Q2 2019 Earnings Call

Company Participants

- Brian Duperreault, President and Chief Executive Officer
- Douglas A. Dachille, EVP and Chief Investment Officer
- Elizabeth Werner, Vice President, Head of Investor Relations
- Kevin Hogan, EVP and Chief Executive Officer, Life and Retirement
- Mark Lyons, Executive Vice President and Chief Financial Officer
- Peter Zaffino, Chief Executive Officer, General Insurance and Global Chief Operating Officer, AIG

Other Participants

- Elyse Greenspan, Analyst
- Jay Gelb, Analyst
- Joshua Shanker, Analyst
- Mike Phillips, Analyst
- Tom Gallagher, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Good day, and welcome to the AIG's Second Quarter 2019 Financial Results Conference Call. This conference is being recorded. And now at this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead.

Elizabeth Werner {BIO 1557593 <GO>}

Thank you, Jake, and good morning, everyone. Today's remarks may contain forward-looking statements, including comments relating to Company performance, strategic priorities, business mix, and market conditions. These statements are not guarantees of future performance or events and are based on management's current expectations. Actual performance and events may materially differ. Factors that could cause results to differ include the factors described in our first quarter 2019 Form 10-Q, our 2018 Annual Report on Form 10-K, and other recent filings made with the SEC. 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.

Additionally, some remarks may refer to non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our earnings release, financial supplement, and slide presentation, all of which are available on our website, www.aig.com.

This morning, you'll hear prepared remarks from our CEO, Brian Duperreault; our COO and CEO of General Insurance, Peter Zaffino; our CEO of Life and Retirement, Kevin Hogan; and our CFO, Mark Lyons. During the Q&A, we ask that you limit your questions to one and with one follow-up.

And at this time, I'd like to turn the call over to Brian.

Brian Duperreault {BIO 1645891 <GO>}

Thank you. Good morning, and thank you for joining us to review our second quarter results. As we continue to position AIG for long-term sustainable and profitable growth, disciplined execution of our strategy is reflected on our strong performance in the second quarter and first half of 2019.

Adjusted return on common equity for the second quarter was 10.4% and 11% year-to-date. Adjusted after-tax income was $1.3 billion or $1.43 a share for the second quarter and $2.7 billion or $3.01 per share year-to-date, nearly $1 per share improvement over the first half of 2018. Throughout the first half of 2019, we remained focused on the foundation work that continues across AIG, particularly in General Insurance, which delivered a second consecutive quarter of profitability with an accident quarter combined ratio including actual CATs of 98.7% or 96.1% as adjusted. Calendar quarter combined ratio was 97.8%.

The turnaround in General Insurance which has been led by Peter Zaffino and his team is impressive. AIG is taking a leadership position in its approach to disciplined underwriting and innovative reinsurance strategies and we have strong momentum heading into the second half of 2019. I can confirm that we expect to achieve underwriting profitability for the entire year. Peter will provide more detail in his remarks on the significant progress being made in General Insurance.

With respect to premium rate trends, I want to follow-up on my comments from the first quarter. Rate increases accelerated in the second quarter, in some cases materially. I've seen a number of market cycles and each one has different characteristics. I would describe this market as one where there was more underwriting discipline and rigor around the deployment of capacity, rather than a major decline in capacity. That discipline seems to be playing out through the pricing models and underwriting processes that are recognizing increased loss cost frequency toward environment and other emerging risks. To me, that means the turn is based on facts, rather than an emotion, and is therefore more sustainable.

With respect to AIG, we are seeing strong rate improvement across most of our global portfolio. In addition to industry dynamics, rate increases reflect our comprehensive and disciplined strategy to reposition our businesses as market leaders by refining our risk appetite, significantly reducing gross and that limits tightening terms and conditions and reducing capacity in certain areas. Peter and Mark will provide more details on rate in their comments.

Life and Retirement also had a solid quarter, posting a 17.3% adjusted return on common equity due to continued discipline and execution of its strategy as well as strong private equity returns and favorable market performance. Equity markets remain highly volatile and unpredictable and as a result, we are not changing our 2019 guidance for Life and Retirement of full year adjusted return on common equity in the low to mid teens. Kevin will provide more additional information on Life and Retirement. Net investment income was $3.7 billion in the second quarter, reflecting strong performance in the equity markets and tightening spreads in the credit markets, as well as a significant gain on private equity investments. Mark will provide more detail on our overall financial results later in the call.

Since I arrived at AIG, we have focused on addressing several critical areas, including refining our approach to underwriting, reducing our risk profile, overhauling our reinsurance strategy to reduce volatility, making our General Insurance business profitable and remediating challenged legacy businesses. We have also been working on AIG's strategic positioning in the global insurance marketplace and longer-term priorities that define who we are as a Company and how we create value for our stakeholders.

Given the progress we have made, we are now placing greater focus on a multiyear enterprise-wide program, which we have branded AIG 200. I've asked Peter in his capacity as Global Chief Operating Officer to lead this effort across all of AIG. AIG 200 will focus on opportunities to improve our core processes and infrastructure. If we were to become a top performing Company, we must make transformative and sustainable improvements that will require investment. This work ultimately will lead to a reduced expense base and improved experience for our clients, policyholders, and colleagues. Like the foundational work that started in late 2017, we are not taking shortcuts with this program. AIG 200 is critical to our long-term success and we will report on our progress on future calls.

With respect to capital management, you will hear from Mark that we did not buy-back shares in the second quarter. Our capital plan for the remainder of the year remains focused on reinvesting in our business and reducing our leverage.

With that, I'll turn it over to Peter.

