
Share capital, beginning of year	\$ 1,734,376	\$ 1,642,709	\$ 1,622,709
Issuance of common shares	—	91,667	50,000
Capital reduction	—	—	(30,000)
Repurchase of common shares	(182,333)	—	—
Share capital, end of year	\$ 1,552,043	\$ 1,734,376	\$ 1,642,709
<b>Retained earnings</b>			
Retained earnings, beginning of year	\$ 811,927	\$ 461,299	\$ 124,608
Net income	348,726	378,740	336,691
Dividends	(104,531)	(28,112)	—
Repurchase of common shares (note 20)	(143,309)	—	—
Retained earnings, end of year	\$ 912,813	\$ 811,927	\$ 461,299
<b>Accumulated other comprehensive income (loss)</b>			
Accumulated other comprehensive income (loss), beginning of year, net of income taxes of \$ 43,484 (2009 – \$(5,984); 2008 – \$11,598)	\$ 96,924	\$ (14,912)	\$ 18,631
<b>Other comprehensive income (loss):</b>			
Change in unrealized gains on available-for-sale assets, net of income taxes of \$13,663 (2009 – \$51,220; 2008 – \$4,401)	37,916	115,798	13,171
Recognition of realized gains on available-for-sale assets, net of income taxes of (\$3,773) (2009 – (\$1,752); 2008 – (\$21,983))	(10,471)	(3,962)	(46,714)
<b>Total comprehensive income (loss)</b>	27,445	111,836	(33,543)
Accumulated other comprehensive income (loss), end of year, net of income taxes of \$53,374 (2009 – \$43,484; 2008 – \$(5,984))	\$ 124,369	\$ 96,924	\$ (14,912)
<b>Total shareholders' equity</b>	\$ 2,589,225	\$ 2,643,227	\$ 2,089,096

See accompanying notes to consolidated financial statements.

# GENWORTH MI CANADA INC.

Consolidated Statements of Comprehensive Income  
(In thousands of dollars)

Years ended December 31, 2010, 2009 and 2008

	2010	2009	2008
Net income	\$ 348,726	\$ 378,740	\$ 336,691
Other comprehensive income (loss):	27,445	111,836	(33,543)
Comprehensive income	\$ 376,171	\$ 490,576	\$ 303,148

See accompanying notes to consolidated financial statements.



# GENWORTH MI CANADA INC.

## Consolidated Statements of Cash Flows (In thousands of dollars)

Years ended December 31, 2010, 2009 and 2008

	2010	2009	2008
Cash provided by (used in):			
Operating activities:			
Net income	\$ 348,726	\$ 378,740	\$ 336,691
Items not involving cash:			
Amortization of premiums on investments	7,871	5,562	9,199
Amortization of intangible assets	4,175	2,991	2,562
Depreciation of premises and equipment	1,574	1,492	1,331
Change in deferred policy acquisition costs	(5,778)	3,288	(30,396)
Future income taxes	11,991	5,192	32,465
Net realized gains on sale of investments	(3,735)	(2,984)	(42,604)
Investment impairments	—	—	2,134
Change in unrealized loss on held-for-trading securities	(3,806)	(8,625)	21,748
Amortization of long-term debt discount and issuance costs	103	—	—
	361,121	385,656	333,130
Change in non-cash balances related to operations:			
Government guarantee fund	(62,840)	(43,947)	30,399
Accrued investment income and other receivable	(3,401)	2,349	3,091
Current income taxes	(131,679)	63,144	30,713
Other assets and subrogation recoverable	(25,749)	(6,827)	(6,529)
Accounts payable and accrued liabilities	18,061	(22,058)	(9,668)
Due to parent and companies under common control	(515)	(72,514)	5,530
Loss reserves	(29,570)	64,448	82,638
Unearned premium reserves	(69,232)	(350,269)	188,565
Accrued net benefit liability under employee benefit plans	5,987	3,006	1,810
	62,183	22,988	659,679
Financing activities:			
Net proceeds from long-term debt issuance	421,463	—	—
Dividends paid	(104,531)	(28,112)	—
Net proceeds from issuance of common shares	—	91,667	50,000
Repurchase of common shares	(325,642)	—	—
Capital reduction	—	—	(30,000)
	(8,710)	63,555	20,000
Investing activities:			
Purchase of bonds	(1,044,282)	(591,728)	(1,500,505)
Proceeds from sale of bonds	911,465	441,555	1,476,013
Purchase of short-term securities	(6,988)	(253,527)	(113,066)
Proceeds from sale of short-term securities	253,527	113,066	53,111
Purchase of equities	(193,117)	—	—
Proceeds from sale of equities	2,099	—	—
Purchase of intangible assets	(1,987)	(8,608)	(9,144)
Purchase of premises and equipment	(566)	(1,443)	(1,582)
	(79,849)	(300,685)	(95,173)
Increase (decrease) in cash and cash equivalents	(26,376)	(214,142)	584,506
Cash and cash equivalents, beginning of year	377,512	591,654	7,148
Cash and cash equivalents, end of year	\$ 351,136	\$ 377,512	\$ 591,654
Supplemental cash flow information:			
Income taxes paid	\$ 257,940	\$ 100,705	\$ 77,151
Interest paid on related party debt	—	2,206	2,856
Interest paid on long-term debt	7,232	—	—

See accompanying notes to consolidated financial statements.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 1. Reporting entity:

Genworth MI Canada Inc. (the "Company") was incorporated under the Canada Business Corporations Act and is domiciled in Canada. Its shares are publicly traded on the Toronto Stock Exchange under the symbol "MIC." The Company's majority shareholder is Brookfield Life Assurance Company Limited ("Brookfield"). Brookfield's ultimate parent company is Genworth Financial Inc., a public company listed on the New York Stock Exchange.

The indirect subsidiary of Genworth MI Canada Inc., Genworth Financial Mortgage Insurance Company Canada ("Genworth Mortgage Insurance Canada" or "Insurance Subsidiary"), is engaged in mortgage insurance in Canada and is regulated by the Office of the Superintendent of Financial Institutions Canada ("OSFI"), as well as financial services regulators in each province.

## 2. Basis of presentation:

The current year financial statements and prior year comparative financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

## 3. Significant accounting policies:

The significant accounting policies used in the preparation of the consolidated financial statements are summarized below:

### (a) Basis of consolidation:

Subsidiaries are businesses in which the Company exercises control through ownership of the majority of the voting shares. The Company consolidates the financial statements of its subsidiaries and eliminates on consolidation all significant intercompany balances and transactions.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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### 3. Significant accounting policies (continued):

#### (b) Premiums:

Premiums written are recorded net of risk premiums.

Insurance premiums are deferred and then taken into underwriting revenues over the terms of the related policies. The unearned portion of premiums is included in the liability for unearned premium reserves. The majority of policies to date have been written for terms of 25 to 35 years. The rates or formulae under which premiums are earned relate to the loss emergence pattern in each year of coverage. The Company performs actuarial studies of its multi-year loss experience on a quarterly basis and adjusts the formulae under which premiums are earned in accordance with the results of such studies.

A premium deficiency provision, if required, is determined as the excess of the present value of expected future losses on claims and expenses (including policy maintenance expenses) on policies in force (using an appropriate discount rate) over unearned premium reserves. Management determined that no premium deficiency provision was required at December 31, 2010, 2009, and 2008.

#### (c) Loss reserves:

Loss reserves represent the amount needed to provide for the expected ultimate cost of settling claims, including adjustment expenses related to defaults by borrowers (both reported and unreported), that have occurred on or before each balance sheet date. The adjustment expenses represent the expected ultimate costs of investigating, resolving and processing claims. Loss reserves are discounted to take into account the time value of money.

The establishment of the provision for loss reserves is based on known facts and interpretation of circumstances and is, therefore, a complex and dynamic process influenced by a large variety of factors. These factors include the Company's experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims, product mix or concentration, claims severity and claim frequency patterns.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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### 3. Significant accounting policies (continued):

Consequently, the process for the establishment of the provision for loss reserves relies on the judgment and opinions of a number of individuals, on historical precedent and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The process of determining the provisions necessarily involves risks that the actual results will deviate, perhaps substantially, from the best estimates made.

These risks vary in proportion to the length of the estimation period and the volatility of each component comprising the liability. To recognize the uncertainty in establishing these best estimates and to allow for possible deterioration in experience, actuaries are required to include explicit margins for adverse deviation in assumptions for asset defaults, reinvestment risk and claims development.

#### (d) Deferred policy acquisition costs:

Deferred policy acquisition costs comprise premium taxes and other expenses that relate directly to the acquisition of new mortgage insurance business. Deferred policy acquisition costs are only deferred to the extent that they can be expected to be recovered from the unearned premium reserves and are amortized to income in proportion to the related premiums and over the periods in which the related premiums are earned.

#### (e) Subrogation recoverable:

Real estate acquired as a result of settling claims is carried in subrogation recoverable at the estimated net proceeds from the sale of such assets.

#### (f) Investments:

Investment sales and purchases are recorded at the investment's trade date.

Interest income from fixed income securities is recognized on an accrual basis and reported as investment income in the consolidated statement of income. Dividends are recognized when the shareholders' right to receive payment is established, which is the ex-dividend date, and are reported as investment income in the consolidated statement of income.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 3. Significant accounting policies (continued):

Realized gains or losses recorded on financial asset sales are measured as the difference between cash received for the financial asset and the cost of the financial asset at the trade date and recognized as investment income in the consolidated statement of income.

The Company has classified its financial assets into the held-for-trading ("HFT") and available-for-sale ("AFS") financial assets categories. Each of these categories is described below.

