

GENWORTH FINANCIAL INC
Form 10-Q
August 01, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended June 30, 2018

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the transition period from _____ to

Commission file number 001-32195

GENWORTH FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

80-0873306
(I.R.S. Employer
Identification Number)

6620 West Broad Street

Richmond, Virginia
(Address of Principal Executive Offices)
(804) 281-6000

23230
(Zip Code)

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definition of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer
Non-accelerated filer

Accelerated filer
Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 24, 2018, 500,679,748 shares of Class A Common Stock, par value \$0.001 per share, were outstanding.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****GENWORTH FINANCIAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Amounts in millions, except per share amounts)**

	June 30, 2018 (Unaudited)	December 31, 2017
Assets		
Investments:		
Fixed maturity securities available-for-sale, at fair value	\$ 60,032	\$ 62,525
Equity securities, at fair value	758	820
Commercial mortgage loans	6,480	6,341
Restricted commercial mortgage loans related to securitization entities	90	107
Policy loans	1,872	1,786
Other invested assets	1,650	1,813
Total investments	70,882	73,392
Cash, cash equivalents and restricted cash	2,243	2,875
Accrued investment income	602	644
Deferred acquisition costs	3,086	2,329
Intangible assets and goodwill	354	301
Reinsurance recoverable	17,385	17,569
Other assets	574	453
Deferred tax asset	601	504
Separate account assets	6,750	7,230
Total assets	\$ 102,477	\$ 105,297
Liabilities and equity		
Liabilities:		
Future policy benefits	\$ 37,913	\$ 38,472
Policyholder account balances	23,366	24,195
Liability for policy and contract claims	9,665	9,594
Unearned premiums	3,669	3,967
Other liabilities	1,965	1,910
Borrowings related to securitization entities	28	40
Non-recourse funding obligations	310	310
Long-term borrowings	4,047	4,224

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Deferred tax liability	23	27
Separate account liabilities	6,750	7,230
Total liabilities	87,736	89,969
Commitments and contingencies		
Equity:		
Class A common stock, \$0.001 par value; 1.5 billion shares authorized; 589 million and 588 million shares issued as of June 30, 2018 and December 31, 2017, respectively; 501 million and 499 million shares outstanding as of June 30, 2018 and December 31, 2017, respectively		
	1	1
Additional paid-in capital	11,981	11,977
Accumulated other comprehensive income (loss):		
Net unrealized investment gains (losses):		
Net unrealized gains (losses) on securities not other-than-temporarily impaired	726	1,075
Net unrealized gains (losses) on other-than-temporarily impaired securities	10	10
Net unrealized investment gains (losses)	736	1,085
Derivatives qualifying as hedges	1,863	2,065
Foreign currency translation and other adjustments	(272)	(123)
Total accumulated other comprehensive income (loss)	2,327	3,027
Retained earnings	1,301	1,113
Treasury stock, at cost (88 million shares as of June 30, 2018 and December 31, 2017)	(2,700)	(2,700)
Total Genworth Financial, Inc. s stockholders equity	12,910	13,418
Noncontrolling interests	1,831	1,910
Total equity	14,741	15,328
Total liabilities and equity	\$ 102,477	\$ 105,297

See Notes to Condensed Consolidated Financial Statements

Table of Contents**GENWORTH FINANCIAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Amounts in millions, except per share amounts)****(Unaudited)**

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Revenues:				
Premiums	\$ 1,136	\$ 1,111	\$ 2,276	\$ 2,247
Net investment income	828	801	1,632	1,591
Net investment gains (losses)	(14)	101	(45)	135
Policy fees and other income	209	210	411	421
Total revenues	2,159	2,223	4,274	4,394
Benefits and expenses:				
Benefits and other changes in policy reserves	1,205	1,206	2,516	2,452
Interest credited	152	163	308	330
Acquisition and operating expenses, net of deferrals	253	240	493	510
Amortization of deferred acquisition costs and intangibles	112	139	216	233
Interest expense	77	74	153	136
Total benefits and expenses	1,799	1,822	3,686	3,661
Income from continuing operations before income taxes	360	401	588	733
Provision for income taxes	111	130	174	246
Income from continuing operations	249	271	414	487
Loss from discontinued operations, net of taxes				
Net income	249	271	414	487
Less: net income attributable to noncontrolling interests	59	69	112	130
Net income available to Genworth Financial, Inc.'s common stockholders	\$ 190	\$ 202	\$ 302	\$ 357
Income from continuing operations available to Genworth Financial, Inc.'s common stockholders per share:				
Basic	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.72
Diluted	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.71

Net income available to Genworth Financial, Inc.'s common stockholders per share:

Basic	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.72
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Diluted	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.71
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Weighted-average common shares outstanding:

Basic	500.6	499.0	500.1	498.8
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Diluted	502.6	501.2	502.6	501.1
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Supplemental disclosures:

Total other-than-temporary impairments	\$	\$ (2)	\$	\$ (3)
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Portion of other-than-temporary impairments included in other comprehensive income (loss)

Net other-than-temporary impairments		(2)		(3)
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Other investments gains (losses)	(14)	103	(45)	138
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Total net investment gains (losses)	\$ (14)	\$ 101	\$ (45)	\$ 135
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See Notes to Condensed Consolidated Financial Statements

Table of Contents**GENWORTH FINANCIAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(Amounts in millions)****(Unaudited)**

	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net income	\$ 249	\$ 271	\$ 414	\$ 487
Other comprehensive income (loss), net of taxes:				
Net unrealized gains (losses) on securities not other-than-temporarily impaired	(185)	(72)	(526)	(84)
Net unrealized gains (losses) on other-than-temporarily impaired securities	(2)		(2)	1
Derivatives qualifying as hedges	(64)	28	(216)	(21)
Foreign currency translation and other adjustments	(98)	61	(185)	180
Total other comprehensive income (loss)	(349)	17	(929)	76
Total comprehensive income (loss)	(100)	288	(515)	563
Less: comprehensive income attributable to noncontrolling interests	10	87	14	205
Total comprehensive income (loss) available to Genworth Financial, Inc. s common stockholders	\$ (110)	\$ 201	\$ (529)	\$ 358

See Notes to Condensed Consolidated Financial Statements

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GENWORTH FINANCIAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Amounts in millions)

(Unaudited)

	Common stock	Additional paid-in capital	Accumulated other comprehensive income (loss)	Retained earnings	Treasury stock, at cost	Total Genworth Financial, Inc.'s stockholder equity	Noncontrolling interests	Total equity
Balances as of December 31, 2017	\$ 1	\$ 11,977	\$ 3,027	\$ 1,113	\$ (2,700)	\$ 13,418	\$ 1,910	\$ 15,328
Cumulative effect of change in accounting, net of taxes			131	(114)		17		17
Repurchase of subsidiary shares							(49)	(49)
Comprehensive income (loss):								
Net income				302		302	112	414
Other comprehensive loss net of taxes			(831)			(831)	(98)	(929)
Total comprehensive income (loss)						(529)	14	(515)
Dividends to noncontrolling interests							(50)	(50)
Stock-based compensation expense and exercises and other		4				4	6	10
Balances as of June 30, 2018	\$ 1	\$ 11,981	\$ 2,327	\$ 1,301	\$ (2,700)	\$ 12,910	\$ 1,831	\$ 14,741
Balances as of December 31, 2016	\$ 1	\$ 11,962	\$ 3,094	\$ 287	\$ (2,700)	\$ 12,644	\$ 1,823	\$ 14,467
Cumulative effect of change in accounting, net of taxes				9		9		9
Comprehensive income:								
Net income				357		357	130	487
Other comprehensive income, net of taxes			1			1	75	76

Total comprehensive income						358	205	563
Dividends to noncontrolling interests							(52)	(52)
Stock-based compensation expense and exercises and other			7			7	2	9
Balances as of June 30, 2017	\$ 1	\$ 11,969	\$ 3,095	\$ 653	\$ (2,700)	\$ 13,018	\$ 1,978	\$ 14,996

See Notes to Condensed Consolidated Financial Statements

Table of Contents**GENWORTH FINANCIAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Amounts in millions)****(Unaudited)**

	Six months ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	\$ 414	\$ 487
Adjustments to reconcile net income to net cash from operating activities:		
Amortization of fixed maturity securities discounts and premiums	(62)	(76)
Net investment (gains) losses	45	(135)
Charges assessed to policyholders	(359)	(365)
Acquisition costs deferred	(40)	(44)
Amortization of deferred acquisition costs and intangibles	216	233
Deferred income taxes	83	166
Trading securities, limited partnerships and derivative instruments	(195)	431
Stock-based compensation expense	16	18
Change in certain assets and liabilities:		
Accrued investment income and other assets	(89)	(23)
Insurance reserves	691	806
Current tax liabilities	(37)	(32)
Other liabilities, policy and contract claims and other policy-related balances	(122)	(158)
Net cash from operating activities	561	1,308
Cash flows used by investing activities:		
Proceeds from maturities and repayments of investments:		
Fixed maturity securities	1,979	2,358
Commercial mortgage loans	350	307
Restricted commercial mortgage loans related to securitization entities	16	11
Proceeds from sales of investments:		
Fixed maturity and equity securities	1,920	2,587
Purchases and originations of investments:		
Fixed maturity and equity securities	(4,082)	(4,733)
Commercial mortgage loans	(489)	(431)
Other invested assets, net	93	(638)
Policy loans, net	15	21
Payments for business purchased, net of cash acquired		(5)
Net cash used by investing activities	(198)	(523)

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Cash flows used by financing activities:		
Deposits to universal life and investment contracts	503	429
Withdrawals from universal life and investment contracts	(1,177)	(1,091)
Proceeds from issuance of long-term debt	441	
Repayment and repurchase of long-term debt	(597)	
Repayment of borrowings related to securitization entities	(12)	(12)
Repurchase of subsidiary shares	(49)	
Dividends paid to noncontrolling interests	(50)	(52)
Other, net	(2)	(29)
Net cash used by financing activities	(943)	(755)
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(52)	39
Net change in cash, cash equivalents and restricted cash	(632)	69
Cash, cash equivalents and restricted cash at beginning of period	2,875	2,784
Cash, cash equivalents and restricted cash at end of period	\$ 2,243	\$ 2,853

See Notes to Condensed Consolidated Financial Statements

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(1) Formation of Genworth and Basis of Presentation

Genworth Holdings, Inc. (Genworth Holdings) (formerly known as Genworth Financial, Inc.) was incorporated in Delaware in 2003 in preparation for an initial public offering (IPO) of Genworth's common stock, which was completed on May 28, 2004. On April 1, 2013, Genworth Holdings completed a holding company reorganization pursuant to which Genworth Holdings became a direct, 100% owned subsidiary of a new public holding company that it had formed. The new public holding company was incorporated in Delaware on December 5, 2012, in connection with the reorganization, and was renamed Genworth Financial, Inc. (Genworth Financial) upon the completion of the reorganization.

On October 21, 2016, Genworth Financial entered into an agreement and plan of merger (the Merger Agreement) with Asia Pacific Global Capital Co., Ltd. (the Parent), a limited liability company incorporated in the People's Republic of China, and Asia Pacific Global Capital USA Corporation (Merger Sub), a Delaware corporation and an indirect, wholly-owned subsidiary of the Parent. Subject to the terms and conditions of the Merger Agreement, including the satisfaction or waiver of certain conditions, Merger Sub would merge with and into Genworth Financial with Genworth Financial surviving the merger as an indirect, wholly-owned subsidiary of the Parent. The Parent is a subsidiary of China Oceanwide Holdings Group Co., Ltd. (together with its affiliates, China Oceanwide). China Oceanwide has agreed to acquire all of our outstanding common stock for a total transaction value of approximately \$2.7 billion, or \$5.43 per share in cash. At a special meeting held on March 7, 2017, Genworth Financial's stockholders voted on and approved a proposal to adopt the Merger Agreement.

The transaction remains subject to closing conditions, including the receipt of required regulatory approvals in the U.S., China, and other international jurisdictions. Both parties are engaging with the relevant regulators regarding the applications and the pending transaction.

The accompanying unaudited condensed financial statements include on a consolidated basis the accounts of Genworth Financial and the affiliate companies in which it holds a majority voting interest or where it is the primary beneficiary of a variable interest entity (VIE). All intercompany accounts and transactions have been eliminated in consolidation.

References to Genworth, the Company, we or our in the accompanying unaudited condensed consolidated financial statements and these notes thereto are, unless the context otherwise requires, to Genworth Financial on a consolidated basis.

We operate our business through the following five operating segments:

U.S. Mortgage Insurance. In the United States, we offer mortgage insurance products predominantly insuring prime-based, individually underwritten residential mortgage loans (flow mortgage insurance). We selectively provide mortgage insurance on a bulk basis (bulk mortgage insurance) with essentially all of our bulk writings being prime-based.

Canada Mortgage Insurance. We offer flow mortgage insurance and also provide bulk mortgage insurance that aids in the sale of mortgages to the capital markets and helps lenders manage capital and risk in Canada.

Australia Mortgage Insurance. In Australia, we offer flow mortgage insurance and selectively provide bulk mortgage insurance that aids in the sale of mortgages to the capital markets and helps lenders manage capital and risk.

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

U.S. Life Insurance. We offer long-term care insurance products as well as service traditional life insurance and fixed annuity products in the United States.

Runoff. The Runoff segment includes the results of non-strategic products which have not been actively sold but we continue to service our existing blocks of business. Our non-strategic products primarily include our variable annuity, variable life insurance, institutional, corporate-owned life insurance and other accident and health insurance products. Institutional products consist of funding agreements and funding agreements backing notes.

In addition to our five operating business segments, we also have Corporate and Other activities which include debt financing expenses that are incurred at the Genworth Holdings level, unallocated corporate income and expenses, eliminations of inter-segment transactions and the results of other businesses that are managed outside of our operating segments, including certain smaller international mortgage insurance businesses and discontinued operations.

The accompanying condensed consolidated financial statements are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and rules and regulations of the U.S. Securities and Exchange Commission (SEC). Preparing financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates. These unaudited condensed consolidated financial statements include all adjustments (including normal recurring adjustments) considered necessary by management to present a fair statement of the financial position, results of operations and cash flows for the periods presented. The results reported in these unaudited condensed consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the audited consolidated financial statements and related notes contained in our 2017 Annual Report on Form 10-K. Certain prior year amounts have been reclassified to conform to the current year presentation.

