Company Name: AIG
Company Ticker: AIG US
Date: 2018-02-09
Event Description: Q4 2017 Earnings Call

Market Cap: 53,427.57
Current PX: 59.43
YTD Change($): -.15
YTD Change(%): -.252

Bloomberg Estimates - EPS
Current Quarter: 1.433
Current Year: 5.759
Bloomberg Estimates - Sales
Current Quarter: 11725.000
Current Year: 48178.857

Q4 2017 Earnings Call

Company Participants

- Elizabeth A. Werner
- Brian Duperreault
- Siddhartha Sankaran
- Peter Zaffino
- Kevin T. Hogan

Other Participants

- Jay Gelb
- Brian Meredith
- Josh D. Shanker
- Kai Pan
- Elyse B. Greenspan
- Erik Bass
- Jon Paul Newsome
- Larry Greenberg
- Adam Klauber
- Thomas Gallagher
- Meyer Shields
- Jay A. Cohen

MANAGEMENT DISCUSSION SECTION

Elizabeth A. Werner

GAAP and Non-GAAP Financial Measures

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

Brian Duperreault

Business Highlights

Opening Remarks

- Today, I'll speak to our fourth-quarter and full-year 2017 financial results, our recent actions and my views on our strategic direction
- We had a busy end to 2017 and 2018 is off to a strong start

- Our fourth quarter operating earnings showed solid results across the majority of our businesses

General, Personal, Life and Retirement Insurance

- In General Insurance, I'm pleased with the stability of our reserves and the outcome of our fourth quarter reserve review
- That development for the quarter was modest and we took decisive actions where needed, which were mostly in Europe
- Importantly, our efforts to stabilize and improve our U.S. Commercial business are reflected in Q4 accident year underwriting improvement
- Across our Personal Insurance and Life and Retirement business, we continued to see solid results and the benefits of diversification

CAT Losses

- Q4 and full year were meaningfully impacted by catastrophes
- California wildfires were largely in line with our third quarter estimate and the greatest contributor to our fourth quarter CAT losses
- Despite full-year CAT losses of $4.2B, our highest ever, AIG delivered $3.2B on adjusted pre-tax operating income
- As I mentioned in past calls, my philosophy on reinsurance is that it is an important tool for AIG to best manage its portfolio of risks
  - It provides another set of eyes on our underwriting, helps to manage volatility and control loss exposure

Reinsurance

- Going forward, you can expect us to be a predictable buyer of reinsurance
- You will hear more from Peter about our insurance strategy and the overall market environment in General Insurance, where we see rate improvement across a number of lines

International

- With respect to the International side of General Insurance, we took a hard look at our European Commercial portfolio and similar to our U.S. approach, we have acted decisively and prudently
- International Personal Insurance had a very strong year and in fourth quarter, we completed the Japan merger that we've assessed with you on our prior calls
- Peter will talk more about our focused approach to managing our International business in his remarks
- As we closed out the year, I view 2017 as a starting point where we laid the foundation with respect to people, structure and underwriting
- We have completed our internal structural changes in both General Insurance and Life and Retirement
  - These changes better position our people in the market and simplify our structure, allowing for greater efficiencies

Expenses

- While the company has made a lot of progress on reducing expenses over the last couple of years, an organization of our size and scale needs to be a top-quartile performer in both underwriting and expense management
- We are committed to continuing to make meaningful progress in that direction in a prudent and thoughtful manner
- In 2017, our reserve and underwriting action set a baseline for General Insurance
- As I've said before, 2018 is The Year of the Underwriter at AIG and I'm committed to empowering underwriters and holding them accountable for driving profitable growth

Acquisition of Validus

- A couple of weeks ago, we announced the acquisition of Validus, a significant step forward in our strategy to deliver profitable growth
- Validus shares our underwriting philosophy of taking prudent risks across products and distribution
- As we stated when we announced the transaction, the talent and diversification Validus brings to AIG is financially accretive and value enhancing
- The company's business mix includes well-positioned companies providing new sources of growth for AIG
- This year, we're also taking another important step forward in our legacy strategy with the formation of DSA Re, a Bermuda company that will manage the majority of our runoff reserves
- You'll hear more from Sid on DSA's priorities

