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PRESENTATION

Operator

Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Genworth MI Canada Inc. 2017 Fourth Quarter Earnings Conference Call. (Operator Instructions) I would like to remind everyone that this conference call is being recorded today.

I will now turn the conference call over to Jonathan Pinto, Vice President, Investor Relations. Mr. Pinto, you may proceed.

Jonathan Pinto - *Genworth MI Canada Inc. - VP of IR*

Thank you. Good morning, everyone, and thank you for joining Genworth Canada's Fourth Quarter 2017 Earnings Call. Leading today's call are Stuart Levings, our President and Chief Executive Officer; and Philip Mayers, our Chief Financial Officer. We will start with our prepared remarks followed by an open question-and-answer session.

Our news release, including our management's discussion and analysis, the financial statements and financial supplement were released last night and are posted on our website at www.genworth.ca. A link to our live webcast and the slides for today's discussion are also posted on our website. A replay of this call will be available via the other number noted in the press release and will also be available on our website following today's presentation. The call will be available online for approximately 45 days following today.

As a reminder, our presentation and discussion today contain a disclaimer on forward-looking statements and non-IFRS statements on disclosure. We note that our actual results may differ from statements that we make, which are forward-looking. We advise you to read the cautionary note regarding these forward-looking statements. As well, some of the financial metrics presented on this call today are non-IFRS measures and, as such, do not have a standardized meaning and are unlikely to be comparable to similar measures by other companies.

I would now like to turn the call over to Stuart to begin his remarks. Stuart?

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Thanks, Jon. Good morning, and thanks for joining our call. Today, I'm going to walk through some key financial highlights from our performance in 2017. I will also share my perspectives on our industry and the themes shaping our environment and outlook for 2018. Phil will discuss some of the highlights from our fourth quarter results. I'll wrap with a reminder of our key strategic priorities for the year.

2017 was another strong year for our business with outstanding underlying results and continued strength and portfolio quality. For the year, we delivered net operating income of $467 million, up 20% over the prior year. This generated a return on equity of 13% and diluted operating earnings per share of $5.09, up 21% over 2016. These results reflect ongoing momentum from premiums earned, sound expense management, stable investment income and the strength of our high-quality insurance portfolio in a favorable economic environment.

Net premiums written total $663 million for the year, down 13% over the prior year. This includes a modest 3% decline in premiums written from transactional insurance. We saw a more significant decline in portfolio insurance premiums year-over-year, driven by regulatory changes introduced in 2016 and weaker demand in response to higher premium rates due to increased regulatory capital requirements. As discussed on prior calls, transactional insurance volumes were impacted by ongoing affordability pressure, driven by elevated house prices and the insured mortgage rate stress test introduced in 2016.

The decline in volume was partially offset by the 18% to 20% increase in average premium rate implemented on March 17 last year. We believe the high loan-to-value origination market will stabilize this year, with potential for modest expansion as borrowers continue to adapt their behavior in response to normalizing housing markets and reduced incentives to avoid high-ratio mortgage insurance. In our view, the B-20 mortgage rate stress test, along with more favorable interest rates for insured versus uninsured mortgages, may reduce the frequency of using gifted down payments to avoid the high-ratio loan qualification criteria, a trend that became more prevalent in 2017.

At 10%, our full year loss ratio came in at the bottom of our estimate range of 10% to 20% and down 12 points from the prior year. This performance reflects the value of a high-quality insurance portfolio in an extremely strong economy. As noted at our recent Investor Day, we expect our loss ratio to normalize over the coming year. This normalization is likely to be a gradual process, however, as housing markets and consumers adjust to government actions and rising interest rates in a strong macroeconomic environment. Based on our current market assumptions, we expect a full year loss ratio range of 15% to 25% for 2018.