(2) Accounting Changes

Accounting Pronouncements Recently Adopted

On January 1, 2018, we early adopted new accounting guidance on the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJA), or stranded tax effects. Under current U.S. GAAP, deferred tax assets and liabilities are adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the period that the changes were enacted. This also includes situations in which the related tax effects were originally recognized in other comprehensive income as opposed to income from continuing

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operations. The following summarizes the components for the cumulative effect adjustment recorded on January 1, 2018 related to the adoption of this new accounting guidance:

(Amounts in millions)	Accumulated other comprehensive income (loss)			Retained earnings	Total stockholders equity
	Net unrealized investment gains (losses)	Derivatives qualifying as hedges	Foreign currency translation and other adjustments		
Deferred taxes:					
Net unrealized gains on investment securities	\$ 192	\$	\$	\$ (192)	\$
Net unrealized gains on derivatives		12		(12)	
Investment in foreign subsidiaries	(3)		(46)	49	
Accrued commission and general expenses			(1)	1	
Cumulative effect of changes in accounting	\$ 189	\$ 12	\$ (47)	\$ (154)	\$

The accounting for the temporary differences related to investment in foreign subsidiaries recorded in accumulated other comprehensive income (loss) at adoption of the TCJA, were provisional. Therefore, additional reclassification adjustments may be recorded in future periods as tax effects of the TCJA on related temporary differences are finalized. However, no reclassification adjustments were recorded in the second quarter of 2018. Other than those effects related to the TCJA, our policy is to release stranded tax effects from accumulated other comprehensive income (loss) using the portfolio approach for items related to investments and derivatives, and upon disposition of a subsidiary for items related to outside basis differences.

On January 1, 2018, we early adopted new accounting guidance related to the hedge accounting model. The new guidance amends the hedge accounting model to enable entities to better portray the economics of their derivative risk management activities in the financial statements and enhance the transparency and understandability of hedge results. In certain situations, the amendments also simplify the application of hedge accounting and removed the requirements to separately measure and report hedge ineffectiveness. We adopted this new accounting using the modified retrospective method and recognized a gain of \$2 million in accumulated other comprehensive income with a corresponding decrease to retained earnings at adoption. This gain was the cumulative amount of hedge ineffectiveness related to active hedges that was previously included in earnings.

On January 1, 2018, we adopted new accounting guidance that clarifies when to account for a change to share-based compensation as a modification. The new guidance requires modification accounting only if there are changes to the fair value, vesting conditions or classification as a liability or equity of the share-based compensation. We adopted this new accounting guidance prospectively and therefore, the guidance did not have any impact at adoption.

On January 1, 2018, we adopted new accounting guidance that clarifies the scope and accounting for gains and losses from the derecognition of nonfinancial assets or an in substance nonfinancial asset that is not a business and accounting for partial sales of nonfinancial assets. The new guidance clarifies when transferring ownership interests in a consolidated subsidiary holding nonfinancial assets is within scope. It also states that the reporting entity should identify each distinct nonfinancial asset and derecognize when a counterparty obtains control. We adopted this new accounting guidance using the modified retrospective method, which had no impact on our consolidated financial statements at adoption.

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

On January 1, 2018, we early adopted new accounting guidance simplifying the test for goodwill impairment. The new guidance states goodwill impairment is equal to the difference between the carrying value and fair value of the reporting unit up to the amount of recorded goodwill. We adopted this new accounting guidance prospectively and will apply it to our 2018 goodwill impairment test.

On January 1, 2018, we adopted new accounting guidance related to the classification and presentation of changes in restricted cash. The new guidance requires that changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents be shown in the statements of cash flows and requires additional disclosures related to restricted cash and restricted cash equivalents. We adopted this new accounting guidance retrospectively and modified the line item descriptions on our consolidated balance sheets and statements of cash flows in our consolidated financial statements. The other impacts from this new accounting guidance did not have a significant impact on our consolidated financial statements or disclosures.

On January 1, 2018, we adopted new accounting guidance related to the income tax effects of intra-entity transfers of assets other than inventory. The new guidance states that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. We adopted this new accounting guidance using the modified retrospective method, which did not have any significant impact on our consolidated financial statements or disclosures at adoption.

On January 1, 2018, we adopted new accounting guidance related to the classification of certain cash payments and cash receipts on our statement of cash flows. The guidance reduces diversity in practice related to eight specific cash flow issues. We adopted this new accounting guidance retrospectively. We will reclassify a \$20 million make-whole premium that was incurred in the first quarter of 2016 previously included in the operating activities section of the statement of cash flows, within the line item other liabilities, policy and contract claims and other policy-related balances to the financing activities section within the line item repayment and repurchase of long-term debt in our 2018 annual consolidated financial statements filed on Form 10-K. The reclassification will result in an increase in net cash used by financing activities and an increase in net cash from operating activities. The remaining specific cash flow issues did not have a significant impact on our consolidated financial statements.

On January 1, 2018, we adopted new accounting guidance related to the recognition and measurement of financial assets and financial liabilities. Changes to financial instruments accounting primarily affects equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. Under the new guidance, equity investments with readily determinable fair value, except those accounted for under the equity method of accounting, are measured at fair value with changes in fair value recognized in net income. The new guidance also clarifies that the need for a valuation allowance on a deferred tax asset related to available-for-sale securities should be evaluated in combination with other deferred tax assets. We adopted this new accounting guidance using the modified retrospective method and reclassified, after adjustments for deferred acquisition costs (DAC) and other intangible amortization and certain benefit reserves, taxes and noncontrolling interests, \$25 million of gains related to equity securities from accumulated other comprehensive income and \$17 million of gains related to limited partnerships previously recorded at cost to cumulative effect of change in

accounting within retained earnings.

On January 1, 2018, we adopted new accounting guidance related to revenue from contracts with customers. The key principle of the new guidance is that entities should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for such goods or services. Insurance contracts are specifically excluded from this new

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

guidance. The Financial Accounting Standards Board (the FASB) has clarified the scope that all of our insurance contracts, including mortgage insurance and investment contracts are excluded from the scope of this new guidance. We adopted this new accounting guidance using the modified retrospective method, which did not have any significant impact on our consolidated financial statements at adoption.

Accounting Pronouncements Not Yet Adopted

In June 2018, the FASB issued new guidance related to accounting for nonemployee share-based payments. The guidance aligns the measurement and classification of share-based payments to nonemployees issued in exchange for goods or services with the guidance for share-based payments to employees, with certain exceptions. The guidance is currently effective for us on January 1, 2019 using the modified retrospective method, with early adoption permitted. While we are still evaluating the full impact, at this time we do not expect any impacts from this new guidance on our consolidated financial statements.

In March 2017, the FASB issued new guidance shortening the amortization period of certain callable debt securities held at a premium. The guidance requires the premium to be amortized to the earliest call date. This change does not apply to securities held at a discount. The guidance is currently effective for us on January 1, 2019 using the modified retrospective method, with early adoption permitted. While we are still evaluating the full impact, at this time we do not expect any significant impact from this guidance on our consolidated financial statements.

In June 2016, the FASB issued new guidance related to accounting for credit losses on financial instruments. The guidance requires that entities recognize an allowance equal to its estimate of lifetime expected credit losses and applies to most debt instruments not measured at fair value, which would primarily include our commercial mortgage loans and reinsurance receivables. The new guidance retains most of the existing impairment guidance for available-for-sale debt securities but amends the presentation of credit losses to be presented as an allowance as opposed to a write-down and permits the reversal of credit losses when reassessing changes in the credit losses each reporting period. The new guidance is effective for us on January 1, 2020, with early adoption permitted beginning January 1, 2019. Upon adoption, the modified retrospective method will be used and a cumulative effect adjustment in retained earnings as of the beginning of the year of adoption will be recorded. We are in process of evaluating the impact the guidance may have on our consolidated financial statements.

In February 2016, the FASB issued new accounting guidance related to the accounting for leases. The new guidance generally requires lessees to recognize both a right-to-use asset and a corresponding liability on the balance sheet. The guidance is effective for us on January 1, 2019, with early adoption permitted. A modified retrospective transition approach is required for leases existing at, or entered into after, the beginning of the period adopted in the financial statements, with certain practical expedients available, which we are in the processes of evaluating. While we are still evaluating the full impact, at this time we do not expect any significant impact from this guidance on our consolidated financial statements.

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Basic and diluted earnings per share are calculated by dividing each income category presented below by the weighted-average basic and diluted common shares outstanding for the periods indicated:

(Amounts in millions, except per share amounts)	Three months ended		Six months ended	
	June 30,	June 30,	June 30,	June 30,
	2018	2017	2018	2017
Weighted-average shares used in basic earnings per share calculations	500.6	499.0	500.1	498.8
Potentially dilutive securities:				
Stock options, restricted stock units and stock appreciation rights	2.0	2.2	2.5	2.3
Weighted-average shares used in diluted earnings per share calculations	502.6	501.2	502.6	501.1
Income from continuing operations:				
Income from continuing operations	\$ 249	\$ 271	\$ 414	\$ 487
Less: income from continuing operations attributable to noncontrolling interests	59	69	112	130
Income from continuing operations available to Genworth Financial, Inc.'s common stockholders	\$ 190	\$ 202	\$ 302	\$ 357
Basic per share	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.72
Diluted per share	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.71
Loss from discontinued operations:				
Loss from discontinued operations, net of taxes	\$	\$	\$	\$
Less: income from discontinued operations, net of taxes, attributable to noncontrolling interests				
Loss from discontinued operations, net of taxes, available to Genworth Financial, Inc.'s common stockholders	\$	\$	\$	\$
Basic per share	\$	\$	\$	\$

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Diluted per share	\$	\$	\$	\$
Net income:				
Income from continuing operations	\$ 249	\$ 271	\$ 414	\$ 487
Loss from discontinued operations, net of taxes				
Net income	249	271	414	487
Less: net income attributable to noncontrolling interests	59	69	112	130
Net income available to Genworth Financial, Inc. s common stockholders	\$ 190	\$ 202	\$ 302	\$ 357
Basic per share	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.72
Diluted per share	\$ 0.38	\$ 0.40	\$ 0.60	\$ 0.71

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(4) Investments***(a) Net Investment Income*

Sources of net investment income were as follows for the periods indicated:

(Amounts in millions)	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Fixed maturity securities taxable	\$ 651	\$ 649	\$ 1,286	\$ 1,290
Fixed maturity securities non-taxable	3	3	6	6
Equity securities	10	9	20	17
Commercial mortgage loans	77	76	159	153
Restricted commercial mortgage loans related to securitization entities	2	2	4	4
Policy loans	41	39	84	81
Other invested assets	53	35	92	67
Restricted other invested assets related to securitization entities		1		1
Cash, cash equivalents and short-term investments	14	10	26	16
Gross investment income before expenses and fees	851	824	1,677	1,635
Expenses and fees	(23)	(23)	(45)	(44)
Net investment income	\$ 828	\$ 801	\$ 1,632	\$ 1,591

(b) Net Investment Gains (Losses)

The following table sets forth net investment gains (losses) for the periods indicated:

(Amounts in millions)	Three months ended		Six months ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Available-for-sale securities:				
Realized gains	\$ 13	\$ 74	\$ 20	\$ 137
Realized losses	(21)	(11)	(37)	(45)

Net realized gains (losses) on available-for-sale securities	(8)	63	(17)	92
Impairments:				
Total other-than-temporary impairments		(2)		(3)
Portion of other-than-temporary impairments included in other comprehensive income (loss)				
Net other-than-temporary impairments		(2)		(3)
Net realized gains (losses) on equity securities sold	8		10	
Net unrealized gains (losses) on equity securities still held	3		(15)	
Trading securities		1		1
Limited partnerships	(2)		5	
Commercial mortgage loans		1		2
Net gains (losses) related to securitization entities		2		4
Derivative instruments ⁽¹⁾	(15)	36	(28)	39
Net investment gains (losses)	\$ (14)	\$ 101	\$ (45)	\$ 135

- (1) See note 5 for additional information on the impact of derivative instruments included in net investment gains (losses).

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

We generally intend to hold securities in unrealized loss positions until they recover. However, from time to time, our intent on an individual security may change, based upon market or other unforeseen developments. In such instances, we sell securities in the ordinary course of managing our portfolio to meet diversification, credit quality, yield and liquidity requirements. If a loss is recognized from a sale subsequent to a balance sheet date due to these unexpected developments, the loss is recognized in the period in which we determined that we have the intent to sell the securities or it is more likely than not that we will be required to sell the securities prior to recovery. The aggregate fair value of securities sold at a loss during the three months ended June 30, 2018 and 2017 was \$640 million and \$228 million, respectively, which was approximately 97% and 95%, respectively, of book value. The aggregate fair value of securities sold at a loss during the six months ended June 30, 2018 and 2017 was \$1,259 million and \$1,104 million, respectively, which was approximately 97% and 96%, respectively, of book value.

The following represents the activity for credit losses recognized in net income on debt securities where an other-than-temporary impairment was identified and a portion of other-than-temporary impairments was included in other comprehensive income (OCI) as of and for the periods indicated:

(Amounts in millions)	As of or for the three months ended June 30,		As of or for the six months ended June 30,	
	2018	2017	2018	2017
Beginning balance	\$ 28	\$ 41	\$ 32	\$ 42
Reductions:				
Securities sold, paid down or disposed	(3)	(3)	(7)	(4)
Ending balance	\$ 25	\$ 38	\$ 25	\$ 38

(c) Unrealized Investment Gains and Losses

Net unrealized gains and losses on available-for-sale investment securities reflected as a separate component of accumulated other comprehensive income (loss) were as follows as of the dates indicated:

(Amounts in millions)	June 30, 2018	December 31, 2017
Net unrealized gains (losses) on investment securities:		
Fixed maturity securities	\$ 2,555	\$ 5,125
Equity securities		69

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Subtotal ⁽¹⁾	2,555	5,194
Adjustments to deferred acquisition costs, present value of future profits, sales inducements and benefit reserves	(1,549)	(3,451)
Income taxes, net	(230)	(583)
Net unrealized investment gains (losses)	776	1,160
Less: net unrealized investment gains (losses) attributable to noncontrolling interests	40	75
Net unrealized investment gains (losses) attributable to Genworth Financial, Inc.	\$ 736	\$ 1,085

⁽¹⁾ Excludes foreign exchange.