Tax Bill

- Lastly, our 2017 results reflect the impact of the tax bill on the re-measurement of our deferred tax asset, which was in line with previous expectations
- We believe the tax bill will be an overall net positive for AIG over the long term and look forward to the benefits of additional economic growth
- Last quarter, I spoke to the urgency this management team has to execute on our strategic priorities
- I'm confident in the changes that are taking place at AIG
  - They are providing positive momentum for the company and its performance going forward

Siddhartha Sankaran

Financial Highlights

New Organizational Structure

- This morning, I'll comment on our fourth quarter financial results, the impact of tax reform, our progress with regards to our Legacy Portfolio and capital and liquidity

- Turning to slide 4, you can see our results presented under our new organizational structure, which became effective during Q4
- Personal Insurance is now being reported with Commercial Insurance as part of the General Insurance segment and Institutional Markets is included with Life and Retirement
- As shown in our recast financial supplement, we no longer present normalized ROE as a reporting metric

Earnings

General Insurance

- However, we continue to include the quarterly noteworthy items that you can use to derive normalized earnings and they are shown on slide 5
- We reported adjusted after-tax EPS of $0.57, which reflected total General Insurance catastrophe losses of $762mm and included $572mm for the Northern and Southern California wildfires as well as losses from U.S. storms
- As a reminder, we provided a preliminary estimate of $500mm for the Northern California wildfires on our third quarter earnings call and actual claims came in modestly lower than we expected
- Our third quarter estimates for Harvey, Irma and Maria are holding up well overall relative to our initial estimates
- The total catastrophe losses for Q4 were split between $300mm in Commercial and $462mm in Personal Insurance

Life and Retirement Businesses

- Our Life and Retirement businesses delivered another solid quarter of results with an adjusted ROE of 10.2% in the quarter and 12.4% for the full year, benefiting from better-than-expected full year investment returns
- Our Legacy Portfolio also delivered solid returns for the quarter and full year

DVRs

- Turning to slide 6, we completed our detailed valuation reviews or DVRs on our reserves in Q4 and recorded net adverse prior-year reserve development of $76mm
- Our DVRs on long-tail lines were largely as expected and we saw favorable net development in North America of $97mm, including the amortization of the ADC
- International had unfavorable development of $177mm, primarily related to large individual claims development in Property and Special Risks business and U.K. Financial Lines

General Insurance

Accident Year Loss Ratio

- Turning to slide 7, our General Insurance ultimate accident year loss ratio as adjusted was 63.0% for the full year or 1.4 points lower than last year on an ultimate basis

- With respect to underlying progress in our portfolio, we see North America Commercial Insurance ultimate accident year loss ratios having improved by approximately 2 points year-on-year, which has been partially offset by deterioration in International Commercial Insurance loss ratios by 1 point
- I would note that our fourth quarter International Commercial loss ratios include a catch-up adjustment for the full year associated with our fourth quarter DVRs and claims review
- Our full year loss ratios for International Commercial are more representative of the starting point for profitability going forward
- Our Personal Insurance loss ratios are now at our expectation and we believe they are sustainable
- Peter will comment more on pricing, underwriting and trends in his remarks

GAAP Net Loss per Share and Tax Rate

- Turning to slide 8, the GAAP net loss per share of $7.33 for Q4 includes a charge of $6.7B to re-measure our U.S. net operating losses and other balance sheet deferred tax assets at the new U.S. statutory tax rate of 21%
- This re-measurement does not alter the amount of taxable earnings that can be sheltered by our net operating losses
- The reduction in the tax rate also does not impact our foreign tax credits, which we expect to fully utilize before they expire
  - These credits will now shelter a larger amount of taxable income
- We expect that our adjusted effective tax rate will be approximately 21% to 22% for the full year of 2018 and our after-tax ROE should improve by approximately 150BPS.
- The tax rate is slightly higher than the statutory rate, largely reflecting a higher blended rate on foreign earnings
- We continue to believe that the overall impact from tax reform is a long-term net positive to our intrinsic value

Balance Sheet

FCF, Dividends and Outflows

- Our balance sheet and FCF remained strong
- As shown on slide 9, parent liquidity at quarter-end was $7.3B
- During the quarter, we received approximately $300mm of dividends from our Life Insurance companies as well as $2B from Legacy Investments, including $1.1B from the sale of remaining life settlements contracts, which we disclosed last quarter
- Outflows during the quarter included approximately $1.2B related to YTD true-up for tax sharing payments to our P&C companies

