Q1 2019 Earnings Call

Company Participants

- Brian Duperreault, Chief Executive Officer
- Kevin Hogan, CEO of Life and Retirement
- Mark Lyons, Chief Financial Officer
- Peter Zaffino, CEO of General Insurance

Other Participants

- Andrew Kligerman, Analyst
- Elyse Greenspan, Analyst
- Josh Shanker, Analyst
- Paul Newsome, Analyst
- Ryan J. Tunis, Analyst
- Tom Gallagher, Analyst
- Yaron Kinar, Analyst

Presentation

Operator

Good day, ladies and gentlemen, and welcome to AIG's First Quarter 2019 Financial Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead. Good morning. And before we get started this morning, I'd like to remind you that today's presentation may contain 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. Factors that could cause this include the factors described in our first quarter 2019 Form 10-Q to be filed and our 2018 Form 10-K under management's 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 the slides for today's presentation, and our financial supplement, which are available on our website. This morning we ask again that you limit yourself to one question and one follow-up. We're joined in the room today by members of senior management including Brian Duperreault, President and CEO; Mark Lyons, CFO; Peter

Zaffino, COO and CEO of General Insurance and; Kevin Hogan, CEO of Life and Retirement. At this time, I'd like to turn the call over to Brian.

Brian Duperreault {BIO 1645891 <GO>}

Good morning, and thank you for joining us today. Our first quarter results reflect a significant foundational work we've been undertaking since late 2017 and that we described to you in detail on our last earnings call in February. I'm pleased with our progress to-date. We remain confident we'll continue through the remainder of the year.

Today we will provide additional detail on our financial results, as well as the progress we're making on a number of fronts in our General Insurance, Life and Retirement and Legacy segments. We are changing our usual lineup so after my opening remarks, I'll be followed by Peter Zaffino, then Kevin Hogan, and Mark Lyons will close out our prepared comments before we move to Q&A.

In the first quarter, we achieved an adjusted after-tax EPS for $1.58 compared to $1.4 in the first quarter of last year. This reflects significant improvement in the core operations of General Insurance in addition to increase investment income due to the rebound in equity markets. Mark will provide more detail regarding the positive impact investment income had across our businesses, which represents $0.32 of our EPS improvement year-over-year.

In the first quarter, General Insurance achieved an underwriting profit of $179 million and the calendar year combined ratio of 97.4. First quarter accident year combined ratio as adjusted was 96.1, this quarter's underwriting profit represents a significant milestone for AIG and reflects the tremendous work undertaken by Peter and his leadership team over the last 18 months to radically improve underwriting fundamentals. Overall, our approach to reinsurance dramatically reduce risk and volatility, onboard acquisitions, and then still continuous expense discipline across General Insurance. We remain confident that GI will continue to improve it's financial performance and deliver an underwriting profit for the full year 2019, as already evidenced by our first quarter results.

I'd like to comment briefly on AAL, as you know, over the last few quarters, I was -- I had been reluctant to talk about AAL because of the significant changes taking place in General Insurance and because our historical disclosure was not in line with our peers. I did say previously that you should assume AAL would be going down, indeed it has. Our estimated 2019 AAL is 3.5, a number I'm not too focused on as it will continue to change as our general insurance strategy evolves and matures, and because we view catastrophe management as a balance sheet topic as opposed to P&L.

As a result of the strategic actions we are taking, AIG is again recognized as the leader in the insurance market. Many of us attended RIMS last week and we're gratified by the level of engagement and support we received from our clients and distribution partners. The marketplace has taken note of our deliberate, broad-based actions to recalibrate our book and aggressively reduce limits, risk and volatility. It is noteworthy, that we are seeing corresponding improvements in almost every area, including retail, E&S, reinsurance and these improvements are not just occurring in the United States, but also in a number of other countries. Peter will discuss this in more detail in his remarks.

I also want to briefly comment on the recent news about changes at Lloyd's. In my view, Lloyd's is taking actions that are necessary for to regain it's pre-eminent position in the industry. Our acquisition of Validus was driven in part because of Talbot, a Lloyd's platform. So we were pleased to see Lloyd's embarking on a plan to restore it's position in the marketplace.

Turning to Life and Retirement; this segment delivered another solid quarter with adjusted pre-tax income of $924 million, and an adjusted ROE of 15%, we are reconfirming our guidance for Illinois for the full year and continue to expect a low to mid-teens adjusted ROE. Kevin will provide more detail on Illinois first quarter in his remarks, including the impact of the rebound in the equity markets.

With respect to our Legacy segment, we continue to make progress on our plan to deconsolidate and fully separate this business, while ensuring we meet our commitments to our policyholders and regulators. As you saw in our press release for consolidated AIG, we continue to expect to achieve a double-digit adjusted return-on-equity within three years. Our first quarter results demonstrate that our world-class team continues to make progress in our journey to restore AIG as a leading insurance company in the world.

With that, I will turn it over to Peter, to expand on General Insurance.

Peter Zaffino {BIO 15942020 <GO>}

Thank you, Brian, and good morning everyone. Today, I will share high level financial information for General Insurance. I will expand on Brian's comments and highlight some of our accomplishments in the quarter, including notable financial progress that's being realized as a result of our underwriting strategy, and the overall repositioning of our business. I will provide insight on our evolving reinsurance program, which has substantially reduced and accelerated volatility containment. And lastly, I will provide market observations based on our experience in the first quarter to make some brief comments as we look ahead to the rest of 2019.

As Brian noted since the beginning of 2018 we've been undertaking significant foundational work in General Insurance around organizational structure, talent recruitment and improving underwriting capabilities, while at the same time, rapidly evolving our reinsurance program and exercising expense discipline. As a result in the first quarter of 2019, we achieved an accident year combined ratio including actual cat of 98.8% or 96.1% as adjusted. The calendar year combined ratio was 97.4%, the accident year loss ratio excluding cats for the quarter was 61.8%, a 130 basis point improvement year-over-year, and a 210 basis point sequential improvement from fourth quarter 2018. In the first quarter, we experienced cat losses of $175 million, which were lower than a year ago.