Peter Zaffino {BIO 15942020 <GO>}

Thank you, Brian. Good morning, everyone. Today, I will provide an overview of several highlights in the second quarter. I will provide detail on the financial performance of General Insurance, highlight rate actions which Brian mentioned, provide insight into the progress we're making in our businesses, and the tangible impact of focused and disciplined actions are having that changed the composition of our portfolio. I'll briefly update you on Validus, summarize progress on our reinsurance program, and lastly share some observations as we look towards the second half of 2019.

We continue to execute on focused actions across General Insurance that will position our businesses to be leaders in their respective markets. These actions include enhancing the quality of our underwriting and desired risk appetite, evolving our reinsurance program to reflect our improving book of business, and exercising expense discipline in order to provide bandwidth for future investment. We are operationalizing these actions throughout General Insurance by embedding more disciplined end-to-end business processes.

I'm very pleased with the demonstrable impact these actions are having on our business results, as evidenced in our improved financial performance in the second quarter, and the first half of the year. I believe this is not only sustainable, but will improve over time. Building on our momentum from the first quarter, we achieved an accident quarter combined ratio including actual CATs of 98.7%, an improvement of 460 basis points year-over-year, and an accident quarter combined ratio, as adjusted of 96.1%, an improvement of 490 basis points year-over-year.

The calendar quarter combined ratio was 97.8%, an improvement of 350 basis points year-over-year. The accident quarter loss ratio, excluding CATs for the second quarter was 61.3%, a 410-basis point improvement year-over-year, and a 50-basis point sequential improvement from the first quarter 2019. This quarter-over-quarter improvement was a result of the change in business mix and continued reduction in lines where we are not achieving our targeted returns, improved areas of performance, reduced volatility stemming from our underwriting actions and comprehensive and vastly improved property reinsurance program, and improved loss experience in certain areas such as Japan Personal Auto and Commercial Properties.

In the second quarter, we experienced net CAT losses of $174 million, which were primarily driven by storms and tornadoes in North America. Overall, our aggregation strategy along with reinsurance continued to reduce our gross and net exposures on a worldwide basis. Net premiums written for the second quarter were $6.6 billion, down approximately 3.7% year-over-year, on an FX constant basis. Our net premiums written excluding Validus and Glatfelter has declined almost 15% year-over-year, we've reduced our exposures by greater magnitude and the re-underwriting of our portfolio improved the quality and rate adequacy of our overall book of business.

Our focused discipline will continue to improve our combined ratio, which I will expand upon later. The second quarter expense ratio of 34.8% represents an 80-basis point improvement year-over-year, and a 50-basis point increase from the first quarter of 2019. This 50-basis point increase is largely due to the second quarter acquisition expense ratio of 22.2%, which reflects an increase of a 40-basis point sequentially, and 110 basis points higher year-over-year. A significant amount of the year-over-year increase is attributable to a one-time favorable premium adjustment in the second quarter of 2018.

The acquisition ratio in the second quarter of 2019 was impacted by improved performance in the travel and warranty businesses, which have lower loss ratios, but higher commissions. The general operating expense ratio was 12.6% in the second quarter, in line with our run rate and expectations, and a 190-basis point improvement from the prior-year. Excluding the impact of acquisitions, general operating expenses on an FX constant basis declined by approximately 18% year-over-year. We continue to execute on our strategy to optimize our portfolio by concentrating on a risk framework and risk appetite that identify areas for growth and remediation and leverage AIG's unique market position.

Moving on to rate in the second quarter, as Brian noted, we continue to see meaningful rate increases across our portfolio on average excluding Validus and Glatfelter in the high single-digits compared to a mid-single digit improvement in the first quarter of the year. In North America, excluding Validus and Glatfelter, and in the UK, we obtained high single-digit increases. The strong rate increases in the US were mostly an E&S casualty, commercial property, both retail and wholesale, D&O, energy and excess casualty. In the UK, the accelerated rate increases were led by Marine and Energy and Financial Lines. In our reinsurance business, we obtained mid-single digit rate improvement on a weighted average basis, which I will provide more detail on lately.

Let me share some specific business highlights from the second quarter where we made material progress. Lexington has undergone extensive repositioning with revised risk appetite and distribution strategy that has resulted in vastly improved submission flow and tighter limits. As a result, we achieved strong rate improvement in the mid-to-high teens in property and casualty. Property submissions were up over 35% year-over-year, and in Casualty, the increase was almost 75% since the second quarter of 2018. We strategically targeted reductions in most of our volatile accounts, resulting in a reduction of Property limits of over 55% and of Casualty limits of over 50%. I'm very pleased with our leadership team, these up and reflect the extent of the re-calibration of the business, the pace of change and progress in becoming a leader in the E&S market space.

In Financial Lines, we're demonstrating leadership as we aggressively execute on our plan to improve the composition of our portfolio, reduced our gross limits for lead layers and prudently deploy our capital in those lead layers. Rate continues to be very strong and ahead of rising loss costs, which Mark will expand on in his remarks. For example, in primary corporate D&O, we saw a rate increase of over 30% with the policy count retention of approximately 90%. In parallel, we reduced primary commercial D&O aggregate limits by approximately 30% and primary commercial D&O policies with limits greater than $10 million in lead layers by over 45%. In our European Financial Lines portfolio, we reduced public US D&O limits by over 50% with premium increases in the high teens. And in the UK, we reduced public US D&O limits by over 20% in the quarter, and increased premiums by over 20% from the prior year.

In North America Property, we continue to execute on our aggressive actions to improve our overall portfolio. This entailed reducing total gross limits by over 60%, increasing average deductible by over 60%, and achieving rate increases of over 20% on a written basis in the quarter. As Brian noted, there has been industry commentary about the evolving tort environment and the expanding impact of social issues and social inflation. These are not new issues and we've been following legislative and case file developments for some time now, including as they relate to post and adaptive reviver [ph] strategies. We're in the business of managing risk and paying claims. AIG is particularly adept at handling very complex claims. Our experienced underwriting actuarial claims professionals have been working together to understand these developments and to appropriately address these emerging complicated and sensitive risks as they mature.