### (i) Financial assets classified as HFT

The HFT financial assets are European Credit Luxembourg notes. The issuer of the notes uses the net proceeds of the offering to buy fixed income investments of European origin and credit risk. The result is a diversified portfolio of European fixed income investments. The securities have been designated as HFT at initial recognition. The basis for designation as HFT is a likelihood of the existence of derivatives in the note collateral with no feasible way to detect and bifurcate these derivatives.

HFT financial assets are recorded at fair value with realized gains and losses on sale and changes in the fair value of these securities recorded in investment income in the consolidated statements of income.

### (ii) Financial assets classified as AFS

AFS financial assets are non-derivative financial assets that are designated as AFS and that are not classified in any other specific financial asset category. The Company classifies bonds and debentures (including bonds and debentures held in the government guarantee fund) and equities in the AFS financial asset category.

AFS financial assets are recorded at fair value with changes in the fair value of these assets recorded in unrealized gains and losses, which are included in other comprehensive income. Realized gains and losses on sale, as well as losses from other-than-temporary declines in the value of AFS investments, are reclassified from accumulated other comprehensive income ("AOCI") and recorded in investment income in the consolidated statements of income. The Company ceases to accrue interest on non-performing bonds which are 90 days or more in arrears, as well as those which are less than 90 days in arrears but are deemed by management to be impaired and where the interest is deemed by management to be uncollectible.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 3. Significant accounting policies (continued):

Once invested assets are classified as non-performing, any accrued but uncollected interest is reversed.

### (g) Cash and cash equivalents:

The Company considers deposits in banks, commercial paper, government treasury bills and short-term investments with original maturities of three months or less as cash and cash equivalents.

### (h) Long-term debt:

The Company's senior unsecured debentures issued during the year together with associated issuance costs are classified as long-term debt on the consolidated balance sheet and are accounted for at amortized cost using the effective interest method.

### (i) Premises and equipment:

Premises and equipment are recorded at cost less accumulated depreciation. The Company capitalizes computer software, which is depreciated over a maximum period of five years, computer hardware, which is depreciated over a maximum period of three years, leasehold improvement costs, which are depreciated over seven years or the term of the lease, and furniture and equipment, which is depreciated over a maximum period of five years. All amortization is recorded on a straight-line basis.

The Company classifies computer software that is part of an operating system or is an integral part of related hardware as premises and equipment.

### (j) Intangible assets:

Intangible assets are recorded at cost less accumulated amortization. The Company's intangible assets consist of computer application software that is not an integral part of related hardware. The software is capitalized and amortized over a maximum period of five years.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 3. Significant accounting policies (continued):

### (k) Income taxes:

Current income taxes are recognized as the estimated income taxes payable for the current year.

The Company follows the asset and liability method of accounting for future income taxes. Future income tax assets and liabilities are based on differences between the financial statement and tax bases of assets and liabilities and are measured using currently enacted or substantively enacted tax rates expected to apply to taxable income in the years in which the temporary differences reverse. The most significant temporary differences relate to policy liabilities and the government guarantee fund reserve.

Changes in future income tax assets and liabilities that are associated with components of other comprehensive income for unrealized investment gains and losses are charged or credited directly to other comprehensive income. Otherwise, changes in future income tax assets and liabilities are included in the provision for income taxes in the consolidated statement of income.

Changes in future income tax assets and liabilities attributable to changes in substantively enacted tax rates are charged or credited to provision for income tax in the period of substantive enactment.

### (l) Pensions and other post-employment benefits:

#### (i) Defined benefit pension and other post-employment plans

The Company's defined benefit pension and other post-employment benefit plan liabilities are accrued in the consolidated balance sheet. For each plan, the Company has adopted the following policies:

- a) Actuarial valuations of benefit liabilities for pension and other post-employment plans are performed as at December 31 of each year using the projected benefit method prorated on service as defined in The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3461, Employee Future Benefits, based on management's assumptions on the discount rate, rate of compensation increase, retirement age, mortality, and health care trend rate. The discount rate is determined by management with reference to AA credit-rated bonds that have maturity dates approximating the Company's obligation terms. Other assumptions are determined with reference to long-term expectations. Obligations are attributed

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 3. Significant accounting policies (continued):

to the period beginning on the employee's date of joining the plan and ending on the earlier of termination, death, or retirement.

- b) Actuarial gains (losses) arise from changes in actuarial assumptions used to determine the benefit obligations. Only gains or losses in excess of 10% of the benefit obligations are amortized over the average remaining service period of active employees.
- c) Prior service costs arising from plan amendments are amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment.

### (ii) Defined contribution plan

Expenses related to the Company's defined contribution plan are recognized in the year the related services are provided by the Company's employees.

### (m) Share-based compensation:

Employee stock options ("Options"), upon being exercised, provide employees with a choice between being compensated in shares of the Company or in cash equal to the net proceeds from the sale of such shares. These types of awards are commonly referred to as stock options with tandem stock appreciation rights. Options granted by the Company are measured at the difference between the quoted market value of the Company's shares at the end of each reporting period and the Option exercise price. This amount is recorded as compensation expense over the Option vesting period, with a corresponding entry to accrued benefit liability under employee benefit plans.

Employee Restricted Share Units ("RSUs") entitle employees to receive an amount equal to the fair market value of the Company's shares and may be settled in shares of the Company or cash. RSUs granted by the Company are measured at the quoted market value of the Company's shares at the end of each reporting period and are recorded as compensation expense over the RSU vesting period, with a corresponding entry to accrued liability under employee benefit plans.

Performance Share Units ("PSUs") are RSUs with performance conditions attached. PSUs granted by the Company are measured at the quoted market value of the Company's shares at the end of each reporting period. These awards are recorded as compensation expense over the PSU vesting period, with a corresponding entry to accrued liability under



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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### 3. Significant accounting policies (continued):

employee benefit plans based on management's best estimate of the outcome of the performance conditions.

Directors' Deferred Share Units ("DSUs") entitle eligible members of the Company's Board of Directors to receive an amount equal to the fair market value of the Company's shares as compensation for director services rendered for the period, and may be settled in shares or cash. The DSUs granted by the Company are measured at the quoted market value of the Company's shares at the end of each reporting period and are recorded as compensation expense in the period the awards are granted, with a corresponding entry to accrued liabilities.

RSUs, PSUs, and DSUs may participate in dividend equivalents at the discretion of the Company's Board of Directors. Dividend equivalents are calculated based on the market value of the Company's shares on the date the dividend equivalents are credited to the RSU, PSU or DSU accounts and are recorded as additional compensation expense.

The Company accounts for forfeitures related to Options, RSUs and PSUs based on management's best estimate of the units that will ultimately vest. This estimate is adjusted if actual experience differs from expectation.

#### (n) Goodwill:

When a business is acquired, the Company allocates the purchase price paid to the assets acquired, including identifiable intangible assets and the liabilities assumed. Any excess of the amount paid over the fair value of those net assets is recorded as goodwill.

Goodwill is tested at least annually for impairment. The impairment test consists of comparing the book value of the business to its fair value. The excess of carrying value of goodwill over fair value of goodwill, if any, is recorded as an impairment charge in the period in which impairment is determined. There have been no write-downs of goodwill due to impairment for the years ended December 31, 2010, 2009 and 2008.

#### (o) Transactions with related parties:

Related party transactions are primarily undertaken in the normal course of business and are measured at the exchange amount.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 3. Significant accounting policies (continued):

### (p) Foreign currency translation:

Transactions in foreign currencies are translated to Canadian dollars at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to Canadian dollars at period-end rates. Foreign currency differences arising on translation are recognized in the consolidated statement of income.

### (q) Use of estimates:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. The principal financial statement components subject to measurement uncertainty include unearned premiums (note 3(b) and note 5), other-than-temporary declines in the value of investments (note 6), loss reserves (note 10), pensions and other post-employment benefits (note 14), and share-based compensation (note 15). Actual results may differ from the estimates used in preparing the consolidated financial statements.

## 4. Future changes in accounting policies:

### International Financial Reporting Standards:

Canadian publicly accountable enterprises will be required to prepare their financial statements in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"), for reporting periods beginning on or after January 1, 2011.

Effective January 1, 2011, the Company will adopt IFRS as the basis for preparing its consolidated financial statements. The Company will initially report its financial results for the period ended March 31, 2011 prepared on an IFRS basis. The Company will also provide comparative financial results on an IFRS basis, including an opening balance sheet, as at January 1, 2010 (the transition date).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **4. Future changes in accounting policies (continued):**

The differences between the Company's accounting policies and IFRS requirements, combined with the Company's decisions on the optional exemptions from retroactive application of IFRS, will result in measurement and recognition differences upon the transition to IFRS. The net impact of these differences will be recorded in the Company's opening retained earnings.

The areas that will be impacted by transition to IFRS include pension and other post-employment benefits, share-based compensation, income taxes and financial statement presentation.

## **5. Change in estimate of unearned premium reserves:**

The Company's actuarial studies of multi-year loss experience, performed in accordance with its accounting policy for premiums, have indicated an acceleration of premium recognition. The impact of the experience update for the year ended December 31, 2010 was an increase of premiums earned of \$48,454 (December 31, 2009 – \$136,354, including the cumulative impact of the initial update of the premium recognition curve in the first quarter of 2009 of \$100,144).

## **6. Financial risk management:**

The primary goals of the Company's financial risk management are to ensure that the outcome of activities involving elements of risk are consistent with the Company's objectives and risk tolerance, and to maintain an appropriate risk and reward balance while protecting the Company's balance sheet from events that have the potential to materially impair its financial strength. Balancing risk and reward is achieved through aligning risk appetite with business strategy, pricing appropriately for risk, diversifying risk and mitigating risk through preventive controls.