We ended the year with an estimated MCT ratio of 168%, above our targeted operating range of 160% to 165%. Our capital priorities remain focused on supporting our core business volumes and ordinary dividends while seeking capital efficiency as appropriate. As noted on our third quarter 2017 call, we increased our quarterly dividend by 7% to $0.47 per common share, paid a total of $1.79 per common share for the year, up $0.09 over the prior year. Our book value at $43.13 per share continues to grow, up 10% over the prior year, driven by ongoing profitability.

Turning to the current environment. We see a number of key themes that will influence our business in 2018. On the economic front, we are encouraged by the strength in labor markets across many regions of the country and the ongoing recovery in oil-producing sectors. Furthermore, we believe that the changes made by both the federal and provincial governments, together with the impact of rising rates and the B-20 mortgage rate stress test, will lead to more balanced housing markets, particularly in the greater Toronto and Vancouver areas. In addition, the increase to the federal government's immigration targets over the next 3 years serves as a strong underpinning for future first-time homebuyer demand.

Without question, the mortgage industry has experienced much change and disruption over the past 12 to 18 months, and the impact continues to unfold. That said, the focus on change is shifting towards the uninsured mortgage statement, which is helping to restore some parity between qualifying criteria for both insured and uninsured borrowers. As noted earlier, this may lead to a modest expansion in the high loan-to-value originations market as borrowers adjust to changing housing markets and mortgage pricing dynamics.

In our view, achieving our goal of 1 point or 2 of additional market share and a stable and modestly larger first-time homebuyer market, along with the full year impact of the 2017 premium rate increase, should bode well for modest growth in our transactional premiums written in 2018.

Turning to portfolio quality. We continue to focus on regional risk dispersion and high-quality loans, managing our exposure to borrowers with low credit scores. As a result, we saw ongoing strength in the quality of our first-time homebuyers. Average credit scores for the quarter remained high at 746, while borrowers with stacked risk factors remained fairly stable and within an acceptable range. The average home price in our transactional insurance volumes remained largely unchanged versus the prior year at $332,000, well below the market average, reflecting the borrowing capacity of our customer segment.

At this point, I will turn the call over to Phil for a more detailed review of our fourth quarter results before wrapping up and going to Q&A.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Thanks, Stuart, and good morning. We ended 2017 with strong fourth quarter net operating income of $121 million. This was higher by $9 million quarter-over-quarter primarily due to lower losses on claims and modestly higher investment income.

Total premiums written declined sequentially by $37 million to $164 million primarily due to seasonally lower transactional volume. Year-over-year, transactional premiums written increased by 5% to $157 million, with $4.5 billion of new insurance written. This reflects the 19% increase in the average premium rate to 348 basis points year-over-year.

Premiums written from portfolio insurance were relatively flat sequentially at $7 million on approximately $1 billion of new insurance written. Compared to 2016, this reduced level of volumes for the last 3 quarters reflects lower demand following the prohibition of refinance transaction and the premium rate increases in response to the higher level of regulatory capital. As expected, premiums earned increased by $1 million sequentially to $171 million and were up by $6 million versus the prior year period.

During the quarter, losses on claims were lower quarter-over-quarter by $8 million at $15 million, and the resulting loss ratio was 9%. This low loss ratio reflects a particularly strong macroeconomic environment, which translated into a 7% lower average reserve per delinquency and favorable loss reserve development of $16 million as compared to $12 million in the third quarter.

Expenses of $34 million were in line with the prior quarter, and the resulting expense ratio of 20% remained consistent with management's expected range of 18% to 20%. Investment income primarily from interest and dividends increased by $3 million quarter-over-quarter to $48 million. This number included $2 million of net realized income from our interest rate hedging program.

Overall, net operating income for the quarter of $121 million generated a strong operating return on equity of 13% and a fully diluted operating EPS of $1.33. A key driver of our very strong full year loss ratio of 10% was the improved economy in Québec and Alberta and the ongoing economic strength in Ontario and British Columbia. The number of outstanding delinquencies declined year-over-year by 17%, led by significant decreases in Québec and Alberta. New delinquencies, net of cures, were essentially flat sequentially as seasonal increases in the Prairies, Pacific and Atlantic regions were offset by a meaningful decrease in Québec. We believe that the level of delinquencies in 2018 will continue to benefit from favorable business fundamentals.

