2020 Morgan Stanley Virtual US Financials Conference

Company Participants

- Sabra Purtill, Chief Financial Officer

Other Participants

- Michael Phillips, Analyst

Presentation

Michael Phillips {BIO 21023048 <GO>}

Okay, thanks everybody for joining us for the next fireside chat on our series here today and continuing tomorrow as well. Again, Mike Phillips here, Morgan Stanley's PNC analyst. And we're joined for the next fireside chat with Sabra Purtill from AIG. Before we get into it, a quick disclosure, number 4 disclosures. Please see the Morgan Stanley website at www.morganstanley.com/disclosures. And any questions, please see your sales representative. So again, thanks for joining us. We have Sabra here. She is the Deputy CFO and Treasurer at AIG. I think all of you know her pretty well. So I'm looking forward to a nice discussion. We have about 25 to 30 minutes to kind of talk on various topics, so looking forward to it.

Sabra, thank you very much for joining us.

Sabra Purtill {BIO 1764408 <GO>}

Thank you for organizing this, and hello to everybody out there. I hope everybody is healthy and safe these days.

Michael Phillips {BIO 21023048 <GO>}

Thanks. So let me just start, I guess, Sabra, with kind of just top of mind on the pandemic, I guess, if we can. You guys have talked about that as more of a "Earnings event", not really a capital event. Since then, I think -- since those conversations in 1Q, we've had a couple of other things happened. Now we've got some crazy stuff going on in the cities with riots, we've got possibly an active hurricane season as well, so a combination of a bunch of things. I guess, maybe first off, how do you think about those combinations of things in combination? Does that pose a threat to capital? Or is that still, in combination, more of an earnings event -- events, plural?

Sabra Purtill {BIO 1764408 <GO>}

Yes. Yes, well, I have to say, this second quarter is definitely going to be an interesting one for the industry because you're right, we've got what is normally a very active catastrophe quarter in the United States, and not so much hurricanes, but the thunderstorms, wind events that we tend to get in the second quarter, tornadoes and so on. Then you've got COVID, which, as many companies have talked about, is going to manifest itself in various ways across different lines, different geographies and over an extended period of time. And then you have the recent unfortunate events that have caused protests across the country and, unfortunately, some property damage and physical damage. So I'll start by saying, we have no idea what the second quarter is going to look like, but it's definitely going to be an unusual one. But having said that, we still look at the environment that we're in as truly an earnings event and not a capital event, particularly when you think about the more traditional CATs and exposures that we -- you would have from storm activity. AIG today is in a much better position than it would have been, had these events occurred even as recently as 3 years ago, and that's a combination of the reunderwriting and reduction in limits, particularly across the property book, a significant elimination of multiyear policy, which, as you know, locks in the price and the underwriting coverage for a period of years. And in addition, we've just substantially increased our utilization of reinsurance to manage the insurance risk on the balance sheet, and finally, have also significantly derisked the investment portfolio. So as you think about these various events, so for instance, the hurricanes or second quarter and third quarter storm activity, our CAT reinsurance programs will provide protection to those events, both on an aggregate as well as on occurrence basis because we have policies for both of those -- for both the U.S. and the International book.

I would also draw your attention to -- this year, we have a slightly different structure for our Private Client Group coverages. And in addition, we've announced the formation of Syndicate 2019, where a significant portion of that book is going to get reinsured in the second quarter. So our exposure to natural CAT losses on the high net worth book that we have will be significantly different than what it would have looked like even last year when that book was 100% on our own paper, and for our own risk.

So as we think, like I said, on the natural catastrophe side of it, our underwriting and reinsurance will help provide protection for there. On the civil unrest and the property damage, that's going to very much depend on the facts and circumstances of each individual loss because, as you know, a large national chain of retailers is going to have a very different exposure to the broken glass or property damage than a owner/proprietor shoe repair shop, for instance, which is going to be more first dollar coverage. But in general, obviously, those events are -- damage from those types of events are covered under traditional insurance policies, unless there's some explicit wording. So whether it was the -- what we saw in Baltimore several years ago or, in fact, what we saw in Chile, last year, property damage caused by those events, to the extent that there's insurance for the property, would be covered.