### **(a) Insurance risk:**

The Company is exposed to insurance risk arising from the underwriting of mortgage insurance policies. Under a mortgage insurance policy, in the event of borrower default, a lender is insured against risk of loss for the entire unpaid loan balance plus interest, customary selling costs and expenses related to the sale of the underlying property. The Company's risk management framework facilitates the identification and assessment of risks, and the ongoing monitoring and management of these risks. The objective of the framework and related internal control procedures is to enhance underwriting income and long-term financial performance.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

The Company's risk management framework encompasses the management of pricing risk, underwriting risk, claims management risk, loss reserving risk, and portfolio concentration risk.

### (i) Pricing risk:

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. The underwriting results of the mortgage insurance business can fluctuate significantly due to the cyclical nature of the Canadian mortgage market. The mortgage market is affected primarily by housing supply and demand, interest rates, and general economic factors. The Company's premium rates vary with the perceived risk of a claim on an insured loan, which takes into account the Company's long-term historical loss experience on loans with similar loan-to-value ratios, terms and types of mortgages, and the borrower credit histories. Before the Company introduces a new product, it establishes specific performance targets, including delinquency rates and loss ratios, which the Company monitors frequently to identify any deviations from expected performance so that it can take corrective action when necessary.

### (ii) Underwriting risk:

Underwriting risk is the risk that the total cost of claims and acquisition expenses will exceed premiums received. The Company employs disciplined underwriting practices across multiple products and geographies. The Company's risk management and underwriting process enables it to assess high loan-to-value mortgage applications on a loan-by-loan basis, taking into account a broad range of factors and ensuring that the underwriting guidelines and procedures established by the Company's risk management function are adhered to. The Company's underwriting policies and procedures are reviewed and updated regularly to manage the Company's exposures and to address emerging trends in the housing market and economic environment.

The Company's underwriting objective is to develop business on a prudent basis and to achieve profitable underwriting results. For the year ended December 31, 2010, the Company's loss ratio was 33% (2009 – 36%).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

### (iii) Claims management risk:

The Company's agreements with lenders require a claim to be filed when the lender has suffered a loss under an insured mortgage policy. The claim is subject to the Company's review, appraisal and possible adjustment. Loss mitigation officers with the requisite degree of experience and competence have authority to approve claim payments up to a maximum dollar amount, based on their level of experience and seniority.

The Homeowner Assistance Program, the Company's primary loss mitigation program, is designed to help homeowners who are experiencing temporary financial difficulties that may prevent them from making timely payments on their mortgage. Initiatives currently employed under the Homeowner Assistance Program include capitalizing arrears, deferring payments for a specified period, arranging a partial payment plan, and increasing the mortgage amortization period.

Under its agreement with lenders, the Company has the right to recover losses from borrowers once a claim has been paid. The Company actively pursues such recoveries.

### (iv) Loss reserving risk:

When a borrower is in arrears with his or her mortgage payments, the insured lender is obligated to diligently pursue efforts to require the borrower to remedy such arrears. Lenders report delinquent loans that are more than 90 days in arrears to the Company on a monthly basis. Loss reserves represent management's best estimate of the amount needed to provide for the expected ultimate cost of settling and adjusting claims related to defaults by borrowers (both reported and unreported) that have occurred on or before each balance sheet date. Loss reserves may differ from the ultimate amount paid to settle claims principally due to additional claim information received and external factors that influence claim frequency and severity, including housing market performance.

The Company reviews its case reserves on an ongoing basis, updates the case reserves as appropriate, and maintains a supplemental loss reserve for potential adverse developments that may occur during the period from the borrower default date to the claim settlement date. Management has established procedures to evaluate the appropriateness of loss reserves, which include a review of the loss reserves by the Company's independent appointed actuary at least annually.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

### (v) Portfolio concentration risk:

A national or regional economic downturn may increase the likelihood that borrowers will not have sufficient income to pay their mortgages and can also adversely affect home values, which increases the Company's losses. The exposure to insurance portfolio concentration risk is mitigated by a portfolio that is diversified across the various concentrations of risk. The Company carefully monitors portfolio concentrations by borrower credit quality, product and geography against predetermined risk tolerances, taking into account the conditions of the housing market and economy in each region of Canada. The Company leverages and utilizes this data to customize underwriting guidelines by product and to develop more effective loss prevention and loss mitigation initiatives.

### (b) Credit risk:

Credit risk is the risk that one party to a financial instrument fails to discharge an obligation and causes financial loss to another party. The Company is exposed to credit risk principally through its invested assets.

The total credit risk exposure at December 31, 2010 is \$4,093,016 (2009 – \$4,074,817) and comprises \$3,936,226 (2009 – \$3,778,352) of bonds and debentures, \$77,139 (2009 – \$423) of preferred shares, \$6,988 (2009 – \$253,527) of short-term securities, \$32,270 (2009 – \$28,869) of accrued investment income and other receivables, and \$40,393 (2009 – \$13,646) of subrogation recoverable.

The Company is indirectly exposed to credit risk through its proportionate interest in the investment assets of the government guarantee fund under the Government Guarantee Agreement (notes 6(e) and 9).

The Company's risk management strategy is to invest primarily in debt instruments of Canadian government agencies and other high-credit-quality issuers and to limit the amount of credit exposure with respect to any one issuer, business sector, or credit rating category, as specified in its investment policy. Credit quality of financial instrument issuers is assessed based on ratings supplied by rating agencies Standard and Poor, Moody's, or Dominion Bond Rating Service.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 6. Financial risk management (continued):

The breakdown of the Company's bonds and debentures, preferred shares, and short-term securities by credit ratings is presented below:

Credit rating	2010		2009	
	Amount	Fair value %	Amount	Fair value %
AAA	\$ 1,337,237	33.3	\$ 1,614,360	40.1
AA	1,426,779	35.5	1,344,137	33.3
A	1,134,426	28.2	1,017,783	25.2
BBB	121,756	3.0	55,924	1.4
Lower than B and unrated	155	—	98	—
	\$4,020,353	100.0	\$4,032,302	100.0

As at December 31, 2010, 97.0% of the Company's investment portfolio was rated 'A' or better, compared to 98.6% at December 31, 2009.

As at December 31, 2010, the cost of 75 AFS securities exceeded their fair value by \$4,792 (2009 – 40 AFS securities exceeded their fair value by \$13,771). This unrealized loss is recorded in AOCI as part of unrealized gains (losses) on AFS securities. In 2010, nominal unrealized losses on these securities arose primarily from higher prevailing interest rates compared to the prior year. In 2009, the unrealized losses on the securities arose primarily from an increase in credit spreads. Based on factors including underlying credit ratings of the issuers, the Company expects that future interest and principal payments will continue to be received on a timely basis. Since the Company has the ability and intent to hold these securities until there is a recovery of fair value, which may be at maturity, these unrealized losses are considered temporary in nature. The Company conducts a monthly review to identify and evaluate investments that show indications of impairment.

An investment is considered impaired if its fair value falls below its cost, and a write-down is recorded when the decline is considered other-than-temporary. Factors considered in determining whether or not a loss is temporary include the length of time and extent to which fair value has been below cost, financial condition and near-term prospects of the issuer, and the ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 6. Financial risk management (continued):

The following AFS securities were in an unrealized loss position:

	2010			2009		
	Fair value	Amortized cost/Cost	Unrealized loss	Fair value	Amortized cost/Cost	Unrealized loss
Government bonds	\$ 28,511	\$ 28,910	\$ (399)	\$ 136,208	\$ 138,674	\$ (2,466)
Corporate bonds	118,055	120,523	(2,468)	329,438	340,743	(11,305)
Preferred shares	28,666	29,051	(385)	—	—	—
Common shares	35,192	36,732	(1,540)	—	—	—
<b>Total</b>	<b>\$ 210,424</b>	<b>\$ 215,216</b>	<b>\$ (4,792)</b>	<b>\$ 465,646</b>	<b>\$ 479,417</b>	<b>\$ (13,771)</b>

At December 31, 2010, \$155 of the Company's investments were impaired, compared to \$98 at December 31, 2009. The breakdown of the Company's other-than-temporarily impaired investments is presented below:

	Credit rating	2010			2009		
		Carrying value prior to impairment	Cumulative impairment loss	Fair value	Carrying value prior to impairment	Cumulative impairment loss	Fair value
Lehman Brothers Holdings Inc.	Unrated	\$ 590	\$ (541)	\$ 155	\$ 590	\$ (541)	\$ 98
		\$ 590	\$ (541)	\$ 155	\$ 590	\$ (541)	\$ 98

Total interest income earned on impaired investments held at December 31, 2010 and sold during the year was \$nil (2009 – \$nil; 2008 – \$1,466).

### (c) Liquidity risk:

Liquidity risk is the risk of having insufficient cash resources to meet financial commitments and policy obligations as they fall due without raising funds at unfavourable rates or selling assets on a forced basis.

Liquidity risk arises from the Company's general business activities and in the course of managing its assets, liabilities and externally imposed capital requirements (note 7). The



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 6. Financial risk management (continued):

liquidity requirements of the Company's business have been met primarily by funds generated from operations, asset maturities, and income and other returns received on securities. Cash provided from these sources is used primarily for loss and loss adjustment expense payments, operating expenses and payment of dividends. To ensure liquidity requirements are met, the Company holds a portion of investment assets in liquid securities. At December 31, 2010, the Company has cash and cash equivalents of \$351,136 (2009 – \$377,512) and short-term securities of \$6,988 (2009 – \$253,527).