And now I want to cover our key financial objectives for 2018. The primary catalyst for our future business performance is the level and quality of new business. As Stuart noted, we expect transactional insurance volumes to be modestly higher in 2018. Furthermore, a full year impact of the 2017 premium rate increases should add to premiums written in 2018 as the average premium rate is expected to rise to 345 to 350 basis points as compared to 331 basis points in 2017.

Both fully insured volumes and premiums written are expected to be moderately lower in 2018 based on the recent quarterly trend for new insurance written of approximately $1 billion, with an average premium rate between 70 and 80 basis points. After growing by 6% in 2017, premiums earned are expected to remain relatively flat to modestly higher as the contribution from the larger 2015 and 2016 book will be partially offset by the lower contribution from the relatively smaller 2017 book of business. At the same time, our expected loss ratio range for 2018 is 15% to 25%, as Stuart noted.

We expect some normalization in 2018 from the very low levels we experienced in 2017, especially in the Ontario and Pacific regions. Overall, we expect that underwriting performance will continue to be strong, underpinned by our high-quality insurance portfolio, fairly stable economic position and underwritten premiums of over $2 billion.

Our $6.4 billion investment portfolio, combined with our portfolio of interest rate swaps, contributed $182 million of pretax income in 2017. The investment portfolio continues to be of a high credit quality, and we expect to maintain the pretax equivalent book yield around the current level of 3.2% in this rising interest rate environment.

Another benefit of rising rates should be the positive contribution to operating investment income from our $3.5 billion interest rate hedging program, which currently reduces our regulatory capital for interest rate risk by over $250 million. At current interest rates, this fixed-for-floating interest rate swaps could add approximately $18 million of income in 2018, representing the difference between the floating rate of approximately 170 basis points and the fixed contract rate of 117 basis points. Overall, we expect moderately higher operating investment income in 2018.

Our capital position continues to be strong with our minimum capital test ratio at 168% and holding company cash and liquid investments of $155 million. During the year, we increased our dividend by 7%, increased the size of our available credit facility to $200 million and executed a $40 million share buyback from holding company cash. In light of the transitional regulatory capital relief for legacy portfolio insurance and expanded amortization mortgages, our MCT ratio may build through the course of 2018 and remain above our targeted operating range of 160% to 165%. This is because we may not be able to deploy all of the capital above our targeted operating range until the transitional benefit substantially runs off in 2019.

Our capital management plans continue to focus on balancing capital strength, flexibility and efficiency, and we may reduce our level of holding company cash closer to $100 million in light of our enhanced financial flexibility from a large credit facility and strong MCT ratio.

In summary, our key financial objectives for 2018 are as follows. We expect modestly higher premiums written. We expect premiums earned to be relatively flat to modestly higher. We estimate a 15% to 25% loss ratio range for the year. We anticipate moderately higher investment income. And we expect our ROE in the range of 12% to 13% in 2018. Based on these objectives, our proven business model and a stable macroeconomic environment, 2018 should be another strong year.

I'll now turn the call back to Stuart to conclude our prepared remarks.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Thanks, Phil. In our view, we have a sound business model operating in a supportive regulatory environment. Our diversified portfolio and strong risk management practices position us well to manage through variability in economic performance. Our strategy for 2018 remains focused on prudent risk management, industry thought leadership and delivering a best-in-class customer service experience.

Our key strategic priorities are, therefore, as follows: invest in process innovation and technology to drive and improve customer experience, continue to exercise prudent risk management and proactive loss mitigation, leverage our data and mortgage expertise to influence our regulatory environment, and maintain an efficient capital structure to ensure capital strength while maximizing ROE. In summary, we believe execution on these priorities will preserve portfolio quality and drive solid underwriting results, producing another year of strong profitability in 2018.

