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American International Group (AIG) Earnings Report: Q1 2016 Conference Call Transcript

The following American International Group conference call took place on May 3, 2016, 08:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Liz Werner; American International Group, Inc.; Investor Relations
- Peter Hancock; American International Group, Inc.; CEO
- Sid Sankaran; American International Group, Inc.; CFO
- Rob Schimek; American International Group, Inc.; Head of Commercial
- Kevin Hogan; American International Group, Inc.; Head of Consumer

Other Participants

- Jay Cohen; BoA Merrill Lynch; Analyst
- Randy Binner; FBR & Company; Analyst
- Josh Shanker; Deutsche Bank; Analyst
- Brian Meredith; UBS; Analyst
- Larry Greenberg; Janney Montgomery Scott; Analyst
- Josh Stirling; Sanford C. Bernstein & Company; Analyst
- Michael Nannizzi; Goldman Sachs; Analyst
- Jay Gelb; Barclays Capital; Analyst
- John Nadel; Piper Jaffray & Company; Analyst
- Meyer Shields; Keefe, Bruyette & Woods, Inc.; Analyst
- Paul Newsome; Sandler O'Neill Asset Management; Analyst
- Jimmy Bhullar; JPMorgan; Analyst
- Ryan Tunis; Credit Suisse; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the AIG first-quarter financial results earnings conference.

Today's conference is being recorded.

At this time, I'd like to turn the conference over to Ms. Liz Werner. Please go ahead.

Liz Werner (Investor Relations):

Thank you, Operator.

Before we get started this morning, I'd like to remind you that today's presentation may contain certain forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance or events.

Actual performance and events may differ, possibly materially, from such forward-looking statements.

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Factors that could cause this include the factors described in our first quarter Form 10-Q and our 2015 Form 10-K, under Management Discussion and Analysis of Financial Condition and Results of Operations and under Risk Factors.

AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our financial supplement and is available on our website, www.AIG.com.

Nothing in today's presentation or in any oral statement made in connection with this presentation is intended to constitute nor shall it be deemed to constitute any offer of any securities for sale or the solicitation of an offer to purchase any securities in any jurisdiction.

This morning, I'm joined by the members of our senior management team, including our CEO, Peter Hancock; our CFO, Sid Sankaran; Head of Commercial, Rob Schimek; Head of Consumer, Kevin Hogan; and our Chief Investment Officer, Doug Dachille. And so we will all be available during Q&A.

And at this time, I'd like to lead off with prepared remarks with Peter.

Peter Hancock (CEO):

Thank you, Liz. Good morning, everyone. I'm happy to report the tangible progress we're making as we deliver on our strategic plan. Across AIG, we're working hard to execute on a transformation that will lead to improved profitability and will best serve all our stakeholders. As we've been repositioning the Company, the support of our brokers, clients, and employees has been greatly appreciated and is essential to our success.

In the first quarter, we reported $0.65 of operating earnings per share, including market related losses of $0.48, largely due to hedge funds. Our market sensitive assets continue to decline, and Sid will speak to our progress to further reduce these asset exposures.

We're off to a solid start to the year; and in the quarter, we reduced expenses by 5% and returned $4 billion of capital to shareholders. As you can see on slide 3 and later in the presentation, our organizational improvements are proceeding on plan and we're on target to reach our $1.6 billion in gross expense reduction by 2017.

The steady pace of capital return continued throughout the quarter. Our strong capital and leverage ratios, attractive free cash flows, and risk management discipline allow us to execute on our plan to return $25 billion of capital to shareholders through 2017.

We are have also provided details on the key drivers of our normalized ROE improvement, including unusual items. It's important to note that normalized ROE may fluctuate from quarter to quarter, due to discrete tax items, as was the case this quarter.

Additionally, the seasonality of anticipated catastrophe losses may result in quarterly ROE volatility. These fluctuations should not meaningfully impact full year ROE and we expect our full year normalized ROE to be within our 8.4% to 8.9% targeted range. While we have seen market volatility impact our investments this quarter, the broader macro environment has not altered our focus or the direction of our strategic plans, as was evident in our continued pace of capital return.

Today, Rob will speak to the successful execution of our Commercial strategy in a competitive Property Casualty market. Kevin will elaborate on the value of the diversity of our Consumer business and, in

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particular, the strong earnings growth in Personal Insurance.

The accomplishments that I'm seeing across the organization are what make me most excited about our future. In my meetings with clients, I've found that we are viewed as trusted partners who provide solutions to their most complex risk management needs. We were recently recognized at the annual RIMS conference as the industry's number one carrier in National Underwriters Risk Management Choice Awards, a recognition of our industry leadership by our clients.

We also improved our competitive position within the group retirement market, given our investments in technology, which resulted in greater retention and positive net flows for the first time in two years. Internally, our organizational realignment has eliminated 95% of matrix reporting, which is energizing employees and resulting in faster decision making.

Finally, I'd like to mention the news last week of our planned joint venture with Hamilton Re and Two Sigma is consistent with our ability to take advantage of AIG's scale through new initiatives. The joint venture reinforces AIG's commitment to data science and targets the small to medium size enterprise market by combining AIG's expertise and data with Two Sigma's technology platform.

Before Sid addresses the financials, I'd like to add that we are actively managing our operating and legacy portfolios that we presented on our strategy update call. Our success in managing these two portfolios is measured by the ROE improvement of the operating portfolio and the reduction in capital retained in our legacy portfolio. Under Charlie Shamieh's leadership, the team is focused on execution and is off to a brisk start. We look forward to updating you on his progresses in future quarters.

We're confident that we're building on the first quarter's accomplishments and moving towards our strategic objectives. With that, I'd like to turn the call over to Sid.