The table below summarizes the carrying value by the earliest contractual maturity of the Company's bonds and debentures:

	Within one year	One to three years	Three to five years	Six to ten years	Over ten years	Total
As at December 31, 2010:						
Bonds and debentures	\$ 467,544	\$ 809,867	\$ 1,299,013	\$ 789,679	\$ 570,123	\$ 3,936,226
As at December 31, 2009:						
Bonds and debentures	291,569	979,151	1,169,790	618,344	719,498	3,778,352

The table below shows the expected payout pattern of the Company's financial liabilities:

	Within one year	One to three years	Three to five years	Six to ten years	Over ten years	Total
As at December 31, 2010:						
Loss reserves	\$ 108,924	\$ 95,685	\$ 2,002	\$ –	\$ –	\$ 206,611
Long-term debt	–	–	150,000	275,000	–	425,000
As at December 31, 2009:						
Loss reserves	170,349	59,249	6,583	–	–	236,181
Long-term debt	–	–	–	–	–	–

### (d) Market risk:

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, equity market fluctuations, foreign currency exchange rates and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded. The market risks to which the Company is exposed are interest rate risk and equity price risk.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

### (i) Interest rate risk

Fluctuations in interest rates have a direct impact on the market valuation of the Company's fixed income securities portfolio. Generally, investment income will move with interest rates over the long term. Short-term interest rate fluctuations will generally create unrealized gains or losses. Generally, the Company's interest income will be reduced during sustained periods of lower interest rates as higher-yielding fixed income securities are called, mature or are sold and the proceeds are reinvested at lower rates, and this will likely result in unrealized gains in the value of fixed income securities the Company continues to hold, as well as realized gains to the extent that the relevant securities are sold. During periods of rising interest rates, the market value of the Company's existing fixed income securities will generally decrease and gains on fixed income securities will likely be reduced or become losses.

As at December 31, 2010, management estimates that an immediate hypothetical 100 basis point, or 1%, increase in interest rates would decrease the market value of the AFS fixed income securities and preferred shares by approximately \$146,000, representing 3.67% of the \$3,982,063 fair value of these securities, and decrease the value of loss reserves by \$1,582. Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the AFS fixed income securities and preferred shares by approximately \$157,000, representing 3.94% of the fair value, and increase the value of loss reserves by approximately \$1,614.

As at December 31, 2009, management estimated that an immediate hypothetical 100 basis point, or 1%, increase in interest rates would decrease the market value of the AFS fixed income securities by approximately \$138,000, representing 3.45% of the \$3,997,394 fair value of the AFS fixed income securities portfolio, and decrease the value of loss reserves by \$1,810. Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the AFS fixed income securities by approximately \$138,000, representing 3.45% of the fair value, and increase the value of loss reserves by approximately \$1,847. During the year, the Company significantly shortened the durations of its AFS investment portfolio. As a result, portfolio convexity has been reduced.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

As at December 31, 2010, management estimates that a 100 basis point, or 1%, increase in interest rates would decrease the market value of the HFT securities by approximately \$1,800, representing 4.70% of the \$38,290 fair value of the HFT fixed income securities portfolio. Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the HFT securities by approximately the same amount.

As at December 31, 2009, management estimated that a 100 basis point, or 1%, increase in interest rates would decrease the market value of the HFT securities by approximately \$1,500, representing 4.35% of the \$34,485 fair value of the HFT fixed income securities portfolio. Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the HFT securities by the same amount.

Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions and should not be relied on as indicative of future results. The analysis in this section is based on the following assumptions: (i) the existing level and composition of fixed income security assets will be maintained; (ii) shifts in the yield curve are parallel; and (iii) credit and liquidity risks have not been considered.

### (ii) Equity price risk

Equity price risk is the risk that the fair values of equities will decrease as a result of changes in the levels of equity indices and the values of individual stocks. Equity price risk exposure arises from the Company's investment in common shares. As at December 31, 2010, the Company had a total investment in common shares of \$118,047. Management estimates that a 10% increase in equity prices would increase the market value of the common shares by \$11,805 and that a 10% decrease in equity prices would decrease the market value of the common shares by the same amount. The Company has policies to limit and monitor exposures to individual issuers and its aggregate exposure to equities.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 6. Financial risk management (continued):

### (e) Government guarantee fund:

#### (i) Credit risk

The total credit risk exposure for the government guarantee fund at December 31, 2010 is \$778,851 (2009 – \$698,452) and comprises \$703,542 of bonds and debentures (2009 – \$663,161) and \$75,309 of short-term securities (2009 – \$35,291).

The Company limits credit exposure relative to the government guarantee fund by investing 100% of the portfolio into securities issued by the Government of Canada or agencies unconditionally guaranteed by the Government of Canada. The breakdown of the Company's guarantee fund investment portfolio by credit rating is presented below:

Credit rating	2010		2009	
	Amount	Fair value %	Amount	Fair value %
AAA	\$ 778,851	100.0	\$ 698,452	100.0
Total	\$ 778,851	100.0	\$ 698,452	100.0

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 6. Financial risk management (continued):

As at December 31, 2010, the cost of 5 AFS bonds exceeded their fair value by \$495 (2009 – the cost of 6 AFS bonds exceeded their fair value by \$246). This unrealized loss is recorded in AOCI as part of unrealized gains (losses) on AFS securities. Due to the fact that the bond issuers are either the Government of Canada or agencies unconditionally guaranteed by the Government of Canada, the Company expects that future interest and principal payments will continue to be received on a timely basis. Since the Company has the ability and intent to hold these securities until there is a recovery of fair value, which may be at maturity, these unrealized losses are considered temporary in nature.

The following AFS bonds were in an unrealized loss position:

	2010			2009		
	Carrying value	Amortized cost	Unrealized loss	Carrying value	Amortized cost	Unrealized loss
Government bonds	\$ 16,968	\$17,312	\$ (344)	\$ 3,230	\$ 3,298	\$ (68)
Agencies unconditionally guaranteed by the Government of Canada	29,399	29,550	(151)	56,836	57,014	(178)
	<u>\$ 46,367</u>	<u>\$ 46,862</u>	<u>\$ (495)</u>	<u>\$ 60,066</u>	<u>\$ 60,312</u>	<u>\$ (246)</u>

### (ii) Liquidity risk

The table below summarizes the carrying value by the earliest contractual maturity of the guarantee fund bonds and debentures:

	Within one Year	One to three years	Three to five years	Six to ten years	Over ten years	Total
As at December 31, 2010:						
Bonds and debentures	\$ 139,593	\$ 128,452	\$ 248,344	\$ 80,953	\$ 192,402	\$ 789,744
As at December 31, 2009:						
Bonds and debentures	10,605	178,785	126,725	192,639	154,407	663,161

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 6. Financial risk management (continued):

### (iii) Market risk

As at December 31, 2010, management estimates that an immediate hypothetical 100 basis point, or 1%, increase in interest rates would decrease the market value of the AFS fixed income securities in the government guarantee fund by approximately \$35,000, representing 4.49% of the \$778,851 fair value of the government guarantee fund investment portfolio, and decrease the value of the exit fee and liability to the Mortgage Insurance Company of Canada ("MICC") by \$7,112 (note 9). Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the government guarantee fund by approximately \$40,000, representing 5.14% of the fair value, and increase the value of the exit fee and liability to MICC by \$7,945.

As at December 31, 2009, management estimated that an immediate hypothetical 100 basis point, or 1%, increase in interest rates would decrease the market value of the AFS fixed income securities in the government guarantee fund by approximately \$32,000, representing 4.58% of the \$698,452 fair value of the government guarantee fund investment portfolio, and decrease the value of the exit fee and liability to the MICC by \$6,191 (note 9). Conversely, a 100 basis point, or 1%, decrease in interest rates would increase the market value of the government guarantee fund by approximately \$36,000, representing 5.15% of the fair value, and increase the value of the exit fee and liability to MICC by \$6,903.

Computations of the prospective effects of hypothetical interest rate changes are based on numerous assumptions and should not be relied on as indicative of future results. The analysis in this section is based on the following assumptions: (i) the existing level and composition of the government guarantee fund investments will be maintained; (ii) shifts in the yield curve are parallel; and (iii) credit and liquidity risks have not been considered.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **7. Capital management and regulatory requirements:**

Capital comprises the Company's shareholders' equity.

The Company's objectives when managing capital are to maintain financial strength and a strong external financial strength rating, to protect its loss-paying abilities, and to maximize returns to shareholders over the long term.

The Insurance Subsidiary is a regulated insurance company governed by the provisions of the Insurance Companies Act ("the Act"), which is administered by OSFI. As such, the Insurance Subsidiary is subject to certain requirements and restrictions contained in the Act. The Act limits dividends to shareholders under certain circumstances.

The Insurance Subsidiary is required under the Act to meet a minimum capital test ("MCT") to support its outstanding mortgage insurance in force. The MCT ratio is calculated based on a model developed by OSFI. The statutory minimum is 100%, and OSFI has established a supervisory MCT ratio for the Insurance Subsidiary of 120% (2009 – 120%). To measure the degree to which the Insurance Subsidiary is able to meet regulatory capital requirements, the appointed actuary must present an annual report to the Audit Committee and management on the Insurance Subsidiary's current and future solvency under various projected scenarios. In addition, the Company has established an internal capital ratio for the Insurance Subsidiary of 145% (2009 – 135%).

As at December 31, 2010, the Insurance Subsidiary had an MCT ratio of 156% (2009 – 149%) and has complied with the regulatory capital requirements.