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The change in net unrealized gains (losses) on available-for-sale investment securities reported in accumulated other comprehensive income (loss) was as follows as of and for the periods indicated:

(Amounts in millions)	As of or for the three months ended June 30,	
	2018	2017
Beginning balance	\$ 917	\$ 1,243
Unrealized gains (losses) arising during the period:		
Unrealized gains (losses) on investment securities	(905)	995
Adjustment to deferred acquisition costs	467	(741)
Adjustment to present value of future profits	20	(28)
Adjustment to sales inducements	9	(6)
Adjustment to benefit reserves	162	(269)
Provision for income taxes	54	17
Change in unrealized gains (losses) on investment securities	(193)	(32)
Reclassification adjustments to net investment (gains) losses, net of taxes of \$(2) and \$21	6	(40)
Change in net unrealized investment gains (losses)	(187)	(72)
Less: change in net unrealized investment gains (losses) attributable to noncontrolling interests	(6)	(9)
Ending balance	\$ 736	\$ 1,180

(Amounts in millions)	As of or for the six months ended June 30,	
	2018	2017
Beginning balance	\$ 1,085	\$ 1,262
Cumulative effect of changes in accounting:		
Stranded tax effects	189	
Recognition and measurement of financial assets and liabilities, net of taxes of \$18 and \$	(25)	

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Total cumulative effect of changes in accounting	164	
Unrealized gains (losses) arising during the period:		
Unrealized gains (losses) on investment securities	(2,586)	1,387
Adjustment to deferred acquisition costs	909	(1,046)
Adjustment to present value of future profits	56	(33)
Adjustment to sales inducements	29	(11)
Adjustment to benefit reserves	902	(337)
Provision for income taxes	149	15
Change in unrealized gains (losses) on investment securities	(541)	(25)
Reclassification adjustments to net investment (gains) losses, net of taxes of \$(3) and \$31	13	(58)
Change in net unrealized investment gains (losses)	(528)	(83)
Less: change in net unrealized investment gains (losses) attributable to noncontrolling interests	(15)	(1)
Ending balance	\$ 736	\$ 1,180

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(d) Fixed Maturity and Equity Securities

As of June 30, 2018, the amortized cost or cost, gross unrealized gains (losses) and fair value of our fixed maturity securities classified as available-for-sale were as follows:

(Amounts in millions)	Amortized cost or cost	Gross unrealized		Fair value
		gains	losses	
	Not other-than-	Other-than-	Other-than-	
	temporarily	temporarily	temporarily	
	impaired	impaired	impaired	
Fixed maturity securities:				
U.S. government, agencies and government-sponsored enterprises	\$ 4,733	\$ 632	\$ (12)	\$ 5,353
State and political subdivisions	2,699	195	(39)	2,855
Non-U.S. government	2,347	69	(36)	2,380
U.S. corporate:				
Utilities	4,550	395	(66)	4,879
Energy	2,160	139	(29)	2,270
Finance and insurance	6,095	288	(108)	6,275
Consumer non-cyclical	4,298	323	(80)	4,541
Technology and communications	2,709	133	(61)	2,781
Industrial	1,244	59	(20)	1,283
Capital goods	2,216	185	(40)	2,361
Consumer cyclical	1,538	66	(31)	1,573
Transportation	1,200	83	(31)	1,252
Other	337	18	(1)	354
Total U.S. corporate	26,347	1,689	(467)	27,569
Non-U.S. corporate:				
Utilities	962	22	(22)	962
Energy	1,316	101	(18)	1,399
Finance and insurance	2,471	102	(36)	2,537
Consumer non-cyclical	709	11	(18)	702
Technology and communications	992	30	(15)	1,007
Industrial	943	46	(12)	977
Capital goods	603	15	(7)	611
Consumer cyclical	527	2	(7)	522

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Transportation	690	48		(11)		727
Other	2,454	128		(24)		2,558
Total non-U.S. corporate	11,667	505		(170)		12,002
Residential mortgage-backed	3,426	156	13	(28)		3,567
Commercial mortgage-backed	3,387	46		(84)		3,349
Other asset-backed	2,966	7	1	(17)		2,957
Total available-for-sale fixed maturity securities	\$ 57,572	\$ 3,299	\$ 14	\$ (853)	\$	\$ 60,032

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

As of December 31, 2017, the amortized cost or cost, gross unrealized gains (losses) and fair value of our fixed maturity and equity securities classified as available-for-sale were as follows:

(Amounts in millions)	Gross unrealized gains		Gross unrealized losses		Fair value
	Amortized cost or cost	Not other-than-temporarily impaired	Other-than-temporarily impaired	Not other-than-temporarily impaired	
Fixed maturity securities:					
U.S. government, agencies and government-sponsored enterprises	\$ 4,681	\$ 870	\$	\$ (3)	\$ 5,548
State and political subdivisions	2,678	270		(22)	2,926
Non-U.S. government	2,147	106		(20)	2,233
U.S. corporate:					
Utilities	4,396	611		(9)	4,998
Energy	2,239	227		(8)	2,458
Finance and insurance	5,984	556		(12)	6,528
Consumer non-cyclical	4,314	530		(13)	4,831
Technology and communications	2,665	192		(12)	2,845
Industrial	1,241	106		(1)	1,346
Capital goods	2,087	273		(5)	2,355
Consumer cyclical	1,493	116		(4)	1,605
Transportation	1,160	134		(3)	1,291
Other	355	25		(1)	379
Total U.S. corporate	25,934	2,770		(68)	28,636
Non-U.S. corporate:					
Utilities	979	42		(4)	1,017
Energy	1,337	158		(5)	1,490
Finance and insurance	2,567	174		(6)	2,735
Consumer non-cyclical	686	30		(4)	712
Technology and communications	913	71		(2)	982
Industrial	958	88		(2)	1,044
Capital goods	614	33		(2)	645
Consumer cyclical	532	9		(1)	540
Transportation	656	68		(3)	721
Other	2,536	193		(4)	2,725

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Total non-U.S. corporate	11,778	866		(33)		12,611
Residential mortgage-backed	3,831	223	14	(11)		4,057
Commercial mortgage-backed	3,387	94	2	(37)		3,446
Other asset-backed	3,056	17	1	(6)		3,068
Total fixed maturity securities	57,492	5,216	17	(200)		62,525
Equity securities	756	72		(8)		820
Total available-for-sale securities	\$ 58,248	\$ 5,288	\$ 17	\$ (208)	\$	\$ 63,345

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table presents the gross unrealized losses and fair values of our fixed maturity securities, aggregated by investment type and length of time that individual fixed maturity securities have been in a continuous unrealized loss position, as of June 30, 2018:

Description of Securities	Less than 12 months			12 months or more			Total		
	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities
(Dollar amounts in millions)									
Fixed maturity securities:									
U.S. government, agencies and government-sponsored enterprises	\$ 314	\$ (6)	35	\$ 84	\$ (6)	5	\$ 398	\$ (12)	40
State and political subdivisions	482	(13)	98	318	(26)	41	800	(39)	139
Non-U.S. government	649	(18)	85	418	(18)	25	1,067	(36)	110
U.S. corporate	9,473	(354)	1,322	1,215	(113)	167	10,688	(467)	1,489
Non-U.S. corporate	4,146	(126)	574	697	(44)	96	4,843	(170)	670
Residential mortgage-backed	866	(19)	133	321	(9)	62	1,187	(28)	195
Commercial mortgage-backed	1,159	(29)	168	590	(55)	87	1,749	(84)	255
Other asset-backed	1,654	(14)	301	194	(3)	54	1,848	(17)	355
Total for fixed maturity securities in an unrealized loss position	\$ 18,743	\$ (579)	2,716	\$ 3,837	\$ (274)	537	\$ 22,580	\$ (853)	3,253
% Below cost:									
<20% Below cost	\$ 18,743	\$ (579)	2,714	\$ 3,828	\$ (270)	533	\$ 22,571	\$ (849)	3,247
20%-50% Below cost			2	9	(4)	4	9	(4)	6
Total for fixed maturity securities in an unrealized loss position	\$ 18,743	\$ (579)	2,716	\$ 3,837	\$ (274)	537	\$ 22,580	\$ (853)	3,253
Investment grade	\$ 17,627	\$ (535)	2,555	\$ 3,704	\$ (261)	508	\$ 21,331	\$ (796)	3,063
Below investment grade	1,116	(44)	161	133	(13)	29	1,249	(57)	190
Total for fixed maturity securities in an unrealized loss	\$ 18,743	\$ (579)	2,716	\$ 3,837	\$ (274)	537	\$ 22,580	\$ (853)	3,253

position

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following table presents the gross unrealized losses and fair values of our corporate securities, aggregated by investment type and length of time that individual investment securities have been in a continuous unrealized loss position, based on industry, as of June 30, 2018:

(Dollar amounts in millions) Description of Securities	Less than 12 months			12 months or more			Total		
	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities
U.S. corporate:									
Utilities	\$ 1,187	\$ (46)	185	\$ 214	\$ (20)	35	\$ 1,401	\$ (66)	220
Energy	639	(19)	102	119	(10)	12	758	(29)	114
Finance and insurance	2,596	(90)	366	243	(18)	32	2,839	(108)	398
Consumer non-cyclical	1,579	(61)	194	188	(19)	23	1,767	(80)	217
Technology and communications	1,111	(42)	142	159	(19)	21	1,270	(61)	163
Industrial	416	(15)	61	55	(5)	7	471	(20)	68
Capital goods	717	(32)	94	64	(8)	11	781	(40)	105
Consumer cyclical	668	(24)	107	86	(7)	11	754	(31)	118
Transportation	492	(24)	67	73	(7)	14	565	(31)	81
Other	68	(1)	4	14		1	82	(1)	5
Subtotal, U.S. corporate securities	9,473	(354)	1,322	1,215	(113)	167	10,688	(467)	1,489
Non-U.S. corporate:									
Utilities	359	(14)	48	81	(8)	10	440	(22)	58
Energy	346	(12)	48	98	(6)	12	444	(18)	60
Finance and insurance	1,007	(28)	143	150	(8)	25	1,157	(36)	168
Consumer non-cyclical	323	(12)	37	57	(6)	5	380	(18)	42
Technology and communications	466	(13)	65	23	(2)	4	489	(15)	69
Industrial	280	(9)	41	34	(3)	4	314	(12)	45
Capital goods	227	(6)	27	29	(1)	4	256	(7)	31
Consumer cyclical	283	(7)	36	28		7	311	(7)	43
Transportation	206	(6)	24	64	(5)	8	270	(11)	32
Other	649	(19)	105	133	(5)	17	782	(24)	122

Subtotal, non-U.S. corporate securities	4,146	(126)	574	697	(44)	96	4,843	(170)	670
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Total for corporate securities in an unrealized loss position	\$ 13,619	\$ (480)	1,896	\$ 1,912	\$ (157)	263	\$ 15,531	\$ (637)	2,159
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For all securities in an unrealized loss position, we expect to recover the amortized cost based on our estimate of the amount and timing of cash flows to be collected. We do not intend to sell nor do we expect that we will be required to sell these securities prior to recovering our amortized cost.

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table presents the gross unrealized losses and fair values of our investment securities, aggregated by investment type and length of time that individual investment securities have been in a continuous unrealized loss position, as of December 31, 2017:

(Dollar amounts in millions)	Less than 12 months			12 months or more			Total		
	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities
Description of Securities									
Fixed maturity securities:									
U.S. government, agencies and government-sponsored enterprises									
	\$ 78	\$ (1)	21	\$ 94	\$ (2)	7	\$ 172	\$ (3)	28
State and political subdivisions	125	(1)	35	327	(21)	42	452	(22)	77
Non-U.S. government	583	(7)	26	239	(13)	20	822	(20)	46
U.S. corporate	1,871	(26)	296	1,347	(42)	190	3,218	(68)	486
Non-U.S. corporate	1,323	(12)	217	548	(21)	77	1,871	(33)	294
Residential mortgage-backed	707	(7)	81	130	(4)	46	837	(11)	127
Commercial mortgage-backed	476	(4)	69	646	(33)	90	1,122	(37)	159
Other asset-backed	853	(4)	160	230	(2)	57	1,083	(6)	217
Subtotal, fixed maturity securities	6,016	(62)	905	3,561	(138)	529	9,577	(200)	1,434
Equity securities	74	(3)	134	100	(5)	58	174	(8)	192
Total for securities in an unrealized loss position	\$ 6,090	\$ (65)	1,039	\$ 3,661	\$ (143)	587	\$ 9,751	\$ (208)	1,626
% Below cost fixed maturity securities:									
<20% Below cost	\$ 6,016	\$ (62)	905	\$ 3,555	\$ (136)	526	\$ 9,571	\$ (198)	1,431
20%-50% Below cost				6	(2)	3	6	(2)	3
Total fixed maturity securities	6,016	(62)	905	3,561	(138)	529	9,577	(200)	1,434
% Below cost equity securities:									
<20% Below cost	74	(3)	134	100	(5)	58	174	(8)	192
Total equity securities	74	(3)	134	100	(5)	58	174	(8)	192

Total for securities in an unrealized loss position	\$ 6,090	\$ (65)	1,039	\$ 3,661	\$ (143)	587	\$ 9,751	\$ (208)	1,626
Investment grade	\$ 5,867	\$ (55)	898	\$ 3,488	\$ (135)	528	\$ 9,355	\$ (190)	1,426
Below investment grade	223	(10)	141	173	(8)	59	396	(18)	200
Total for securities in an unrealized loss position	\$ 6,090	\$ (65)	1,039	\$ 3,661	\$ (143)	587	\$ 9,751	\$ (208)	1,626

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following table presents the gross unrealized losses and fair values of our corporate securities, aggregated by investment type and length of time that individual investment securities have been in a continuous unrealized loss position, based on industry, as of December 31, 2017:

Description of Securities	Less than 12 months			12 months or more			Total		
	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities	Fair value	unrealized losses	Number of securities
(Dollar amounts in millions)									
U.S. corporate:									
Utilities	\$ 181	\$ (2)	33	\$ 219	\$ (7)	36	\$ 400	\$ (9)	69
Energy	106	(1)	22	140	(7)	15	246	(8)	37
Finance and insurance	626	(6)	91	222	(6)	30	848	(12)	121
Consumer non-cyclical	299	(7)	46	221	(6)	31	520	(13)	77
Technology and communications	217	(4)	32	210	(8)	29	427	(12)	61
Industrial				62	(1)	9	62	(1)	9
Capital goods	176	(2)	25	81	(3)	14	257	(5)	39
Consumer cyclical	137	(2)	24	95	(2)	13	232	(4)	37
Transportation	117	(1)	21	97	(2)	13	214	(3)	34
Other	12	(1)	2				12	(1)	2
Subtotal, U.S. corporate securities	1,871	(26)	296	1,347	(42)	190	3,218	(68)	486
Non-U.S. corporate:									
Utilities	113	(1)	23	72	(3)	8	185	(4)	31
Energy	118	(2)	19	74	(3)	12	192	(5)	31
Finance and insurance	347	(3)	56	117	(3)	19	464	(6)	75
Consumer non-cyclical	69	(1)	11	60	(3)	6	129	(4)	17
Technology and communications	107	(1)	18	30	(1)	6	137	(2)	24
Industrial	52		9	38	(2)	5	90	(2)	14
Capital goods	54		11	46	(2)	3	100	(2)	14
Consumer cyclical	131	(1)	21				131	(1)	21
Transportation	47	(1)	7	64	(2)	8	111	(3)	15
Other	285	(2)	42	47	(2)	10	332	(4)	52
Subtotal, non-U.S. corporate securities	1,323	(12)	217	548	(21)	77	1,871	(33)	294

Total for corporate securities in an unrealized loss position	\$ 3,194	\$ (38)	513	\$ 1,895	\$ (63)	267	\$ 5,089	\$ (101)	780
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Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The scheduled maturity distribution of fixed maturity securities as of June 30, 2018 is set forth below. Actual maturities may differ from contractual maturities because issuers of securities may have the right to call or prepay obligations with or without call or prepayment penalties.