Thanks for listening. That concludes our prepared remarks. I will now turn the call back to the operator to commence with Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from Geoff Kwan with RBC Capital Markets.

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Hi, good morning. I just had one question. Obviously, the loss ratio continues to be very impressive. With your guidance range, like what would be the -- I guess it's a 2-part question. Number one is, what sort of things would you need to see to get the loss ratio at 25% this year? And then if we want to go very -- in terms of downside risk, like what type of scenario would you need to see for you to have negative earnings?

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Hi Geoff, thanks for the question. I think the first thing to think about is NAFTA and the potential economic fallout that could occur should that not be successful. And obviously, as you know, employment is the key driver of our losses. So if there were to be a more abrupt disruption to implement than what we are expecting in our base case scenario, that would certainly put additional pressure on the loss ratio. Typically, you'd see a further decline in house prices at the same time, so that would compound that. As to whether we -- or what scenario we would see negative earnings, you're talking about a definite tail event, something in a range of -- beyond a 1-in-20-year type event, you have to see loss ratio probably in and around 100% because you still have investment income that will cover off expenses. So it's a very significant tail event, certainly something that we're not anticipating on the horizon at this point.

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

I guess maybe to ask another way. Like under the 25%, would that be, say, unemployment going up 200 basis points, prices down 10? And then, on the -- like I said, I know it, hopefully, will never happen, but on the negative earnings side, is that price is down 30%, 40%, unemployment up? I know you've given some sensitivities in the past, the various downside scenarios. I'm just wondering, given where we are today in the market, how to kind of think about that.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Yes. You're in the ballpark there. That's about right. I mean, you have to see that 35-ish percent house price decline, unemployment up easily beyond 10% for that 100% loss ratio-type scenario. And then for our 25%, yes, a couple of points, 100 to 200 basis points on unemployment, for sure, would start to put some pressure. And it all depends when that happens, too. If it happens towards the latter part of the year, obviously, it's not going to impact 2018's losses as much as it is 2019's losses. If it happens earlier in this year, then yes, it could start to have that impact.

Geoffrey Kwan - *RBC Capital Markets, LLC, Research Division - Analyst*

Ok great, thank you.

Operator

Your next question comes from Tom MacKinnon, BMO Capital.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

Thanks very much. A question for Phil with respect to investment income. It looks like investment income before investment expenses was up nicely quarter-over-quarter and up year-over-year as well. I know you have a bit of a shorter duration. You talk about the book yield being generally about the same next year, but obviously, the impact of rising interest rates is going to be helping. So what's been driving the increase, really, in investment income quarter-over-quarter? And how should we be looking at the book yield if we move into a higher rate environment into 2018 and 2019?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Yes. Great questions, Tom. So simply, for the quarter, what's driving the $2 million quarter-over-quarter increase is the performance of our interest rate swap portfolio. We entered into $3.5 billion of interest rate swaps primarily to mitigate interest rate risk, and we did so at a point in time when pricing was favorable. As a result of it, our swaps, the floating leg that we are paid now exceeds the fixed portion that we're required to pay. And that contributed $2 million in the quarter. So for the full year, the interest rate swaps only had an expense of $0.5 million, but in the third and in the fourth quarter, it was a positive contributor to investment income. As we roll into 2018, those swaps continue to be in place. And right now, we see -- or the floating rate is around 170. The fixed leg is at 117. So we estimate that the contribution to income in 2018 could be anywhere around $18 million, and if rates stay at the same levels, it's a similar number going into 2019. So it's not as much the yield on the actual investments. It's really interest rate swaps that are driving the year-over-year, quarter-over-quarter improvement. On the core portfolio, while rates are moving up, bond spreads will come in. Replacement yield is around that 3.2%, so we expect the investment yield to stay around 3.2%. And any growth in investment income from interest and dividends is likely to be driven more so from growth in assets rather than necessarily growth from the portfolio yield.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

So all things -- if there was no change at all in terms of your interest and dividend income year-over-year, excluding the swaps, that would be flat. But including the effect of the swaps, it would be up $18 million year-over-year. Is that one way of looking at it?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

It would be because -- that is the way we're looking at it. And to the extent rates -- the bank -- if there were further increases in Bank of Canada, the floating rate could even go higher than it currently is, so there's potential upside there. But obviously, interest rates are really a function of many different factors in the economy, so we'll continue to monitor that closely.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

I mean, the interest and dividend, I think, for the entire year was, what is it, about $180 million. So this is like 10% increase going next year. Is that right? Is that the way to look at that as we go to the $18 million...