Sid Sankaran (CFO):

Thank you, Peter, and good morning, everyone. This morning I'll speak to our quarterly financial results, progress on our expense initiatives, and our active capital management.

Turning to slide 4. Our core operating earnings showed good progress this quarter, with solid underwriting results in both Commercial and Consumer, as well as strong expense management. We also reported net favorable reserve development this quarter of approximately $60 million across Commercial and Personal Insurance.

Looking ahead, while we were only one month into the second quarter, our early estimates of losses from earthquakes in Japan and Ecuador, along with the Texas floods, are in a range of $200 million to $300 million, roughly split between our Commercial and Consumer portfolios. Also of note, UGC delivered another strong quarter, driven by improved loss experience and lower expenses.

Our reported operating tax rate was lower in the first quarter, at just over 19%, benefiting from the favorable resolution of certain tax audit items in the quarter. We continue to expect our 2016 accrued operating tax rate to be approximately 32%. As a reminder, our valuable deferred tax asset allows us to maximize free cash flow to our parent.

Slide 5 depicts the net investment income trends for interest and dividends and other market sensitive assets. Interest and dividends on our core investment portfolio has remained very steady, at over $3 billion per quarter. Investments that are effectively marked to market through earnings contributed to significant volatility in recent quarters and include hedge funds, PICC, and ABS CDOs, which were driven by credit spreads. These investments accounted for roughly $870 million of pretax operating losses in the first quarter.

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On our January strategy update call, we announced plans to reduce our hedge fund allocation by about half, freeing up $2 billion of capital towards our $25 billion capital return goal by the end of 2017. We kicked off our hedge fund strategy in 2015. As of quarter end, we had submitted notices of redemption for $4.1 billion of our hedge fund portfolio; and as of today, we have received $1.2 billion of proceeds from those redemptions.

Yesterday, we announced the sale of PICC Property Casualty shares for gross proceeds of approximately $1.25 billion that will result in a nonoperating pretax realized gain of nearly $900 million. This transaction will have a positive impact on dividends and tax sharing payments from subsidiaries, as well as book value per share, ex AOCI and DTA. In addition, we monetized $1.7 billion of legacy assets during the first quarter and $3.8 billion over the last two quarters.

We continue to make progress toward divestiture of UGC with the filing of our S-1 and we are on track to close advisor group this quarter. With actions taken to date, we are already at the low end of the $5 billion to $7 billion of divestitures that are funding part of our $25 billion capital return target.

Over the past four years, we've reduced our exposure to assets and derivatives that are effectively marked to market in earnings by approximately 40%. Future volatility will be reduced by the strategic actions with respect to the hedge funds and legacy portfolio that I spoke to.

Turning to slide 6, we're making good progress on our expense reduction efforts, with total general operating expenses down 5% from the same period last year on a constant dollar basis, reflecting the restructuring actions that we took in the latter part of 2015. In addition, we recognized another $188 million of pretax nonoperating restructuring charges in the quarter, which is largely related to the items announced in the second half of 2015. As a result of these actions, we expect our annual GOE run rate to decline by approximately $700 million to $800 million on an annualized basis, with the larger impact in the second half of 2016. We remain confident in our $1.4 billion net GOE reduction goal by 2017.

Slide 7 shows the improvement in our normalized ROE from a year ago, which, excluding this quarter's tax benefit, was 8.4%. ROE increased by over 1 point from a year ago, due to the nearly $12 billion of capital returned to shareholders in 2015, our focus on expense efficiency, and improvements in Personal Insurance underwriting.

Book value per share ex-AOCI and DTA and including dividend growth was essentially flat this quarter, at $59.05 per share, as shown on slide 8, and was negatively impacted by capital markets volatility, including net realized capital losses which totaled about $700 million after tax in the first quarter. Approximately half of those net realized losses were related to non-economic accounting volatility, resulting from differences in where we report the impact of FX on inter company liabilities versus the matching available for sale investments. The offsetting FX gain on the AFS investments is recorded in AOCI.

We also realized losses upon the sale of energy positions which, at the end of the quarter, represented roughly 5% of our total AFS portfolio. These Q1 items may result in a shortfall to our 2016 book value per share growth target; however, we still expect to achieve double-digit book value per share growth this year. Our ability to reach a three-year compounded 10% growth in book value per share will, in part, depend on capital markets and macroeconomic conditions.

Slide 9 shows our continued execution against our capital management targets. During the quarter, we deployed about $3.5 billion towards the purchase of approximately 63 million common shares, and we also repurchased $10 million of our outstanding warrants for $173 million. Since quarter end and through May 2, we repurchased an additional 870 million of common shares, which leaves about $3.7 billion unused under the $5 billion authorization that we announced in February.

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During the quarter, we issued $1.5 billion of five-year senior debt and $1.5 billion of 10-year senior debt. We created incremental economic value for shareholders through the completion of tender offers for approximately $800 million of purchase price of debt, which had a positive NPD. This leaves our financial leverage ratio at the end of the quarter at just shy of 20%, at the low end of our 20% to 25% targeted range that we spoke to on our strategy update call.

Our RBC and rating agency capital ratios continue to remain within our targets. In addition, at quarter end, we had $7.1 billion of parent liquidity. Our balance sheet remains very strong.

As Peter stated, we look forward to delivering on our strategic plan that we outlined in January and providing you with additional disclosure as we progress throughout 2016. Now with that, I'd like to turn the call over to Rob.

Rob Schimek (Head of Commercial):

Thank you, Sid. Today I'll begin my remarks on page 12, which highlights our first quarter and the progress we're making towards our targets.