And COVID, as we said, COVID is a weird one, right, because it's an insurance loss on both the General Insurance side to the extent that coverage terms prevail, it's a mortality event on the Life Insurance side, although, to date, we still think it's a very manageable mortality blip that we have in our book. And then the big question is really the long-term economic impact to both our investment portfolios as well as exposure to growth in GI or demand on the L&R side. But we -- to date, we don't see anything from either COVID or the combination of these things, which lead us to believe that we would need to have any significant increase in the capital basis or that there would be significant damage done to the operating company and capital basis, which would require any form of capital raise or recapitalization. I know that's not true of everyone. Obviously, there's been some opportunistic capital raises recently in this space. There's also been some defensive capital raises. But to date, our focus has really been on strengthening holding company liquidity because of the capital markets uncertainty so that we have ample liquidity to address upcoming debt maturities and maintain significant financial flexibility in these times.

Michael Phillips {BIO 21023048 <GO>}

Okay. Thanks. It's a good overview. I think we'll have a lot to follow-up over the next course of this conversation for everything you mentioned. So maybe the first one, just quickly, I guess, on -- this is kind of a real quick one on the riots. I mean anything you can quantify there or talk about potential exposure or concentration in maybe large cities, anything you can share there?

Sabra Purtill {BIO 1764408 <GO>}

Yes. I think it's premature because we'll have to see what we actually get in terms of the claims volumes. But again, I would remind you that the coverage is going to be very different for somebody who is a large corporate, where they basically retain the working layer of property damage, and we're attaching at more of an excess level. We're not a big player, as you know, in the small and middle market commercial space. So I think, to the extent, the damages were done in a part of town where there's more small business as opposed to like a downtown business district, then it's going to be different. And as you know, there's been events across the country, large towns and big cities and the rest. I think we tend to focus on the biggest cities, but I'm down in Virginia most of the time and we've had demonstrations -- peaceful demonstrations in the small town that we live in, and then there's been more violent protests in Richmond, which was just on the road from us. So -- but again, in general terms, yes, property damage caused by these sorts of events would be covered under somebody's property coverages subject to the deductions and limits that they have.

Michael Phillips {BIO 21023048 <GO>}

Okay. No, that's helpful. I guess, maybe at a higher level then, just to take a step back for a second, just talking again more about the impact of pandemic and losses from it, have you seen any change from clients in their perception of risk and maybe demand for different products or possibly thinking about retentions and self-insurance structures or what have you that would be a kind of a ripple effect from the pandemic itself?

Sabra Purtill {BIO 1764408 <GO>}

Yes. That's probably a better question to ask the brokers because they're probably more actively involved in early discussions with clients about upcoming policy renewals and the rest. I mean what I would just note is, I think there was already conversations going on relative to the cost because, obviously, we've been through a pretty hardening pricing cycle. And as you know, when costs go up or when coverages are more limited, then you see people moving from the admitted to the excess market, or people go from self-insurance to maybe some elements of excess. And I think that's more driven by the cost than anything else. But of course, we would expect, like I said -- when people come to us, we're generally not the first conversation large corporations or multinationals have as they think about pricing and terms and conditions with the product.

Michael Phillips {BIO 21023048 <GO>}

Okay, sure. So I guess, just on the pricing front -- go ahead.

Sabra Purtill {BIO 1764408 <GO>}

But Just to put a -- I guess, to put a -- it seems inconceivable to me with all this -- the unusual events of this year with COVID as well as the hardening pricing cycle, I'd be shocked if any major corporation or a business wasn't trying to think about what they needed to do for their coverages and what they can afford, frankly.

Michael Phillips {BIO 21023048 <GO>}

Right. That makes sense. Okay. I guess, sticking within the appraising theme, does -- what effect, I guess, does the slowing economy have on insurance companies, your guys' ability to push for more rates in times that we're in through the next quarter or two?