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

That's the way to look at it, and I think -- exactly. And it really is reflection of our efforts to hedge interest rates, which also gave us protection from rising rates, but at the same time, we did so when the market was not necessarily anticipating a rising rate environment. So hence, it's contributing to profitability on a go-forward basis.

Tom MacKinnon - *BMO Capital Markets Equity Research - MD*

Ok thanks for that.

Operator

Your next question comes from Paul Holden with CIBC.

Paul David Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Thank you, good morning. So I just have one question regarding practices around the amortization of unearned premium and the loss experience curve. And the reason I will ask it is based on the review that recently took place in the Genworth Australia business and the addition, too, on our premiums, we had to make for a change on loss recognition pattern, i.e. losses were taking longer than previously assumed to develop. So I'm wondering, a, what's the risk of that taking place in Canada; and b, how often do you review your loss pattern recognition? I believe it's quarterly, but maybe you can just quickly run through that process.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Certainly, Paul. We do review the earnings curve pattern on a quarterly basis, looking at recent historical performance. We look at the economic drivers, and we essentially establish corridors for those assumptions. And to the extent that either the performance or the economic drivers change materially, that drives a more in-depth review. Having said that, if anything, we are not seeing a trend where the claims pattern is lengthening. Having said that, obviously, we've been in very strong economic conditions, and therefore, home price appreciation has certainly benefited us and has resulted in, in many regions, the loss curve being somewhat curtailed. But that's something that we're very sensitive to. And we take a more of what's a long-term norm perspective. So I think there's certainly room within our current earnings curve for some modest change in the pattern because we recognize that you are sort of projecting what the future might look like, and there's obviously some uncertainty there. But having said that, we do not anticipate any changes in our earnings curve in the coming year, and we do an in-depth full actuarial review in the first quarter this year, which is underway at this point in time.

Paul David Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Okay. And if there is some kind of economic shock scenario, like Stuart highlighted earlier, is there a possibility that, that results in a -- I don't know if you want to call it a troop of reserves, but some kind of reversal of the prior release of unearned premiums? Is it possible for what happened -- sorry, go ahead.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

I mean, one can never say it isn't possible, but I think it would take a very severe change in the economic scenario, such that you're seeing more -- the tail of claims being protracted for a longer period of time. Having said that, under IFRS and Australian GAAP, that change would apply perspectively. However, under U.S. GAAP, it was applied effectively with a cumulative catch-up adjustment in the current period. That's something that we're continuing to review given that we're -- we report on -- the IFRS perspective treatment may be more appropriate, but that's work in progress at this point in time. But having said that, it would really take a material change in the economic landscape to see the claims being extended more than our earnings curve assumes.

Paul David Holden - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research*

Ok, thank you.

Operator

And your next question comes from Jaeme Gloyn with National Bank Financial.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Thanks and good morning. I was just wondering if you could help me understand the impact of the interest rate swaps on your MCT. You're getting a bit of a benefit because of these interest rate swaps on the capital required. I was hoping you could quantify that for me.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Definitely, Jaeme. The benefit is in excess of $250 million in terms of a reduction of capital for interest rate risk plus contributions to capital available. There are 2 components. The capital available component comes from the positive mark-to-market on the swap portfolio. So therefore, that becomes part of our AOCI, forms part of our equity and, therefore, forms a source of capital available. On the other side, because (inaudible) short in duration, that reduces the effective duration and our exposure to interest rate risk. And therefore, under the regulatory test, capital is calculated on, I believe, 120 basis point shock to interest rates at 150% MCT. So by reducing the duration and -- it essentially reduces the shock related to our asset portfolio and, therefore, reduces capital required. So today, the combined number is in excess of $250 million. So it is material, and that was by design. Clearly, when we entered into a swap, it was to hedge the interest rate risk because we felt that, relative to the regulatory capital, the cost of loss was cost-effective.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay, great. So safe to assume that the capital required benefit or reduction is sufficient enough that these swaps are going to be in place for the long term. Is that a fair assessment?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