The first quarter expense ratio of 34.3% represents a 230 basis point improvement year-over-year and a 60 basis point improvement from the fourth quarter of 2018. The general operating expense ratio was ultimately 5% from the first quarter, in line with the fourth quarter of 2018 and a 240 basis points lower than the first quarter of 2018. On a like-for-like basis, excluding the impact of acquisitions, operating expenses declined by approximately 18% year-over-year. These reductions were achieved while we remain committed to making investments in talent, business process and infrastructure to support our long-term profitable growth objectives. The acquisition ratio of 21.8% in the first quarter was in line with prior year quarter and the fourth quarter of 2018, in line with our expectations given our current mix of business.

In addition to improved underwriting results, net investment income was favorable this quarter coming in at $1.1 billion, bringing General Insurance's pre-tax operating income to $1.3 billion. Mark will provide more details on the General Insurance financial results in his prepared remarks. As we stated over the last few quarters to deliver improvement, particularly in our commercial businesses, our primary area of focus was to create a framework that clearly defined it's segments of business that we wanted to underwrite, while leveraging the distinct value we believe AIG delivers in the insurance market. This framework enabled us to develop a cohesive risk appetite and to pivot to becoming a value-added partner with our brokers and clients based on our expertise, not just our capacity.

While it may sound simple and perhaps even repetitive, this was our major initiative in 2018. And when coupled with the strengthening of our core underwriting fundamentals, the changing mix of our business, the addition of Validus and Glatfelter, and the improvement we have driven in rate, we were able to craft a dramatically improved comprehensive and strategic reinsurance program for 2019. We remain committed to our journey of continuous improvement across General Insurance and are executing on changes to core businesses to shift our overall portfolio composition.

Some highlights of actions we are taking that are driving improved operating and financial results include the following. In Lexington, for both property and casualty, we've narrowed our risk appetite in our focus on smaller and mid-market insurance and are committed to the wholesale distribution channel. We're also taking aggressive action on our renewal portfolio to align with our new risk appetite while exiting under-performing risks. As a result, we've see momentum in both, property and property casualty. Property submissions are up over 20% year-over-year and we are achieving low to mid-teens rate improvement on the portfolio. In our casualty business, our submission count is up over 20% year-over-year as the marketplace has responded positively to our more tailored distribution strategy, enabling us to identify opportunities for profitable new business program. In our casualty portfolio we're achieving low-teens rate improvement. Overall, we're very pleased with the pace of the re-positioning of our Lexington portfolio.

In financial lines as I mentioned on last quarter's call, we've been focused on reducing gross primary limits, and we remain very committed to deploying capacity for lead layers while obtaining better balance by participating in excess layers. We also have been disciplined on rate. For example, we've achieved in primary corporate D&O over 20% rate, in primary private D&O over 15%, and an excess D&O over 10%. In our North America book across primary US D&O segments, aggregate limits were reduced by approximately 20% in the first quarter of 2018 to the first quarter of 2019, and we also significantly reduced our policies above $10 million in lead layers by almost 35%. The impact of our disciplined approach to risk selection and pricing is also reflected in our UK Financial lines book where our total limits across all layers of public D&O decreased nearly 35% year-over-year yet our repeat premium was only down slightly despite our underwriting actions.

In North America Property, we continue to take aggressive actions to improve our portfolio. Our total gross limits in the first quarter declined 49% compared with the first quarter of 2018. Our average gross limit for risk management accounts declined 14%. Our average deductible increased 25% and we've been able to achieve high single-digit rate increases on our in-force portfolio. In addition to these portfolio actions, the acquisitions of Validus and Glatfelter directly aligned with our objective to improve our core business and diversify our portfolio. Both companies have delivered on their strong reputation for underwriting excellence and track records of generating underwriting profit.

On our year-end 2018 earnings call, we provide a considerable detail on the substantial enhancements we're making to our reinsurance program. I do not intend to repeat that information today, however, I do want to stress that reinsurance continues to play a critical role in our overall strategy and I'm very pleased with what we've accomplished. Together with the substantial improvements we're making to our underwriting approach and capabilities, our reinsurance program is contributing to our reduced risk profile and helping us reshape the better balance of our portfolio. The relationships we're building with reinsurers and the support we have received as we overhaul our reinsurance program is clear and strong industry endorsement of the work we're undertaking to improve our core business. We'll continue to refine and enhance our reinsurance program as our portfolio improves.

Let me briefly comment on rate. As I mentioned when I highlighted our progress in some businesses, we're seeing broad-based market support for premium rate increases across multiple lines at or better than our loss cost trends which Mark will discuss in more detail. At a high level, we obtained rate increases of around 4% in our commercial portfolio including over 4% in North American commercial lines excluding Validus and Glatfelter, and almost 6% in the UK and 3% in Europe. While rate remains an important area of focus for us, we continue to believe that disciplined methodical risk selection coupled with a focus on terms and conditions will be the primary drivers of sustained, improved financial performance and profitability.

Turning to our Reinsurance business; Validus Re had a very strong start to the year. In the first quarter, we did see market loss increases for Typhoon Jebi and other 2018 events. Despite these increases, Validus Re did not have any net adverse development in the quarter due to reinsurance treaties that absorb these losses. Instead, Validus Re produced a $16 million favorable loss development in the first quarter. Year-over-year, net premiums earned increased approximately 20% as we successfully executed on growth initiatives and diversified non-GAAP classes. We're also seeing increased evidence of price discipline. Ceded commissions are broadly flat to slightly down, and on excess of loss placements pricing is generally flat to modestly up.