Sabra Purtill {BIO 1764408 <GO>}

That's a really good question. And I think, to some extent, you have to keep in mind the parts of the market where you're basically having to file and get approval for rates, as distinct from those areas where we're basically deciding based on our pricing expectations what we want to charge, and particularly for the E&S market. The way I think of it right now is that we went through a period where a lot of people went home to work or where some people got laid off. And obviously, for businesses that are closed, they're not going to be paying workers' compensation, insurance. And so we would see less premium from those sorts of policies, and also less losses. But in areas where you are seeing increased claims or activity, so whether it's, say, in the health care worker space or workers' comp, people are going to be pushing for rate to increase the premiums to cover the risks, particularly as you think about this virus being around for a while without a vaccine. So like I said, I think there's some countervailing forces going on, and what will ultimately be the determinant of the amount of rate we get will depend on kind of the attractiveness of the product, given where we think the loss exposure is.

And I think that's one thing to just talk about. And we'll probably all be talking about it more over the course of the next couple of weeks and months is, this is going to be a really unusual year for the actuaries to figure out what to do with loss picks because on the one hand, you obviously have the claims from COVID, so whether it's mortality or whether it's an increase in frequency on some aspects of workers' comp book, but then you're going to have other areas of the book where there's probably less activity because of the shelter in place and working from home or just the significant change in people's habits, right? So there's probably fewer drunken driving accidents because people aren't going out to restaurants and then trying to drive home, for instance. And I think it'll take a little time to figure out kind of the net-net impact on loss picks and 2020 accident year experience because of all these changes in behaviors.

Michael Phillips {BIO 21023048 <GO>}

Yes. It's interesting. It's certainly got to be fun as this develops on how the loss picks outlook. You're right.

Sabra Purtill {BIO 1764408 <GO>}

Yes. Well, like, one thing that's been mentioned, for instance, is, okay, there's a huge drop in personal auto mileage because people aren't driving to work, but we are seeing more severe accidents because the roads are less crowded.

Michael Phillips {BIO 21023048 <GO>}

Right.

Sabra Purtill {BIO 1764408 <GO>}

On the commercial auto side, we'd note -- we still got a lot of trucks running around delivering things. So there's not -- I don't think there's really any significant benefit trend from the commercial auto side from frequency. But you would still think that with fewer cars on the road, there might be ultimately some benefit in the loss picks. But nevertheless, I think what we can all agree is that you can't try to figure out this year until we have more developed experience on actual accidents this year because you can't compare 2020 to 2019 or prior accident years in any reasonable way right now. We just need more true actual 2020 experience and data to understand what the trend is going to look like. And then there will be some favorable trends. I mean the joke I was making with somebody the other day is, if I'm working from home and I trip and fall down the stairs in my house, is that a workers' comp claim, because if I tripped and fell over at work, it would be, but I'm working in my own house.

Michael Phillips {BIO 21023048 <GO>}

Right.

Sabra Purtill {BIO 1764408 <GO>}

Right?

Michael Phillips {BIO 21023048 <GO>}

Yeah. A lot of flowing parts.

Sabra Purtill {BIO 1764408 <GO>}

It is. It's just going to be a very unusual year. That's why I say for this second quarter, I think for all of the companies in the industry, it's just going to be an unusual quarter. And we'll have to understand it and explain it, obviously. But it's going to be an unusual quarter. And that's even on the investment side, right? So think about where the markets are now versus what they were at March 31. I mean the S&P is -- I think it's still in positive territory today for the year. And that's not what we would all have expected back in late April, early May when we were reporting first quarter results.

Michael Phillips {BIO 21023048 <GO>}

Right. So I mean you mentioned something in the opening comments on the equity capital raises that we've seen. And as you said, some that are maybe more defensive, some are a little more offensive. But let's couple that with -- and in fact, we had one today that was probably more on the offensive side, so these things are continuing. So couple that with what we're seeing with the hardening reinsurance pricing environment. To what extent those events do you think have any kind of dampening impact on the level of price acceleration for reinsurance?