Turning to Validus Re, this business had a very good quarter. The main areas of focus were the April 1 Japan renewals and June 1 Florida renewals. Demand was generally flat but capacity tightened due to a combination of factors such as prior hurricane loss development and reduced capacity from the ILS and retrocessional markets resulting in rate increases. Validus continued to show discipline in shaping the portfolio. For example, as I mentioned last quarter, in connection with Japan renewals on April 1, the average rate change in the portfolio was 10%, with rate increases ranging from 15% to 25% for loss impacted CAT layers and flat to 7% for layers not impacted by CATs. For the Florida renewals, our portfolio aggregate reduced by 17% year-over-year, while risk adjusted rates increased by 9% representing a net 3% premium increase relative to our expiring Florida renewals.

A quick update on our reinsurance program, reinsurance plays a critical role in our overall strategy to manage volatility and we continue to be very pleased with our ongoing accomplishments and strategic position. When combined the advancements we're making on underwriting discipline and the composition of our core portfolio, we see strong progress towards delivering a sustainable, profitable and less volatile underwritings. In the second quarter, just two additional property treaties that were placed below our CAT program to address specific areas of concentration and repurchasing aggregate retro public for Validus Re. The more meaningful of the two property treaties is a single limit per current cap cover for the Caribbean NOI. The attachment points are $200 million and $100 million for the Caribbean NOI respectively with a single shared limit of $325 million.

We also continue to manage our exposures for large individual properties. In addition to gross limits management, we purchased facultative automatic reinsurance on some of the higher asset risks in the portfolio, providing additional volatility containment. As we move into the second half of 2019 and into peak hurricane season, we now have comprehensive currency and aggregate protection in place and we will continue to further enhance, refine and evolve our reinsurance program as our gross underwriting improvement begins to earn into future quarters. I look forward to updating you on our next call.

Turning to talent in General Insurance, we continue to focus on building and retaining a best-in-class team. We strengthened our underwriting leadership team in the second quarter, added new talent to our reinsurance organization, expanded our operational capabilities that linked to the rest of the organization, and overall, continue to build our bench. Additionally in personal insurance, we added a season veteran to lead high network as we continue to refine our strategy to reformulate our business. I'm extremely proud of our team globally. The performance of General Insurance in the first half of 2019 reflects the dedication, commitment, capabilities and extraordinary efforts of our colleagues across the globe.

Lastly, I want to comment on AIG 200, which Brian mentioned in his opening remarks. As we look to the second half of 2019 and beyond, it's critical that we focus on our infrastructure and businesses across all of AIG and invest to modernize and digitize our workflows, as well as create a more unified AIG. As we did with General Insurance over the last 18 months, we are filling critical roles in adding a number of seasoned executives to the corporate center with proven track records of achieving excellent results during transformation. In my capacity as AIG's Global Chief Operating Officer, I look forward to meeting this next phase of work that will accelerate the progress we're making towards achieving AIG's long-term strategic operational financial goals and enable us to become a top-performing company.

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

Kevin Hogan {BIO 4650423 <GO>}

Thank you, Peter, and good morning everyone. Life and Retirement recorded adjusted pretax income of just over $1 billion for the quarter and adjusted return on common equity of 17.3%. Adjusted pretax income increased by $87 million from the prior year quarter. A primary driver of this increase was a one-time gain of $138 million for a private equity holding following an initial public offering. Our earnings also benefited from the broader capital markets environment. Net investment income reflected both higher returns on fair value option securities of $48 million and higher call and tender income of $22 million due to significantly lower interest rates.

Additionally, favorable mortality drove an increase of $35 million. These favorable impacts were partially offset by an allowance for reinsurance recoveries of $38 million in our life insurance business and expected spread compression in our retirement businesses. New money rates are below portfolio yields across our retirement portfolios resulting in reduced but still attractive spreads in many products. The prior year comparison for adjusted pretax income also reflects net positive actuarial adjustments of $51 million in the second quarter of 2018, a benefit of $98 million in life insurance and an unfavorable adjustment of $47 million in individual retirement.

Our market assumptions for the full-year have not changed and recent market volatility is a reminder that the second half may be much more challenging from a capital markets perspective. While our first half results provide some balance for the full year outlook, declining equity markets would, among other things, negatively impact fees as well as deferred acquisition cost amortization. Further with recent large declines in US interest rates, our current expectation is that base net spreads will decline to the higher end of our approximately zero to 2 basis points range per quarter.

Finally, declining interest rates would typically result in higher returns on fair value option securities, although the overall impact on net investment income would depend on the timing and degree of interest rate movement. From a statutory perspective, we expect to continue to generate solid earnings and for our strong year-end risk-based capital levels to improve over year-end 2018. Separately, we are pleased the FASB appears poised to extend the required date for adoption of the new accounting for long duration contracts until 2022. Nevertheless, we have a large and growing effort underway to understand and operationalize all the changes which are very broad reaching. It's too early to comment on impact, but we take comfort in the quality, underlying economics and cash flows of our in-force and the new business we write.

Our results for the first half of the year reflect strong growth from our ongoing strategy to leverage our broad product portfolio and diversified distribution network to satisfy customer needs. With strong market demand and favorable pricing conditions during most of this period, we significantly increased sales and fixed and indexed annuities. We expect lower levels of sales for certain product lines in the second half due to lower interest rates and the uncertain environment. We will remain disciplined with respect to product pricing and features and continue to leverage our broad capabilities to deploy capital to available attractive new business opportunities.