With now part of our first quarter results, I do want to briefly comment on the April 1 Japanese renewals and Florida's June 1 renewals. For Japan rate increases ranged from 15% to 25% on loss impacted cat layers, layers that were not impacted by catastrophes were price flat to up 6%. We chose not to increase our Japan exposure during these renewals. Shifting to Florida, the property reinsurance market has meaningfully underperformed over the last two years and we believe it will undergo a meaningful price correction at June 1. This is driven by loss activity in 2017 and 2018, and the need to modify loss cost to account both increased frequency and severity.

Before closing, I'd be remiss if I did not acknowledge the efforts of the General Insurance leadership team and all of our colleagues around the world. I'm extremely proud of their hard work and accomplishments to-date. Our improved results are due in large parts of the team's tireless efforts coupled with their incredible focus, dedication and courage to make material changes and difficult choices, all of which have had positioned us well for the remainder of 2019.

Looking ahead, we will continue to evolve our underwriting capabilities, streamline our operations, maintain expense control, and invest in people and strategies that will enable us to further strengthen relationships with our clients and distribution partners. While there is still much work ahead of us, we remain laser-focused on our longer-term goal of achieving underwriting excellence and sustained profitability. Our momentum is palpable and we will continue our disciplined approach to decision-making as we work to restore AIG as an industry leader.

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 pre-tax income of $924 million for the quarter, and adjusted return-on-equity of 15%. Adjusted pre-tax income increased by $32 million from the prior year quarter. The primary drivers of this increase were capital market driven impacting acquisition costs through lower deferred acquisition costs amortization of $46 million due to rising equity markets in the quarter resulting in increased expected future fee income, and net investment income reflecting both higher returns on fair value option securities of $46 million driven by tightening credit spreads, and higher accretion income of $26 million reflecting interest rates declining in the quarter.

Our earnings also benefited from non-recurring expense items and reserve refinements in our International Life business of approximately $25 million. These favorable impacts were partially offset by lower returns from alternative investments and lower fee in advisory income due to lower asset levels during the quarter driven by the market downturn at the end of last year. Prior year comparison also reflects a one-time bond payment recovery in the first quarter of 2018. Our full year expectations for adjusted pre-tax income, as well as our market assumptions have not changed. There could be some upside to our full year outlook should market conditions hold or improve.

Keep in mind that declining equity markets and widening of credit spreads would accelerate deferred acquisition costs amortization and lower net investment income on fair value options securities, respectively. In addition, as on [ph] significant changes in the overall rate environment our current expectation is that base net spreads will decline by approximately zero to two basis points per quarter, at least through the end of this year. From a statutory perspective, we expect to generate solid earnings and for our strong year-end risk-based capital levels to improve over year-end 2018. Our team continues to do an outstanding job leveraging our broad product expertise and diversified distribution network to meet the evolving needs of our customers.

In fact, LIMRA recently published 2018 results and we were ranked as the number one provider in total annuity sales reflecting our capabilities and balance across annuity lines. This is the first time we had held these positions since 2007. Although we are pleased with the results, I want to stress that our strategy is not about market share but instead to be in a position to compete at scale in each of our businesses. Our strong top line growth in the first quarter reflects the execution of our ongoing strategy. With favorable pricing conditions during the quarter we significantly grew fixed and indexed annuity sales. We also increased group retirement deposits, grew international life sales, and closed a large pension risk transfer transaction in the quarter.

The pension risk transfer deal, which we recently announced, represented approximately $750 million of pension obligations. As with all such transactions, earnings will emerge overtime and the earnings impact during the first quarter was immaterial. We remain well positioned across our businesses to serve a growing market, enabling us to continue to deploy capital at or above our targeted economic returns, while recognizing we will incur some additional new business expenses associated with such growth.

I will now talk briefly about the results for each of the businesses. For Individual Retirement, premiums and deposits grew by 30%. With these strong sales levels, we achieved positive net flows for the first time since the third quarter of 2016. Net flows for Retail Mutual Funds continued to be challenged. Retail Mutual Funds, which is a comparatively small part of our earnings, is a defensively positioned portfolio that is counter cyclical to our individual annuities and may continue to face headwinds in the current environment.

Assets under management and related fee income decreased, driven by lower asset levels following the equity market decline in the fourth quarter. Net investment income increased primarily due to the market driven factors mentioned earlier. For Group Retirement, premiums and deposits grew by approximately 11% for the quarter, with higher group acquisitions in planned annuity contributions and individual product sales. Surrenders and other withdrawals increased, primarily driven by the loss of one large group due to the planned sponsor reducing the number of providers offered in it's plan, and higher individual surrenders and other withdrawals. We expect higher surrenders and other withdrawals to continue to negatively impact net flows, but it is 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 net flows for a period of time, we've continued to produce solid earnings for this business and assets under administration are at the same level as the first quarter of 2018. After adjusting for accretion income and unusual items, new money rates are still below portfolio yields across our retirement portfolios, resulting in reduced but still attractive spreads in many products. Also in a rising rate environment, it may be appropriate for us to increase crediting rates for certain of our in-force business.

For our Life Insurance business, total premiums and deposits and sales increased for the quarter, driven by strong sales growth in our UK Individual Protection Product line, as well as the addition of group protection sales with the acquisition of Ellipse. Our US Life sales declined as we deemphasized guaranteed universal life sales in the current interest rate environment. For our US Life business, we continue to make progress on making the necessary infrastructure changes to completely separate our operating model from Fortitude Re and to pursue possible transactions that would lead to deconsolidation in the future. Adjusted pre-tax income increased due to overall mortality experience which was within pricing expectations, positive reserve and reinsurance refinements, and lower operating expenses and commissions.

Lastly, for Institutional Markets, as I mentioned earlier, we executed a large pension risk transfer transaction in the quarter, at attractive economics statutory and accounting returns. The market pipeline for pension risk transfer transactions over the next 12 to 18 months continues to be robust. We also executed a GIC issuance of $250 million in the quarter. Overall, our institutional markets business continues to be well positioned to capitalize on available growth across it's product lines while remaining focused on achieving targeted returns.