Acquisition of Validus

- With respect to our acquisition of Validus, we remain on track for an expected closing in mid-2018
- As to our view of expected returns on the Validus acquisition, we see cash returns in the high-single-digit range, which takes into account our outlook for expense and capital synergies as well as the additional usage of our existing net operating losses

- We evaluate transactions based on economic value and accretion to our franchise value
- I would note, as a result of the reduction of the statutory tax rate that I mentioned earlier, we reduced committed deferred tax assets by approximately $400mm for our U.S. non-life companies and about $500mm for our U.S. life companies
  - This reduced the RBC ratios shows for each group by about 10 points to 20 points

Regulatory Capital Ratios and Dividends

- Our regulatory capital ratios remained strong and tax reform did not require us to downstream capital to any of our insurance subsidiaries
- We expect approximately $5B in dividends and $1B of tax sharing payments from our insurance subsidiaries in 2018, that is before any potential legacy-related activity and subject to our customary approvals

Legacy Strategy

DSA Re

- We have continued to successfully execute on our legacy strategy
- As Brian noted earlier, we formed a Bermuda-domiciled legal entity, named DSA Reinsurance Company Limited or DSA Re, to re-insure our legacy life and non-life runoff lines
  - By combining these runoff lines into a single well-capitalized legal entity, we were able to achieve operating synergies and strong diversification in assets
- Legacy remains non-core and will be managed by a team with extensive runoff expertise
- DSA Re will be a licensed re-insurer with approximately $37B or over 80% of legacy total insurance reserves and will be backed by approximately $40B of invested assets managed by AIG Investments
- Our objective with respect to DSA Re remains to efficiently manage our legacy liabilities, honor our policy and service obligations and maximize AIG’s financial flexibility
  - The formation of this entity will allow us to accelerate these objectives

Earnings from Securities

- Additionally, as shown on page 7 of the financial supplement, we had another strong quarter and full year of earnings from securities carried at fair value
- Earnings on these assets totaled $524mm in the quarter and $1.5B for the full year for a full-year return of over 11.5%
- Our expectation is for these returns to more closely resemble long-term historical returns that we estimate are in the range of 6% to 8%
  - Assuming these returns, we expect total 2018 net investment income for our core insurance businesses and legacy insurance portfolios to be approximately $13B.
- The greatest variable to our estimate remains projected market returns
- Kevin will comment further on the impacts for Life and Retirement

Summary

To sum up, we continue to execute on plans to improve our results

We've demonstrated the value of maintaining a strong balance sheet and FCF profile, which gives us flexibility to execute on our strategic options

Peter Zaffino

Highlights

Opening Remarks

- This morning, I will discuss the General Insurance fourth quarter and full year underwriting results, our efforts to manage risk and volatility, actions to improve the performance of our core business and our new organizational structure and leadership team, which I had commented on last quarter

CAT Losses

- Turning to slide 11, as you've heard, CAT losses significantly impacted our 2017 performance
- However, going forward, you can expect us to more thoughtfully manage frequency and severity of CAT exposure through our reinsurance strategy and the management of our gross exposures

Adjusted Accident Year Combined Ratio

- Turning to Q4, the adjusted accident year combined ratio improved 3.1 points over the prior-year quarter
- As Sid mentioned, we've seen improvement across portions of our portfolio, but we're not satisfied with our current accident year results and are making the necessary changes to drive better financial performance

Expenses, Net Premiums, Divestitures and Loss Ratio

- With respect to expenses, while our overall expenses declined 12% for the year, our expense ratio has remained flat as we've continued to reduce premiums as part of our remediation efforts
- In 2018, we've identified additional opportunities to improve efficiency as we transition to a more decentralized model, while we further invest in talent within General Insurance
- Total net premiums written declined 9% for the quarter and 10% for the year, excluding FX
- Divestitures accounted for 6 points of a full-year decline, while the remainder primarily reflects remediation of underperforming lines
- Going forward, in light of our reinsurance strategy and actions to manage the overall portfolio, we expect 2018 premium volume to be relatively flat with 2017 levels
- While the General Insurance underlying accident year loss ratio improved y-over-y, we still have work that needs to be done across the Commercial Lines

North America and International 2017 Results

- Slides 12 and 13 provide additional insights into North America and International 2017 results

- Last year, you saw the greatest impact from our remediation efforts in the North America Commercial, where accident year loss ratios began improving
- In addition, in aggregate, fourth quarter North America Commercial claim trends have been favorable relative to our expectations
- North America Personal Insurance net premiums written reflected growth in new travel business, which was offset by strategic divestitures and lower volumes and warranty