I will now talk briefly about the results for the quarter for each of the businesses. For Individual Retirement, premiums and deposits grew by 13%. We produced strong sales in fixed and indexed annuities during the quarter, although fixed annuity sales declined from first quarter levels. We do expect lower sales of fixed annuities in the prevailing interest rate environment. We achieved positive net flows, excluding Retail Mutual Funds, which is a comparatively small part of our earnings. Total assets under management increased driven by strong equity markets performance and growth of annuity deposits during the first half of the year. For Group Retirement, premiums and deposits were lower than the prior year quarter, primarily due to two large group acquisitions in the second quarter last year. In-plant contributions and individual product sales continued to be strong.

Net flows improved from the prior year quarter due to lower group surrender activity, but still remained negative. Although the timing of group acquisitions and individual contributions will result in quarter-over-quarter variances in deposits, we expect surrenders and other withdrawals to continue to drive negative net flows. It is also important to note that the financial impact of outflows will vary based on product characteristics. For example, the impact will be lower if the outflow is from a higher guaranteed minimum interest rate annuity policy or from a lower margin group mutual fund offering. Despite facing negative flows for a period of time, we've continued to produce solid earnings for this business as assets under administration have continued to grow.

For our Life Insurance business, total premiums and deposits increased for the quarter driven by sales growth in our UK individual protection product line as well as the addition of group protection from the acquisition of Ellipse. Our US life sales declined as we deemphasized guaranteed universal life sales in the current interest rate environment and index universal life sales remain under pressure. Overall, mortality experience was favorable to pricing expectations and the prior year quarter. We have been pleased with our mortality results over the last several quarters while recognizing that there will always be some volatility quarter-to-quarter. Adjusted pre-tax income decreased from the prior year quarter, primarily due to the favorable actuarial adjustments in the second quarter of 2018 and the current quarter reinsurance recoveries allowance that I mentioned earlier.

Institutional Markets' premiums and deposits were lower than the prior year quarter, primarily due to large get issuance in the second quarter of last year. We continue our opportunistic strategy in the pension risk transfer business and the market pipeline over the next 12 to 18 months remains robust. Overall, our Institutional Markets business continues to be well positioned to capitalize on available growth across its product lines while remaining focused on achieving targeted returns.

Lastly, I wanted to briefly comment on AIG 200 which includes Life and Retirement. We plan to focus on investments that will accelerate our efforts to enhance the customer and distributor experience across our businesses, complete the work needed to fully focus our Life Insurance business on the core portfolio, further prepare for the new standards of care in advisory expectations and position our businesses for future product and distribution channel expansion, while improving overall efficiency.

To close, we remain committed to our ongoing strategy to leverage our broad product expertise and distribution footprint to deploy capital to the most attractive opportunities, which we believe positions us well to help meet growing needs for protection, retirement savings and lifetime income solutions.

Now, I will turn it over to Mark.

Mark Lyons {BIO 21746221 <GO>}

Right, thank you, Kevin and good morning all. AIG's adjusted after-tax earnings per share was $1.43 for the quarter compared to $1.05 per share in the corresponding quarter of 2018. In dollar terms, AIG had nearly $1.7 billion of adjusted pretax income and $1.3 billion of adjusted after-tax income. Book value per share, which excludes AOCI and DTA on an adjusted basis increased to $1.42 per share or nearly 2.6% as compared to the first quarter of 2019.

As respect to adjusted return on common equity or ROCE, which also excludes AOCI and DTA, AIG returned an annualized 10.4% for the quarter and the segments achieved the following returns on attributed equity. General Insurance achieved the 10.3% return. As Kevin mentioned Life and Retirement is 17.3% return and Legacy with a 5.2% return. As mentioned last quarter, AIG now is using the term return on common equity because last quarter, we introduced some preferred stock into our capital structure.

Net investment income or NII for the second quarter was $3.74 billion on an adjusted pretax income basis and $3.75 billion on the GAAP basis, compared to $3.72 billion and $3.88 billion respectively in the sequential first quarter of 2019. This level of NII had the benefit of an approximate $0.13 per share after tax gain, associated with an IPO in our alternative private equity asset class. This $142 million pretax gain is reflected in Life and Retirement for $138 million, and $4 million within our Legacy segment.

Strengthening equity markets and tighter credit spreads also helped this quarter's investment results, I am pleased to recall that effective last quarter, AIG implemented two changes in the accounting presentation that now recognized changes in the fair market value of equity securities below the line and the non-insurance subsidiary NII that had been reflected within other income is now reflected in the NII line profits.

Turning to General Insurance, for the second consecutive quarter, the segment produced both a calendar quarter and a current accident quarter underwriting profit, with a calendar quarter combined ratio of 97.8% as Peter mentioned, which of course reflects actual catastrophe losses and prior period development, and a 96.1% current accident quarter combined ratio, excluding CATs. The actual CAT ratio for the second quarter of 2019 was 2.6% of net premium and for the first quarter of 2019 sequentially was 2.7%. The prior-year development ratio or PYD ratio net of the ADC and amortization was a favorable 0.9 loss ratio points for the quarter and for the first quarter of 2019 sequentially was 1%.

Furthermore, improved gross underwriting along with reinsurance purchases designed to reduce per risk attachment points and provide horizontal exposure coverage, reduced the level of large net property losses. The North America segment of General Insurance produced a 96.8% current accident year excluding CATs combined ratio with the North America Commercial lines component producing a 99.2% current accident quarter combined ratio, excluding CATs, which represents a 9.3 combined ratio point improvement over the second quarter of 2018.

The North America Personal lines operation produced a 90.1% current accident quarter combined ratio, excluding CATs, which represents a 7.8% combined ratio point improvement over the corresponding quarter of 2018. The International segment of General Insurance produced a 95.5% current accident quarter combined ratio, excluding CATs versus 98% even comparable ratio in the second quarter of 2018. This improvement was driven by the commercial segment, which saw a 6.5 combined ratio point reduction over the second quarter of 2018.