Senior executive management is responsible for developing the capital strategy and overseeing the capital management processes of the Company and its Insurance Subsidiary. Capital forecasting techniques are used to predict the adequacy of capital for planning purposes. Based on forecasted capital, capital management is accomplished through establishing appropriate investment policies and incorporating capital requirements into dividend capacity planning.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 8. Investments:

The fair values of invested assets, excluding the government guarantee fund, are summarized as follows:

	December 31, 2010				December 31, 2009			
	Market value	Amortized cost	Unrealized gain (loss)	% market value	Market value	Amortized cost	Unrealized gain (loss)	% market value
Cash and cash equivalents:								
Government treasury bills	\$ 339,093	\$ 339,093	\$ –	7.6	\$ 231,519	\$ 231,519	\$ –	5.3
Bankers' acceptances	–	–	–	–	64,898	64,898	–	1.5
Time deposits	–	–	–	–	65,943	65,943	–	1.5
Cash	12,043	12,043	–	0.2	15,152	15,152	–	0.3
	351,136	351,136	–	7.8	377,512	377,512	–	8.6
Available-for-sale securities:								
Government bonds:								
Canadian federal	950,846	931,875	18,971	21.2	1,073,117	1,053,507	19,610	24.3
Canadian provincial	606,978	581,687	25,291	13.5	637,602	614,647	22,955	14.5
	1,557,824	1,513,562	44,262	34.7	1,710,719	1,668,154	42,565	38.8
Corporate bonds:								
Financial	1,231,336	1,170,706	60,630	27.5	1,420,446	1,370,884	49,562	32.2
Energy	301,623	288,719	12,904	6.7	230,456	220,195	10,261	5.2
Infrastructure	252,292	239,966	12,326	5.6	206,310	199,534	6,776	4.7
All other sectors	309,415	299,527	9,888	6.9	175,425	166,394	9,031	4.0
	2,094,666	1,998,918	95,748	46.7	2,032,637	1,957,007	75,630	46.1
Preferred shares:								
Financial	67,009	66,717	292	1.5	423	421	2	–
Industrial	1,412	1,406	6	–	–	–	–	–
Energy	8,718	8,630	88	0.2	–	–	–	–
	77,139	76,753	386	1.7	423	421	2	–
Common shares:								
Energy	45,222	42,601	2,621	1.0	–	–	–	–
Infrastructure	18,840	18,185	655	0.4	–	–	–	–
Communications	22,074	22,468	(394)	0.5	–	–	–	–
All other sectors	31,911	31,464	447	0.7	–	–	–	–
	118,047	114,718	3,329	2.6	–	–	–	–
Asset-backed bonds	252,434	245,187	7,247	5.6	254,038	252,116	1,922	5.8
	4,100,110	3,949,138	150,972	91.3	3,997,817	3,877,698	120,119	90.7
Held-for-trading securities:								
Financial	38,290	50,000	(11,710)	0.9	34,485	50,000	(15,515)	0.7
Total investments	\$ 4,489,536	\$ 4,350,274	\$ 139,262	100.0	\$ 4,409,814	\$ 4,305,210	\$ 104,604	100.0



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 8. Investments (continued):

The fair value amounts of invested assets, excluding the government guarantee fund, equities, and cash and cash equivalents are shown by contractual maturity of the security. Yields are based upon fair value.

Terms to maturity	2010		2009	
	Fair value	Yield %	Fair value	Yield %
Debt securities issued or guaranteed by the Government of Canada:				
One year or less	\$ 208,244	4.6	\$ 397,527	1.8
One to three years	236,155	4.8	432,129	4.3
Three to five years	740,893	3.1	645,613	3.7
Five to ten years	267,808	4.9	155,254	5.1
Over ten years	104,724	4.6	80,196	4.8
	1,557,824	4.0	1,710,719	3.6
Corporate debt securities:				
One year or less	266,288	5.2	147,569	4.9
One to three years	573,712	5.0	547,022	5.0
Three to five years	558,120	4.8	524,177	5.3
Five to ten years	521,871	5.1	463,090	5.2
Over ten years	465,399	5.5	639,302	5.9
	2,385,390	5.1	2,321,160	5.3
	\$ 3,943,214	4.6	\$ 4,031,879	4.6

### (a) Securities lending:

The Company participates in a securities-lending program through an intermediary, whereby the Company lends securities it owns to other financial institutions to allow them to meet delivery commitments. Securities with an estimated fair value of at least 105% of the fair value of the securities loaned are received as collateral. The fair value of securities participating in the securities-lending program at December 31, 2010 is \$269,928 (December 31, 2009 – \$325,482).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 8. Investments (continued):

### (b) Fair value measurements:

The following table sets forth inputs used as of December 31, 2010 and 2009 in valuing the Company's financial instruments carried at fair value:

2010	Total	Level 1	Level 2	Level 3
Investments:				
Bonds and debentures – AFS	\$ 3,897,936	\$ –	\$ 3,897,936	\$ –
Bonds and debentures – HFT	38,290	–	–	38,290
Preferred shares	77,139	–	77,139	–
Common shares	118,047	118,047	–	–
Short-term securities	6,988	6,988	–	–
Bonds and debentures in the government guarantee fund	703,542	–	703,542	–
Short-term securities in the government guarantee fund	75,309	75,309	–	–
	\$ 4,917,251	\$ 200,344	\$ 4,678,617	\$ 38,290

2009	Total	Level 1	Level 2	Level 3
Investments:				
Bonds and debentures – AFS	\$ 3,743,867	\$ –	\$ 3,642,737	\$ 101,130
Bonds and debentures – HFT	34,485	–	–	34,485
Preferred shares	423	–	423	–
Short-term securities	253,527	253,527	–	–
Bonds and debentures in the government guarantee fund	663,161	–	663,161	–
Short-term securities in the government guarantee fund	35,291	35,291	–	–
	\$ 4,730,754	\$ 288,818	\$ 4,306,321	\$ 135,615

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 8. Investments (continued):

During the years ended December 31, 2010 and 2009, the reconciliation of investments measured at fair value using unobservable inputs (Level 3) is presented as follows:

2010	AFS bonds and debentures	HFT bonds and debentures	Total
Beginning balance, January 1, 2010	\$ 101,130	\$ 34,485	\$ 135,615
Purchases	—	—	—
Sales and settlements	—	—	—
Transfers into Level 3	—	—	—
Transfers out of Level 3	(101,130)	—	(101,130)
Amortization of bond premium	—	—	—
Change in fair value through income	—	3,805	3,805
Change in fair value through OCI	—	—	—
Ending balance, December 31, 2010	\$ —	\$ 38,290	\$ 38,290

2009	AFS bonds and debentures	HFT bonds and debentures	Total
Beginning balance, January 1, 2009	\$ 117,911	\$ 25,860	\$ 143,771
Purchases	46	—	46
Sales and settlements	(18,902)	—	(18,902)
Transfers into Level 3	—	—	—
Transfers out of Level 3	—	—	—
Amortization of bond premium	(188)	—	(188)
Change in fair value through income	—	8,625	8,625
Change in fair value through OCI	2,263	—	2,263
Ending balance, December 31, 2009	\$ 101,130	\$ 34,485	\$ 135,615

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **8. Investments (continued):**

For the year ended December 31, 2010, the Level 3 instruments comprise \$38,290 European Luxembourg notes classified as HFT. For the year ended December 31, 2009, the Level 3 instruments comprise \$101,130 commercial mortgage backed bonds classified as AFS and \$34,485 European Luxembourg notes. The European Luxembourg notes are not externally rated but have been given an internal rating of BBB. The commercial mortgage backed bonds are all investment grade and rated AAA.

During the year ended December 31, 2010, \$101,130 of bonds and debentures classified as AFS were transferred from Level 3. The transfers from Level 3 resulted primarily from observable market data now being available, thus eliminating the need to estimate data beyond observable data available.

The potential impact of using reasonable possible alternative assumptions for valuing Level 3 financial instruments at December 31, 2010 would be to increase their fair value by approximately \$1,800 or decrease their fair value by approximately the same amount (December 31, 2009 – increase fair value by approximately \$5,513 or decrease fair value by approximately \$5,337).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 9. Government guarantee fund and Government Guarantee Agreement:

The government guarantee fund reflects the Company's proportionate interest in the assets held in the government guarantee fund established under the Government Guarantee Agreement, including accrued income and net of applicable accrued exit fees. The fair value of the government guarantee fund as at December 31, 2010 is \$645,733 (2009 – \$576,417).

The following table summarizes the components of the government guarantee fund:

	December 31, 2010	December 31, 2009
Invested assets at fair value (a)	\$ 789,869	\$ 699,207
Accrued contribution and accrued income (b)	18,201	14,700
Accrued exit fee and MICC liability (c)	(162,337)	(137,490)
	<u>\$ 645,733</u>	<u>\$ 576,417</u>

- (a) Investments held under the Government Guarantee Agreement including government bonds, bonds unconditionally guaranteed by the Government of Canada, and cash; plus
- (b) the Company's accrued contributions of 10.5% of premiums written on insured mortgages for the last quarter of the year and accrued interest on invested assets; less
- (c) the cumulative exit fee applicable to the fair value of the Company's proportionate interest in investments held under the Government Guarantee Agreement and accrued contributions, and the Company's liability for the net proportionate interest in the guarantee fund of its predecessor MICC.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 9. Government guarantee fund and Government Guarantee Agreement (continued):

The 1988 Bank for International Settlements ("BIS") agreement signed by the Government of Canada introduced risk-related capital adequacy guidelines for Canadian chartered banks. Qualifying residential mortgages carry a 50% risk weighting, while mortgages insured by Canada Mortgage and Housing Corporation ("CMHC"), an agency of the Government of Canada, carry no risk weighting. The BIS capital guidelines did not provide a reduced risk weighting for residential mortgages insured by a private mortgage insurer, thereby putting private mortgage insurers at a disadvantage to CMHC. In 1988, MICC was such an insurer. In 1995, the Company acquired certain assets and assumed certain government guarantee fund liabilities from MICC related to MICC's residential mortgage insurance line of business for \$20,000.