European Commercial Business

- Our European Commercial business was impacted by reserve strengthening, adverse loss emergence and certain catch-up adjustments in Q4, which Sid discussed
- We took underwriting actions in late-2016 and the 2017 accident year has seen an early improvement in trend, but rate and risk selection important is still required in these portfolios. We continue to work on remediating our book

Market Conditions

- Transitioning to market conditions, as Brian said, we are getting rate across multiple lines of business and U.S. Property is showing the greatest improvement
- Q4 is seasonally our lowest quarter for U.S. Property and the rate increases have varied based on exposure, geography and the impact of recent events
- However, we saw rate strengthening each month during the quarter, which averaged in the high-single digits and appears to be sustaining in Q1
- Our primary objectives are to partner with our clients, provide solutions at renewal and offer alternatives for our new clients
  - As a result, recent retention has improved y-over-y

U.S. Casualty

- Moving to other parts of the portfolio, in U.S. Casualty, we observed rate increases in the mid-single digits, which had a wide range depending on line of business, attachment point and experience
- We are maintaining a view on loss cost trends and taking rate to be responsive to our observations

Reinsurance

- Turning to slide 14, last quarter, we stated that one of our main priorities is to take a more strategic approach to reinsurance, building long-term relationships with our partners to manage future volatility
- Our reinsurance philosophy is to take smaller net lines in property and casualty, reduce volatility and be consistent buyers of reinsurance
- During the January 1 reinsurance renewals, we began to execute on our strategy by reducing severity and frequency exposures to North American CAT and net retention on our property per risk and also obtaining a new catastrophe cover for international CAT

    - We expect these enhancements and anticipated changes for the remainder of the year will substantially reduce our risk of future volatility

- Y-over-y, our PMLs are down 30% for the 1-in-100 and 1-in-250 events and on a pro forma basis when we include the acquisition of the Validus, our PMLs will be approximately 20% lower than the prior year, positioning us to pursue other opportunities as they may arise

Acquisition of Validus

- Our recently announced acquisition of Validus is another example of a strong start to 2018
- The acquisition brings valuable complementary businesses and allows us to expand our capabilities in treaty reinsurance, including access to the ILS market throughout the CAT, a Lloyd's platform, a commercial E&S surplus business and a crop insurer
- I've known the Validus leadership team for many years and their underwriting expertise and track record speaks for itself
- Given AIG's diversity and capital strength, I believe we'll be able to seek unique opportunities for profitable growth with Validus
- Last quarter, I said that I intend to run to our problems

Organizational Design and New Structure

- We recently announced our organizational design and additions to leadership that will provide the foundation for improving our financial business results
- Our new structure is composed of distinct end-to-end businesses that support transparency, accountability and process efficiencies
- Our core underwriting businesses will be led by Lex Baugh for North America, Chris Townsend for International and Gaurav Garg for Personal Insurance
- Chris joins us in early March and will implement our new operating model across our International businesses to drive local decision-making and increased accountability
- Tom Bolt recently joined us as Chief Underwriting Officer in January and he will play a critical role in bringing quality and consistency to our underwriting guidelines and process and assisting us in advancing our analytical capabilities

Closing Remarks

In closing, the modifications we've made to our structure, coupled with our talented leadership team, will enable us to improve strategic, financial and operational performance

Kevin T. Hogan

Highlights

Life and Retirement

- As you can see on slide 16, Life and Retirement produced solid results for the quarter with $782mm in adjusted pre-tax income despite approximately $90mm in adjustments, primarily for fixed and variable annuity products within Individual and Group Retirement due to ongoing modernization of our actuarial systems and related model refinements

Adjusted Pre-Tax Income and Adjusted ROE

- Our results for the year was strong with over $3.8B in adjusted pre-tax income and adjusted ROE of 12.4%
- Total yields for our spread-based products benefited from significant increases in alternative and yield enhancement income for the year
- It is important to note, however, that our base yields continued to be compressed due to the reinvestment environment

Asset Growth and Product Portfolio

- Additionally, asset growth, driven by strong equity markets, continued to help partially mitigate the impact of the low rate environment on our results
- One of Life and Retirement's greatest strength is the breadth of our product portfolio across our businesses, which served us particularly well in a year marked by industry sales challenges, especially in the individual annuity market
- We emphasized growth in Life Insurance and Institutional Markets sales and continued to maintain steady sales results for our Group Retirement business