Sabra Purtill {BIO 1764408 <GO>}

Yes. I'm not in the best position, since I'm not working in the reinsurance business day-in, day-out, like many of our colleagues at AIG. But just harkening back to some of the comments that Peter has made, and he does believe that there's going to be an impact on some of the ILS and the retro market. And I would anticipate that some people are raising capital because they do, in fact, think that there's going to be a very attractive reinsurance market and that because of the trapped capital in some of these areas as well as potentially losses that come through from either COVID or other CATs that they want to have the capital to be able to write more business.

Michael Phillips {BIO 21023048 <GO>}

Sure. Okay. You also mentioned in the opening kind of the comments about reinsurance and your reinsurance changes that you've made, not just recently, but over the past couple of years. So you've been working through a lot to refine those programs. So how does -- I guess, how does the hardening market there affect your reinsurance structures moving forward? Do you think the rising prices and maybe tightening terms and conditions there, do they discourage any further reinsurance purchasing on your end?

Sabra Purtill {BIO 1764408 <GO>}

We'll have to see how things play out during the course of this year and what it looks like. As you know, most of our principal catastrophe treaties are January 1 renewals, and so we renewed our programs long before the recent unpleasantness, as you might say. But I would just note that you have to remember that the primary reason why we began the reinsurance is, one, it was prudent to have some, particularly on the catastrophe side; but, two, previously, the company had been writing very large limits in both Property and Casualty lines, large limits with limited reinsurance, and in many cases, they were multiyear policies. So we had to use reinsurance as a means of kind of addressing those kinds of concentrations, aggregations of risk. And as we've gone through, and David McElroy talked about it a couple of weeks ago, as we've kind of gone through two turns of reunderwriting on the GI side, we have reduced the limits that we're putting now, we've ventilated some exposures, we've raised attachment shield, we have different terms and conditions. And that, at the end of the day, is really the primary tool that an insurance company needs to manage risk. So we can probably think a little bit differently about our reinsurance needs as we go forward. And a classic example, of course, would be what we did with our high net worth personal lines business with the Syndicate. So effectively, we are still going to be able to participate in that business. We're going to write paper and reinsure it into the Syndicate or through other programs. But we'll be able to still be a very strong participant in an attractive part of the personal lines market without having all of the tail risk of the CAT cover because as you know that people who are very wealthy tend to live in places that have particularly a hurricane or earthquake exposure, and there also tends to be a concentration in certain neighborhoods, which creates aggregation as well. But again, I keep going back to, it's good that this is happening today as opposed to 3 years ago because we didn't have those sorts of reinsurance coverages in place, we hadn't started the repricing and the reunderwriting cycle. So now as we come into what's clearly a harder market than what it was at the beginning of the year, we have much more options and flexibility to think about both where we write new business or where we think about having a reinsurance coverage as attached or detached.

Michael Phillips {BIO 21023048 <GO>}

Okay. That's helpful. I guess, we've seen some areas start to reopen a bit. And maybe, have you seen any, I guess, differences in exposure units there between the opened regions versus the closed regions? And if so, maybe how big from what you're seeing since things are starting to able to open back up again?

Sabra Purtill {BIO 1764408 <GO>}

Yes. We haven't provided an update on that yet, and I would say it's still too early. I mean as you know, New York just went into -- New York City went into Phase 1 on Monday. And I think it's in some of these larger urban areas where -- such as New York, where you've seen much more shutdown. There's other parts of the country where it wasn't as dramatic. Again, in Virginia, where I am, we're on Phase 2, and they're already starting about -- talking about Phase 3 in another 10 days or something like that. But similar to what we saw in the employment report last week, I think that as people are permitted to engage in more normal levels of economic activity, then, obviously, we're going to see exposure come back. But from a insurance business that reports on a quarterly basis, right, we still haven't seen second quarter and what the impact has been, will be in our second quarter premiums relative to the shutdown. So third quarter, fourth quarter is probably when we can talk a little bit more about how we're seeing the increase in exposures from what will be lows, obviously, in the second quarter. When you think about it, it was March 11, right, when basically everybody was told to go home.