Net premiums written declined 12% after adjusting for foreign exchange. The single largest driver of the decrease was the greater use of reinsurance, representing approximately half of the 12% decline. Casualty products exits in North America and our remediation efforts also contributed to the decline in the quarter.

Overall, we expect a decrease of approximately $2.5 billion in net premiums written in 2016, reflecting an increase in our use of reinsurance, along with exits from unprofitable lines. This is an increase from our previous $1.5 billion estimate and is consistent with our 4 points of expected accident year loss ratio improvement and an anticipated flat expense ratio.

We continue to experience new business growth and strong retention in profitable sub segments and will absolutely continue to grow in these areas. Consistent with our vision to be our clients' most valued insurer, we are investing in lines where we offer a compelling value proposition, such as D&O, cyber, M&A, multinational, and our large limit and middle market Property offerings.

Overall, US rates improved almost 1 point in the quarter, despite continued rate pressure in the Excess and Surplus lines Property business. US Casualty rates increased 3%, which is consistent with what we've seen in the past few quarters, and we expect that trend to continue. Rates were modestly positive for Financial lines in our Specialty businesses in the US. I would like to stress that we are thoroughly reviewing granular client retention metrics to differentiate our pricing strategy, based on account-by-account profitability.

Slide 13 shows the continued improvement in Commercial's adjusted accident year loss ratio between 2011 and the first quarter of 2016, including the effect of prior period development for each accident year, which we previously presented on our strategy call. While the first quarter result of 64.5% included higher than expected attritional losses in Property, it represents a 1.7 point improvement over the full year of 2015 and we are on track to reach our 62% exit run rate for 2016.

In March, we announced a two-year agreement under which a share of our new and renewal US Casualty business will be ceded to Swiss Re. We do not disclose the details of individual reinsurance agreements and the Swiss Re deal represents just one of a number of programs we have in place. We extend our thanks to all of our reinsurance partners with whom we are highly aligned for the confidence they have expressed in the continuing improving trend in our portfolio and in our leadership team.

Upon expiration of the existing agreements, we expect to have a more profitable book of business and to

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be well positioned to retain more business or renew our reinsurance agreements under terms at least as favorable as they are today. Collectively, we expect to cede approximately $1.5 billion in additional premiums related to quota share reinsurance in 2016, compared to the levels ceded in 2015. The expected 2016 average ceded loss ratio will be at least 5 points higher than 2015, and ceding commissions will continue to cover fully loaded costs for each deal, both individually and in the aggregate.

The first quarter accident year loss ratio does not reflect the full impact of reinsurance, as the benefit will grow each quarter over the next year. We expect that reinsurance will account for close to 2 points of our adjusted accident year loss ratio improvement by the end of 2017.

On February 2, we formally communicated to our distribution partners that we would no longer offer coverage in four specific underperforming portions of our North American Casualty and Environmental book. By exiting these few highly targeted areas, we have the ability to significantly improve profitability, as well as refocus our energy and technical expertise towards industry segments and client partnerships that are mutually beneficial.

Moving to our risk selection strategy. We achieved improvements in US Casualty and US Property, as we continue to optimize our mix of business and accelerate the use of underwriting, pricing and analytic tools.

With respect to our strategy of sharpening our focus on valued clients, you will recall that in 2015, approximately 83% of our US Casualty clients purchased only one or two products and that some of those relationships were unprofitable. This represents approximately 15% of total US Casualty premiums, and we successfully remediated the majority of this business as it came up for renewal in the first quarter.

The top of slide 14 shows the adjusted accident year loss ratio for each sub segment that made up our $20 billion of net premiums earned in 2015, which falls into three product sets, grow, maintain or improve, and remediate. The bottom of the page shows the change in size and the accident year loss ratio for each portion of the portfolio for the full year 2015 and the first quarter of 2016. For the first quarter of 2016, we measured size based on net premiums written, which is a leading indicator of our progress, since the benefits of our recent actions will emerge in net premiums earned as the year continues.

I will highlight four key observations for you on this page. First, I'm extremely pleased with the portfolio's change in mix of business. The grow and maintain portion of the business has increased from 50% of total premiums in 2015 to 59% of premiums in the first quarter, while the business we are remediating in Product Set 3 decreased from 15% of the portfolio to 9% over the same time period.

The second observation is that in addition to reducing the size of Product Set 3, the accident year loss ratio for this worst performing portion of the business improved significantly, from 91% for the full year 2015 to 86% on an earned basis in the first quarter, driven mostly by the North American Casualty and Environmental exits. My third observation is that the improved portion of Product Set 2 declined from 35% of total premiums in 2015 to 32% of premiums in the first quarter, while we improved the accident year loss ratio on an earned basis by 5 points, from 73% to 68% over that same time period. These changes were primarily the result of our client and risk selection strategies and the expansion of reinsurance.

Finally, my fourth observation is that our progress will not always be linear, due to market conditions, short tail losses, and other issues outside of our control. Product Set 1 declined in size from 15% of total premiums in 2015 to 13% of premiums in the first quarter, and the accident year loss ratio increased from 41% to 48% during that time, driven mostly by International Property.

The accident year loss ratio for Product Set 1 still remains very strong and, as I mentioned earlier, investing in growth areas is a fundamental part of our strategy. We are deploying a disproportionate

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amount of our resources to teams focused on Product Set 1 to anticipate product needs and foster innovation to create value for our clients.

Our strategy is best characterized as one of focus and pace. We've moved quickly to concentrate our efforts on growing our strongest performing business and our most valued relationships, while continuing to invest in data analytics, innovation, and engineering to help our clients better mitigate risk.