Institutional Markets

- Results for Institutional Markets are now reported as part of Life and Retirement, which is consistent with many of our peers
- Our diversified position in Institutional Markets further emphasizes the breadth of our product portfolio and market presence
  - This business is well positioned to capitalize on available growth opportunities, but we remain focused on achieving targeted economic returns

Individual Retirement

- Now, I will briefly discuss our results for Q4
- Turning to Individual Retirement on slide 17, regulatory uncertainties and disruption have continued to significantly affect distributors, negatively impacting industry sales, particularly our variable annuity products

Fixed and Index Annuities

- Although our sales of Fixed and Index Annuities increased for the quarter, overall Individual Retirement net flows remained negative
- Individual Retirement's assets under administration were at historical highs at quarter-end, driven by equity market performance and positive Index Annuity net flows, which resulted in increased fee income

- We continued our practice of active spread management, but as expected, we saw continued compression, reflecting current reinvestment conditions
- This quarter, base net investment spreads benefited from unexpected accretion income for Fixed Annuities and growth in Index Annuities

Group Retirement

- Turning to Group Retirement on page 18, our investments in VALIC to transform the plan sponsor and participant experience continued to pay off
- New group acquisitions increased significantly for the year
- Despite strong sales for the year, net flows declined as individual surrenders increased
- Similar to Individual Retirement, Group Retirement achieved record assets under administration and despite disciplined rate management experienced expected base yields compression

Base Net Investment Spread

- This quarter, base net investment spread benefited from unexpected accretion income and a cumulative update to cost of funds
- While we have seen recent increases in risk-free rates, spreads continued to be at historically tight levels
- Looking forward, across Individual and Group Retirement, absent significant changes in the overall rate environment, we continue to expect our base net spreads will decline by approximately 1 basis point to 3BPS per quarter
- And as Sid mentioned, we would also expect returns in alternatives and securities carried at fair value to moderate to more historical levels, noting this impacts total yields, but not base yields nor spreads

Life Insurance

- Let’s now move to Life Insurance on slide 19, our Life Insurance business continued to make progress
- In the U.S., our new modern administrative platform, distribution simplification efforts and narrowed product focus are supporting strong top line growth
- Our premiums and deposits increased and we had a strong growth in both term and universal life insurance sales for the quarter and the year
- While mortality experience was elevated for the quarter, for the year, it was better than the prior year and within pricing expectations

Institutional Markets

- Turning to slide 20, Institutional Markets benefited from opportunistic transactions in a number of its product lines, including pension risk transfers
- Our strong capabilities in the pension risk transfer business as well as our disciplined pricing and strong balance sheet position us well to selectively participate in this growing market
- Overall sales growth in Institutional Markets over the last year has increased assets under management, resulting in higher net investment income

Closing Remarks

To close, our results reflect our strong diversification and focus on writing profitable business, which we believe positions us well for the future

QUESTION AND ANSWER SECTION

<Q - Jay Gelb>: My first question is on the General Insurance accident year loss ratio that you referenced in the slides. How much more improvement do you feel would be needed to achieve your target returns?

<A - Brian Duperreault>: Should I do this? You want to do that, Peter?

<A - Peter Zaffino>: Well, I think it's going to be a combination of things, because that accident year loss ratio is a mix in the portfolio, you've got casualty, you've got property, you've got different combined ratios, you mix it together, maybe you want more property, probably push your loss ratio down a bit and more cash that goes up and I think you got to add the expense issue that I mentioned earlier, we've got to continue to work on our expense levels too.

So, it isn't just the loss ratio that's going to get us to our level that we want to get to in terms of returns. It's going to be a mix of business and it's going to be an expense and loss combination. But we still have ways to go. I mean we're not there yet. And I think we can clearly improve that. And we've got a bit of a tailwind, which is helping us in that effort. So, that tells us we can get there a little faster. Hope that answers the question.

<Q - Jay Gelb>: It does. Thank you. And then my follow-up is on capital management. With $6B plus potentially coming in for additional deployable cash in 2018, can you update us on your perspective on the dividend and buybacks? I noticed there wasn't any buy backs in Q4, but that was also the same quarter where it probably took into account Validus being announced. So, if you can update us on your views there, that'd will be helpful. Thank you.