Effective January 1, 1991, MICC entered into an agreement with the Government of Canada to ensure that it could effectively compete with CMHC. This agreement (the "Government Guarantee Agreement") provided MICC with a Government of Canada guarantee of its obligations under eligible residential mortgage insurance policies. In the event of wind-up, the Government of Canada will pay an amount of claims less 10% of the original insured amount. As a result of the credit support provided by the Government of Canada guarantee, the risk weighting for eligible insured mortgages was reduced from 50% to 5%.

The Government Guarantee Agreement requires:

- (a) contribution of 10.5% of premiums written on eligible insured mortgages over the next 25 years to a guarantee fund, which could be used in the event that the guarantee is called; and
- (b) payment of an annual risk premium equal to 1% of the estimated Government of Canada net exposure.

Monies can be withdrawn from the government guarantee fund if the dollar value of the government guarantee fund is at least equal to the sum of the estimated Government of Canada gross exposure on the guarantee plus the greater of 15% of the estimated Government of Canada gross exposure and \$10 million. Upon withdrawal of the monies from the government guarantee fund, an exit fee of 1% of the amount of the fund for each year from the effective date of the Government Guarantee Agreement (February 1992) to the date of the withdrawal up to a maximum of 25% must be paid to the Government of Canada.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **9. Government guarantee fund and Government Guarantee Agreement (continued):**

In conjunction with the acquisition of MICC's residential mortgage insurance business, the Government Guarantee Agreement has been assigned to the Company with the consent of Her Majesty In Right of Canada. The mortgage insurance policies issued by MICC prior to the assignment of the Government of Canada Guarantee Agreement continue to be covered by the guarantee. MICC assigned its interest in the assets held in the government guarantee fund to the Company, and the Company agreed to pay MICC the value of MICC's proportionate interest in the government guarantee fund when the value of MICC's proportionate interest in the government guarantee fund was at least equal to the sum of MICC's estimated Government of Canada gross exposure on the guarantee plus the greater of 15% of MICC's estimated Government of Canada gross exposure and \$10 million. Effective 2004, given that the threshold had been reached, the Company commenced payment to MICC under the terms of the agreement, increasing the Company's interest in the government guarantee fund.

Equity in earnings of the government guarantee fund of \$3,692 (2009 – \$4,981; 2008 – (\$533)) is included in net income. Equity in the earnings of the government guarantee fund comprises investment income of \$26,530 (2009 – \$21,827; 2008 – \$23,529) less exit fees of \$22,838 (2009 – \$16,846; 2008 – \$24,062).

## **10. Loss reserves:**

The carrying value of loss reserves reflects the present value of expected claims costs and expenses plus provisions for adverse deviation and is considered to be an indicator of fair value. The discount rate used to determine present value at December 31, 2010 was 3.59% (2009 – 3.57%). The margin for adverse deviation used to determine the provision for adverse deviation at December 31, 2010 was 4.5% (2009 – 3.5%). There is no ready market for the trading of loss reserves, and the value agreed between parties in an arm's-length transaction may be materially different.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 10. Loss reserves (continued):

Changes in loss reserves recorded in the balance sheet for the years ended December 31, 2010, 2009 and 2008 and their impact on losses and adjustment expenses are as follows:

	December 31, 2010	December 31, 2009	December 31, 2008
Loss reserves, beginning of year	\$ 236,181	\$ 171,733	\$ 89,095
Incurred losses and adjustment expenses:			
Increase in losses and expenses on claims occurring in prior years	31,221	59,170	11,472
Increase in losses and expenses on claims occurring in the current year	175,189	196,586	148,513
Paid losses occurring during:			
Prior years	(200,232)	(160,263)	(67,292)
Current year	(35,748)	(31,045)	(10,055)
Loss reserves, end of year	\$ 206,611	\$ 236,181	\$ 171,733

## 11. Income taxes:

Provision for income taxes comprises the following:

	2010	2009	2008
<b>Consolidated Statements of Income</b>			
Provision for income taxes:			
Current	\$ 124,776	\$ 160,372	\$ 107,850
Future	11,991	5,192	32,465
	\$ 136,767	\$ 165,564	\$ 140,315

## Consolidated Statements of Other Comprehensive Income

Income tax expense (recovery) related to:			
Change in unrealized gains (losses) on AFS securities	\$ 13,663	\$ 51,220	\$ 4,401
Recognition of realized gains on AFS securities	(3,773)	(1,752)	(21,983)
	\$ 9,890	\$ 49,468	\$ (17,582)



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 11. Income taxes (continued):

Income taxes are payable on the change in unrealized gains or losses reported in the Company's consolidated statements of comprehensive income in the year in which they are incurred, and are included in the income taxes payable balance on the Company's consolidated balance sheets.

Income taxes reflect an effective tax rate that differs from the statutory tax rate for the following reasons:

	2010	2009	2008
Income before income taxes	\$ 485,493	\$ 544,304	\$ 477,006
Combined basic Canadian federal and provincial income tax rate	30.0%	32.0%	32.0%
Income tax expense based on statutory rate	\$ 145,648	\$ 174,177	\$ 152,642
Increase (decrease) in income tax expense resulting from:			
Non-deductible (non-taxable) expenses	251	106	182
Effect of decrease in rates on future income taxes	(4,312)	(9,849)	(12,354)
Effect of tax rate adjustment relating to enactment of new legislation	—	1,144	—
Adjustment for prior periods	(4,820)	(14)	(155)
Income tax expense	\$ 136,767	\$ 165,564	\$ 140,315

The difference in the effective income tax rate of 28.2% implicit in the \$136,767 provision for income taxes in 2010 from the Company's statutory income tax rate of 30% was primarily attributable to a decrease in federal and provincial income tax rates and income tax rate favourability relating to the 2009 taxation year which was realized upon completion of the Company's 2009 tax returns.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 11. Income taxes (continued):

The difference in the effective income tax rate of 30.4% implicit in the \$165,564 provision for income taxes in 2009 from the Company's statutory income tax rate of 32.0% was primarily attributable to the effect of a decrease of rates on future income taxes, including the revaluation of the Company's opening future tax liability, offset by the enactment of tax legislation which caused income previously subject to tax at future income tax rates to be taxable in the current period.

The difference in the effective income tax rate of 29.4% implicit in the \$140,315 provision for income taxes in 2008 from the Company's statutory income tax rate of 32.0% was primarily attributable to the effect of a decrease of rates on future income taxes, including the revaluation of the Company's opening future tax liability.

Future income tax liability comprises the following:

	2010	2009
Future income tax assets:		
Employee benefits	\$ 3,338	\$ 2,881
Policy liabilities	2,671	3,070
Losses available for carry-forward	2,336	—
Financing costs	893	—
Total future income tax assets	9,238	5,951
Future income tax liabilities:		
Investments including unrealized gains on AFS securities	(13,052)	(15,221)
Guarantee fund reserve	(159,481)	(144,594)
Policy reserves	(49,547)	(46,929)
Premises and equipment and intangible assets	(2,586)	(2,425)
Total future income tax liabilities	(224,666)	(209,169)
Net future income tax liability	\$ (215,428)	\$ (203,218)

Management reviews the valuation of future income tax assets on an ongoing basis to determine if a valuation allowance is necessary. The Company expects to fully utilize the benefits available from existing future income tax assets. No valuation allowance is required for the years ended December 31, 2010, 2009 and 2008.

The aggregate amount of income taxes paid for the year ended December 31, 2010 was \$257,940 (2009 – \$100,705; 2008 – \$77,151).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 12. Related party transactions and balances:

Following the closing of the Company's IPO on July 7, 2009, the Company and its Insurance Subsidiary entered into a Transition Services Agreement ("TSA") with Genworth Financial Inc., the Company's ultimate parent company. The agreement prescribes that these companies will provide certain services to one another, with most services being terminated if Genworth Financial Inc. ceases to beneficially own more than 50% of the common shares of the Company. The services rendered by Genworth Financial Inc. and affiliated companies consist of information technology, finance, human resources, legal and compliance, and other specified services. The services rendered by the Company and the Insurance Subsidiary relate mainly to financial reporting and tax compliance support services. These transactions are in the normal course of business, and are measured at the exchange amount. Balances owing for service transactions are non-interest bearing and are settled on a quarterly basis.

The Company incurred net related party charges of \$6,155 for the year ended December 31, 2010 (2009 – \$6,984; 2008 – \$9,803). The balance owed for related party services at December 31, 2010 is \$260 (December 31, 2009 – \$775).

## 13. Commitments:

The Company leases office space, office equipment, computer equipment and automobiles. Future minimum rental commitments for non-cancellable leases with initial or remaining terms of one year or more consist of the following at December 31, 2010:

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2011	\$2,197
2012	1,995
2013	1,747
2014	1,505
2015	1,519
	<hr/>
	\$8,963

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Operating lease expense for the year ended December 31, 2010 was \$2,754 (2009 – \$3,001; 2008 – \$2,902).

Software and hardware related to the Company's application infrastructure will require upgrades during 2011 and 2012. The total expenditure related to these upgrades is expected to be in the range of \$4,500 to \$5,000.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **14. Pensions and other post-employment benefits:**

### **(a) Defined contribution pension benefits:**

The Company's eligible employees participate in a registered defined contribution pension plan. The plan provides pension benefits to employees of the Company with two years of service with the exception of Quebec employees, who are entitled to pension benefits after one year of service. The Company is responsible for contributing a predetermined amount to a participant's retirement savings, based on a percentage of that employee's salary.