(Amounts in millions)	Amortized cost or cost	Fair value
Due one year or less	\$ 1,692	\$ 1,701
Due after one year through five years	11,006	11,149
Due after five years through ten years	12,517	12,601
Due after ten years	22,578	24,708
Subtotal	47,793	50,159
Residential mortgage-backed	3,426	3,567
Commercial mortgage-backed	3,387	3,349
Other asset-backed	2,966	2,957
Total	\$ 57,572	\$ 60,032

As of June 30, 2018, securities issued by finance and insurance, utilities and consumer non-cyclical industry groups represented approximately 22%, 15% and 13%, respectively, of our domestic and foreign corporate fixed maturity securities portfolio. No other industry group comprised more than 10% of our investment portfolio.

As of June 30, 2018, we did not hold any fixed maturity securities in any single issuer, other than securities issued or guaranteed by the U.S. government, which exceeded 10% of stockholders equity.

(e) Commercial Mortgage Loans

Our mortgage loans are collateralized by commercial properties, including multi-family residential buildings. The carrying value of commercial mortgage loans is stated at original cost net of principal payments, amortization and allowance for loan losses.

We diversify our commercial mortgage loans by both property type and geographic region. The following tables set forth the distribution across property type and geographic region for commercial mortgage loans as of the dates indicated:

(Amounts in millions)	June 30, 2018		December 31, 2017	
	Carrying value	% of total	Carrying value	% of total
Property type:				
Retail	\$ 2,375	37%	\$ 2,239	35%
Industrial	1,644	25	1,628	26
Office	1,482	23	1,510	24
Apartments	474	7	478	8
Mixed use	237	4	223	3
Other	280	4	275	4
Subtotal	6,492	100%	6,353	100%
Unamortized balance of loan origination fees and costs	(3)		(3)	
Allowance for losses	(9)		(9)	
Total	\$ 6,480		\$ 6,341	

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in millions)	June 30, 2018		December 31, 2017	
	Carrying value	% of total	Carrying value	% of total
Geographic region:				
South Atlantic	\$ 1,669	26%	\$ 1,625	26%
Pacific	1,652	25	1,622	26
Middle Atlantic	926	14	927	14
Mountain	617	10	556	9
West North Central	453	7	446	7
East North Central	399	6	394	6
West South Central	360	6	336	5
East South Central	214	3	208	3
New England	202	3	239	4
Subtotal	6,492	100%	6,353	100%
Unamortized balance of loan origination fees and costs	(3)		(3)	
Allowance for losses	(9)		(9)	
Total	\$ 6,480		\$ 6,341	

The following tables set forth the aging of past due commercial mortgage loans by property type as of the dates indicated:

(Amounts in millions)	June 30, 2018				Current	Total
	31 - 60 days past due	61 - 90 days past due	Greater than 90 days past due	Total past due		
Property type:						
Retail	\$	\$	\$	\$	\$ 2,375	\$ 2,375
Industrial					1,644	1,644
Office			6	6	1,476	1,482
Apartments					474	474
Mixed use					237	237
Other					280	280
Total recorded investment	\$	\$	\$ 6	\$ 6	\$ 6,486	\$ 6,492

% of total commercial mortgage loans	%	%	%	%	100%	100%
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(Amounts in millions)	December 31, 2017				Current	Total
	31 - 60 days past due	61 - 90 days past due	Greater than 90 days past due	Total past due		
Property type:						
Retail	\$ 5	\$	\$	\$ 5	\$ 2,234	\$ 2,239
Industrial					1,628	1,628
Office			6	6	1,504	1,510
Apartments					478	478
Mixed use					223	223
Other					275	275
Total recorded investment	\$ 5	\$	\$ 6	\$ 11	\$ 6,342	\$ 6,353
% of total commercial mortgage loans	%	%	%	%	100%	100%

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As of June 30, 2018 and December 31, 2017, we had no commercial mortgage loans that were past due for more than 90 days and still accruing interest. We also did not have any commercial mortgage loans that were past due for less than 90 days on non-accrual status as of June 30, 2018 and December 31, 2017.

We evaluate the impairment of commercial mortgage loans on an individual loan basis. As of June 30, 2018, our commercial mortgage loans greater than 90 days past due included an impaired loan. This loan had an appraised value in excess of the recorded investment and the current recorded investment of this loan is expected to be recoverable.

During the six months ended June 30, 2018 and the year ended December 31, 2017, we modified or extended two and ten commercial mortgage loans, respectively, with a total carrying value of \$12 million and \$27 million, respectively. All of these modifications or extensions were based on current market interest rates and did not result in any forgiveness in the outstanding principal amount owed by the borrower.

The following table sets forth the allowance for credit losses and recorded investment in commercial mortgage loans as of or for the periods indicated:

(Amounts in millions)	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Allowance for credit losses:				
Beginning balance	\$ 9	\$ 11	\$ 9	\$ 12
Charge-offs				
Recoveries				
Provision		(1)		(2)
Ending balance	\$ 9	\$ 10	\$ 9	\$ 10
Ending allowance for individually impaired loans	\$	\$	\$	\$
Ending allowance for loans not individually impaired that were evaluated collectively for impairment	\$ 9	\$ 10	\$ 9	\$ 10
Recorded investment:				
Ending balance	\$ 6,492	\$ 6,250	\$ 6,492	\$ 6,250
Ending balance of individually impaired loans	\$ 6	\$	\$ 6	\$

Ending balance of loans not individually impaired that were evaluated collectively for impairment	\$ 6,486	\$ 6,250	\$ 6,486	\$ 6,250
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As of June 30, 2018 and December 31, 2017, we had one individually impaired loan within the office property type with a recorded investment and unpaid principal balance of \$6 million. As of June 30, 2017, we had no individually impaired commercial mortgage loans.

In evaluating the credit quality of commercial mortgage loans, we assess the performance of the underlying loans using both quantitative and qualitative criteria. Certain risks associated with commercial mortgage loans can be evaluated by reviewing both the loan-to-value and debt service coverage ratio to understand both the probability of the borrower not being able to make the necessary loan payments as well as the ability to sell the underlying property for an amount that would enable us to recover our unpaid principal balance in the event of default by the borrower. The average loan-to-value ratio is based on our most recent estimate of the fair value for the underlying property which is

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evaluated at least annually and updated more frequently if necessary to better indicate risk associated with the loan. A lower loan-to-value indicates that our loan value is more likely to be recovered in the event of default by the borrower if the property was sold. The debt service coverage ratio is based on normalized annual income of the property compared to the payments required under the terms of the loan. Normalization allows for the removal of annual one-time events such as capital expenditures, prepaid or late real estate tax payments or non-recurring third-party fees (such as legal, consulting or contract fees). This ratio is evaluated at least annually and updated more frequently if necessary to better indicate risk associated with the loan. A higher debt service coverage ratio indicates the borrower is less likely to default on the loan. The debt service coverage ratio should not be used without considering other factors associated with the borrower, such as the borrower's liquidity or access to other resources that may result in our expectation that the borrower will continue to make the future scheduled payments.

The following tables set forth the loan-to-value of commercial mortgage loans by property type as of the dates indicated:

(Amounts in millions)	June 30, 2018					Total
	0% - 50%	51% - 60%	61% - 75%	76% - 100%	Greater than 100%	
Property type:						
Retail	\$ 848	\$ 505	\$ 1,022	\$	\$	\$ 2,375
Industrial	676	355	613			1,644
Office	438	447	589	8		1,482
Apartments	201	122	146	5		474
Mixed use	101	54	82			237
Other	49	42	189			280
Total recorded investment	\$ 2,313	\$ 1,525	\$ 2,641	\$ 13	\$	\$ 6,492
% of total	36%	23%	41%	%	%	100%
Weighted-average debt service coverage ratio	2.30	1.85	1.61	1.07		1.91

(Amounts in millions)	December 31, 2017					Total
	0% - 50%	51% - 60%	61% - 75%	76% - 100%	Greater than 100% ⁽¹⁾	
Property type:						

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Retail	\$ 919	\$ 500	\$ 820	\$	\$	\$ 2,239
Industrial	731	363	532	2		1,628
Office	575	386	534	13	2	1,510
Apartments	226	101	146	5		478
Mixed use	99	59	65			223
Other	68	28	179			275
Total recorded investment	\$ 2,618	\$ 1,437	\$ 2,276	\$ 20	\$ 2	\$ 6,353
% of total	41%	23%	36%	%	%	100%
Weighted-average debt service coverage ratio	2.65	1.85	1.62	0.62	1.04	2.09

- (1) Included a loan with a recorded investment of \$2 million in good standing, where the borrower continued to make timely payments, with a loan-to-value of 102%. We evaluated this loan on an individual basis and as it is in good standing, the current recorded investment is expected to be recoverable.

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The following tables set forth the debt service coverage ratio for fixed rate commercial mortgage loans by property type as of the dates indicated:

(Amounts in millions)	June 30, 2018					Total
	Less than 1.00	1.00 - 1.25	1.26 - 1.50	1.51 - 2.00	Greater than 2.00	
Property type:						
Retail	\$ 41	\$ 216	\$ 406	\$ 1,137	\$ 575	\$ 2,375
Industrial	19	66	208	751	600	1,644
Office	34	70	178	678	522	1,482
Apartments	12	18	79	186	179	474
Mixed use	5	4	38	86	104	237
Other	1	147	23	87	22	280
Total recorded investment	\$ 112	\$ 521	\$ 932	\$ 2,925	\$ 2,002	\$ 6,492
% of total	2%	8%	14%	45%	31%	100%
Weighted-average loan-to-value	54%	60%	59%	59%	44%	54%

(Amounts in millions)	December 31, 2017					Total
	Less than 1.00	1.00 - 1.25	1.26 - 1.50	1.51 - 2.00	Greater than 2.00	
Property type:						
Retail	\$ 43	\$ 235	\$ 301	\$ 1,020	\$ 640	\$ 2,239
Industrial	23	61	174	700	670	1,628
Office	51	61	157	569	672	1,510
Apartments		17	77	191	193	478
Mixed use	2	4	26	86	105	223
Other	1	149	14	71	40	275
Total recorded investment	\$ 120	\$ 527	\$ 749	\$ 2,637	\$ 2,320	\$ 6,353
% of total	2%	8%	12%	42%	36%	100%
Weighted-average loan-to-value	55%	60%	58%	58%	42%	52%

As of June 30, 2018 and December 31, 2017, we did not have any floating rate commercial mortgage loans.

(f) Restricted Commercial Mortgage Loans Related To Securitization Entities

We have a consolidated securitization entity that holds commercial mortgage loans that are recorded as restricted commercial mortgage loans related to securitization entities.

(g) Limited Partnerships or Similar Entities

Limited partnerships are accounted for at fair value when our partnership interest is considered minor (generally less than 3% ownership in the limited partnerships) and we exercise no influence over operating and financial policies. If our ownership percentage exceeds that threshold, limited partnerships are accounted for using the equity method of accounting. In applying either method, we use financial information provided by the investee generally on a one-to-three month lag.

Investments in partnerships or similar entities are generally considered VIEs when the equity group lacks sufficient financial control. Generally, these investments are limited partner or non-managing member equity investments in a widely held fund that is sponsored and managed by a reputable asset manager. We are not the primary beneficiary of any VIE investment in a limited partnership or similar entity. As of June 30, 2018 and

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December 31, 2017, the total carrying value of these investments was \$295 million and \$222 million, respectively. Our maximum exposure to loss is equal to the outstanding carrying value and future funding commitments. We have not contributed, and do not plan to contribute, any additional financial or other support outside of what is contractually obligated.

(5) Derivative Instruments

Our business activities routinely deal with fluctuations in interest rates, equity prices, currency exchange rates and other asset and liability prices. We use derivative instruments to mitigate or reduce certain of these risks. We have established policies for managing each of these risks, including prohibitions on derivatives market-making and other speculative derivatives activities. These policies require the use of derivative instruments in concert with other techniques to reduce or mitigate these risks. While we use derivatives to mitigate or reduce risks, certain derivatives do not meet the accounting requirements to be designated as hedging instruments and are denoted as derivatives not designated as hedges in the following disclosures. For derivatives that meet the accounting requirements to be designated as hedges, the following disclosures for these derivatives are denoted as derivatives designated as hedges, which include both cash flow and fair value hedges.