To close, we remain committed to our ongoing strategy to leverage our broad product expertise and distribution footprint and 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 6494178 <GO>}

Thank you, Kevin, and good morning all. So getting right into it; AIG's adjusted after-tax earnings per share was $1.58 for the quarter compared to $1.04 per share in the corresponding quarter of 2018. In dollar terms, AIG had $1.85 billion of adjusted pre-tax income and $1.39 billion of adjusted after-tax income. Book value per share excluding AOCI in the DTA increased $0.52 per share or nearly 1% as compared to the fourth quarter of 2018.

As respect, adjusted return on common equity or ROCE, which also excludes AOCI and DTA, AIG returned an annualized 11.6% for the quarter and the segments achieved the following returns on attributed equity. General Insurance achieved a 14% return, Life and Retirement a 15% return, and Legacy at a 4.4% annualized return. AIG is now using the term return on common equity because this quarter we introduced some preferred into our capital structure. As respect, net investment income or NII, it should be noted that due to the markets rebounding from poor fourth quarter 2018 performance, this quarter had outsized gains and likes of which should not be viewed as recurrent across the next three quarters in 2019. As a result, I will begin my comments about NII across the company so I don't need to do so within each segment.

Net investment income for the first quarter was $3.72 billion on an adjusted pre-tax income basis and $3.88 billion on a GAAP basis compared to $2.81 billion and $2.75 billion respectively in the sequential fourth quarter of 2018. This material improvement was predominantly due to the improving equity markets, tighter credit spreads and improved alternative investment performance but was also partially due to changes in accounting presentation by AIG, effective in the quarter in two ways. Firstly, AIG now recognizes changes in the fair value of loss in securities below the line, which is much more consistent with the vast majority of our peers. The impact of this geography change for the quarter was a reduction in net investment income of $79 million.

Secondly, we reclassed NII that had heretofore been reported in the other income line of non-insurance subsidiary into the official net investment income line. The impact of this change with $116 million increase to the NII line this quarter, and it is hoped that this reclassification now removes a consistent source of confusion amongst the investor and analyst communities. It's important to note that this reclassification did not alter adjusted pre-tax earnings at all, simply geography.

And I also want to point you to Pages 12 and 13 in the financial supplement, to see the historical quarterly impact of these two reclassifications. When assessing AIG's investment portfolio volatility and result in NII, we believe it's helpful to provide a summarized view, somewhat akin to the way our Chief Investment Officer thinks about the portfolio. This view looks at the portfolio as two broad asset classes; assets that are inherently fairly predictable and those that are inherently fairly volatile. The fairly predictable class is comprised of available-for-sale fixed maturity securities, mortgages and other loans and short-term investments, which totaled about $293 billion carrying value of assets, or approximately 91% of the portfolio.

The other $29 billion of carrying value assets are fairly volatile and are comprised at fair value option securities, hedge funds, private equity, real estate and miscellaneous other investment. The fairly predictable assets provided about $12.5 billion of gross NII on an annual basis or about a 4.25% yield, whereas the fairly volatile assets have yielded NII of approximately 5.8% over the last five quarters of what you can see in this financial supplements, ranging from about 2% to over 9%. Therefore, just using the last five quarters as a simple volatility measure, the NII from the fairly volatile assets could range from nearly $600 million to $2.6 billion, annually.

One must also reflect that there are annual investment expense of roughly $450 million that must be netted against us. The volatility shown in the fourth quarter of 2018 and the first quarter of 2019, implies that an overreaction to the fourth quarter's lower net investment income wasn't warranted and neither it's overreaction to the higher net investment income this quarter. It's nearly impossible to accurately forecast market performance over the balance of the year, and the simple framework we've just provided shows the difficulty in predicting short-term market performance.

It's also important to recall that in the fourth quarter due to materiality, we recorded an $86 million pre-tax hit to income associated with hedge fund and Japanese equity mark usually recorded on a one-month lag. For the first quarter of 2019 forward, we are now recognizing hedge funds without any lag at all. So the first quarter it did indeed reflect a full three months of results, and therefore all current and future hedge fund commentary will center on that quarter's activities rather than containing one month in the prior quarter. The only remaining lagged investment recognition is for private equity holdings, which has a full one quarter lag.

Nevertheless, the fourth quarter lagged results booked entirely in AIG's first quarter, contributed positive net investment income, highlighting AIG's positive selection benefit versus any broad applicable market index.

Turning to General Insurance and as previously noted, the segment produced both a calendar quarter and accident quarter underwriting profit with an actual cat ratio of 2.7% this quarter versus 5.7% in the first quarter of 2018. The North America segment of General Insurance produced a 98% accident quarter excluding cats combined ratio within the North America commercial lines producing a 96.4% accident quarter ex-cats, which represents a 10.7 combined ratio point improvement over the first quarter of 2018. Although 1.8 points to this was due to expense ratio improvement, the 8.9 points of accident quarter loss ratio improvement can be largely attributed to the gross underwriting changes beginning to earn in along with the material reinsurance protection that Peter highlighted.

The North American personal lines operation worsened this quarter, primarily due to increased frequency in the attritional loss ratio. The international segment of General Insurance produced a 94.5% accident quarter combined ratio ex-cats versus 96.8% comparable ratio in the first quarter of 2018. Both the commercial and the personal lines segment contributed improvement predominantly on the expense ratio side.

Looking at the quarter from an AAL perspective, the 2019 full year AAL is estimated to be 3.5%, and as Brian noted in his remarks, the combination of gross underwriting changes, most notably, the reduction in gross fire and associated parent limits, along with purposeful reductions in exposures, was complemented with a radically altered reinsurance program that provides critical and non-critical cat protection within many of the progress structures, along with the cat program that provides material vertical and horizontal, regional and global protection, which is also further enhanced with specific carve-out CAT program for our private client group in the United States.