The cost of the defined contribution plan is recognized as compensation expense as services are provided by participants in the plan.

### **(b) Defined benefit pension and other employee future benefits:**

The Company maintains two types of benefit liabilities: defined benefit pension liabilities for a Supplemental Executive Retirement Plan ("SERP") and other non-pension post-employment benefits.

The SERP is a supplemental plan that provides pension benefits in excess of the amounts payable under the Company's registered defined contribution plan. The other non-pension post-employment benefits provide medical and life insurance coverage upon retirement.

The benefit liabilities represent the amount of pension and other employee future benefits that employees and retirees have earned as at year end. The Company's actuaries perform valuations of the benefit liabilities for pension and other employee future benefits as at December 31 of each year. The actuarial valuation for the year ended December 31, 2010 was performed based on pension and other employee future benefit membership data as at January 1, 2009. The next actuarial update of the membership data will occur as at January 1, 2012.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **14. Pensions and other post-employment benefits (continued):**

Components of the change in the benefit liabilities year over year and the pension and other employee future benefit expense are as follows:

Benefits earned by employees represent benefits earned in the current year. They are determined with reference to the current workforce and the amount of benefits to which employees will be entitled upon retirement, based on the provisions of the benefit plans.

Interest costs on benefit liabilities represent the increase in the liabilities that results from the passage of time.

Actuarial gains or losses may arise in two ways. First, each year the Company's actuaries recalculate the benefit liabilities and compare them to those estimated as at the previous year end. Any differences that result from changes in assumptions or from plan experience being different from management's expectations at the previous year end are considered actuarial gains or losses. Second, actuarial gains or losses arise when there are differences between expected and actual return on plan assets. Actuarial gains and losses based on plan asset return do not impact the Company, as both defined benefit plans are unfunded.

At the beginning of each year, a determination is made as to whether the unrecognized actuarial gain or loss is more than 10% of the defined benefit liability balances. Any unrecognized actuarial gain or loss in excess of this 10% threshold is recognized in expense over the remaining service period of active employees.

Prior service costs are changes in the benefit liabilities as a result of changes to provisions of the plans. These amounts are recognized in expense over the remaining service period of active employees.

Settlements occur when benefit liabilities for plan participants are settled, usually through lump sum cash payments and, as a result, the Company no longer has a liability to provide these employees with benefit payments in the future.

Transitional obligation is the unrecognized benefit liability at the beginning of the year to which CICA Handbook Section 3461 first applied. The transitional obligation is recognized in expense over the remaining service period of active employees.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 14. Pensions and other post-employment benefits (continued):

The SERP and other post-employment benefit plans are unfunded. Pension and benefit payments related to these plans are paid directly by the Company. The benefit liabilities in respect of the plans are as follows:

	Pension benefits		Other post-employment benefits	
	2010	2009	2010	2009
Accrued benefit liability	\$ 4,409	\$ 3,630	\$ 6,426	\$ 5,660
Fair value of plan assets	—	—	—	—
Unfunded benefit liability	\$ 4,409	\$ 3,630	\$ 6,426	\$ 5,660

Pension and other post-employment benefit expenses are determined as follows:

	Pension benefits			Other post-employment benefits		
	2010	2009	2008	2010	2009	2008
Defined benefit expense:						
Benefits earned by employees	\$ 402	\$ 257	\$ 349	\$ 441	\$ 373	\$ 541
Interest cost on accrued benefit liability	412	365	305	308	253	307
Net actuarial gain recognized in expense	(9)	(35)	—	(89)	(119)	—
Amortization of prior service costs	245	233	214	—	—	—
Amortization of transitional obligation	7	7	7	106	106	106
Annual benefits expense	\$1,057	\$ 827	\$ 875	\$ 766	\$ 613	\$ 954

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 14. Pensions and other post-employment benefits (continued):

	Pension benefits			Other post-employment benefits		
	2010	2009	2008	2010	2009	2008
Defined contribution expense	\$ 2,665	\$ 2,346	\$ 2,544	\$ —	\$ —	\$ —
Total annual pension and other employee future benefit expenses recognized in the consolidated statements of income	\$ 3,722	\$ 3,173	\$ 3,419	\$ 766	\$ 613	\$ 954
Weighted average assumptions used to determine benefit expenses:						
Discount rate	7.00%	7.50%	7.50%	7.00%	7.50%	7.50%
Rate of compensation increase	4.25%	4.25%	4.25%	4.25%	4.25%	4.25%
Assumed overall health care trend rate <sup>(1)</sup>	n/a	n/a	n/a	7.71% <sup>(1)</sup>	7.89%	6.50%

<sup>(1)</sup>Trending to an ultimate assumed health care trend rate of 4.50%.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 14. Pensions and other post-employment benefits (continued):

Changes in the estimated financial positions of the pension benefit plans and other employee future benefit plans are as follows:

	Pension benefits		Other post-employment benefits	
	2010	2009	2010	2009
Benefit liability, beginning of year	\$ 5,496	\$ 4,487	\$ 3,978	\$ 3,621
Benefits earned by employees	402	257	441	373
Interest cost on accrued liability	412	365	308	253
Benefits paid to pensioners and employees	(278)	(218)	—	(12)
Actuarial loss (gain)	390	328	1,220	(257)
Prior service costs	—	277	—	—
Benefit liability, end of year	\$ 6,422	\$ 5,496	\$ 5,947	\$ 3,978
Weighted average assumptions used to determine the benefit liability:				
Discount rate, end of year	5.75%	7.00%	5.75%	7.00%
Rate of compensation increase	3.50%	4.25%	3.50%	4.25%
Assumed overall health care trend rate	n/a	n/a	7.60% <sup>(1)</sup>	7.71%

<sup>(1)</sup>Trending to an ultimate health care trend rate of 4.50%.



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 14. Pensions and other post-employment benefits (continued):

	Pension benefits		Other post-employment benefits	
	2010	2009	2010	2009
Benefit liability, end of year	\$ 6,422	\$ 5,496	\$ 5,947	\$ 3,978
Unrecognized actuarial gain	258	657	692	2,001
Unrecognized prior service costs	(2,258)	(2,502)	—	—
Unrecognized transitional obligation	(13)	(21)	(213)	(319)
Accrued benefit liability, end of year	\$ 4,409	\$ 3,630	\$ 6,426	\$ 5,660

Sensitivity of assumptions:

A sensitivity analysis of changes in the assumed health care cost trend rate is as follows:

	Other post-employment benefits	
	Benefit liability	Benefit expense
Assumed overall health care trend rate (%):		
Impact of:		
1% increase	\$ 1,012	\$ 139
1% decrease	(761)	(103)

This sensitivity analysis is hypothetical. Actual experience may differ from expected experience.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 14. Pensions and other post-employment benefits (continued):

Cash flows:

Cash payments made by the Company during the year in connection with employee future benefit plans are as follows:

	Pension benefits			Other post-employment benefits		
	2010	2009	2008	2010	2009	2008
Benefits paid on defined benefit plans	\$ 278	\$ 218	\$ 20	\$ –	\$ 12	\$ –
Contributions to defined contribution plans	2,665	2,346	2,544	–	–	–
	\$ 2,943	\$ 2,564	\$ 2,564	\$ –	\$ 12	\$ –

Estimated future benefit payments:

Estimated future benefit payments in the next five years and thereafter are as follows:

	Pension benefit plan	Other employee future benefit plan
2011	\$ 59	\$ 43
2012	141	59
2013	379	77
2014	122	98
2015	59	123
2016 to 2020	1,350	1,051

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 15. Share-based compensation:

In connection with its IPO, the Company adopted long-term incentive plans that provide for the granting of employee stock options ("Options"), employee Restricted Share Units ("RSUs"), and directors' Deferred Share Units ("DSUs"). Each of these plans is described below:

### (a) Options

The Option incentive plan provides employees with the choice of receiving compensation in the form of common shares of the Company or cash equal to the difference between the quoted market value of the Company's shares and the exercise price on the exercise date. The majority of Options outstanding vest 50% on each of the second and third anniversaries of the grant date. The Options expire 10 years from the date of grant.

### (b) RSUs

The RSU incentive plan provides employees with the choice of receiving compensation in the form of common shares of the Company or cash equal to the quoted market value of the Company's shares on the exercise or redemption date. RSUs must be redeemed no later than December 1 in the third calendar year in respect of which the RSUs are granted.

Performance Share Units ("PSUs") are RSUs with performance conditions attached. The PSUs vest three years from the date of grant provided that certain performance conditions are met by the Company. The performance conditions are based on the Company's earnings per share, net income, contribution margin, underwriting income and investment income.

### (c) DSUs

DSUs are granted to the eligible directors of the Company on a quarterly basis as compensation for director services performed. The DSUs vest immediately on the date of grant and must be redeemed no later than December 15 of the calendar year commencing immediately after the director's termination date. The DSU incentive plan provides the Board of Directors with the discretion to elect to pay DSUs credited to directors in common shares of the Company, cash equal to the quoted market value of the Company's shares on the redemption date, or any combination of cash and common shares.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 15. Share-based compensation (continued):

RSUs, PSUs, and DSUs may participate in dividend equivalents at the discretion of the Company's Board of Directors. Dividend equivalents are calculated based on the quoted market value of the Company's shares on the date the dividend equivalents are credited to the RSU, PSU or DSU accounts.

The Company has reserved 3,000,000 common shares of its issued and outstanding shares for issuance under these long-term incentive plans.