The following table sets forth our positions in derivative instruments as of the dates indicated:

(Amounts in millions)	Balance sheet classification	Derivative assets		Derivative liabilities		
		Fair value		Fair value		
		June 30, 2018	December 31, 2017	Balance sheet classification	June 30, 2018	December 31, 2017
Derivatives designated as hedges						
Cash flow hedges:						
Interest rate swaps	Other invested assets	\$ 49	\$ 74	Other liabilities	\$ 71	\$ 25
Foreign currency swaps	Other invested assets	2	1	Other liabilities	1	
Total cash flow hedges		51	75		72	25
Total derivatives designated as hedges		51	75		72	25
Derivatives not designated as hedges						

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Interest rate caps and floors	Other invested assets	1		Other liabilities		
Foreign currency swaps	Other invested assets	1	11	Other liabilities	8	
Equity index options	Other invested assets	70	80	Other liabilities		
Financial futures	Other invested assets			Other liabilities		
Equity return swaps	Other invested assets	1		Other liabilities		2
Other foreign currency contracts	Other invested assets	106	110	Other liabilities	23	20
GMWB embedded derivatives	Reinsurance recoverable ⁽¹⁾	12	14	Policyholder account balances ⁽²⁾	235	250
Fixed index annuity embedded derivatives	Other assets			Policyholder account balances ⁽³⁾	420	419
Indexed universal life embedded derivatives	Reinsurance recoverable			Policyholder account balances ⁽⁴⁾	13	14
Total derivatives not designated as hedges		191	215		699	705
Total derivatives		\$ 242	\$ 290		\$ 771	\$ 730

- (1) Represents embedded derivatives associated with the reinsured portion of our guaranteed minimum withdrawal benefits (GMWB) liabilities.
- (2) Represents the embedded derivatives associated with our GMWB liabilities, excluding the impact of reinsurance.
- (3) Represents the embedded derivatives associated with our fixed index annuity liabilities.
- (4) Represents the embedded derivatives associated with our indexed universal life liabilities.

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The fair value of derivative positions presented above was not offset by the respective collateral amounts received or provided under these agreements.

The activity associated with derivative instruments can generally be measured by the change in notional value over the periods presented. However, for GMWB, fixed index annuity embedded derivatives and indexed universal life embedded derivatives, the change between periods is best illustrated by the number of policies. The following tables represent activity associated with derivative instruments as of the dates indicated:

(Notional in millions)	Measurement	December 31, 2017	Additions	Maturities/ terminations	June 30, 2018
Derivatives designated as hedges					
Cash flow hedges:					
Interest rate swaps	Notional	\$ 11,155	\$ 1,436	\$ (1,672)	\$ 10,919
Foreign currency swaps	Notional	22	39		61
Total cash flow hedges		11,177	1,475	(1,672)	10,980
Total derivatives designated as hedges		11,177	1,475	(1,672)	10,980
Derivatives not designated as hedges					
Interest rate swaps	Notional	4,679		(5)	4,674
Interest rate caps and floors	Notional		805		805
Foreign currency swaps	Notional	349	128	(23)	454
Credit default swaps	Notional	39		(19)	20
Equity index options	Notional	2,420	1,246	(927)	2,739
Financial futures	Notional	1,283	2,660	(2,680)	1,263
Equity return swaps	Notional	96	1	(78)	19
Other foreign currency contracts	Notional	3,264	398	(549)	3,113
Total derivatives not designated as hedges		12,130	5,238	(4,281)	13,087
Total derivatives		\$ 23,307	\$ 6,713	\$ (5,953)	\$ 24,067

(Number of policies)	Measurement	December 31, 2017	Additions	Maturities/ terminations	June 30, 2018
Derivatives not designated as hedges					

GMWB embedded derivatives	Policies	30,450	(1,343)	29,107
Fixed index annuity embedded derivatives	Policies	17,067	(255)	16,812
Indexed universal life embedded derivatives	Policies	985	(28)	957
<i>Cash Flow Hedges</i>				

Certain derivative instruments are designated as cash flow hedges. The changes in fair value of these instruments are recorded as a component of OCI. We designate and account for the following as cash flow hedges when they have met the effectiveness requirements: (i) various types of interest rate swaps to convert floating rate investments to fixed rate investments; (ii) various types of interest rate swaps to convert floating rate liabilities into fixed rate liabilities; (iii) receive U.S. dollar fixed on foreign currency swaps to hedge the foreign currency cash flow exposure of foreign currency denominated investments; (iv) forward starting interest rate swaps to hedge against changes in interest rates associated with future fixed rate bond purchases and/or interest income; (v) forward bond purchase commitments to hedge against the variability in the anticipated cash flows required to purchase future fixed rate bonds; and (vi) other instruments to hedge the cash flows of various forecasted transactions.

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The following table provides information about the pre-tax income effects of cash flow hedges for the three months ended June 30, 2018:

(Amounts in millions)	Gain (loss) recognized in OCI	Gain (loss) reclassified into net income from OCI	Classification of gain (loss) reclassified into net income
Interest rate swaps hedging assets	\$ (54)	\$ 39	Net investment income
Interest rate swaps hedging liabilities	5		Interest expense
Foreign currency swaps	1		Net investment income
Total	\$ (48)	\$ 39	

The following table provides information about the pre-tax income effects of cash flow hedges for the three months ended June 30, 2017:

(Amounts in millions)	Gain (loss) recognized in OCI	Gain (loss) reclassified into net income from OCI	Classification of gain (loss) reclassified into net income	Gain (loss) recognized in net income ⁽¹⁾	Classification of gain (loss) recognized in net income
Interest rate swaps hedging assets	\$ 82	\$ 31	Net investment income	\$	Net investment gains (losses)
Interest rate swaps hedging assets		1	Net investment gains (losses)		Net investment gains (losses)
Interest rate swaps hedging liabilities	(6)		Interest expense		Net investment gains (losses)
Foreign currency swaps	(1)		Net investment income		Net investment gains (losses)

Total	\$ 75	\$ 32	\$
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(1) Represents ineffective portion of cash flow hedges as there were no amounts excluded from the measurement of effectiveness.

The following table provides information about the pre-tax income effects of cash flow hedges for the six months ended June 30, 2018:

(Amounts in millions)	Gain (loss) recognized in OCI	Gain (loss) reclassified into net income from OCI	Classification of gain (loss) reclassified into net income
Interest rate swaps hedging assets	\$ (227)	\$ 74	Net investment income
Interest rate swaps hedging assets		5	Net investment gains (losses)
Interest rate swaps hedging liabilities	22		Interest expense
Total	\$ (205)	\$ 79	

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(Unaudited)

The following table provides information about the pre-tax income effects of cash flow hedges for the six months ended June 30, 2017:

(Amounts in millions)	Gain (loss) reclassified		Classification of gain (loss) reclassified into net income	Gain (loss) recognized in net income (1)	Classification of gain (loss) recognized in net income
	Gain (loss) recognized in OCI	Gain (loss) into net income from OCI			
Interest rate swaps hedging assets	\$ 33	\$ 61	Net investment income	\$	Net investment gains (losses)
Interest rate swaps hedging assets		2	Net investment gains (losses)		Net investment gains (losses)
Interest rate swaps hedging liabilities	(2)		Interest expense		Net investment gains (losses)
Foreign currency swaps	(1)		Net investment income		Net investment gains (losses)
Total	\$ 30	\$ 63		\$	

(1) Represents ineffective portion of cash flow hedges as there were no amounts excluded from the measurement of effectiveness.

The following tables provide a reconciliation of current period changes, net of applicable income taxes, for these designated derivatives presented in the separate component of stockholders' equity labeled derivatives qualifying as hedges, for the periods indicated:

(Amounts in millions)	Three months ended June 30,	
	2018	2017
Derivatives qualifying as effective accounting hedges as of April 1	\$ 1,927	\$ 2,036
Current period increases (decreases) in fair value, net of deferred taxes of \$9 and \$(27)	(39)	48
Reclassification to net (income), net of deferred taxes of \$14 and \$12	(25)	(20)

Derivatives qualifying as effective accounting hedges as of June 30 \$ 1,863 \$ 2,064

(Amounts in millions)	Six months ended	
	June 30,	
	2018	2017
Derivatives qualifying as effective accounting hedges as of January 1	\$ 2,065	\$ 2,085
Cumulative effect of changes in accounting:		
Stranded tax effects	12	
Changes to the hedge accounting model, net of deferred taxes of \$(1) and \$	2	
Total cumulative effect of changes in accounting	14	
Current period increases (decreases) in fair value, net of deferred taxes of \$43 and \$(11)	(165)	19
Reclassification to net (income), net of deferred taxes of \$28 and \$23	(51)	(40)
Derivatives qualifying as effective accounting hedges as of June 30	\$ 1,863	\$ 2,064

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The total of derivatives designated as cash flow hedges of \$1,863 million, net of taxes, recorded in stockholders' equity as of June 30, 2018 is expected to be reclassified to net income in the future, concurrently with and primarily offsetting changes in interest expense and interest income on floating rate instruments and interest income on future fixed rate bond purchases. Of this amount, \$104 million, net of taxes, is expected to be reclassified to net income in the next 12 months. Actual amounts may vary from this amount as a result of market conditions. All forecasted transactions associated with qualifying cash flow hedges are expected to occur by 2057. During the six months ended June 30, 2018, we reclassified \$5 million to net income in connection with forecasted transactions that were no longer considered probable of occurring.

Derivatives Not Designated As Hedges

We also enter into certain non-qualifying derivative instruments such as: (i) interest rate swaps and financial futures to mitigate interest rate risk as part of managing regulatory capital positions; (ii) credit default swaps to enhance yield and reproduce characteristics of investments with similar terms and credit risk; (iii) equity index options, equity return swaps, interest rate swaps and financial futures to mitigate the risks associated with liabilities that have guaranteed minimum benefits, fixed index annuities and indexed universal life; (iv) interest rate swaps and interest rate caps and floors where the hedging relationship does not qualify for hedge accounting; (v) credit default swaps to mitigate loss exposure to certain credit risk; (vi) foreign currency swaps, options and forward contracts to mitigate currency risk associated with non-functional currency investments held by certain foreign subsidiaries and future dividends or other cash flows from certain foreign subsidiaries to our holding company; and (vii) equity index options to mitigate certain macroeconomic risks associated with certain foreign subsidiaries. Additionally, we provide GMWBs on certain variable annuities that are required to be bifurcated as embedded derivatives. We also offer fixed index annuity and indexed universal life products and have reinsurance agreements with certain features that are required to be bifurcated as embedded derivatives.

We also had, prior to the fourth quarter of 2017, derivatives related to securitization entities where we were required to consolidate the related securitization entity as a result of our involvement in the structure. The counterparties for these derivatives typically only had recourse to the securitization entity. The interest rate swaps used for these entities were typically used to effectively convert the interest payments on the assets of the securitization entity to the same basis as the interest rate on the borrowings issued by the securitization entity. Credit default swaps were utilized in certain securitization entities to enhance the yield payable on the borrowings issued by the securitization entity and also included a settlement feature that allows the securitization entity to provide the par value of assets in the securitization entity for the amount of any losses incurred under the credit default swap.

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(Unaudited)

The following tables provide the pre-tax gain (loss) recognized in net income for the effects of derivatives not designated as hedges for the periods indicated:

(Amounts in millions)	Three months ended		Classification of gain (loss) recognized in net income
	2018	2017	
Interest rate swaps	\$ (2)	\$ (1)	Net investment gains (losses)
Credit default swaps related to securitization entities		2	Net investment gains (losses)
Equity index options	8	13	Net investment gains (losses)
Financial futures	(13)	9	Net investment gains (losses)
Equity return swaps	1	(6)	Net investment gains (losses)
Other foreign currency contracts	1	31	Net investment gains (losses)
Foreign currency swaps	(10)	2	Net investment gains (losses)
GMWB embedded derivatives	13	1	Net investment gains (losses)
Fixed index annuity embedded derivatives	(15)	(16)	Net investment gains (losses)
Indexed universal life embedded derivatives	2	2	Net investment gains (losses)
Total derivatives not designated as hedges	\$ (15)	\$ 37	

(Amounts in millions)	Six months ended		Classification of gain (loss) recognized in net income
	2018	2017	
Interest rate swaps	\$ (3)	\$ 1	Net investment gains (losses)
Credit default swaps related to securitization entities		4	Net investment gains (losses)
Equity index options	(7)	26	Net investment gains (losses)
Financial futures	(37)	(8)	Net investment gains (losses)
Equity return swaps	(4)	(14)	Net investment gains (losses)
Other foreign currency contracts	9	26	Net investment gains (losses)
Foreign currency swaps	(18)	5	Net investment gains (losses)
GMWB embedded derivatives	27	34	Net investment gains (losses)
Fixed index annuity embedded derivatives	(7)	(36)	Net investment gains (losses)
Indexed universal life embedded derivatives	7	3	Net investment gains (losses)
Total derivatives not designated as hedges	\$ (33)	\$ 41	

Derivative Counterparty Credit Risk

Most of our derivative arrangements with counterparties require the posting of collateral upon meeting certain net exposure thresholds. For derivatives related to securitization entities, there are no arrangements that require either party to provide collateral and the recourse of the derivative counterparty is typically limited to the assets held by the securitization entity and there is no recourse to any entity other than the securitization entity.

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The following table presents additional information about derivative assets and liabilities subject to an enforceable master netting arrangement as of the dates indicated:

(Amounts in millions)	June 30, 2018			December 31, 2017		
	Derivatives assets (1)	Derivatives liabilities (2)	Net derivatives	Derivatives assets (1)	Derivatives liabilities (2)	Net derivatives
Amounts presented in the balance sheet:						
Gross amounts recognized	\$ 234	\$ 104	\$ 130	\$ 278	\$ 47	\$ 231
Gross amounts offset in the balance sheet						
Net amounts presented in the balance sheet	234	104	130	278	47	231
Gross amounts not offset in the balance sheet:						
Financial instruments ⁽³⁾	(39)	(39)		(23)	(23)	
Collateral received	(125)		(125)	(170)		(170)
Collateral pledged		(427)	427		(288)	288
Over collateralization	1	363	(362)		264	(264)
Net amount	\$ 71	\$ 1	\$ 70	\$ 85	\$	\$ 85

- (1) Included \$4 million and \$2 million of accruals on derivatives classified as other assets and does not include amounts related to embedded derivatives as of June 30, 2018 and December 31, 2017, respectively.
- (2) Included \$1 million of accrual on derivatives classified as other liabilities as of June 30, 2018. Does not include amounts related to embedded derivatives and derivatives related to securitization entities as of June 30, 2018 and December 31, 2017.
- (3) Amounts represent derivative assets and/or liabilities that are presented gross within the balance sheet but are held with the same counterparty where we have a master netting arrangement. This adjustment results in presenting the net asset and net liability position for each counterparty.