In closing, we took a number of significant actions to improve Commercial's performance for the year. Although there's a lot more work to do, I'm confident that we're headed in the right direction and we're on target with the goals we've communicated.

With that, I'd like the to turn the call over to Kevin.

Kevin Hogan (Head of Consumer):

Thank you, Rob, and good morning, everyone. This morning, I'll provide an update on the Department of Labor's final rule and discuss the operating performance of our Consumer businesses.

Beginning with the final Department of Labor fiduciary rule, published on April 8, the initial compliance date is April 10, 2017, with full compliance required by January 1, 2018. We are currently reviewing this final rule to evaluate its full impact on our customers, distribution partners, financial advisors, and our business, while continuing to prepare for compliance with the rule.

We remain in active discussions with our distribution partners to be in the best position possible to meet the evolving needs of retirement savers. We plan to continue to offer a broad product portfolio through our diverse distribution network to meet the growing needs of consumers for guaranteed lifetime income and other savings solutions.

Turning to retirement results on slide 16, it was a strong quarter for retirement sales, with 24% growth from a year ago, led by fixed annuities and retail mutual funds. Sales continue to benefit from our multiple product and distribution channel strategy, as reflected in our well diversified base of assets under management.

Market volatility during the quarter resulted in a flight to quality and increased investor appetite for fixed annuities. While risk-free rates declined, credit spreads were robust, allowing us to provide attractive overall rates while still maintaining our pricing and asset quality disciplines.

Net flows for retirement this quarter improved both sequentially and year-over-year, and notably were positive for each one of our product lines, reflecting the strength of our distribution platform. The positive net flows in Group Retirement reflect our ongoing investments to enhance both our planned sponsor service and participant experience.

As you can see on slide 17, we continued to maintain our discipline in managing crediting rates and net spreads. Looking forward, absent significant changes in the overall rate environment, we continue to expect our base yields will decline by approximately 2 basis points to 4 basis points per quarter.

In Life, as shown on slide 18, we saw growth in premiums and deposits of 4% from the same period last year on a constant dollar basis. Mortality trends continued to be in line with our expectations. We saw good growth in US Life sales from the same period last year, reflecting the evolution of our distribution strategy and further development of our independent distribution channels.

We are also making progress in executing on our plans to finance our remaining redundant reserves, with a series of reinsurance transactions that will improve the returns in that portfolio and allow for increased distributions to parent. We will provide you with updates on these transactions as they are completed.

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Turning to slide 19, the first quarter was very strong for Personal Insurance, with $222 million of pretax operating income. We saw significant improvements in the accident year loss ratio in the US, which primarily related to US Personal Property, which experienced fewer large claims and generated an increase in premiums.

We also continued to see strong premium growth in our Private Client Group in the US. Net premiums written for PCG were up 13% from the same period last year, with nine consecutive months of double-digit growth.

We also continued to make progress on the expense front in Personal Insurance, and we are seeing benefits from our strategy to narrow our focus to 15 countries for individual Personal Insurance products, while continuing to serve our multinational partners. In addition, we are seeing the results of our overall organizational expense initiatives.

Japan delivered a meaningful part of the acquisition cost and GOE savings this quarter, and acquisition costs benefited from our efforts to reposition direct marketing in Japan. While we continue to expect that expenses will be the key lever to future margin expansion in Personal Insurance, progress will not be linear quarter to quarter, due to the nature of our ongoing investments. With respect to Japan, we remain focused on the successful execution of the merger, as we have previously reported.

To close, while we have already experienced some catastrophe and severe loss events, as Sid highlighted, that will impact Personal Insurance operating results in the second quarter, we remain focused on continued execution of our strategic priorities across all of our Consumer businesses. Now I would like to turn it back to Liz to open up the Q&A.

Liz Werner (Investor Relations):

Thank you. Operator, before we open the line, I just want to remind everybody that, similar to past quarters, we'll take one question and one follow-up, and then we'd ask that you please get back in queue so that we can answer as many questions as possible. With that, I will begin the Q&A.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions)

Jay Cohen with Bank of America.

Jay Cohen (Analyst - BoA Merrill Lynch):

Yes, thank you. Just one question on the Personal Insurance. You talked about the A&H business being restructured. What's going on in that business? What kind of premium decline should we be expecting going forward?

Sid Sankaran (CFO):

The A&H restructuring has been undertaken for the last couple of years, Jay, and I think what we're seeing in A&H is a combination of foreign exchange effects, particularly in the international business, which is the bulk of that business, and it is the faster growing part of that business. So in particular, in the United States, in the Travel business, we have focused on a sustainable and competitive position there and we believe that recent market developments are likely to ensure that our position is the one that our distribution partners will be choosing.

Jay Cohen (Analyst - BoA Merrill Lynch):

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Thanks. That's helpful. And then just a follow-up question for Rob. Rob, obviously you've got ambitious goals this year in the Commercial side. As you look at the first quarter, can you talk about -- and I know this is not going to happen in a linear fashion -- but can you talk about the progress you made in the first quarter relative to what you had expected and where you are at this point?

Rob Schimek (Head of Commercial):

Okay. Sure, Jay. I'll say that overall I'm quite pleased with where we were in the first quarter. I would say that our progress with respect to reinsurance was better than we had anticipated. Our progress with respect to the longer tail lines, Casualty in particular, was better than we had expected. But our progress with respect to shorter tail lines, Property was the area that I think that we didn't live up to my expectations. And in particular, that was with respect to attritional losses in the US.

I'm very confident that the team has some good strategies and a great plan for what we'll do to address that in 2016. But overall, I'm quite pleased with the progress.

Operator:

Randy Binner with FBR Investments.