The combination of these front and back-end actions has provided material volatility containment at all upper return period levels, leading to a reduced AAL. My view of the first quarter's accident year results is therefore a 99.6% combined ratio, inclusive of AAL, and 98.8% accident quarter combined ratio inclusive of actual cats. As a result, we will be speaking of cats in the future only in terms of risk tolerance along with our measurement against that tolerance by various return periods and not focusing on AAL.

Now shifting to the business mix in General Insurance; the overall quarter-over-quarter net written premium reduced by 2.3%, but some areas had large swings both up and down, as can be seen in the financial supplement. However, at a high level and excluding the impact of Validus and Glatfelter, and adjusting for the Fuji two-month lag elimination in the first quarter of 2018, net written premiums decreased approximately 17% after additionally adjusting for foreign exchange. Approximately one-third of the 70% reduction is associated with direct underwriting actions, and about two-thirds can be largely attributed to increased reinsurance spreadings.

With respect to general operating expenses or GOE, the reduction was $237 million quarter-over-quarter when adjusting for Validus and Glatfelter since neither was part of AIG in the first quarter of 2018. This represents as Peter noted, a 240 basis point improvement in the GOE ratio quarter-over-quarter. As we stated on previous calls in General Insurance, and across the company more broadly, we continue to undertake a comprehensive review of workflows and process improvement opportunities, as well as overall expense levels.

Turning to the prior year development, the quarter saw $74 million of net favorable development, with $72 million of this favorable developments stemming from General Insurance and $2 million favorable from the Legacy operations. There were no reserve deep dive into any specific line of business this quarter, but the actual versus expected review was uncomprehensively across our global operations. The result was that most areas had loss emergence either better or in line with expectation, so no material reserve changes would be necessary. The $74 million in net favorable development is mostly driven by the amortization associated with the deferred gain of the adverse development cover, namely $58 million and the remaining $16 million of General Insurance net bearable development which is scattered across many lines and regions.

Additionally, with the revised underwriting and low per risk attachment reinsurance strategy, our historical reporting a net severe loss will no longer makes sense. So from now on will be commenting on attritional and cut losses only. Peter commented on General Insurance's achieved rate increases for the quarter and I'd like to additionally point out that for North American commercial in particular, the rate increases have been accelerating and the March increase alone averaged over 7% which is clearly an excess of loss trends and thereby providing additional margin expansion. Similarly, our monitoring of portfolio composition clearly shows the superior rate adequacy of new business relative to that of lost business, as well as improvements to the renewal books adequacy, this shift in overall portfolio rate adequacy provide additional lift for continued improved performance.

Turning to the Life and Retirement segment, adjusted pre-tax income of $944 million represents a $32 million increase over the first quarter of 2018 and a $301 million increase sequentially over the 4th quarter of 2018. These results, as Kevin mentioned, translates to a 15% annualized return on average attributed common equity for the quarter. All the units reported an increase in the adjusted pretax income sequentially relative to the 4th quarter of last year. Individual retirement had stronger investment income and positive net flows for the quarter, but with based net investment spreads that are expected to experience a downward draft that Kevin highlighted. Group retirement net flows were negative due the slightly lower sequential premiums and deposits and sequentially higher surrenders in the growth. Group retirement business like others in the industry is exposed to client consolidations via mergers or by the reduction of providers offered in plans. The quarter saw favorable results from Life International operations and institutional markets for the second quarter in a row, if successful in the pension risk transfer space.

Turning to legacy, adjusted pre-tax income was up $262 million sequentially in the 4th quarter of last year. But such comparisons are not overly meaningful given the non-recurring loss recognition charge taken on certain cancer and disability A&H plant last quarter. However, the quarter's $89 million of adjusted FFO income translates into a 4.4% annualized return on attributed common equity. But given that the quarter experienced the already discussed investment rebound as well, our view of a 2% to 3% return for the full 2019 year remains valid. As respect tax, the effective tax rate is 22.5% for the quarter excluding discrete items applicable to adjusted pre-tax income. Including discrete items, the tax rate was 22.9%. As you know, the effective tax rate is updated each quarter using actual results then supplemented by re-forecast of the remaining quarters. And as always, the tax rate is heavily influenced this quarter by the geographic distribution of income by tax jurisdiction.

Moving on to capital actions, we issued $1.1 billion of securities in the first quarter split between $600 million of 10-year debt with a 4.15% coupon, a $500 million of non-cumulative preferred stock, with a 5.85% dividend. We did not repurchase any shares in the quarter so our Board authorization remains at $2 billion.

With that I'll strength back over to Brian.

Brian Duperreault {BIO 1645891 <GO>}

Well, thank you, Mark. I think we can go to questions-and-answers. So first question, please.

Questions And Answers

Operator

(Operator Instructions) Our first question now comes from Elyse Greenspan from Wells Fargo. Please go ahead, your line is open.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Hi, thanks, good morning. My first question, going back to some of your comments on this call and on prior calls you made reference of all these underwriting changes and how they're beginning to earn. And I guess I'd like to get a better sense of the forward momentum. I know on last quarter's call, you guys had mentioned that the prior management teams go big strategy at AIG have resulted in multi-year policies that are still on your books in 2019. So, could you just give us a sense of the running off of those policies and how that could benefit to incremental underlying margin improvement as we go through the balance of 2019 and into 2020?

A - Brian Duperreault {BIO 1645891 <GO>}

Okay, Elyse. Well, Peter, I think you should take the...

A - Peter Zaffino {BIO 15942020 <GO>}

Okay. Hi, Elyse thanks for the question. There were a meaningful amount of long-term deals done in the core property book historically and when we had announced that we're changing underwriting guidelines, that was something we did not want to do going forward. But as you mentioned, it takes a little bit of time to earn out so we should see a meaningful reduction in long-term deals by the back half of 2019. So, I think as we back half '19 as we enter 2020 will have cut our long-term deals in half and we'll start to see the majority of the portfolio, increasing in terms of just annual 12-month deals.