Except for derivatives related to securitization entities, several of our master swap agreements contain credit downgrade provisions that allow either party to assign or terminate derivative transactions if the other party's long-term unsecured debt rating or financial strength rating is below the limit defined in the applicable agreement. Beginning in 2018, we have renegotiated with many of our counterparties to remove the credit downgrade provisions from the master swap agreements. If the provisions defined in these agreements had been triggered as of June 30,

2018 and December 31, 2017, we could have been allowed to claim \$71 million and \$85 million, respectively, or have been required to disburse up to \$1 million as of June 30, 2018. The chart above excludes embedded derivatives and derivatives related to securitization entities as those derivatives are not subject to master netting arrangements.

We actively responded to the risk in our derivatives portfolio arising from our counterparties' right to terminate their bilateral over-the-counter derivatives transactions with us following the downgrades of our life insurance subsidiaries by Moody's Investors Service, Inc. and A.M. Best Company, Inc. in February 2018. As of June 30, 2018, no counterparties exercised their rights to terminate or revise the terms of their transactions with us.

Credit Derivatives

We sell protection under single name credit default swaps in combination with purchasing a security to replicate characteristics of similar investments based on the credit quality and term of the credit default swap. Credit default triggers for single name reference entities follow the Credit Derivatives Physical Settlement Matrix

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published by the International Swaps and Derivatives Association. Under these terms, credit default triggers are defined as bankruptcy, failure to pay or restructuring, if applicable. Our maximum exposure to credit loss equals the notional value for credit default swaps. In the event of default for credit default swaps, we are typically required to pay the protection holder the full notional value less a recovery rate determined at auction.

The following table sets forth our credit default swaps where we sell protection on single name reference entities and the fair values as of the dates indicated:

(Amounts in millions)	June 30, 2018			December 31, 2017		
	Notional value	Assets	Liabilities	Notional value	Assets	Liabilities
Investment grade						
Matures in less than one year	\$ 20	\$	\$	\$ 39	\$	\$
Total credit default swaps on single name reference entities	\$ 20	\$	\$	\$ 39	\$	\$

(6) Fair Value of Financial Instruments

Assets and liabilities that are reflected in the accompanying unaudited condensed consolidated financial statements at fair value are not included in the following disclosure of fair value. Such items include cash and cash equivalents, short-term investments, investment securities, separate accounts, securities held as collateral and derivative instruments. Apart from certain of our borrowings and certain marketable securities, few of the instruments are actively traded and their fair values must often be determined using models. The fair value estimates are made at a specific point in time, based upon available market information and judgments about the financial instruments, including estimates of the timing and amount of expected future cash flows and the credit standing of counterparties. Such estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular financial instrument, nor do they consider the tax impact of the realization of unrealized gains or losses. In many cases, the fair value estimates cannot be substantiated by comparison to independent markets.

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The following represents our estimated fair value of financial assets and liabilities that are not required to be carried at fair value as of the dates indicated:

(Amounts in millions)	Notional amount	Carrying amount	June 30, 2018			
			Total	Fair value		
				Level 1	Level 2	Level 3
Assets:						
Commercial mortgage loans	\$ (1)	\$ 6,480	\$ 6,514	\$	\$	\$ 6,514
Restricted commercial mortgage loans	(1)	90	96			96
Other invested assets	(1)	151	151			151
Liabilities:						
Long-term borrowings	(1)	4,047	3,727		3,577	150
Non-recourse funding obligations	(1)	310	209			209
Borrowings related to securitization entities	(1)	28	28		28	
Investment contracts	(1)	13,757	14,007			14,007
Other firm commitments:						
Commitments to fund limited partnerships	402					
Commitments to fund bank loan investments	30					
Ordinary course of business lending commitments	119					
December 31, 2017						
(Amounts in millions)	Notional amount	Carrying amount	Fair value			
			Total	Level 1	Level 2	Level 3
Assets:						
Commercial mortgage loans	\$ (1)	\$ 6,341	\$ 6,573	\$	\$	\$ 6,573
Restricted commercial mortgage loans	(1)	107	116			116
Other invested assets	(1)	277	299			299
Liabilities:						
Long-term borrowings	(1)	4,224	3,725		3,566	159
Non-recourse funding obligations	(1)	310	201			201
Borrowings related to securitization entities	(1)	40	41		41	
Investment contracts	(1)	14,700	15,123		5	15,118
Other firm commitments:						
Commitments to fund limited partnerships	317					
Commitments to fund bank loan investments	18					
Ordinary course of business lending commitments	168					

(1) These financial instruments do not have notional amounts.

Recurring Fair Value Measurements

We have fixed maturity, short-term investments, equity securities, limited partnerships, derivatives, embedded derivatives, securities held as collateral, separate account assets and certain other financial instruments, which are carried at fair value. Below is a description of the valuation techniques and inputs used to determine fair value by class of instrument.

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Limited partnerships

Limited partnerships are valued based on comparable market transactions, discounted future cash flows, quoted market prices and/or estimates using the most recent data available for the underlying instrument. We utilize the net asset value (NAV) of the underlying fund statements as a practical expedient for fair value.

Fixed maturity, short-term investments and equity securities

The fair value of fixed maturity, short-term investments and equity securities are estimated primarily based on information derived from third-party pricing services (pricing services), internal models and/or broker quotes, which use a market approach, income approach or a combination of the market and income approach depending on the type of instrument and availability of information. In general, a market approach is utilized if there is readily available and relevant market activity for an individual security. In certain cases where market information is not available for a specific security but is available for similar securities, a security is valued using that market information for similar securities, which is also a market approach. When market information is not available for a specific security or is available but such information is less relevant or reliable, an income approach or a combination of a market and income approach is utilized. For securities with optionality, such as call or prepayment features (including mortgage-backed or asset-backed securities), an income approach may be used. In addition, a combination of the results from market and income approaches may be used to estimate fair value. These valuation techniques may change from period to period, based on the relevance and availability of market data.

We utilize certain third-party data providers when determining fair value. We consider information obtained from pricing services as well as broker quotes in our determination of fair value. Additionally, we utilize internal models to determine the valuation of securities using an income approach where the inputs are based on third-party provided market inputs. While we consider the valuations provided by pricing services and broker quotes to be of high quality, management determines the fair value of our investment securities after considering all relevant and available information. We also use various methods to obtain an understanding of the valuation methodologies and procedures used by third-party data providers to ensure sufficient understanding to evaluate the valuation data received, including an understanding of the assumptions and inputs utilized to determine the appropriate fair value. For pricing services, we analyze the prices provided by our primary pricing services to other readily available pricing services and perform a detailed review of the assumptions and inputs from each pricing service to determine the appropriate fair value when pricing differences exceed certain thresholds. We evaluate changes in fair value that are greater than certain pre-defined thresholds each month to further aid in our review of the accuracy of fair value measurements and our understanding of changes in fair value, with more detailed reviews performed by the asset managers responsible for the related asset class associated with the security being reviewed. A pricing committee provides additional oversight and guidance in the evaluation and review of the pricing methodologies used to value our investment portfolio.

In general, we first obtain valuations from pricing services. For certain private fixed maturity securities where we do not obtain valuations from pricing services, we utilize an internal model to determine fair value since transactions for identical securities are not readily observable and these securities are not typically valued by pricing services. If prices

are unavailable from public pricing services we obtain broker quotes. For all securities, excluding certain private fixed maturity securities, if neither a pricing service nor broker quotes valuation is available, we determine fair value using internal models.

For pricing services, we obtain an understanding of the pricing methodologies and procedures for each type of instrument. Additionally, on a monthly basis we review a sample of securities, examining the pricing service s

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assumptions to determine if we agree with the service's derived price. When available, we also evaluate the prices sampled as compared to other public prices. If a variance greater than a pre-defined threshold is noted, additional review of the price is executed to ensure accuracy. In general, a pricing service does not provide a price for a security if sufficient information is not readily available to determine fair value or if such security is not in the specific sector or class covered by a particular pricing service. Given our understanding of the pricing methodologies and procedures of pricing services, the securities valued by pricing services are typically classified as Level 2 unless we determine the valuation process for a security or group of securities utilizes significant unobservable inputs, which would result in the valuation being classified as Level 3.

For private fixed maturity securities, we utilize an income approach where we obtain public bond spreads and utilize those in an internal model to determine fair value. Other inputs to the model include rating and weighted-average life, as well as sector which is used to assign the spread. We then add an additional premium, which represents an unobservable input, to the public bond spread to adjust for the liquidity and other features of our private placements. We utilize the estimated market yield to discount the expected cash flows of the security to determine fair value. We utilize price caps for securities where the estimated market yield results in a valuation that may exceed the amount that would be received in a market transaction and value all private fixed maturity securities at par that have less than 12 months to maturity. When a security does not have an external rating, we assign the security an internal rating to determine the appropriate public bond spread that should be utilized in the valuation. To evaluate the reasonableness of the internal model, we review a sample of private fixed maturity securities each month. In that review we compare the modeled prices to the prices of similar public securities in conjunction with analysis on current market indicators. If a pricing variance greater than a pre-defined threshold is noted, additional review of the price is executed to ensure accuracy. At the end of each month, all internally modeled prices are compared to the prior month prices with an evaluation of all securities with a month-over-month change greater than a pre-defined threshold. While we generally consider the public bond spreads by sector and maturity to be observable inputs, we evaluate the similarities of our private placement with the public bonds, any price caps utilized, liquidity premiums applied, and whether external ratings are available for our private placements to determine whether the spreads utilized would be considered observable inputs. We classify private securities without an external rating and public bond spread as Level 3. In general, increases (decreases) in credit spreads will decrease (increase) the fair value for our fixed maturity securities.

For broker quotes, we consider the valuation methodology utilized by the third party and analyze a sample each month to assess reasonableness given then-current market conditions. Additionally, for broker quotes on certain structured securities, we validate prices received against other publicly available pricing sources. Broker quotes are typically based on an income approach given the lack of available market data. As the valuation typically includes significant unobservable inputs, we classify the securities where fair value is based on our consideration of broker quotes as Level 3 measurements.

For remaining securities priced using internal models, we determine fair value using an income approach. We analyze a sample each month to assess reasonableness given then-current market conditions. We maximize the use of observable inputs but typically utilize significant unobservable inputs to determine fair value. Accordingly, the valuations are typically classified as Level 3.

A summary of the inputs used for our fixed maturity, short-term investments and equity securities based on the level in which instruments are classified is included below. We have combined certain classes of instruments together as the nature of the inputs is similar.

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Level 1 measurements

Equity securities. The primary inputs to the valuation of exchange-traded equity securities include quoted prices for the identical instrument.

Short-term investments. Short-term investments primarily include commercial paper and other highly liquid debt instruments. The fair value of short-term investments classified as Level 1 is based on quoted prices for the identical instrument.

Separate account assets. The fair value of separate account assets is based on the quoted prices of the underlying fund investments and, therefore, represents Level 1 pricing.

Level 2 measurements

Fixed maturity securities

Third-party pricing services: In estimating the fair value of fixed maturity securities, approximately 91% of our portfolio is priced using third-party pricing sources. These pricing services utilize industry-standard valuation techniques that include market-based approaches, income-based approaches, a combination of market-based and income-based approaches or other proprietary, internally generated models as part of the valuation processes. These third-party pricing vendors maximize the use of publicly available data inputs to generate valuations for each asset class. Priority and type of inputs used may change frequently as certain inputs may be more direct drivers of valuation at the time of pricing. Examples of significant inputs incorporated by third-party pricing services may include sector and issuer spreads, seasoning, capital structure, security optionality, collateral data, prepayment assumptions, default assumptions, delinquencies, debt covenants, benchmark yields, trade data, dealer quotes, credit ratings, maturity and weighted-average life. We conduct regular meetings with our third-party pricing services for the purpose of understanding the methodologies, techniques and inputs used by the third-party pricing providers.

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The following table presents a summary of the significant inputs used by our third-party pricing services for certain fair value measurements of fixed maturity securities that are classified as Level 2 as of June 30, 2018:

(Amounts in millions)	Fair value	Primary methodologies	Significant inputs
U.S. government, agencies and government-sponsored enterprises	\$ 5,353	Price quotes from trading desk, broker feeds	Bid side prices, trade prices, Option Adjusted Spread (OAS) to swap curve, Bond Market Association OAS, Treasury Curve, Agency Bullet Curve, maturity to issuer spread
State and political subdivisions	\$ 2,803	Multi-dimensional attribute-based modeling systems, third-party pricing vendors	Trade prices, material event notices, Municipal Market Data benchmark yields, broker quotes
Non-U.S. government	\$ 2,364	Matrix pricing, spread priced to benchmark curves, price quotes from market makers	Benchmark yields, trade prices, broker quotes, comparative transactions, issuer spreads, bid-offer spread, market research publications, third-party pricing sources
U.S. corporate	\$ 24,571	Multi-dimensional attribute-based modeling systems, broker quotes, price quotes from market makers, internal models, OAS-based models	Bid side prices to Treasury Curve, Issuer Curve, which includes sector, quality, duration, OAS percentage and change for spread matrix, trade prices, comparative transactions, Trade Reporting and Compliance Engine (TRACE) reports
Non-U.S. corporate	\$ 10,049	Multi-dimensional attribute-based modeling systems, OAS-based models, price quotes from market makers	Benchmark yields, trade prices, broker quotes, comparative transactions, issuer spreads, bid-offer spread, market research publications, third-party pricing sources
Residential mortgage-backed	\$ 3,533	OAS-based models, To Be Announced pricing models, single factor binomial models, internally priced	Prepayment and default assumptions, aggregation of bonds with similar characteristics, including collateral type, vintage, tranche type, weighted-average life, weighted-average loan age, issuer program and delinquency ratio, pay up and pay down factors, TRACE reports
	\$ 3,305		

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Commercial mortgage-backed		Multi-dimensional attribute-based modeling systems, pricing matrix, spread matrix priced to swap curves, Trepp commercial mortgage-backed securities analytics model	Credit risk, interest rate risk, prepayment speeds, new issue data, collateral performance, origination year, tranche type, original credit ratings, weighted-average life, cash flows, spreads derived from broker quotes, bid side prices, spreads to daily updated swaps curves, TRACE reports Spreads to daily updated swaps curves, spreads derived from trade prices and broker quotes, bid side prices, new issue data, collateral performance, analysis of prepayment speeds, cash flows, collateral loss analytics, historical issue analysis, trade data from market makers, TRACE reports
Other asset-backed	\$ 2,791	Multi-dimensional attribute-based modeling systems, spread matrix priced to swap curves, price quotes from market makers, internal models	

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Internal models: A portion of our non-U.S. government, U.S. corporate and non-U.S. corporate securities are valued using internal models. The fair value of these fixed maturity securities were \$16 million, \$1,067 million and \$567 million, respectively, as of June 30, 2018. Internally modeled securities are primarily private fixed maturity securities where we use market observable inputs such as an interest rate yield curve, published credit spreads for similar securities based on the external ratings of the instrument and related industry sector of the issuer. Additionally, we may apply certain price caps and liquidity premiums in the valuation of private fixed maturity securities. Price caps and liquidity premiums are established using inputs from market participants.