Michael Phillips {BIO 21023048 <GO>}

Right. So on that still, on -- one of the hot topics early on that was business interruption, and that seems to have quieted down a bit. Some states have actually even pulled back a bit. Louisiana has done a little bit to kind of pull -- maybe take the pressure off there, and it's just been relatively somewhat quieter. What do you attribute that to? Is it -- do you think there's the threat of BI on insurances that's kind of gone away? Or is it just kind of a temporary low? Or maybe any updated thoughts on the exposure there for not just you guys but the industry as well?

Sabra Purtill {BIO 1764408 <GO>}

Yeah, it's -- I think it remains to be seen what the solution is going to be for protecting small and medium-sized businesses from this sort of catastrophe event going forward. But I think an observation would be that people, and by that, I mean particularly legislatures where you heard or saw some of these bills passed. The issue is a lot more complicated. And I think there's sometimes a tendency in the popular mind for people to think of, "Well, my insurance company, I pay them all that money and they're big and wealthy and how come they're not paying me my claim because I think I'm entitled to my claim." But this is, obviously, cutting across huge swathes of small- and medium-sized businesses in the United States. And the insurance companies neither price for nor underwrite for a pandemic-type business interruption insurance. And I think that the regulators, (technical difficulty) from their own knowledge of what their purpose is as a regulator, which is to protect the solvency of the industry so it can pay claims for everybody, I think there's just been more education going on. But as you know, there are some proposals that are being discussed to kind of come up with like TRIA type funds to think about as a way of providing some protection for business interruption or losses from COVID that aren't currently covered by business standard kind of ISO business interruption forms. For us, as we've indicated, we're not a big small- or medium-sized business insurer, we're very large multinational Fortune 100-type insurer. And in our markets, we've done a really deep scrub, and less than 1% of our property limits have any kind of contagious disease coverage, and even in those cases, it's mostly cleanup as opposed to like a true business interruption-type coverage. And a lot of -- in our market, like I said, we're going to be very much governed by the terms and conditions of very specific policies as opposed to subject to some of these lawsuits you're seeing in the small- and medium-sized business area where people are suing their insurer or trying to get expanded coverage terms based on maybe less-than-clear language in contracts and the rest.

Michael Phillips {BIO 21023048 <GO>}

Okay. In earlier comments here, we talked about the difficulties for the actuaries on loss picks on the P&C side. I guess, let's take that over to the Life and Retirement side. You've guided to some higher mortality rates in 2Q, 3Q for this year because of COVID. And I mean, I guess, to what extent does guidance on mortality take into effect maybe indirect impacts on mortality, so maybe like fewer car accidents or customers getting medical care because of backlogs because of COVID and things like that? So maybe any update since then on how things are looking and some ripple effects because of -- on the mortality side?

Sabra Purtill {BIO 1764408 <GO>}

Yes. Well, as Kevin commented on in our earnings call back in May, we put up a little bit of IBNR on our Life and Retirement mortality book because the reported experience that we have seen during the quarter was actually a little bit better than pricing, but we felt pretty strongly that just given the kind of suddenness of the illness spike in the United States that there was probably delays in some of the death reporting. And in fact, as we got into the second quarter, we have obviously seen an increase in the number of deaths that were related to COVID, still very manageable overall. I think others have, in the life insurance space, have talked about that as well. And obviously, people do -- various pandemic sensitivities and the rest, although, frankly, with the curve clearly having gotten bent some in the United States, so hopefully, we don't have to think realistically about scenarios where 4 million people die or something like that.