Q - Elyse Greenspan {BIO 17263315 <GO>}

Okay, great. And then my second question, you guys referenced on strong strong prices, it seems like you guys saw in March really improving from the trend I guess. Could you just give us a sense on your forward view on pricing, and then as we think about pricing versus trend, can you give us a sense of when that could really start to earn and be beneficial to the margins you saw in the first quarter?

A - Brian Duperreault {BIO 1645891 <GO>}

I'm going to talk a little bit about this, and let Peter talk about the pricing itself. I just want to point out that, yes, this pricing, it's warranted needed. The whole industry is recognizing that. In our own case, we had other things we had to do to. So there's more things going on. Then just getting price on the portfolio and that is Peter said the selection process, getting the right risks on board, positioning ourselves properly in their program that attachment point putting the right limit out etc. So, a lot of that is causing the improvement on our portfolio and pricing is a component of it, unimportant component, but a component. Peter, do you want to go a little bit more into the pricing?

A - Peter Zaffino {BIO 15942020 <GO>}

Sure. I think we outlined a lot of it in the prepared remarks. I think what's happening, which is a little bit different is that we're seeing it across the board. It's in multiple lines -- I mean, certainly, Property has under-performed the most and so, whether it's cut capacity, attritional losses on how capacity has been deployed, we're seeing rate within the E&S as well as their many markets. So, that's I think going to be consistent throughout the rest of the year. We've seen in the financial lines. I think as we can participate in many lines of business and then in many parts of the program, we're seeing that momentum, as Mark mentioned in his prepared remarks, pickup in margin and we would expect that to continue throughout the year. So, it's a very orderly, meaning. It's one that is not just spiking in one line; it's across multiple lines and in a lot of parts of the world. So, I think this is something that's hard to predict how long it last but we are going to lead with -- again risk selection but also making sure we're getting paid appropriately for the limits that we put out and the risk that we're underwriting.

A - Brian Duperreault {BIO 1645891 <GO>}

Yes, this pricing isn't just the first-quarter phenomenon, it's been building through '18 and so, it will bleed in as we are in these premiums and as Mark pointed out, this seems to be some acceleration.

Operator

Our next question comes from Yaron Kinar from Goldman Sachs. Please go ahead, your line is now open.

Q - Yaron Kinar {BIO 17146197 <GO>}

Good morning, everybody. So two questions, first, I think in the press release, Brian, you talked about an expectation that this year will be profitable on both in the calendar year and as year basis. I was just curious, is that with catastrophes that your comment is based on?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, with catastrophes, I can't tell you whether we're going to have a large catastrophe year, or a small catastrophe year. I mean we have this thing called AAL, which I did insert into the number and as I said, is 3.5. I don't really want to talk about it after that. I mean look at I think over a long period of time to be years where we have catastrophes years we don't. But on the average, we expect to make an underwriting profit and I expect to make an underwriting profit this year, but I can't predict whether it's going to be a big cut year or not, but I mean on some kind of an average basis, certainly, that is our belief, a very strong belief.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay. So, basically this comment is without using how it's still assuming some normalized catastrophe load?

A - Brian Duperreault {BIO 1645891 <GO>}

Well, we put in AAL in, I mean, I said we put in AAL in the first quarter and it was the arithmetic, it's under 100. You put in AAL for the whole year will be -- I'm saying we believe it will be under 100, but I can't tell you the actual cuts. That's my point.

Q - Yaron Kinar {BIO 17146197 <GO>}

Okay, appreciate it. And then my second question is on NII. So Mark, if I take the math for the sum of the parts of the that you weighed out, I get about $13.7 billion of NII for the year and I think that's a little bit above the $13 billion guidance that as I previously offered, so how should we think of NII on a normalized basis from here?

A - Peter Zaffino {BIO 15942020 <GO>}

Well, first off some features, would give you partial credit and some features just are binary and say yes or no. But I'll give you a partial credit on that. So, you reflected the $450 million of investment expenses I think gross to net. But you have to recognize that the original guidance of $13 billion did not include the re-class. And depending on whether you look at the last quarter where the request was honored $16 million or you look at a longer period of time where it's closer to $115 which would be $600 million, I would get closer to $13 billion to $13.3 billion [ph], if that's helpful.

Q - Yaron Kinar {BIO 17146197 <GO>}

Yes, but you also had a re-class of the equity fair value adjustment. Right?

A - Peter Zaffino {BIO 15942020 <GO>}

That's right.

Q - Yaron Kinar {BIO 17146197 <GO>}

So would get a 13 to (inaudible). Okay, so you get a 13 to 13.3 with both three classes?

A - Peter Zaffino {BIO 15942020 <GO>}

Yes, if you reflect that you will be approximately there.

Operator

The next question is from Paul Newsome from Sandler O Neill. Please go ahead, your line is open.

Q - Paul Newsome {BIO 1541286 <GO>}

Good morning. I was hoping you could talk a little bit about cat load volatility, just on a normalized basis there's been so much change with your business mix and reinsurance and the like and I guess I've been traditionally think of insurance companies is sort of having their the toughest cat quarter in the third, second through the second worst and maybe first and second is about the same. But do you think that AIG is going to follow, sort of the traditional pattern or with all these changes, do you think there'll be a difference in your normal cat load volatility from quarter to quarter?

A - Brian Duperreault {BIO 1645891 <GO>}

I would love to give this to somebody else. Everybody try this to start with. And so, I think there is -- yes, there is an inherent seasonality to cats because of the storm seasons, which are third and fourth quarter in the quakes can happen anytime. I mean, we've had whether in the first quarter winter storm losses winter storm losses etc. But, yes, by and large, say the first half would be a little lighter than the second half, that's just traditional. I don't think that's changing now, but you know, I don't -- first of all, I don't really want to talk about AALs anymore but anyway, we think about it as an annual number because you really have to think of it at least on an annual basis. Peter do you want to say some...