It's also informative to comment on the General Insurance performance on a year-to-date six-month basis versus the first six months of 2018, and on that basis, year-to-date net earned premiums were up 1.1%. The calendar year combined ratio improved 5 points even and the current accident year combined ratio, excluding CATs, improved 4.2 points. Furthermore, the general operating expense ratio or GOE ratio improved 2.2 points prior to adjustments from the Validus acquisition. Lastly, the year-to-date General Insurance return on attributed common equity is 12.1% in 2019 versus 5.3% in the first half of 2018, a 680-basis point improvement.

Turning to prior-year development or PYD, this quarter saw $63 million of net favorable development with $66 million of favorable stemming from General Insurance and $3 million of unfavorable emanating from Legacy operations. Although actual versus expected loss emergence was reviewed globally, the areas receiving deeper reserve dive this quarter were mostly US exposures, primary and excess casualty on both admitted and non-admitted basis, environmental, healthcare, GL and MedNow within programs, personalized property and some specialties lines.

The $63 million of net favorable development is mostly driven by the amortization associated with the deferred gain of the adverse development cover for $58 million. The remaining post ADC $5 million of net favorable development was scattered across many lines, but unpacking this further, and looking at things on a pre-ADC basis, net favorable development was a $132 million split as $129 million favorable in North America, $6 million favorable internationally, and pre-affirmations are mentioned $3 million unfavorable from the Legacy segment.

But an equally relevant view of this $135 million of pre-ADC favorable general insurance PYD is that $230 million represents favorable development for accident years 2015 and prior across many lines and is largely subject to the ADC, and $95 million of unfavorable development for accident years 2016 to 2018, which is split $55 million from US admitted excess casualty, $10 million from US primary casualty workers' compensation life combined, and $30 million of unfavorable development emanating mostly from short-tailed personal lines and European property and specialty lines.

I am pleased that this quarter's deep dive review, representing 30% of total reserves that also have historically been volatile lines of business, resulted in relatively minor movements. For example, on a year-to-date basis, accident year 2017's loss ratio has only moved one-tenth of a loss ratio point and accident year 2018s move doesn't even register. The Legacy segment incurred $47 million of unfavorable development from accident year 2018, stemming from two environmental cleanup cost cap policies written in 2006 each for 30-year terms, which is totally distinct from General Insurance but only $3 million in favorable for legacy across all actual years.

Peter commented earlier on General Insurance's achieved rate increases for the quarter and helping to put the pervasiveness of these rate increases in context, nearly 60% of the quarter's gross premium was associated with double-digit rate increases, whereas less than 10% of associated with rate decrease. I'd also like to add some color on the related concept of margin expansion, which is defined as the beneficial impact of the effective rate changes over loss cost trends. In North America Commercial, the weighted average loss cost trend was approximately 3.5%, but that varies widely by product line and ranges from a positive 1% trend to a plus 9% trend that is on line.

Given the discussion of rate changes given by Peter earlier, on a written basis, one can see that the degree of margin expansion above what was already contemplated with our 2019 plan loss ratio has been significant in the quarter, and this expansion has been centered and led by commercial property, E&S casualty business and directors and officers liability, although almost all lines had some degree of expansion.

Turning to the Life and Retirement Segment, Kevin has already provided a good overview, but I would add that the boost to NII from the previously referenced IPO at an approximate 230-basis point beneficial impact on the quarter's annualized return on common equity, and therefore their return would have still been approximately 15% without that impact. All units reported increases in adjusted pretax income sequentially and quarter-over-quarter except for the life unit which is experiencing growth along with the associated expense drag on income.

Individual Retirement net flows for the quarter were $300 million negative, but improved materially compared to the $1 billion negative in the second quarter of 2018. These net flows, however, were approximately $470 million positive across all annuity types, fixed, variable and index combined. With indexed annuities providing $1.1 billion of positive net flows, as mentioned by Kevin, retail mutual fund outflows were the most challenged in the quarter.

On a year-to-date basis, indexed and variable annuities combined show a flat surrender rate whereas fixed annuity saw a minor uptick. Net investment spreads for Individual Retirement were under pressure during the quarter, whereas Group Retirement net spreads increased. Life Insurance, we've seen growth in international sales, favorable mortality experience relative to the original pricing assumptions and the comparison with the second quarter of 2018 becomes favorable when controlling for that quarter's $98 million of beneficial actuarial refinements.

Assets under administration grew in both individual and Group Retirement primarily due to strong equity market performance. Institutional Markets pretax income improved quarter-over-quarter, but deposits and premium shrank comparatively due to a large GIC issuance in 2018 that was not repeated in 2019.

Turning to Legacy, adjusted pretax income was up slightly on a sequential basis to $119 million, and the after-tax income to attributed common shareholders is $93 million in the quarter, which translated to a 5.2% annualized return. Legacy NII was comparable to the first six months of 2018, but even though the year-to-date return on common equity is 4.7%, we continue to anticipate a 2% to 3% return for the second half of 2019, similar to original guidance.

As respect to tax, the effective tax rate is 22.4% for the year applicable to adjusted pretax income and 21.8% for the quarter, which is inclusive of discrete items. As you know, the effective tax rate is updated each quarter using actual results or that supplemented by reforecasting the remaining quarters. And as always, the tax rate is heavily influenced each quarter by the geographic distribution of income by tax jurisdiction. It's worth noting that approximately $350 million of the DTA was consumed this quarter. The utilization of net operating losses in foreign tax credits with both Life and Retirement and General Insurance contributing towards that consumption. As Brian noted, we did not repurchase any shares in the second quarter, so our Board authorization remains at $2 billion. As compared to the first quarter of 2019, our total debt and hybrids to total capital leverage ratio improved another 120 basis points sequentially this quarter to 26.9%.