Randy Binner (Analyst - FBR & Company):

Thanks. Just up couple on Commercial lines. Just to get the numbers right on the Swiss Re, I think you said that there would be $1.5 billion ceded relative to 2015 and the decrease in this quarter's top line in Commercial lines was attributed to the Swiss Re deal. So is the Swiss Re deal something like $1 billion ceded off of gross? Is that the right way to think of it? So that would be 66% of it, and the remaining 33% would be something that you would try to negotiate over the balance of 2016.

Rob Schimek (Head of Commercial):

I want to make sure that I say this for you as clearly as possible. First of all, I don't want to comment about Swiss Re specifically. Let's just talk about reinsurance transactions overall.

So what I said in my prepared remarks is that we expect to see $1.5 billion of additional premiums related to quota share in 2016 compared to the 2015 levels. So we already were using quota share in 2015. The increase from all reinsurance transactions, Swiss Re and other during 2016, we expect to increase the amount that we cede by $1.5 billion.

So as we write business throughout the course of 2016, a piece of the business that we write in 2016 will attach to this quota share reinsurance agreement. And you should think of it as that premium volume on a net written premium basis will decline, but it won't affect earned premium until those premiums earn in over the course of the next year, after the date they've been written.

So for example, premiums written on December 31, 2016 will be covered by a reinsurance agreement that was covering the year 2016 on a quota share basis, but those premiums won't be fully earned until December 31, 2017. So you'll feel the full effect of that in our income statement across the -- really across a year after the premiums have been written. I hope that's helpful.

Randy Binner (Analyst - FBR & Company):

It is. And then just the follow-up in Commercial Lines still, you mentioned there was reserve redundancies in the quarter. Can you give any color on what line of accident years that was related to? I'm just curious how that might have related to some of the adverse development we saw in the fourth quarter.

Sid Sankaran (CFO):

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I'd point you to the 10-Q, the main item that I'd probably call out is we're favorable in both Commercial and Consumer, Commercial mostly driven by Specialty; and in North America, there was a slight negative. But that negative was related to reinsurance adjustments in Property. So it was not related to any long tail lines.

Operator:

Josh Shankar with Deutsche Bank.

Josh Shanker (Analyst - Deutsche Bank):

Thank you for taking my question. Sid, in his prepared remarks, said that there were about $4 billion in hedge fund redemptions set and 1 point something has so far been received. How does that compare to the $2 billion capital plan? What are the relationship between those two numbers exactly?

Sid Sankaran (CFO):

I think the main thing you need to look at is, with respect to what we've put in notice for redemption, that typically the capital charge for those assets is roughly 50%, or even slightly north of that. So take the $4 billion and apply the capital charge and that gives you a sense of what you think the capital impact should be.

Josh Shanker (Analyst - Deutsche Bank):

And the second question is given the reinsurance transactions in the quarter, what were the impacts that they had on first quarter loss ratio and expense ratio, given where you would have been if those transactions had not been put in place?

Rob Schimek (Head of Commercial):

They're minimal. They're minimal because we've not earned much of that premium in the first quarter.

Operator:

Brian Meredith with UBS.

Brian Meredith (Analyst - UBS):

Yes, thanks. A couple questions here. First one, Rob, I'm just curious, the growth coming from Property lines, and if you look at broker service and stuff, that's been the most competitive line of business out there, can you describe your Property book, where you're growing and why we shouldn't be concerned that you're growing in what the brokers are saying is the most competitive line?

Rob Schimek (Head of Commercial):

First thing I'll do is I'll acknowledge and reaffirm that that is the most competitive line. You'll notice when I commented about rates, I said that Property rates in the US were down in the first quarter, and that's actually been a continuing theme over the course of the last two years, at least.

Our growth in Property has been focused on the highly engineered space. As we mentioned previously, we've increased the number of engineers on our team today to be approximately 700 engineers worldwide. Most of those engineers support our Property business, but not solely our Property business. And actually today, we have more engineers than underwriters in the US Property market.

So when we're growing in Property, what we're doing is transforming our book from being one where we were a capital provider amongst many to instead being a risk management partner with our clients,

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where we're using our engineering capability to reduce the likelihood of a loss in the first place.

And so our growth in that area is in the Large Limits Property space and in the middle market Property space, where engineering is the backbone of the business that we're writing. We're shrinking in the traditional Excess and Surplus lines shared and layered Property business.

Brian Meredith (Analyst - UBS):

Got you. Then just a follow-up to that on the Property. Would that carry lower attritional loss ratios, those engineered lines, and maybe more volatility to them?

Rob Schimek (Head of Commercial):

We expect those engineered lines to carry lower attritional loss ratios, yes.

I'll just add that we also use reinsurance as a tool in the Property space. And we'll continue to look at opportunities for reinsurance in the Property space to manage severe losses, as well as, of course, to manage our natural catastrophe exposures.

Operator:

Larry Greenberg with Janney.

Larry Greenberg (Analyst - Janney Montgomery Scott):

Good morning. So Rob, the increase in the reduction of premium in Commercial to $2.5 billion from $1.5 billion for this year, I assume a big part of that increase is coming from reinsurance. But just any color on the breakdown of that?

Rob Schimek (Head of Commercial):

That is really completely from the increase in use of reinsurance. I think I'd just so that the reinsurance market has been more robust than we had initially anticipated and, as you know, we're viewing our reinsurers as partners. We have excellent relationships and opportunities to succeed together. But ultimately, the business that we're ceding to those reinsurers is improving our mix of business.

And ultimately not passing business that is poor business from AIG to our reinsurers, but instead the reinsurers, I think, find the business that we're ceding attractive for a number of reasons, including the fact that, in many cases, they're holding less capital against the business than we are. And many of our reinsurers also have a lower targeted return level than AIG has.