Equity securities. The primary inputs to the valuation include quoted prices for identical assets, or similar assets in markets that are not active.

Securities lending collateral

The fair value of securities held as collateral is primarily based on Level 2 inputs from market information for the collateral that is held on our behalf by the custodian. We determine fair value after considering prices obtained by third-party pricing services.

Short-term investments

The fair value of short-term investments classified as Level 2 is determined after considering prices obtained by third-party pricing services.

Level 3 measurements

Fixed maturity securities

Internal models: A portion of our U.S. corporate, non-U.S. corporate, residential mortgage-backed and other asset-backed securities are valued using internal models. The primary inputs to the valuation of the bond population include quoted prices for identical assets, or similar assets in markets that are not active, contractual cash flows, duration, call provisions, issuer rating, benchmark yields and credit spreads. Certain private fixed maturity securities are valued using an internal model using market observable inputs such as interest rate yield curve, as well as published credit spreads for similar securities where there are no external ratings of the instrument and include a significant unobservable input. Additionally, we may apply certain price caps and liquidity premiums in the valuation of private fixed maturity securities. Price caps are established using inputs from market participants. For structured securities, the primary inputs to the valuation include quoted prices for identical assets, or similar assets in markets that are not active, contractual cash flows, weighted-average coupon, weighted-average maturity, issuer rating, structure of the security, expected prepayment speeds and volumes, collateral type, current and forecasted loss severity,

average delinquency rates, vintage of the loans, geographic region, debt service coverage ratios, payment priority with the tranche, benchmark yields and credit spreads. The fair value of our Level 3 fixed maturity securities priced using internal models was \$3,201 million as of June 30, 2018.

Broker quotes: A portion of our state and political subdivisions, U.S. corporate, non-U.S. corporate, residential mortgage-backed, commercial mortgage-backed and other asset-backed securities are valued using broker quotes. Broker quotes are obtained from third-party providers that have current market knowledge to provide a reasonable price for securities not routinely priced by third-party pricing services. Brokers utilized for valuation of assets are reviewed annually. The fair value of our Level 3 fixed maturity securities priced by broker quotes was \$412 million as of June 30, 2018.

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Equity securities. The primary inputs to the valuation include broker quotes where the underlying inputs are unobservable and for internal models, structure of the security and issuer rating.

Restricted other invested assets related to securitization entities

We previously held trading securities related to securitization entities that were classified as restricted other invested assets and were carried at fair value. The trading securities represented asset-backed securities. In 2017, these trading securities were sold as we repositioned these assets in connection with the maturity of the associated liabilities. The valuation for trading securities was determined using a market approach and/or an income approach depending on the availability of information. For certain highly rated asset-backed securities, there was observable market information for transactions of the same or similar instruments, which was provided to us by a third-party pricing service and was classified as Level 2. For certain securities that are not actively traded, we determined fair value after considering third-party broker provided prices or discounted expected cash flows using current yields for similar securities and classified these valuations as Level 3.

GMWB embedded derivatives

We are required to bifurcate an embedded derivative for certain features associated with annuity products and related reinsurance agreements where we provide a GMWB to the policyholder and are required to record the GMWB embedded derivative at fair value. The valuation of our GMWB embedded derivative is based on an income approach that incorporates inputs such as forward interest rates, equity index volatility, equity index and fund correlation, and policyholder assumptions such as utilization, lapse and mortality. In addition to these inputs, we also consider risk and expense margins when determining the projected cash flows that would be determined by another market participant. While the risk and expense margins are considered in determining fair value, these inputs do not have a significant impact on the valuation. We determine fair value using an internal model based on the various inputs noted above. The resulting fair value measurement from the model is reviewed by the product actuarial, risk and finance professionals each reporting period with changes in fair value also being compared to changes in derivatives and other instruments used to mitigate changes in fair value from certain market risks, such as equity index volatility and interest rates.

For GMWB liabilities, non-performance risk is integrated into the discount rate. Our discount rate used to determine fair value of our GMWB liabilities includes market credit spreads above U.S. Treasury rates to reflect an adjustment for the non-performance risk of the GMWB liabilities. As of June 30, 2018 and December 31, 2017, the impact of non-performance risk resulted in a lower fair value of our GMWB liabilities of \$50 million and \$63 million, respectively.

To determine the appropriate discount rate to reflect the non-performance risk of the GMWB liabilities, we evaluate the non-performance risk in our liabilities based on a hypothetical exit market transaction as there is no exit market for these types of liabilities. A hypothetical exit market can be viewed as a hypothetical transfer of the liability to another similarly rated insurance company which would closely resemble a reinsurance transaction. Another hypothetical exit

market transaction can be viewed as a hypothetical transaction from the perspective of the GMWB policyholder. In determining the appropriate discount rate to incorporate non-performance risk of the GMWB liabilities, we also considered the impacts of state guarantees embedded in the related insurance product as a form of inseparable third-party guarantee. We believe that a hypothetical exit market participant would use a similar discount rate as described above to value the liabilities.

For equity index volatility, we determine the projected equity market volatility using both historical volatility and projected equity market volatility with more significance being placed on projected near-term

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volatility and recent historical data. Given the different attributes and market characteristics of GMWB liabilities compared to equity index options in the derivative market, the equity index volatility assumption for GMWB liabilities may be different from the volatility assumption for equity index options, especially for the longer dated points on the curve.

Equity index and fund correlations are determined based on historical price observations for the fund and equity index.

For policyholder assumptions, we use our expected lapse, mortality and utilization assumptions and update these assumptions for our actual experience, as necessary. For our lapse assumption, we adjust our base lapse assumption by policy based on a combination of the policyholder's current account value and GMWB benefit.

We classify the GMWB valuation as Level 3 based on having significant unobservable inputs, with equity index volatility and non-performance risk being considered the more significant unobservable inputs. As equity index volatility increases, the fair value of the GMWB liabilities will increase. Any increase in non-performance risk would increase the discount rate and would decrease the fair value of the GMWB liability. Additionally, we consider lapse and utilization assumptions to be significant unobservable inputs. An increase in our lapse assumption would decrease the fair value of the GMWB liability, whereas an increase in our utilization rate would increase the fair value.

Fixed index annuity embedded derivatives

We have fixed indexed annuity products where interest is credited to the policyholder's account balance based on equity index changes. This feature is required to be bifurcated as an embedded derivative and recorded at fair value. Fair value is determined using an income approach where the present value of the excess cash flows above the guaranteed cash flows is used to determine the value attributed to the equity index feature. The inputs used in determining the fair value include policyholder behavior (lapses and withdrawals), near-term equity index volatility, expected future interest credited, forward interest rates and an adjustment to the discount rate to incorporate non-performance risk and risk margins. As a result of our assumptions for policyholder behavior and expected future interest credited being considered significant unobservable inputs, we classify these instruments as Level 3. As lapses and withdrawals increase, the value of our embedded derivative liability will decrease. As expected future interest credited decreases, the value of our embedded derivative liability will decrease.

Indexed universal life embedded derivatives

We have indexed universal life products where interest is credited to the policyholder's account balance based on equity index changes. This feature is required to be bifurcated as an embedded derivative and recorded at fair value. Fair value is determined using an income approach where the present value of the excess cash flows above the guaranteed cash flows is used to determine the value attributed to the equity index feature. The inputs used in determining the fair value include policyholder behavior (lapses and withdrawals), near-term equity index volatility, expected future interest credited, forward interest rates and an adjustment to the discount rate to incorporate

non-performance risk and risk margins. As a result of our assumptions for policyholder behavior and expected future interest credited being considered significant unobservable inputs, we classify these instruments as Level 3. As lapses and withdrawals increase, the value of our embedded derivative liability will decrease. As expected future interest credited decreases, the value of our embedded derivative liability will decrease.

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Borrowings related to securitization entities

We record certain borrowings related to securitization entities at fair value. The fair value of these borrowings is determined using either a market approach or income approach, depending on the instrument and availability of market information. Given the unique characteristics of the securitization entities that issued these borrowings as well as the lack of comparable instruments, we determine fair value considering the valuation of the underlying assets held by the securitization entities and any derivatives, as well as any unique characteristics of the borrowings that may impact the valuation. After considering all relevant inputs, we determine fair value of the borrowings using the net valuation of the underlying assets and derivatives that are backing the borrowings. Accordingly, these instruments are classified as Level 3. Increases in the valuation of the underlying assets or decreases in the derivative liabilities will result in an increase in the fair value of these borrowings.

Derivatives

We consider counterparty collateral arrangements and rights of set-off when evaluating our net credit risk exposure to our derivative counterparties. Accordingly, we are permitted to include consideration of these arrangements when determining whether any incremental adjustment should be made for both the counterparties and our non-performance risk in measuring fair value for our derivative instruments. As a result of these counterparty arrangements, we determined that any adjustment for credit risk would not be material and we have not recorded any incremental adjustment for our non-performance risk or the non-performance risk of the derivative counterparty for our derivative assets or liabilities. We determine fair value for our derivatives using an income approach with internal models based on relevant market inputs for each derivative instrument. We also compare the fair value determined using our internal model to the valuations provided by our derivative counterparties with any significant differences or changes in valuation being evaluated further by our derivatives professionals that are familiar with the instrument and market inputs used in the valuation.

Interest rate swaps. The valuation of interest rate swaps is determined using an income approach. The primary input into the valuation represents the forward interest rate swap curve, which is generally considered an observable input, and results in the derivative being classified as Level 2. For certain interest rate swaps, the inputs into the valuation also include the total returns of certain bonds that would primarily be considered an observable input and result in the derivative being classified as Level 2.

Interest rate caps and floors. The valuation of interest rate caps and floors is determined using an income approach. The primary inputs into the valuation represent the forward interest rate swap curve, forward interest rate volatility and time value component associated with the optionality in the derivative which are generally considered observable inputs and results in the derivatives being classified as Level 2.

Interest rate swaps related to securitization entities. The valuation of interest rate swaps related to securitization entities was determined using an income approach. The primary input into the valuation represented the forward interest rate swap curve, which was generally considered an observable input, and resulted in the derivative being

classified as Level 2.

Inflation indexed swaps. The valuation of inflation indexed swaps was determined using an income approach. The primary inputs into the valuation represented the forward interest rate swap curve, the current consumer price index and the forward consumer price index curve, which were generally considered observable inputs, and resulted in the derivative being classified as Level 2.

Foreign currency swaps. The valuation of foreign currency swaps is determined using an income approach. The primary inputs into the valuation represent the forward interest rate swap curve and foreign currency

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exchange rates, both of which are considered an observable input, and results in the derivative being classified as Level 2.

Credit default swaps. We have single name credit default swaps and we previously sold protection under index tranche credit default swaps. For single name credit default swaps, we utilize an income approach to determine fair value based on using current market information for the credit spreads of the reference entity, which is considered observable inputs based on the reference entities of our derivatives and results in these derivatives being classified as Level 2. For index tranche credit default swaps, we utilized an income approach that utilized current market information related to credit spreads and expected defaults and losses associated with the reference entities that comprised the respective index associated with each derivative. There were significant unobservable inputs associated with the timing and amount of losses from the reference entities as well as the timing or amount of losses, if any, that were absorbed by our tranche. Accordingly, the index tranche credit default swaps were classified as Level 3. As credit spreads widened for the underlying issuers comprising the index, the change in our valuation of these credit default swaps were unfavorable.

Credit default swaps related to securitization entities. Credit default swaps related to securitization entities represented customized index tranche credit default swaps and were valued using a similar methodology as described above for index tranche credit default swaps. We determined fair value of these credit default swaps after considering both the valuation methodology described above as well as the valuation provided by the derivative counterparty. In addition to the valuation methodology and inputs described for index tranche credit default swaps, these customized credit default swaps contained a feature that permitted the securitization entity to provide the par value of underlying assets in the securitization entity to settle any losses under the credit default swap. The valuation of this settlement feature was dependent upon the valuation of the underlying assets and the timing and amount of any expected loss on the credit default swap, which was considered a significant unobservable input. Accordingly, these customized index tranche credit default swaps related to securitization entities were classified as Level 3. As credit spreads widened for the underlying issuers comprising the customized index, the change in our valuation of these credit default swaps were unfavorable.

Equity index options. We have equity index options associated with various equity indices. The valuation of equity index options is determined using an income approach. The primary inputs into the valuation represent forward interest rates, equity index volatility, equity index and time value component associated with the optionality in the derivative, which are considered significant unobservable inputs in most instances. The equity index volatility surface is determined based on market information that is not readily observable and is developed based upon inputs received from several third-party sources. Accordingly, these options are classified as Level 3. As equity index volatility increases, our valuation of these options changes favorably.

Financial futures. The fair value of financial futures is based on the closing exchange prices. Accordingly, these financial futures are classified as Level 1. The period end valuation is zero as a result of settling the margins on these contracts on a daily basis.