It is a fair assessment that it is a long-term strategy of ours given -- subject to the cost of capital. The cost of capital for the ones we put in place is very attractive, and they essentially run over the course of -- we've entered into them in 2016-2017. So they're 5-year swaps, so they do have some time to run. So there's going to be a trend over the several coming quarters. Obviously, the capital benefit will diminish as the remaining duration decreases.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And that $250 million, if I'm thinking about this correctly, you just basically increase capital required by $250 million, and the MCT percentage point impact will be about 15 points. Is that right? Or is that too high?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

There are 2 components. There's about $170 million of a reduction of capital at $150 million for interest rate risk, and there's a contribution to capital available from the mark-to-market on the swap of about $95 million.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Okay, got you. And then the second question is just around the average reserve per delinquency. Can you just refresh my memory on what specifically drives that? Is there any subjective component that management can apply to the average reserve given that it has sort of declined from quarter-over-quarter and given where house prices are going and risks in the market just maybe a little bit counterintuitive. So just a little explanation on that, please.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

No worries, Jaeme. What's driving that is really a shift in the mix. What you're seeing is the -- you're seeing pure delinquencies coming from Québec. Québec, typically, in the recent years, has had a higher average loss because of the performance of the housing market and the economy. But given the material improvement in Québec, obviously, that's to our benefit. At the same time, we've seen price stabilization, if not price increases, in Alberta and Québec and somewhat in the Atlantic. So that's really driving the reduction in the average reserve per delinquency. And at the same time, you're beginning to see some delinquencies from B.C. and Ontario. But once again, the expected losses, those are very small. But given that the total reserves divided by all delinquencies, you're getting a little bit of a mix benefit in the delinquency population combined with the lower expected loss in the regions that have had, traditionally, in the recent years, higher losses, that being Québec, Atlantic and Alberta.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

What I would add as well to that, Jaeme, is just that the actual case reserving doesn't allow for much discretion. There is an assessment of the property value, calculation of outstanding balance plus cost, et cetera. So it's fairly fact-based. The one area that does still have some assumptions, of course, is the IBNR, which is included in that average reserve per delq. And that is where we do have some assumptions around the future trends of new delqs, et cetera, et cetera, cures, as you know, including a provision for adverse development. So to the extent that, to your point, we see some softening in house prices, we are providing for that in our provision for adverse development.

Jaeme Gloyn - *National Bank Financial, Inc., Research Division - Analyst*

Okay. That's excellent. And just to follow up on one of the comments in that answer around losses in Ontario and B.C., I would think that the commentary previously would have been that there's no losses in Ontario and B.C. over the last sort of 6 to 8 quarters. Is that changed now? There are some losses creeping in, and would that be something that's attributable to just a little bit of a pullback in the home prices? Or can you ascribe any other factors to those losses in Ontario and B.C.?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Yes. I think, Jaeme, the comment was more around we're seeing a higher number of delinquencies, which is typical seasonality, but we're not still expecting a loss. So therefore, they go in the denominator but not in the numerator. So therefore, they have a positive impact on the average reserve per delinquency. But no, we haven't seen any change in the trend of losses. In fact, I would say B.C. and Ontario are still contributing virtually no losses at this time.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Yes. They do form part of our expectation for the normalization as to why the loss ratio is going up to 15% to 25%. Absolutely, given what we're seeing in the housing markets now and, particularly, in the greater Toronto area, we would expect some of those delinquencies to start having a reserve associated with them and eventually growing to a claim of some size.