We also had a bond issuance mature for $1 billion in mid-July that was effectively pre-funded by our March 2019 debt raising. This debt overlapped at June 30 when adjusted results in an additional 80-basis point improvement in the total debt and hybrids-to-total capital ratio to 26.1%. When you look at this on a year-to-date basis, there was a 320-point reduction in this leveraged metric.

Adjusted book value per share increased nearly 2.6% in the quarter and book value per share increased 6.2% sequentially and 13.2% since year-end 2018 benefiting from AOCI gains. As respect to the agency discussions, we completed our reviews last month with the following results for our various financial strength ratings. AM Best affirmed our A rating, and stable outlook. S&P affirmed our A plus rating and upgraded our outlook to stable, and Fitch affirmed our A plus rating and their negative outlook on an interim basis until their full review, which takes place later this year. Moody's reviewed us as well, but this was considered an internal review within their multi-year process.

Lastly, as Kevin alluded to, as for the financial accounting landscape, AIG is in the process of evaluating and planning for three fundamental accounting changes currently that will be implemented in 2020 through 2022 depending upon the standard. These are long-duration accounting affecting our Life and Retirement Division, IFRS 17 affecting our General Insurance International operations, but mostly in a compliance sense, and thirdly is FASB CECL or current expected credit loss model which really affects both sides of the balance sheet. We will provide more details around the impact of these changing accounting standards over the next few quarters.

And on that exciting note, I'll return it back to Brian.

Brian Duperreault {BIO 1645891 <GO>}

Thank you. Okay, Jake, well, let's go to the Q&A portion of this. First question, please.

Questions And Answers

Operator

(Operator Instructions) We will begin with Elyse Greenspan with Wells Fargo.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks. Good morning. My first question on General Insurance. You've again mentioned a lot of the underwriting actions that you've taken within that book combined with obviously now you are getting more of a pricing tailwind. So it does sound like the second half of this year, the margin should be better than the first half. Brian, I know you guys said you have the target for the underwriting profit maintaining that for the full year. Could you just give us a sense of how the second half that accident year combined ratio is adjusted within General Insurance, the type of improvement that we should expect from that 96.1% that we saw in the first half of the year?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, Elyse, I said, we expect an underwriting profit for the year, it's very hard to predict the accident quarter. So, I mean, we've been improving the volatility of this book, and so I think that the results get to be a little bit more predictable, but we still have a relatively interesting mix of business. So I just -- I don't really want to predict some to the decimal point change. We want to continue to sequentially improve, but will that happen in some kind of straight line, I can't tell you, but over time, yes, we continue to target an improvement in the General Insurance and as I said, get to a sustainable 10-point return on adjusted equity over the next couple of years, but don't hold me to what the accident quarter is going to be. Next question?

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, wait, I just -- excuse me, I also had a follow-up. So my second...

A - Brian Duperreault {BIO 1645891 <GO>}

Go ahead, please.

Q - Elyse Greenspan {BIO 17263315 <GO>}

My second question just on AIG 200 that you guys outlined throughout the call. I just want to get a sense on does that ultimately -- does the 200 million that you guys are looking for 200 basis points of improvement in your expense ratio? Just trying to get a sense of where that 200 comes from? And if you can just give us a sense of the timeframe there and any investments that we should be thinking about that you're making?

A - Mark Lyons {BIO 21746221 <GO>}

That's interesting. It's going to be more than 200 basis points, I'll tell you that. Now it's really a reference to -- we've just in this year celebrating -- let us go back 100 years, and so this is to look forward to the next 100, and so maybe I should have called it -- well, I won't give you a number. But anyway, yes. So look if we're ever going to be a great Company, and it's our intention to be a great Company, if you assess where we are now, the Life and Retirement, great set of products, great distribution platform, handling issues that come along in terms of the market. Peter is bringing the General Insurance to an underwriting excellence position where it belongs. It is what we do for a living. We've got the best investment management in the business.

But the one thing we've never been noted for is operational excellence and this is the one thing that we have not invested in. We've got legacy processes, too many manual interventions on and on and on. And it is a drag on our performance if you look at the GI expense ratio in particular. I pick a number, it is at least 500 basis points too high in my mind, and how are you ever going to get that down? We have to transform the Company, we have to do it fundamentally, it's going to take us some time, but it's the next great step and to me, it's as important as anything we've been doing to-date in this Company. And so it's a very, very important effort. It's across the whole Company and it will provide that long-term benefit and get us to that position of greatness that we aspire to. Next question, please?

Operator

And that question will come from Mike Phillips with Morgan Stanley.

Q - Mike Phillips {BIO 21023048 <GO>}

Thank you. Good morning. Brian, I appreciate your comments at the beginning on kind of the comments on the discipline of the market and being more fact based and how that's driving this cycle. I guess some of your peers have talked about, have described the cycle as reserve driven and income statement driven. And I guess, want to hear your thoughts on that description and the question kind of goes to not for your book, but just kind of overall for the industry profitability of the current year versus kind of the profitability of prior year still?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I think the market is reacting to the fact that they don't think the current year profitability without these rate changes would have matched prior years. And I mean that's logical given the kind of trends that we refer to whether it's social inflation or the kind of tort movements, just frequency of loss. And so I think the market is reacting as I said in a natural way, a way that one would expect a well-managed industry to do. So, I am encouraged by that. What else would you like to ask, Mike?

Q - Mike Phillips {BIO 21023048 <GO>}

Yes, okay. Yeah, thanks. Just a specific one on the torts, the legislative changes that we've had and a lot of headlines obviously on the sexual harassment stuff, is that the next asbestos for the industry?