The following table summarizes information about these share-based compensation plans:

<b>2010</b>	Number of Options	Weighted average exercise price	Fair value at December 31, 2010	Number of RSUs	Fair value at December 31, 2010	Number of DSUs	Fair value at December 31, 2010	Number of PSUs	Fair value at December 31, 2010
Outstanding, as at January 1, 2010	810,000	\$ 19.16	\$ 6,828	84,406	\$ 2,329	3,257	\$ 90	—	\$ —
Granted	191,700	27.07	100	42,450	1,171	6,366	176	18,000	497
Dividend equivalents granted	—	—	—	4,082	113	208	6	496	14
Forfeited	(17,500)	(19.00)	(150)	(7,158)	(198)	—	—	—	—
Outstanding, as at December 31, 2010	984,200	\$ 20.70	\$ 6,778	123,780	\$ 3,415	9,831	\$ 272	18,496	\$ 511
Weighted average period (in years) over which expense is recognized	2.6	—	—	2.7	—	—	—	3.0	—
Outstanding as a percentage of outstanding shares	0.94%	—	—	0.12%	—	0.01%	—	0.02%	—

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 15. Share-based compensation (continued):

	Number of Options	Weighted average exercise price	Fair value, December 31, 2009	Number of RSUs	Fair value, December 31, 2009	Number of DSUs	Fair value, December 31, 2009
<b>2009</b>							
Granted	812,500	\$ 19.16	\$ 6,454	85,900	\$ 2,328	3,243	\$ 88
Dividend equivalents granted	—	—	—	706	19	14	—
Forfeited	2,500	19.00	(20)	(2,200)	(60)	—	—
Outstanding, end of year	810,000	19.16	\$ 6,434	84,406	\$ 2,287	3,257	\$ 88
Weighted average period (in years) over which expense is recognized	2.5	—	—	2.5	—	—	—
Outstanding as a percentage of outstanding shares	0.69%	—	—	0.07%	—	—	—

The total compensation expense related to Options, RSUs, DSUs and PSUs for the year ended December 31, 2010 is \$2,775, \$1,346, \$183 and \$138, respectively, for a total of \$4,442 recognized in sales, underwriting and administrative expenses (December 31, 2009 – Options, RSUs and DSUs of \$1,270, \$440 and \$88, respectively, for a total of \$1,798). The total share-based liability outstanding as at December 31, 2010 is \$6,240 (December 31, 2009 – \$1,798).

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 16. Premises and equipment:

The Company's premises and equipment consist of the following assets:

2010	Cost	Accumulated depreciation	Net book value
Software	\$ 973	\$ 258	\$ 715
Furniture and equipment	2,781	2,212	569
Leasehold improvements	2,429	1,525	904
Computer hardware and other	2,953	2,305	648
	<u>\$ 9,136</u>	<u>\$ 6,300</u>	<u>\$ 2,836</u>

2009	Cost	Accumulated depreciation	Net book value
Software	\$ 905	\$ 92	\$ 813
Furniture and equipment	2,618	1,659	959
Leasehold improvements	2,383	1,172	1,211
Computer hardware and other	2,664	1,803	861
	<u>\$ 8,570</u>	<u>\$ 4,726</u>	<u>\$ 3,844</u>

## 17. Intangible assets:

The Company's intangible assets are summarized as follows:

2010	Cost	Accumulated amortization	Net book value
Software	\$ 27,120	\$ 13,001	\$ 14,119

2009	Cost	Accumulated amortization	Net book value
Software	\$ 25,133	\$ 8,826	\$ 16,307

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 18. Goodwill:

On January 17, 1995, the Company acquired certain assets and assumed certain liabilities from MICC related to MICC's residential mortgage insurance line of business for total cash consideration of \$20,000. The excess of the purchase price over the estimated fair value of the net assets acquired of \$19,581 was recorded as goodwill. After the acquisition date and prior to the adoption of CICA Handbook Section 3062, \$8,409 of the value of goodwill was charged to amortization expense. Goodwill is tested at least annually for impairment (note 3(n)).

No impairment charge has been recognized on goodwill to date.

## 19. Transactions with lenders:

Gross premiums written from one major lender (defined as a lender that individually accounts for more than 10% of the Company's gross premiums written) was \$211,285, representing 37% of the Company's total gross premiums written for the year ended December 31, 2010 (2009 and 2008 – gross premiums written from two and three unrelated major lenders that accounted for more than 10% of the Company's gross premiums written were \$175,276 or 47% and \$274,382 or 38%, respectively).

## 20. Share capital:

The share capital of the Company comprises the following:

	December 31, 2010	December 31, 2009
Authorized:		
Unlimited common shares		
1 special share		
Issued:		
104,789,394 common shares		
(117,100,000 at December 31, 2009)	\$ 1,552,043	\$ 1,734,376
1 special share (1 at December 31, 2009)	–	–
Share capital	\$ 1,552,043	\$ 1,734,376

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 20. Share capital (continued):

### (a) Share repurchase:

On July 19, 2010, the Company made an offer ("the Offer") to repurchase up to \$325 million of its common shares validly tendered to the Offer. On August 27, 2010, in accordance with the terms of the Offer, the Company repurchased 12,310,606 common shares at a price of \$26.40 per common share, representing 10.5% of its public float, for an aggregate of approximately \$325 million in cash. Genworth Financial Inc., through its wholly owned subsidiary Brookfield, participated in the Offer by making a proportional tender and continues to hold approximately 57.5% of the outstanding common shares of the Company.

Upon the completion of the Offer, the Company's share capital was reduced by an amount equal to the average carrying value of the repurchased shares for cancellation. The excess of the aggregate purchase price over the average carrying value, together with the incremental after-tax costs associated with the transaction, were recorded as a reduction to retained earnings.

### (b) Reorganization and initial public offering ("IPO"):

At incorporation on May 25, 2009, the Company issued one common share for cash of \$1.00. On June 29, 2009, the Company issued one special share to Brookfield. The attributes of the special share provide that the holder be entitled to nominate and elect a certain number of directors to the Board, as determined by the number of common shares that the holder of the special share and affiliates beneficially own.

Pursuant to an underwriting agreement dated June 29, 2009, the Company filed a prospectus that qualified issuance of 44,740,000 common shares at a purchase price of \$19.00. Of these shares, 5,100,000 were newly issued common shares of the Company, for which the Company collected net proceeds of \$91,667. The remaining shares issued to public shareholders were previously owned by the parent company, which collected the remaining proceeds from the IPO. The IPO was completed on July 7, 2009.



# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## **20. Share capital (continued):**

On July 30, 2009, the underwriters of the IPO exercised an overallotment option to purchase an additional 5,034,100 common shares of the Company from Brookfield at the IPO purchase price of \$19.00 per common share. Following the exercise of the overallotment option, Brookfield has an approximate 57.5% ownership interest in the Company.

## **21. Long-term debt:**

On June 29, 2010, the Company completed an offering of \$275,000 principal amount of senior unsecured debentures ("Series 1"). The Series 1 debentures were issued for gross proceeds of \$274,862 or a price of \$99.95, before approximate issuance costs of \$2,413. The issuance costs of \$2,413 and the discount of \$138 will be amortized over the term of the debentures using the effective interest method. The debentures bear interest at a fixed annual rate of 5.68% until maturity on June 15, 2020, payable in equal semi-annual instalments commencing on December 15, 2010. The debentures may be redeemed at the option of the issuer, in whole or in part, at any time.

On December 16, 2010, the Company completed an additional offering of \$150,000 principal amount of senior unsecured debentures ("Series 2"). The Series 2 debentures were issued at par, before approximate issuance costs of \$986. The issuance costs of \$986 will be amortized over the term of the debentures using the effective interest method. The debentures bear interest at a fixed annual rate of 4.59% until maturity on December 15, 2015, payable in equal semi-annual instalments commencing on June 15, 2011. The debentures may be redeemed at the option of the issuer, in whole or in part, at any time.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

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## 21. Long-term debt (continued):

The following details the Company's long-term debt as at December 31, 2010:

	Series 1	Series 2
Date issued	June 29, 2010	December 16, 2010
Maturity date	June 15, 2020	December 15, 2015
Principal amount outstanding	\$275,000	\$150,000
Carrying value (unamortized cost)	\$272,545	\$149,021
Fair value	\$278,451	\$150,806
Fixed annual rate	5.68%	4.59%
Semi-annual interest payment due each year on:	June 15, December 15	June 15, December 15

The Company incurred interest expense of \$8,322 for the year ended December 31, 2010, with accrued interest payable of \$987 as at December 31, 2010.

# GENWORTH MI CANADA INC.

Notes to Consolidated Financial Statements (continued)  
(In thousands of dollars, except per share amounts)

Years ended December 31, 2010, 2009 and 2008

## 22. Earnings per share:

Basic and diluted earnings per share have been calculated using the weighted average and dilutive number of shares outstanding during the year of 112,850,311 (2009 – 114,487,123; 2008 – 111,408,332) and 113,940,471 (2009 – 114,917,515; 2008 – 111,408,332), respectively. The difference between basic and diluted earnings per share is caused by the grant of Options, RSUs, and DSUs.

The earnings per share are computed below:

	December 31, 2010	December 31, 2009	December 31, 2008
Basic earnings per share:			
Net income	\$ 348,726	\$ 378,740	\$ 336,691
Weighted average common shares outstanding	112,850,311	114,487,123	111,408,332
Basic net earnings per common share	\$ 3.09	\$ 3.31	\$ 3.02
Diluted earnings per share:			
Weighted average common shares outstanding	113,940,471	114,917,515	111,408,332
Diluted net earnings per common share	\$ 3.06	\$ 3.30	\$ 3.02