A - Peter Zaffino {BIO 15942020 <GO>}

So, the only thing I would add, Brian because the question was also around volatility and we use that word a lot in our scripts, but in addition to putting together a much more comprehensive program and in addition to making it an aggregate, our standard deviation in expected volatility around our different return periods has decreased by 50%. So while it's not certain, the expected value around whether it's a AALs, PMLs has reduced significantly in terms of what we think is going to happen. So, that is something that through the entire reinsurance design has been very beneficial and gives us more confidence.

And one thing I would add into that, clearly, it's question, Paul is in my prepared remarks, I tried to show that for risk is also helpful in that regard. And that's the cat programs that we'll put in place, let alone the carve-out of DCG is materially better our vertical and horizontal protection regionally and globally. So, I think that helps with the containment, then I would ask you to not forget one thing we talked about last quarter, which was the way the gross underwriting changes earn in is because they started earlier is one due, but the reinsurance, mostly attached in the latter half of 2018. Some of that was risk attaching some of that in to the benefit of the of the cat program which is most occurring, but the point is, we'll look at increasing protection and volatility reduction as we go from quarter to quarter to quarter in 2019.

Q - Paul Newsome {BIO 1541286 <GO>}

Thank you. And then any updates on the capital management thoughts, there weren't any buybacks in this quarter but did raise some capital. Just wanted to see if there is any additional thoughts you have there?

A - Peter Zaffino {BIO 15942020 <GO>}

Now, if look we were largely blacked out first quarter. So, at the end of -- because of those offerings, you mentioned. So, I think we continue to look at it. My philosophy hasn't changed. I think it's an appropriate capital management tool. And as we go through the year, we will look at how we want to use that capital. And so, no, no changes there.

Operator

This question is from Josh Shanker from Deutsche Bank. Please go ahead.

Q - Josh Shanker {BIO 5292022 <GO>}

Good morning everyone. I was interested in understanding about the timing of the reinsurance purchasing for the remainder of the year. You had said about two-thirds of the reduction; I guess in the sum of AIG's invalid versus 1Q '18 premium year-over-year was related to reinsurance buying. Are you buying more reinsurance, which will have a similar effect in the quarters to come out or first quarter, the big by quarter? And then how does that affect expense ratio, as we go forward?

A - Peter Zaffino {BIO 15942020 <GO>}

Thanks, Josh. We have the only probably material impact that we foresee as of now is how the sort of casualty quota share will earn through the year for the US because that's a big session and one that just commenced on a risk attaching based in the first quarter so that was the most material. I don't believe that we will see any other material purchases on property. So, we've done a lot on the per-risk. As Mark mentioned on the aggregate we have done some facultative purchasing to make sure that we take out the volatility of our long-term deals on property and I don't think that as we look to the remaining part of the year we have thought about the impact of reinsurance and do not believe it will impact our expense ratio, as we head into the second and third quarters.

Operator

Our next question is from Ryan Tunis from Autonomous Research. Please go ahead.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Thanks, good morning question for Peter. Maybe Mark can now but severe assets. I know you're not disclosing those anymore, but could you give us some idea of how those ran here versus; I think $125 million was the expected level last year? And also, in terms of the GOE run rate is 839 this quarter in General Insurance, which is down about $50 million from 4Q levels, is that 839 number a pretty good one to use over the remainder of the year, do you think?

A - Peter Zaffino {BIO 15942020 <GO>}

So, let me comment on severe then I will turn it over to Mark. But in the quarter, we had less gross activity than if you looked at our multiple quarter average. But I think the bigger issue was just in terms of how we address the property per-risk and buying down and taking out volatility in addition to one of the areas of our business, which had a little bit more frequency on severity. We ended up working through a quota share to mitigate a lot of the volatility. So, I think it was -- one was the growth, but more importantly is what we've done to protect volatility to reinsurance. Mark, anything you want to add?

A - Mark Lyons {BIO 6494178 <GO>}

Yes, I would just say on the severe without getting into any specifics it was a very light view of it so it's, which is another reason, but the front end underwriting changes Peter talked about the reinsurance changes, it just changes the game, but there was nothing adverse on severe.

A - Peter Zaffino {BIO 15942020 <GO>}

Do you want to comment on the GOE?

A - Mark Lyons {BIO 6494178 <GO>}

The GOE, because the 839 year quoting incorporates Validus we attended two quarter-over-quarter that excludes that you get apples-to-apples. So, it's probably a more realistic line but I think you should be thinking more in terms of ratio rather than on the dollar sense. We've had two consecutive quarters of GOE being 12.5% of earned premium and that can move a little bit as a function of miscellaneous items and accounting that could affect our premium and things like that, but that's probably the preferred way to look at it.

Q - Ryan J. Tunis {BIO 16502263 <GO>}

Okay. And then I just had a follow-up on -- We had on volatility, but curious on how you guys are thinking about volatility within the attritional loss ratio. So, if you have a view, what the central tenancies like say 63.1 you think is a good run rate, how many points away from that is one center deviation it could just be explained by adverse lack. Is it 1 point now, is it two points? Because like it companies like Travelers we're used to it being less than a point for quarter could be just explained by adverse activity. Are we at that point yet or could we still see two or three points swings often what you think you really running at?

A - Mark Lyons {BIO 6494178 <GO>}

So, couple of thoughts come to mind. One, I don't really look at it that way, I suppose, I could go back, but we have a massively diverse global geographic presence and different characteristics. The company you mentioned is much more of a frequency-driven a company and therefore more predictive. We have a lot of we're changing that mix to be much more mid and smaller but the in-force book still has a lot of severity characteristics, low frequency, high severity characteristics so I would say there's a fair amount, the reinsurance is going to contain that gives you asked a net loss ratio question. So, it's going to contain that more, but I would expect it to be wider than travel than Travelers.

Operator

Next question is from Andrew Kligerman from Credit Suisse. Please go ahead.