And then of course, I think that the reinsurers really believe in the underwriting actions that we've taken. So those are the things that I think have created the increase in use of reinsurance, and that's the primary driver of the increase.

Larry Greenberg (Analyst - Janney Montgomery Scott):

Great. And then just one follow-up for Sid. Since you are reporting the DIB and GCM in the other asset line, we're getting less disclosure on that. And I'm just wondering if you could give us what the equity is today in the DIB and GCM and perhaps some numbers on how much in ABS CDOs are held there.

Sid Sankaran (CFO):

Yes, I think that I would point you to -- we don't give that disclosure on the DIB and GCM anymore -- but the large bulk, as we've said, of the equity in DIB and GCM is in the ABS holdings. And that number

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typically, although it changes in terms of mark to market, is in the range of $2.5 billion to $3 billion.

Operator:

Josh Stirling with Sanford Bernstein.

Josh Stirling (Analyst - Sanford C. Bernstein & Company):

Hello. Good morning. Peter, thank you for taking the question. Appreciate all the color and update on the operating initiatives. Obviously, it's great to hear about all the progress.

I'm wondering if you'd be willing to speak to a higher level question, if you think strategically, it's been a couple of months since you folks announced the new strategy and announced that you'd accept some activists joining your Board. I'm wondering if you can update us a bit on your conversations within the group, as well as your general thinking on some of the big strategic questions, like remaining a SIFI in light of the MetLife court victory or how you're thinking on divestitures as evolving as your businesses become more modular.

And I ask both of these, in particular, I think, because you said you'd very much like to beat your $25 billion capital return goals over the next two years. And I imagine that you're probably going to have to consider additional divestitures or maybe pursue a path to de-SIFI to achieve that.

Peter Hancock (CEO):

I think that as we've indicated, the $25 billion goal is achievable with all of the actions that we've laid out. So I would say that there is a contingency against adverse market environment baked into our plan. So I do not think that being a SIFI in any way inhibits that $25 billion goal. It's not the binding constraint at all.

But I think that the MetLife decision certainly raises the opportunity, should it be favorable, to consider that down the road. But I repeat that our current designation as a non-bank SIFI does not constrain our objectives as laid out in our strategic update. We are watching very carefully the appeal process and we point to the efforts that we've made as a Company to delever the Company, to derisk the Company, since the crisis.

And so I think that any designation by FSOC around non-bank SIFI status should look at the metrics relative to others to show what we've done to delever the Company. So I think that we have great confidence that our plan to improve operating margins, to return capital to shareholders, will deliver expansion in ROE in our operating portfolio; and the thoughtful divestiture of the legacy assets in an orderly way will realize the optimal balance between book value growth and ROE expansion.

Josh Stirling (Analyst - Sanford C. Bernstein & Company):

That's helpful, Peter. I'm wondering, Rob, if just tactically, we've had a lot of conversations about reinsurance. And I really love your guys' slide on page 14. I'm wondering if we could set reinsurance aside for a second and just think about gross or a primary, an ex-reinsurance view of the business. Can you give us any kind of metrics we can hang our hat on around the amount of pricing you're taking in the worst businesses or the ultimate, the amount of size that you expect the remediate or the improved bucket to be, as you look out over the next year or two?

Rob Schimek (Head of Commercial):

One thing I think I would say to you, Josh, is we will likely show you a version of slide 14 at the end of the year that's recalibrated to what did 2016 look like. We'll show you the best 15%, the worse 15%, and then

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the middle part of the portfolio.

I clearly believe that what you should expect is that for the business that we hold on our books in 2015 that we've been working on remediating, you should continue to see Product Set 3 significantly reduce in size. And as we've said we would, we've taken clear action to exit specific underperforming products and client relationships. But remember, we can only do that as those policies come up for renewal with proper notification, in accordance with the state laws and regulations.

We've also given our underwriters better tools to help them make good judgments in their underwriting decisions. And I think all of those things should continue to show that Product Set 3 will decline in size and the loss ratio will improve. Product Set 2, the middle part, I think you'll continue to see growth in the maintain side of Product Set 2, and you'll see us continue to improve both the loss ratio and reduce the size of the improved side of Product Set 2. But we do expect to grow in Product Set 1.

I think that reinsurance is really serving to help us in Product Set 2, more than anything, and that's the place -- what you should understand is really our actions to exit and our actions to remediate that are driving down the volume in Product Set 3, and you should also expect that we'll continue to disproportionately put our resources toward a growth in Product Set 1.

But I think we'll continue to try to find ways to help you to have better transparency into the performance of the portfolio, using a slide like slide 14 going forward.

Operator:

Michael Nannizzi with Goldman Sachs.

Michael Nannizzi (Analyst - Goldman Sachs):

Thanks so much. Rob, you guys talked about Commercial overall, but you didn't really drill down into North America specifically. There we did see nice margin improvement, a couple hundred basis points, and premiums were down there 25%. One question I have is, of the 400 basis points to 600 basis points of margin improvement that you're targeting, what proportion do you expect to come from North America versus International? And is the North America piece where the reinsurance and non renewal has a more disproportionate impact?

Rob Schimek (Head of Commercial):

You were correct on pretty much everything you said. The reinsurance is focused much more around North America. The remediation efforts are focused much more around North America. And to be specific, focused much more around the United States. We continue to see great opportunities for growth and we see that the profitability in Canada in North America feels good.

I will say with respect to international, really our bigger challenge in international is around expenses. The loss ratios in our international business, I feel good about. We need to continue to make sure that we can deliver those loss ratios with an efficient structure that will keep our expense ratios at a manageable level.