A - Brian Duperreault {BIO 1645891 <GO>}

I think asbestos has been the next asbestos for this industry as it keeps on giving, so I don't want to -- I got to leave that to supreme. But it's certainly a society-wide problem, all this stuff that's going on and it will be reflected in societies' reaction to it. As Peter pointed out, the one thing that we have been known for -- when I talk about being a great Company, this kind of large widespread phenomenon is something we've been handling for a very long time, but it is certainly an issue that everybody has at the top of their mind.

A - Peter Zaffino {BIO 15942020 <GO>}

Thank you, Mike. Next question, please.

Operator

We'll hear from Yaron Kinar with Goldman Sachs.

Q - Yaron Kinar {BIO 17146197 <GO>}

Hi, good morning, everybody. I wanted to start with a question on NII. So you had two strong quarters openings of the year, how should we think of the kind of $13.2 billion to $13.3 billion run rate that you talked about last quarter with the rate environment being what it is today?

A - Brian Duperreault {BIO 1645891 <GO>}

Yes, okay. Well, I think I'll have Mark do this one.

A - Mark Lyons {BIO 21746221 <GO>}

Thank you. I mean, it's a reasonable question. I mean, what I would just kind of comment on, last quarter, we kind of gave you a framework, we said it's roughly 91% of the carrying value of investable assets is in pretty stable, predictable stuff. I mean, that's still got some variability to it of course, but on a relative basis. And then there was another 9% that has a lot more volatility to it. Some because of the inherent asset class itself and some because of the accounting election that was put through. And that mix is still pretty much in force this quarter. So there is couple of things. One, if you look back even through our fin sub, you're going to see in PE and hedge fund composites pretty, pretty broad volatility. We have a minus 11% in the fourth quarter that rebounded to 18% and 16% this quarter. It was 5% in the latter part, third quarter of '18. So you can kind of go backwards and pick your own standard error on those kinds of things.

The other thing that, and Brian alluded to it and Kevin alluded to it, if you go into the assumption that where the interest rates are now stays at this level, with natural maturities and natural turnover in fixed income, you're going to be reinvesting in lower yielding fixed income securities. That could put some downward pressure on it, latter half and then into 2016. So all those things taken into account, we still think that the original guidance we had given coming into the year was $13 billion. And through that (technical difficulty) that I mentioned, you could really get to about $13.5 billion, in that range and that's -- for the reasons we just mentioned, that's pretty much where we still are.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay.

A - Brian Duperreault {BIO 1645891 <GO>}

The other question, Yaron?

Q - Yaron Kinar {BIO 17146197 <GO>}

Yes. My next question is going back to the AIG 200 initiatives. Is that something that you would expect to complete by the 2021 -- the end of 2021 when you're targeting the double-digit ROE? And also with the costs associated with this program will those be included in adjusted operating income or not?

A - Brian Duperreault {BIO 1645891 <GO>}

Yes, well, I would say, yes. I put it as a probably a three plus year program, but once that period ends, this constant improvement should never end and I -- so I think there will be continuous improvement after that, but let's say the -- a project name will probably end in that period of time. And yes, we would include the cost and benefits net-net in the -- in our belief that we'll get to that double-digit position at that point.

Did you want to add anything, Mark?

A - Mark Lyons {BIO 21746221 <GO>}

Yes, just one thing, that the second part of your question was, of course, you will see that in net income, but that kind of restructuring charges is generally is excluded from operating income.

Q - Yaron Kinar {BIO 17146197 <GO>}

Got it. Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay. You're welcome. Next question please.

Operator

And now we'll take a question from Tom Gallagher with Evercore.

Q - Tom Gallagher {BIO 3311667 <GO>}

Good morning.

A - Brian Duperreault {BIO 1645891 <GO>}

Hey, Tom.

Q - Tom Gallagher {BIO 3311667 <GO>}

Hey, guys. So, Mark, just a follow-up on the NII question, so if I followed your $13.5 billion expectation for the year, that implies per quarter, NII running around $3 billion or so for the next couple of quarters if we stay in the current rate environment is that approximately right?

A - Mark Lyons {BIO 21746221 <GO>}

Yes, if your linear on it.

Q - Tom Gallagher {BIO 3311667 <GO>}

Got it. And then my follow-up is just from Slide 5, there is a footnote that says about 20% of your fixed maturities are in variable rate securities. Are those -- I think that saw -- I would saw for like $50 billion of variable rate securities, are those traditional floaters? And is that -- is that the main source of pressure on NII from a base spread standpoint?

A - Mark Lyons {BIO 21746221 <GO>}

First off, your mix is right, it's about 80:20 and -- notional sounds approximately right as well. So, I mean, yes with floating that's going to be a natural impact on it, which, yes, what have you got, it's not like you just let it go, I mean, there is risk management and hedge aspects associated with it. But, Doug, do you want to?

A - Douglas A. Dachille {BIO 6533554 <GO>}

(Multiple speakers). Hi, good morning. When you look at that, that's the holdings of the floating-rate assets, but there are a couple of factors you have to think about with respect to the impact to net investment income. First of all, the reason we hold those floating-rate assets, it provides diversification, but the other reason we hold them is we have a lot of liabilities that reprice frequency -- frequently during the course of the year. So there is some asset liability management that's associated with holding floaters. So we hold floating-rate assets against liabilities that have a floating rate repricing characteristic. To the extent there is any excess floaters that we invested in because we thought there was value to the extent there is an asset liability mismatch, we typically swap those floating-rate assets into fixed. So, while we're telling you what percentage of the portfolio actually has floating rate as a component of the available for sale, that's not necessarily the exact amount of exposure we have to the repricing of the floating rate.

Q - Tom Gallagher {BIO 3311667 <GO>}

Understood, thanks.