Operator

Your next question comes from Graham Ryding with TD Securities.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Good morning. Maybe I could start on capital. Given your transitional relief, I think you said it sort of falls off towards the second half of 2019. If we were to make the assumption that in 2019, your level of business activity was similar to your guidance for this year, would you be able to give us some idea of where you see the MCT ratio trending towards?

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Graham, there is definitely going to be a build in our MCT this year, as we mentioned earlier, as we continue to have excess capital. And while we benefit from that transitional arrangement, we're probably not going to be able to access all of that. But in 2019, the view would be to start accessing some of that. So we wouldn't necessarily expect our MCT to continue to build beyond that to the extent that we're able to maximize utilization of our capital by growing our core business, which is certainly still our key focus. Beyond that, we will always be looking for ways to deploy that excess capital either through strategic acquisitions if they make sense or, beyond that, a return of capital to shareholders in either the form of a special or a buyback. As to the actual quantum of the MCT at that point, that will be a function of all those things in terms of how much our base grows in 2019, the size of the market, et cetera, et cetera. But I would say the focus should be on the fact that we're always trying to maintain an efficient capital structure. Our guidance is to have a range of 160% to 165%. This is a temporary scenario where we're going to see a build beyond that 165%.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Got it. I guess what I was trying to go with that is I was trying to almost quantify, to some degree, how much of that excess capital there could be in 2019, making the assumption that you would deploy it and bring your MCT down to 160% to 165%. I'm just trying to quantify that to some extent.

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Yes. If you think of it in terms of earnings less ordinary dividend, I mean, our capital build, all things being equal, is somewhere in the range of $250 million, which is about 10 points of MCT per year. So you can see that in 2018, 2019. Primarily, that would be the case because the new business we are writing is -- to your point, if we assume it's relatively consistent year-over-year, the capital being released from all the books of business is essentially going to fund new books of business. And then on the portfolio insurance side, we are seeing a lower demand, and therefore, the big books of portfolio insurance that we wrote in 2015, '16 and first quarter 2017, as they run off, they will also be positively generating capital. So if you look at 10 points of MCT in '18 and if you ran the course of 2019, 10 points of MCT, you can quickly figure out the magnitude of capital. And potentially, over and above that, subject to whether any regulatory changes between now and 2019, you could also see the base capital requirements winding down, primarily from the aging of the portfolio insurance deals.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

And one other thing to keep in mind there, Graham, just because we are talking about a lot of assumptions here, there is, as you know, an exercise underway to refine some of the elements of our current capital structure with OSFI, specifically around the credit score used in the model. And so if those changes are made, they will be effective January 1, 2019, and at this point, we don't have an idea as to what the impact of that will be fully. So therefore, to the extent there is excess MCT, obviously, some of that could get soaked up by refinements to that capital model as well. But I think it's safe to say there will be excess capital still in 2019.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Got it. That's helpful. The majority shareholders, they made a comment that they are looking to do a secured debt transaction backed by some assets. Do you know if their stake in Genworth Canada is being considered as collateral behind that secured debt transaction?

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Well, they haven't really been clear on the exact terms of the secured financing at this time. I understand that they will be coming out with more clarity on that if and when that proceeds. At this time, obviously, they've got a number of assets that are pretty liquid that they could consider pledging, and that's all we know at this time.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Okay, fair enough. And then my last question would just be around the portfolio insurance. Is there anything on the horizon that you see that could increase demand for portfolio insurance? Or is it -- does it really come back to sort of, possibly, an adjustment to the capital and the pricing around portfolio insurance?

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Yes. I think definitely, the pricing is the big issue, and that certainly is something we're working on. And as I mentioned, the regulator is considering some potential refinements to the model, of which loan-to-value capital could be one. But beyond that, I think there's also -- at some point, there's an adjustment in the industry as to what is feasible economically. And as base rates have been rising, there may be some more room for absorbing MI premiums, and so there could well be a recovery in some level of demand in portfolio insurance. We're not really expecting it to be 2018, but I think beyond that, if you think about 2019 and beyond, we could definitely see some growth in the demand for portfolio insurance again.