Michael Nannizzi (Analyst - Goldman Sachs):

So in terms of the loss ratio, the severe losses ticked up year-over-year. Was that, for you, an unusual level of severe losses or is that something you expect should continue in that range?

Rob Schimek (Head of Commercial):

Really expect -- first of all, severe losses overall were pretty much in line with our expectations. We do

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expect that severe losses will be lumpy quarter to quarter, and we do think that they'll be lumpy from geography to geography. With that said, we continue to be keenly focused on severe losses in the international portfolio to make sure that we're managing that effectively. But quite frankly, I think we think of it on an overall basis and we were satisfied with severe losses during the quarter.

Operator:

Jay Gelb with Barclays.

Jay Gelb (Analyst - Barclays Capital):

With regard to the share buyback, if I was looking at what a ratable level of share buybacks would have been over each quarter for two years, I was looking at around $2.75 billion. In the first quarter, that came in at $3.5 billion. Does that mean that AIG's just pulling forward the pace of the buyback or, based on my math, it looks like return of capital at that current pace could be slightly over $30 billion over the two years?

Sid Sankaran (CFO):

Well, Jay, we don't really comment on our timing of capital return. I would just point you to, obviously in the first quarter, we had very strong share repurchase. But in addition, two items of note, we did also generate incremental net present value via our debt tender, and that obviously impacted our use of capital, as well as the warrants. We expect that we're not likely to follow any form of metronome in terms of the timing of share repurchase. It will vary, based on what we see as relative value quarter to quarter as we return capital and hit our $25 billion target.

Jay Gelb (Analyst - Barclays Capital):

In the past, you've said at least $25 billion. I just want to make sure that's still the case.

Sid Sankaran (CFO):

At least $25 billion. That's correct.

Jay Gelb (Analyst - Barclays Capital):

All right. And then Sid, are there any signs of a recovery in the alternative asset income in 2Q? That was a $900 million drag on results in the last quarter. Are you seeing any signs of recovery so far in 2Q?

Sid Sankaran (CFO):

It's a little too early to tell right now, Jay. Obviously, we'll have a better sense as the different indices provide their results to us shortly.

Peter Hancock (CEO):

I think the important thing to remember is that our strategy is to reduce our reliance on those alternative earnings over the course of the next 18 months. And so as you look at the exit run rate of ROE of the operating portfolio at the end of 2017, you don't need to factor in any over reliance on alternative assets as a source of net investment income.

Operator:

John Nadel with Piper Jaffray.

John Nadel (Analyst - Piper Jaffray & Company):

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Thank you. Good morning. A question for Rob. I just wanted to follow up on a couple of quick data points here. The accident year loss ratio in Commercial, I believe you indicated that the reinsurance deals to date really had no significant impact on that. But you expect, over the course of the next year, it has about a 2 point positive swing. Is that right?

Rob Schimek (Head of Commercial):

That's correct. And by the end of 2017, John, it will have about a 2 point improvement in the adjusted accident year loss ratio. And remember, the reason that that's the case is because the business that we write late this year won't be fully earned until late next year.

John Nadel (Analyst - Piper Jaffray & Company):

Understood. And then so if we look at under the hood at the other pieces, you mentioned that attritional losses on the Property side were higher than you would have otherwise expected. When you look at the rest of the Commercial business, were there areas where you feel like you just outperformed relative to your expectations?

Rob Schimek (Head of Commercial):

Continue to be very pleased with the performance of our Financial lines book of business. Really was quite happy with what we did in the Casualty space. That team has been working very hard over a long period of time. I'm quite proud of what our result are that we've achieved there.

So I think that the combination of tools that we've developed, the discipline of the underwriters, and the use of reinsurance all bode very well for what the outcome will be for us for the longer tail Casualty business. We're really focused at this point in time on improving the attritional losses in the Property book.

Operator:

Meyer Shields with KBW.

Meyer Shields (Analyst - Keefe, Bruyette & Woods, Inc.):

Thanks. Let's start with a question for Sid. Is there any way of getting a handle of how much the capital charge is likely to go down for P&C, assuming that the year-over-year improvements in both reserves and accident year results continue?

Sid Sankaran (CFO):

Yes, I think we don't disclose that, but I think you're really likely to see, based on the shift in mix in Rob's business, that the other liability line in the Property Casualty companies, which have obviously the highest RBC charge, that shift in business is going to drive that component of our RBC charge down.

Meyer Shields (Analyst - Keefe, Bruyette & Woods, Inc.):

Okay. And Rob, can you talk a little about the decline in the proportion of net written premiums from Product Set 1? Is that seasonality or is that the disappointment you were alluding to?

Rob Schimek (Head of Commercial):

I guess the way I want you to think about Product Set 1 is just remember that as you would likely expect, we're using internal tools and metrics to inform the underwriting actions in each of these product sets. And while in general we want to grow Product Set 1, we're guided by our return on equity and our RAC

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spread for each of these products in any given Product Set.

So during the first quarter, we did grow well in businesses such as cyber and M&A that are parts of Product Set 1. But we were disciplined in the highly competitive International Property market, where we were guided by our ROE and our RAC metrics.

Operator:

Paul Newsome with Sandler O'Neill.

Paul Newsome (Analyst - Sandler O'Neill Asset Management):

I guess my name changed. But he was better looking. I have a couple of questions. One relates to the hedge funds. As I think through next quarter's results, from my expectations, I assume, it looks like because there's a lag in how you and everybody else reports the hedge funds and alternatives, that essentially the first quarter hedge fund results will be your second quarter results.

The piece that I'm not so certain about is the impact of the redemptions that have happened so far and whether or not the redemptions themselves will change how much of the results in the third quarter -- in the second quarter, given that you report the hedge funds and alternatives on a lag.