Equity return swaps. The valuation of equity return swaps is determined using an income approach. The primary inputs into the valuation represent the forward interest rate swap curve and underlying equity index values, which are generally considered observable inputs, and results in the derivative being classified as Level 2.

Forward bond purchase commitments. The valuation of forward bond purchase commitments is determined using an income approach. The primary input into the valuation represents the current bond prices and interest rates, which are generally considered an observable input, and results in the derivative being classified as Level 2.

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Other foreign currency contracts. We have certain foreign currency options classified as other foreign currency contracts. The valuation of foreign currency options is determined using an income approach. The primary inputs into the valuation represent the forward interest rate swap curve, foreign currency exchange rates, forward interest rate, foreign currency exchange rate volatility, foreign equity index volatility and time value component associated with the optionality in the derivative. As a result of the significant unobservable inputs associated with the forward interest rate, foreign currency exchange rate volatility and foreign equity index volatility inputs, the derivative is classified as Level 3. As foreign currency exchange rate volatility and foreign equity index volatility increases, the change in our valuation of these options will be favorable for purchase options and unfavorable for options sold. We also have foreign currency forward contracts where the valuation is determined using an income approach. The primary inputs into the valuation represent the forward foreign currency exchange rates, which are generally considered observable inputs and results in the derivative being classified as Level 2.

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

The following tables set forth our assets by class of instrument that are measured at fair value on a recurring basis as of the dates indicated:

(Amounts in millions)	June 30, 2018				NAV ⁽¹⁾
	Total	Level 1	Level 2	Level 3	
Assets					
Investments:					
Fixed maturity securities:					
U.S. government, agencies and government-sponsored enterprises	\$ 5,353	\$	\$ 5,353	\$	\$
State and political subdivisions	2,855		2,803	52	
Non-U.S. government	2,380		2,380		
U.S. corporate:					
Utilities	4,879		4,257	622	
Energy	2,270		2,132	138	
Finance and insurance	6,275		5,817	458	
Consumer non-cyclical	4,541		4,462	79	
Technology and communications	2,781		2,769	12	
Industrial	1,283		1,243	40	
Capital goods	2,361		2,242	119	
Consumer cyclical	1,573		1,319	254	
Transportation	1,252		1,196	56	
Other	354		201	153	
Total U.S. corporate	27,569		25,638	1,931	
Non-U.S. corporate:					
Utilities	962		629	333	
Energy	1,399		1,224	175	
Finance and insurance	2,537		2,387	150	
Consumer non-cyclical	702		594	108	
Technology and communications	1,007		991	16	
Industrial	977		872	105	
Capital goods	611		445	166	
Consumer cyclical	522		474	48	
Transportation	727		524	203	
Other	2,558		2,476	82	

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Total non-U.S. corporate	12,002		10,616	1,386	
Residential mortgage-backed	3,567		3,533	34	
Commercial mortgage-backed	3,349		3,305	44	
Other asset-backed	2,957		2,791	166	
Total fixed maturity securities	60,032		56,419	3,613	
Equity securities	758	643	69	46	
Other invested assets:					
Derivative assets:					
Interest rate swaps	49		49		
Interest rate caps and floors	1		1		
Foreign currency swaps	3		3		
Equity index options	70			70	
Equity return swaps	1		1		
Other foreign currency contracts	106		106		
Total derivative assets	230		160	70	
Securities lending collateral	211		211		
Short-term investments	708	1	707		
Limited partnerships	248				248
Total other invested assets	1,397	1	1,078	70	248
Reinsurance recoverable ⁽²⁾	12			12	
Separate account assets	6,750	6,750			
Total assets	\$ 68,949	\$ 7,394	\$ 57,566	\$ 3,741	\$ 248

(1) Limited partnerships that are measured at fair value using the net asset value per share (or its equivalent) practical expedient have not been categorized in the fair value hierarchy.

(2) Represents embedded derivatives associated with the reinsured portion of our GMWB liabilities.

Table of Contents**GENWORTH FINANCIAL, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)**

(Amounts in millions)	December 31, 2017			
	Total	Level 1	Level 2	Level 3
Assets				
Investments:				
Fixed maturity securities:				
U.S. government, agencies and government-sponsored enterprises	\$ 5,548	\$	\$ 5,547	\$ 1
State and political subdivisions	2,926		2,889	37
Non-U.S. government	2,233		2,233	
U.S. corporate:				
Utilities	4,998		4,424	574
Energy	2,458		2,311	147
Finance and insurance	6,528		5,902	626
Consumer non-cyclical	4,831		4,750	81
Technology and communications	2,845		2,772	73
Industrial	1,346		1,307	39
Capital goods	2,355		2,234	121
Consumer cyclical	1,605		1,343	262
Transportation	1,291		1,231	60
Other	379		210	169
Total U.S. corporate	28,636		26,484	2,152
Non-U.S. corporate:				
Utilities	1,017		674	343
Energy	1,490		1,314	176
Finance and insurance	2,735		2,574	161
Consumer non-cyclical	712		588	124
Technology and communications	982		953	29
Industrial	1,044		928	116
Capital goods	645		454	191
Consumer cyclical	540		486	54
Transportation	721		551	170
Other	2,725		2,673	52
Total non-U.S. corporate	12,611		11,195	1,416
Residential mortgage-backed	4,057		3,980	77
Commercial mortgage-backed	3,446		3,416	30
Other asset-backed	3,068		2,831	237

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Total fixed maturity securities	62,525		58,575	3,950
Equity securities	820	696	80	44
Other invested assets:				
Derivative assets:				
Interest rate swaps	74		74	
Foreign currency swaps	12		12	
Equity index options	80			80
Other foreign currency contracts	110		110	
Total derivative assets	276		196	80
Securities lending collateral	268		268	
Short-term investments	902	107	795	
Total other invested assets	1,446	107	1,259	80
Reinsurance recoverable ⁽¹⁾	14			14
Separate account assets	7,230	7,230		
Total assets	\$ 72,035	\$ 8,033	\$ 59,914	\$ 4,088

⁽¹⁾ Represents embedded derivatives associated with the reinsured portion of our GMWB liabilities.

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GENWORTH FINANCIAL, INC.

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(Unaudited)

We review the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers between levels at the beginning fair value for the reporting period in which the changes occur. Given the types of assets classified as Level 1, which primarily represents mutual fund investments, we typically do not have any transfers between Level 1 and Level 2 measurement categories and did not have any such transfers during any period presented.

Our assessment of whether or not there were significant unobservable inputs related to fixed maturity securities was based on our observations obtained through the course of managing our investment portfolio, including interaction with other market participants, observations related to the availability and consistency of pricing and/or rating, and understanding of general market activity such as new issuance and the level of secondary market trading for a class of securities. Additionally, we considered data obtained from third-party pricing sources to determine whether our estimated values incorporate significant unobservable inputs that would result in the valuation being classified as Level 3.

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The following tables present additional information about assets measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value as of or for the dates indicated:

(Amounts in millions)	Beginning balance as of April 1, 2018	Total realized and unrealized gains (losses)						Transfer into Level 3 ⁽¹⁾	Transfer out of Level 3 ⁽¹⁾	Ending balance as of June 30, 2018	Total gains (losses) included in net income attributable to assets still held
		Included in net income	Included in OCI	Purchases	Sales	Issuances	Settlements				
Fixed maturity securities:											
State and political subdivisions	\$ 53	\$	\$ (1)	\$	\$	\$	\$	\$	\$	\$ 52	\$
U.S. corporate:											
Utilities	553	(1)	(7)	66	(12)		(2)	25		622	
Energy	146						(1)		(7)	138	
Finance and insurance	580		(41)				(74)		(7)	458	
Consumer non-cyclical	79									79	
Technology and communications	25		1	4			(18)			12	
Industrial	39		1							40	
Capital goods	103		(1)	24					(7)	119	
Consumer cyclical	252		(1)	7	(3)		(1)			254	
Transportation	57						(1)			56	
Other	166				(10)		(3)			153	
Total U.S. corporate	2,000	(1)	(48)	101	(25)		(100)	25	(21)	1,931	
Non-U.S. corporate:											
Utilities	336		(4)					15	(14)	333	
Energy	195		(2)				(18)			175	
Finance and insurance	153	1	(3)	1			(1)		(1)	150	1

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Consumer non-cyclical	120		(1)			(11)			108	
Technology and communications	28		1			(13)			16	
Industrial	108		(1)	3		(5)			105	
Capital goods	186	1				(21)			166	1
Consumer cyclical	52				(1)	(3)			48	
Transportation	166		(2)	22			17		203	
Other	83		(1)						82	
Total non-U.S. corporate	1,427	2	(13)	26	(1)	(72)	32	(15)	1,386	2
Residential mortgage-backed	34		1	17		(1)		(17)	34	
Commercial mortgage-backed	6			28			13	(3)	44	
Other asset-backed	172		(1)	6		(24)	45	(32)	166	
Total fixed maturity securities	3,692	1	(62)	178	(26)	(197)	115	(88)	3,613	2
Equity securities	45			1					46	
Other invested assets:										
Derivative assets:										
Equity index options	60	8		15		(13)			70	8
Total derivative assets	60	8		15		(13)			70	8
Total other invested assets	60	8		15		(13)			70	8
Reinsurance recoverable ⁽²⁾	13	(1)							12	(1)
Total Level 3 assets	\$ 3,810	\$ 8	\$ (62)	\$ 194	\$ (26)	\$ (210)	\$ 115	\$ (88)	\$ 3,741	\$ 9

(1) The transfers into and out of Level 3 for fixed maturity securities were related to changes in the primary pricing source and changes in the observability of external information used in determining the fair value, such as external ratings or credit spreads, as well as changes in the industry sectors assigned to specific securities.

(2) Represents embedded derivatives associated with the reinsured portion of our GMWB liabilities.

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GENWORTH FINANCIAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Amounts in millions)	Total realized and unrealized gains (losses)										Total gains (losses) included in net income attributable to
	Beginning balance as of April 1, 2017	Included in net income	OCIPurchases	Sales	Issuances	Settlements	Transfer into Level 3	Transfer out of Level 3 ⁽¹⁾	Ending balance as of June 30, 2017	assets still held	
Fixed maturity securities:											
U.S. government, agencies and government-sponsored enterprises	\$ 1	\$	\$	\$	\$	\$	\$	\$	\$	\$ 1	\$
State and political subdivisions	37									37	
U.S. corporate:											
Utilities	578		13	30			30	(13)		638	
Energy	162		4				(7)	1		160	
Finance and insurance	818	4	39	24	(7)		(3)		(14)	861	4
Consumer non-cyclical	122									122	
Technology and communications	59		5	4					(10)	58	
Industrial	47		1	13						61	
Capital goods	153		2						(37)	118	
Consumer cyclical	263		4				(1)			266	
Transportation	97		4				(1)			100	1
Other	142						(3)	37		176	
Total U.S. corporate	2,441	4	72	71	(7)		(15)	68	(74)	2,560	5
Non-U.S. corporate:											
Utilities	386		3						(30)	359	
Energy	206		3						(32)	177	
Finance and insurance	168	1	4	4			(5)			172	1
Consumer non-cyclical	129		1				(1)			129	
Technology and communications	48									48	

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Industrial	110		2						112	
Capital goods	170		1			(15)		(7)	149	
Consumer cyclical	67								67	
Transportation	193		1	6			1	(11)	190	
Other	24		2	15					41	
Total non-U.S. corporate	1,501	1	17	25		(20)	1	(81)	1,444	1
Residential mortgage-backed	46		1				26		73	
Commercial mortgage-backed	59	(1)	2	8	(9)			(7)	52	
Other asset-backed	175	(7)	10	10	(35)	(5)	9	(7)	150	
Total fixed maturity securities	4,260	(3)	102	114	(51)	(40)	104	(169)	4,317	6
Equity securities	47			1					48	
Other invested assets:										
Derivative assets:										
Equity index options	77	13		9		(18)			81	
Other foreign currency contracts	1	(1)								
Total derivative assets	78	12		9		(18)			81	
Total other invested assets	78	12		9		(18)			81	
Reinsurance recoverable ⁽²⁾	15								15	
Total Level 3 assets	\$ 4,400	\$ 9	\$ 102	\$ 124	\$ (51)	\$ (58)	\$ 104	\$ (169)	\$ 4,461	\$ 6

(1) The transfers into and out of Level 3 for fixed maturity securities were related to changes in the primary pricing source and changes in the observability of external information used in determining the fair value, such as external ratings or credit spreads, as well as changes in the industry sectors assigned to specific securities.

(2) Represents embedded derivatives associated with the reinsured portion of our GMWB liabilities.

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GENWORTH FINANCIAL, INC.

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(Unaudited)

The following tables present additional information about assets measured at fair value on a recurring basis and for which we have utilized significant unobservable (Level 3) inputs to determine fair value as of or for the dates indicated:

(Amounts in millions)	Beginning balance included as of January 1, net 2018		Total realized and unrealized gains (losses) included in net income attributable to assets held		Transfer into Level 3 (1)		Transfer out of Level 3 (1)		Ending balance as of June 30, 2018							
	OCI	in income	OCI	in income	Purchases	Sales	Issuances	Settlements	OCI	in income						
Fixed maturity securities:																
U.S. government, agencies and government-sponsored enterprises	\$	1	\$	\$	\$	\$	\$	\$	(1)	\$	\$					
State and political subdivisions		37		1		(4)			18		52	1				
U.S. corporate:																
Utilities		574		(1)		(25)		69	(12)		(4)	25	(4)	622		
Energy		147				(5)		22			(19)		(7)	138		
Finance and insurance		626		1		(67)		26			(110)		(18)	458	1	
Consumer non-cyclical		81				(2)								79		
Technology and communications		73				(5)		4			(60)			12		
Industrial		39				1								40		
Capital goods		121				(9)		24			(10)		(7)	119		
Consumer cyclical		262				(10)		17	(3)		(12)			254		
Transportation		60				(1)					(3)			56		
Other		169				(1)		(10)			(5)			153		
Total U.S. corporate		2,152				(124)		162	(25)		(223)		25	(36)	1,931	1

Non-U.S. corporate:

Utilities	343	(13)	22	(20)	15	(14)	333
Energy	176	(6)	23	(18)			