Graham Ryding - *TD Securities Equity Research - Research Analyst of Financial Services*

Great, thank you.

Operator

(Operator Instructions) And your next question comes from Geoffrey Dunn with Dowling & Partners.

Geoffrey Murray Dunn - *Dowling & Partners Securities, LLC - Partner*

Thank you. First, Phil, this may be a dumb question, but I understand your expectation for the swap impact in '18. How do we think about what investment income does in '19? Do you get a drop-off? Is there continued build? How do the value and accounting of that work out over more than a year basis?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Yes. Well, given the swaps are 5-year swaps, the fixed portion is locked in at 117 basis points. So really, the 2019 income would be essentially what our interest rate in 2019 at the floating level. And assuming that -- current interest rates forecast suggests that there could be some further increases in interest rates. But if you baseline it at current interest rates, you would see another $18 million in 2019, which will be similar to the contribution in 2018, so it wouldn't necessarily be an increase. If rates do go higher and stay higher, you could see a step-up in 2019 as well. And at the same time, on our base investment portfolio, obviously, as we turn the portfolio over, the portions that turn over in 2018-2019, there's a potential that you could be investing that yield around 3.2% or marginally higher. So you could see 2 positive catalysts going into 2019.

Geoffrey Murray Dunn - *Dowling & Partners Securities, LLC - Partner*

Okay. And then in terms of the loss development, obviously, the quarters in '17 have been aided by favorable development, particularly out of the IBNR. The balance of the IBNR has come down. What kind of changes have you made given your experience in '17? And how do we think about the remaining both, I guess, going forward, how you're thinking about IBNR provision each quarter versus what you did in '17 and also the potential development that might still be in the IBNR balance at the end of the year?

Philip Mayers - *Genworth MI Canada Inc. - CFO and SVP*

Yes. I think it's a great question. I think -- we need to remember loss reserves are estimates. And we use our best estimate based on the consensus economic forecast. Clearly, we saw some very strong economic performance coming out of Québec and Alberta during the course of the year. And even in the fourth quarter, we saw a material reduction in unemployment in Québec. So I think that's what led to the higher-than-normal levels of favorable development. As we go into 2018, what we've done is obviously -- or IBNR at the end of 2017 really reflects our current view of the Alberta and Québec economies, which are obviously more favorable. Having said that, we still are providing for some seasonality going into the January, February, March time frame, where we tend to see a higher level of delinquencies during those months. So that's still part of our reserves. But certainly, in Alberta, we're no longer expecting that delinquencies will rise. If anything, we're expecting delinquencies to be relatively flat outside of seasonality. So that's really being the biggest adjustment we've made in our IBNR. It's really resizing our expectations for levels of delinquencies in Alberta and Québec and really reflecting the current run rate more so than what would have been previous run rates, which turned out to be higher than what have materialized in recent quarters. So it's a dynamic process. We review these assumptions on a monthly and quarterly basis. Our actuaries go through and do significant analysis on underlying trends, both economic as well as the delta claim roll rates. So it's a full bottoms-up analysis. Where we can't totally actually predict is really what the economy will do. And any major shift in the economic patterns, whether that's unemployment or home price appreciation, could lead to some level of development. But having said that, we tend to think that the rapid declines in unemployment are probably behind us, and we might have a more stable economic outlook going into 2018. And therefore, we would expect more modest levels of development.

Geoffrey Murray Dunn - *Dowling & Partners Securities, LLC - Partner*

Ok, thank you.

Operator

If there are no further questions, I will turn the call back to Mr. Levings.

Stuart Levings - *Genworth MI Canada Inc. - CEO, President and Director*

Thanks again for joining us today. We appreciate your time and all your support over the past year. This concludes our fourth quarter 2017 earnings call. Thank you for your participation, and you may now disconnect.