But going back to your point, yes, in the first quarter, we had seen better than -- pricing on mortality. Second quarter, we've seen more, still manageable. But again, there's some serious suppositions around that what you're seeing in mortality from COVID because it does tend to be have a higher fatality rate for older people or people with comorbidities, so what you might be seeing, to some extent, is a front-ending of a death that might have occurred any, sometime in the next 3 to 5 years anyway. And I think that will be the interesting point to see. Clearly, like I -- as I mentioned before, yes, personal auto frequency is down, but severity is up. So while you still may see lower levels of deaths from auto accidents, we're still going to see those. And then the other area where we're watching very carefully is suicides. Historically, during periods of financial crisis, there is an increase in suicides. We certainly saw that during the great financial crisis, and we'll continue to monitor that. But that tends to -- obviously, that's not an immediate reaction to what we're in, right now, tends to come from financial distress and stress on that front.

Michael Phillips {BIO 21023048 <GO>}

Okay. Thanks.

Sabra Purtill {BIO 1764408 <GO>}

So all in, to kind of wrap a bow around it, I would say, we would still expect mortality experience for this year to be higher than last year, even if we do have some benefits from, say, like you said, lower automobile accidents and such.

Michael Phillips {BIO 21023048 <GO>}

Okay. Unfortunately -- I mean, we could go all day. Unfortunately, we've got to be a little conscious with time.

Sabra Purtill {BIO 1764408 <GO>}

Yeah, I know.

Michael Phillips {BIO 21023048 <GO>}

I mean we're close, so -- and that does stink. So let me kind of throw real quickly and let you take them where you want. Thoughts on, one, Fortitude, given the recent closure of that and any comments you want to make around that. And then secondly, comments on capital liquidity, I guess, especially in light of the debt raise that you recently did. So maybe those two quickly, if you want, and then we can kind of wrap it up. Thanks.

Sabra Purtill {BIO 1764408 <GO>}

Sure. On Fortitude, we are really pleased to have closed that in the second quarter. We were -- fingers crossed, we're hoping to get it done by June 30, and we managed to get it across the finish line a little bit early. I know there were some concerns because of the market sensitivity of the long-duration assets in that portfolio. Some people were concerned that maybe it wouldn't close, so we were pleased to announce that it did close. Just a reminder to everybody on that, it is a reinsurance transaction, so you will continue to see the assets and the liabilities of those companies on our GAAP balance sheet. We will need to make some revisions to our non-GAAP measure for adjusted book value because of the kind of asymmetrical accounting we have with funds -- withheld reinsurance. But we'll walk you through all that on the second quarter when we announce earnings. Then also, of course, a reminder, we only own 3.5% of it going forward. So effectively, in the third quarter, you really won't see any earnings from Fortitude going forward. And I know some people still have those numbers in their estimates.

Yes. On the liquidity side, as mentioned, we started the year in a really strong position, more than $7 billion of cash and short-term investments at the holding company. Taking into consideration the sale of Fortitude and then the debt raise that we did, we have in excess of -- I think after the closing of Fortitude, we're above about $12 billion in liquidity. We will, obviously, use -- part of the funds from Fortitude are being put down into the Life and Retirement and the GI subsidiaries to support their risk-based capital ratios as well as their financial flexibility. And then with the debt raise, that was really a pre-funding of upcoming debt maturities. So we've got about $2.6 billion in debt maturing this year, including the repayment of the revolving credit that we drew down on the first quarter. Then we've got another $1.5 billion. So we feel that we're in a very strong financial position to both meet all of our holding company obligations as well as to have the financial flexibility with the Fortitude transaction to put a little bit of capital down into the operating subsidiaries as well.

Michael Phillips {BIO 21023048 <GO>}

Okay. Thanks, Sabra, very much for your time. With that, I think we're probably got to wrap it up. More meetings to get to for you, I'm sure, and everybody else. So thank you very much for the time, great comments. And I thank everybody else for attending in the audience. And Sabra, once again, thank you, and we will talk to you very soon here.

Sabra Purtill {BIO 1764408 <GO>}

Great. Thank you. Thank you all.

Michael Phillips {BIO 21023048 <GO>}

Thanks guys.

Sabra Purtill {BIO 1764408 <GO>}

Bye-bye.