A - Brian Duperreault {BIO 1645891 <GO>}

Okay, next question.

Operator

One moment please. We will now take a question from Jay Gelb from Barclays.

Q - Jay Gelb {BIO 21247396 <GO>}

Thanks and good morning, I appreciate it.

A - Brian Duperreault {BIO 1645891 <GO>}

Good morning, Jay.

Q - Jay Gelb {BIO 21247396 <GO>}

Good morning. With regard to capital management, you had some discussion in the prepared remarks about why the Company did not repurchase shares in the first half in terms of taking down the leverage ratio and at the same time free cash flow seems quite strong and the stock is currently trading at 80% of book value. Can you talk about what your expectations might be for the second half in terms of buybacks?

A - Brian Duperreault {BIO 1645891 <GO>}

I think Mark mentioned in his prepared remarks, we're going to, and I said the same thing. We're going to -- we're going to continue to look at our leverage, so let's not forget that, but my bias has always been to invest in the business and in this situation where we've got a market that's improving daily, and also an effort in the Company to self-improve through the AIG 200, I think that there will be plenty of opportunities for us to invest in the Company itself, and I think that's the long-term best use of the funds and that's where we're going, Jay.

Q - Jay Gelb {BIO 21247396 <GO>}

That sounds good. I do have a follow-up. This one is for Peter. I was wondering if you can give us any indications of what you're seeing in terms of the pricing environment so far through the third quarter, if the positive trends are accelerating?

A - Peter Zaffino {BIO 15942020 <GO>}

It's too early, Jay, really to comment, but I would expect just based on sort of qualitative commentary that the third quarter early reactions are similar to what we've seen in the second quarter.

Q - Jay Gelb {BIO 21247396 <GO>}

Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Good. Terrific. Let's take another question.

Operator

We'll now hear from Joshua Shanker with Deutsche Bank.

Q - Joshua Shanker {BIO 5292022 <GO>}

Well, thank you for fitting me in, I appreciate it. Good morning.

A - Brian Duperreault {BIO 1645891 <GO>}

Good morning, Josh, it's good to hear from you.

Q - Joshua Shanker {BIO 5292022 <GO>}

Thank you. So, you talked about rate, everyone's talking about rate and whatnot, but in some ways, AIG is writing its own ticket. There is an overhaul of the portfolio going on. It's ongoing. When you talk about rate, is that pricing only or is that joined with an overhaul how AIG underwrites its P&C business?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, I'm going to start and Mike and Peter can finish. So, these rates that we refer to are really like same store sales rate, kind of thing, right. So we're matching apples with apples. But as you point out there is another thing going on, which is the sharing of business that was either poorly selected or under price limits that we didn't think we were getting paid for. So there is another underlying improvement taking place in addition to this rate comparison. Mark, do you want to add?

A - Mark Lyons {BIO 21746221 <GO>}

Yes, thank you. First off, Josh, I appreciate that one opening comment you made that in terms of writing your own ticket, I think clear point of differentiation is, in a lot of sectors, AIG is pushing the market, it's not like we're benefiting from the results of others, we are pushing it and that's contributory to our view on a lot of different things. In terms of the rate changes as Peter quoted for, they are effective rate changes, taken into account as much as you can, to the examples that Brian mentioned, limits and contraction and the cash flow movements and so forth. But there is a broader lift that does not reflect. I mean that's the explicit rate change, the implicit rate change is that portfolio quality differential. So when you non-renew or get rid of business of rate adequacy of X and you're bringing in new business that's much stronger than that X, it has beneficial lift as well. That will find its way into the ultimate loss ratio, but that's in addition to the individual rate changes that we are covering up.

A - Brian Duperreault {BIO 1645891 <GO>}

Peter, have you got anything you want to add?

A - Peter Zaffino {BIO 15942020 <GO>}

I just want to build on what both of you had commented on, which is the most important thing we're making sure that the underwriters are doing is risk selection, how to recalibrate the portfolio, making disciplined decisions around limit deployment, understanding their aggregations, understanding what's actually happening with loss cost and underlying trends. We're very pleased with the rate that we've been driving. But that's become an outcome of the discipline that we've been driving over the last five or six quarters.

A - Brian Duperreault {BIO 1645891 <GO>}

Josh, we got maybe time for follow-up and no other question.

Q - Joshua Shanker {BIO 5292022 <GO>}

It is absolutely a follow-up, right on it. And so next year, as I think about the shape of the portfolio and your purchase of reinsurance over the past 12 months, can we imagine that the shaping of the same, that you have the same reliance on reinsurance for the next 12 months or is that going to change over time?

A - Mark Lyons {BIO 21746221 <GO>}

Well, I think we've been addressing our reinsurance to the portfolio that we had, as that portfolio changes, right, so we get rid of the large limit strategy, you don't have to buy as much in terms of protecting the Company from those very large limits, portfolio mix, but I'd say the basis of our philosophy of around the reinsurance that it is -- it's geared to addressing exposures that we feel we should share because of accumulations or because of volatility, that's going to continue. But yes, as the portfolio evolves, we'll adjust our total program accordingly.

Q - Joshua Shanker {BIO 5292022 <GO>}

Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Thanks Josh. And I'm going to call this to an end, and thank you. And I just want to just thank everybody for joining us today and for your questions. And before we end the call, of course, I do want to acknowledge our colleagues around the world for their tireless efforts and dedication to the journey that we're on here at AIG, and I am proud of what we're accomplishing and appreciate everybody's hard work.

I also want to thank our business partners, shareholders and stakeholders for their support. It's meant a lot to me and my leadership team and we remain committed to making AIG the leading insurance Company in the world. Have a great day.

Operator

And with that ladies and gentlemen, this does conclude your conference for today. We do thank you for your participation and you may now disconnect.