Q - Andrew Kligerman {BIO 1551668 <GO>}

Great, thank you. I just wanted to follow up on Paul's question about the buybacks and I understand you in blackout period, but given your debt to capital is pretty close to 30%, is it fair to assume that you probably don't want to do much by way of buyback for the balance of the year?

A - Mark Lyons {BIO 6494178 <GO>}

I don't want to predict anything here. Do I want to don't I want to I mean I think we have to go through it quarter-by-quarter and really understand uses of that capital. So, we have a buyback authorization in place, continues to be there to be used. I don't want to comment more than that.

Q - Andrew Kligerman {BIO 1551668 <GO>}

And then just with regard to the personal lines, so I know Mark earlier was talking about two-thirds of the normal -- when you take out the acquisitions etcetera premium were down -- net written premium were down 17%, two-thirds due to the reinsurance. And now just looking at the personal lines, North America down 6%, International down 12%; could you give us a sense of what the reinsurance component of that decline was and also you mentioned in the release, A&H premiums were lower, is there some competitive situation going on with that that's putting pressure on A&H?

A - Brian Duperreault {BIO 1645891 <GO>}

Peter?

A - Peter Zaffino {BIO 15942020 <GO>}

So on the personal insurance in the United States, our travel book; our warranty book came in exactly where we had thought it would in terms of combined ratio for the quarter; so we're really talking more about the high net worth book. And looking at the composition of that book, we not only had that contribute from the sort of global aggregate where we lowered our attachment point, we also bought more per risk, we also bought a specific cat program that has different attachment points depending on peaks zones for our high net worth book that we think will dampen volatility, and also allow us as we want to reposition in certain peak zones, the portfolio and accelerate our underwriting.

We just hired a terrific individual, Cathleen Zortman [ph], who has decades of experience in driving high net worth portfolios, we're really excited she is joining us, and that will happen in the second quarter, and we'll begin to accelerate like we have on other portions of the portfolio and an improvement in terms of it's footprint, and the reinsurance is I think very responsible and it will respond well throughout the year depending on what happens in terms of cats.

Q - Andrew Kligerman {BIO 1551668 <GO>}

And so the question which -- how much of the.

A - Peter Zaffino {BIO 15942020 <GO>}

You shouldn't read anything on the A&H, it's a terrific portfolio, performance is very well in terms of it's combined ratio and a scenario where Brian and I very much want to grow our book, and we should take a longer-term view but it's an area where we think we'll have growth over the longer term.

A - Brian Duperreault {BIO 1645891 <GO>}

And we've stepped our.

A - Peter Zaffino {BIO 15942020 <GO>}

We just have named a global leader, Ed Leven [ph], and so he has joined us and we have a strategy in place and beginning to accelerate our growth, it will take some time but really excited about that portfolio and what it could mean for us long-term.

A - Brian Duperreault {BIO 1645891 <GO>}

Let me answer the one last question, and then we'll wrap it up. So operator, the last question, please.

Operator

Certainly. And this comes from Tom Gallagher from Evercore. Please go ahead.

Q - Tom Gallagher {BIO 3311667 <GO>}

Thanks. First question on P&C; you had big growth in specialty risk in terms of net premium written, just curious what kind of combined ratio that's being booked at? Is that going to add meaningfully to underwriting improvement as that earns in and can you just provide a little color what -- kind of what drove that significant growth?

A - Peter Zaffino {BIO 15942020 <GO>}

It was mostly the acquisition. We had Talbot and CRS, which is the crop and so that's in the specialty classes; and I'll look at Talbots say terrific syndicate and has very balanced portfolio with marine, specialty classes including energy, political risk and political violence, and we've been working very hard to determine what's going to fit within AIG, what's going to fit within the syndicate and do believe that that business will perform well over the short, medium and long-term and will contribute like Validus re has to our overall improvement in combined ratio. But it's very good and on a calendar year basis it performed quite well in the quarter.

Q - Tom Gallagher {BIO 3311667 <GO>}

Got you. And then, just a follow-up on net investment income; Mark, I was following the stable asset class returns versus the more volatile ones. And just looking at the $29 billion that you characterized as more volatile; if I'm looking at your guide for full year NII, I think that only would imply something like a 3% return on that $29 billion carrying value portfolio. And you have I think plenty of higher returning asset classes in there like private equity and alike. First off, is that right? And secondly, does that imply your $13.2 billion NII guidance is just conservatively assuming returns on that portfolio, can you provide some color on that? Thanks.

A - Mark Lyons {BIO 6494178 <GO>}

Well, first off Tom, the first question would be what period of time should you assess volatility? I purposely looked at something that worked for this since it's up which was current in four prior quarters or five quarters. That particular one averaged 5.8% over that period with a swing of 2% to 9% that shows you some of that volatility. So that's implying like another $1.7 billion on 5.8% basis, which to the 12.5% takes you to 14.2%; you got to take out the $450 million annually for investment expenses and then the re-class impact that wouldn't have been in there in the original guidance of $13 billion even. With -- and that composite gets you down to the $13 billion to $13.3 billion. But I think what question you have to answer for yourself is what's the proper volatility measurement, I just gave you an example of one.

Q - Tom Gallagher {BIO 3311667 <GO>}

Okay. Thank you.

A - Brian Duperreault {BIO 1645891 <GO>}

Very good, thanks Tom. So before we end the call, I want to thank everyone who dialed into your remarks. I'm approaching my two-year anniversary at AIG and I couldn't be prouder of what we're accomplishing at this great company. And I'm grateful for the tremendous support we are receiving across the industry, and I want to thank all our colleagues at AIG for their hard work, dedication and resiliency, and we still have a lot of work ahead of us, but our first quarter results demonstrate we are on the right path. So thank you very much. Have a great day.

Operator

Ladies and gentlemen, that now concludes today's conference call. Thank you for your participation, you may now disconnect.