Sid Sankaran (CFO):

Yes, I would just make two quick points. The lag impact, obviously, is a short lag, so we wouldn't anticipate a very material impact. And it's on a portion that's obviously on the equity method.

The second point is we gave you our estimate of about $1.2 billion of proceeds. So you can think of that as a reduction in our overall hedge fund exposure and assume that that's reinvested, as we told you before, in high grade, investment grade bonds and some real estate.

Rob Schimek (Head of Commercial):

And more than half of the $1.2 billion came in April.

Sid Sankaran (CFO):

That's right.

Rob Schimek (Head of Commercial):

Of the redemption proceeds. So well in excess of half that $1.2 billion was received from redemptions that took place in April.

Paul Newsome (Analyst - Sandler O'Neill Asset Management):

So it should have an impact. And then I have an unrelated question about the Property Casualty business. Obviously, the mix is going more towards Property, less towards liability. As I think of it, my model, does that also mean that we should think about a higher cat load as a percent of premium prospectively, as the mix changes toward more Property?

Rob Schimek (Head of Commercial):

Well, I guess I would I say that our overall cat load I expect to come down. Obviously, as the mix of business changes, it will just be proportionate to the total book of business. But I want to emphasize that we're actually bringing our cat load down for the entire portfolio. At the same time, remember that some of our lines, for example, Financial lines and Specialty, are continuing to demonstrate growth. So you

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should expect to see growth in Financial lines, growth in Specialty, and you'll continue to see us decline the total amount of cat load across the portfolio.

Peter Hancock (CEO):

And I think that this is a continuation of a rebalancing of our Property portfolio that has been going on for five years, which is to de-emphasize the over-concentration in Gulf cat exposed Property and take advantage of the diversity of our geographic global reach, as well as the investments we've made in highly engineered Property and middle market, where it's really avoided the concentrated risk that is prevalent in the shared and layered market that was in the Property book five years ago.

So I think this is a continued diversification of the Property book to reduce the PML and AAL in a steady way. And obviously, the soft reinsurance market helps even more to iron out any concentrations.

Operator:

Jimmy Bhullar with JPMorgan.

Jimmy Bhullar (Analyst - JPMorgan):

Couple of questions. First, Rob, you spoke in detail about your expectations on the loss ratio. Can you talk about the expense ratio in the Commercial business over the next couple of years?

Rob Schimek (Head of Commercial):

I'm really pleased with the progress we're making on the expense ratio. We participate as a part of the broader AIG expense initiatives, which really has been underway for quite some time. And so as you can see here, even in the first quarter, what's happening is the expense reductions that began previously are actually happening in front of the reduction of premiums that we're experiencing on a net earned basis. And so it is our intention to continue to maintain a flat expense ratio as we continue to manage the overall book in the Commercial space.

Jimmy Bhullar (Analyst - JPMorgan):

So basically, as premiums are coming down, you shouldn't really expect an improvement in expense ratio, but maybe overall expenses stay somewhat flat?

Rob Schimek (Head of Commercial):

That's right. I think what happens is -- I think expenses will decline, to be clear. I think that the expense ratio will be relatively flat. And again, just to be clear, when we are doing reinsurance on a quota share basis, we're receiving a ceding commission that is covering our fully allocated costs on both a deal-by-deal as well as on an overall basis across all of these quota share reinsurance agreements. So as the premium volume comes down, we're also reducing the expenses proportionally.

Operator:

Ryan Tunis with Credit Suisse.

Ryan Tunis (Analyst - Credit Suisse):

Thanks. Good morning. Just taking a step back, looking at slide 14, clearly there's a lot of moving parts here, thinking about what we're run rating at versus what's earning in this quarter. The reported accident or loss ratio in Commercial is 64.5. But if we look at it on the written basis, it looks like it's closer to 63, which would be about 75% of the way there to the 4 points you said you think you can get and we're only

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a quarter into this. Is that the right way to think about it or would you caution us against that in any way?

Rob Schimek (Head of Commercial):

I guess I wouldn't caution you against it. We'd just state that I think that we're on target, and I don't want there to be any expectation beyond that at this point.

What I think is important to understand on page 14, and I said this in my prepared remarks, the premium that we're showing for 2016 is on a net premiums written basis. But the accident year loss ratios that you're seeing are on an earned basis. And so the earned accident year loss ratio, for example, that you're seeing in Product Set 3 of 86% includes any of the premium that was earned in the first quarter for that Product Set, regardless of when it was written.

And so I just would caution, it's very difficult for you to make any particular assumptions that we're anything other than on target at this point in time.

Ryan Tunis (Analyst - Credit Suisse):

Okay. Understood. Just on Product Set 1, 7 points of accident year loss ratio deterioration there. Just curious how much of that would you attribute to pricing pressure, rate headwinds, versus elevated attritional losses? Thanks.

Rob Schimek (Head of Commercial):

It's really all International Property. And the International Property book actually last year had particularly low loss ratios. So it's a combination, I think, of increased rate, rate pressure for Property on a global basis, but also just that we performed particularly well in 2015 in the International Property space.

So I'm not concerned about the increase in the loss ratio that you're seeing there for Product Set 1. With that said, we focus on both the size of Product Set 1 and maintaining a strong performance from an underwriting perspective in that, as well as all the other product sets.

Liz Werner (Investor Relations):

Operator, I'm afraid that we're going to have to follow up with whoever is left in the queue. We're over our allotted hour. So if it's possible, please reach out to me directly, and hopefully we can catch up with everybody and make sure we get to everyone's questions this morning. And thank you all for dialing in.

Operator:

This does conclude today's conference.

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