<A - Brian Duperreault>: Yeah. Well, capital management is a key thing in what one does. We're blessed with having the kind of capital built-out that we have and how you deploy it. I've said earlier that, to me, the buybacks are capital management tool, we'll use those that management tool when we think it's appropriate, but I would rather deal with our portfolio and the fact that there are pieces of it that I'd like to fill in, we have white space there.

So, that would be my priority. Our dividend process should be long-term in nature, consistent with the kind of business we do and that would be a more steady move, right? That I wouldn't think you'd make large scale changes in your dividend approach. So, it really gets down to can I find opportunities to use the capital in a way that's accretive and structurally improving? And if I can't, we have the stock buyback as a tool.

<Q - Brian Meredith>: Two here quickly. First one, just, Peter, I'm just curious, where are we in the process? I mean you got the senior leadership in place in the General Insurance business, Commercial, but where are we as far as kind of the next level down and kind of building out your teams and kind of upgrading underwriting talent?

<A - Peter Zaffino>: Well, I mentioned that Tom recently arrived and Chris will be joining us in early March. So, we have the foundation for our core underwriting leadership. We actually have been hiring actually some significant talent at that next layer and the layer below. Ken Riegler, who just recently joined us, has taken a very prominent position within North America. Tim DeSett joined us to run our North America field.

And so, we have been continuing to add very strong talent at the next layer, but we also have some really strong talents in the organization that now that we've announced the org structure, we've been putting people in positions where they can start to drive influence and improve on the accident year loss ratios in 2018 and 2019.

So, I'm really very encouraged by the number of people that have shown interest and want to join and I'm really pleased with the progress that we've made to-date.

<A - Brian Duperreault>: You got a follow-up, Brian?

<Q - Brian Meredith>: Yeah, yeah. And I'm just curious with the changes in the reinsurance program, the AALs that you guys have been providing, any change that we should think about going into 2018?

<A - Peter Zaffino>: Well, we're taking a look at – as I said, we're really pleased with where the PMLs have gone in all the return periods on our new reinsurance structure and that coupled also with reducing gross exposures in North America and different parts of the rest of the world. And I think we're going to take a hard look at AALs. I don't think it'll be commensurate to the decrease you see in the PMLs and we think we should have some benefit in 2018 from AALs and we'll give more guidance as to we get into 2018.

<Q - Josh D. Shanker>: This isn't a new issue, but one that I want to better understand. There's two different numbers that the DTA on the balance sheet and the DTA you use for calculating book value per share. I know you guys took a big write-down related to the change in U.S. tax law, but there's a different change to both, $7B on the balance sheet and $4B on the calculation of book value per share. Can you explain a little bit the difference between those two?

<A - Brian Duperreault>: Yeah. Sid?

<A - Siddhartha Sankaran>: Well, Josh, Liz will be happy to walk you through all the details off line, but you've got the NOLs and the FTCs, the foreign tax credit, so the items that I referred to with respect to my script. So, we can obviously follow up with more detail, but it's relatively straightforward in terms of the calculations.

<A - Brian Duperreault>: Got a follow-up?

<Q - Josh D. Shanker>: Yes. And in terms of – there's a little bit of a reserve deficiency on recent years offset by better results in prior years. Where do you stand on terms of the confidence in the end of your loss picks for this year? And do you feel those – your predecessor said, sometimes we're going to be deficient, sometimes we're going to be redundant, we have a very large book, do you take that tax as well?

<A - Brian Duperreault>: Well, I can't comment on what my predecessor said, but I said 2017, to me, is a start point. I feel confident that we have a good handle on where the issues are line-by-line, country-by-country. And so, yeah, I think we're poised now and we've got the structure and we've got the understanding. Now, we just got to execute.

<Q - Kai Pan>: My first question is on the International Commercial. Could you give me more detail about what kind of remediation efforts you're taking and what's the timeline of that relative to the North America Commercial? Just try to figure out what we see the turnaround soon as we have seen in North America.

<A - Brian Duperreault>: Well, let me start. I think Peter can give you a lot more color, but I think if you look at the portfolio, usually you round up the usual suspects. It's combination of things like selection and maybe some deterioration on a particular portfolio. There wasn't one single line. It was a combination of things. And I think the issues around our gross limits and net limits exacerbated any issues that would pop up in a portfolio, but the question is, what we do going forward and Peter?

<A - Peter Zaffino>: Yes. As Sid mentioned in his opening comments, we took a really hard look at Q4 within International with a little bit more of a focus in Europe. And so, some of the trends – again, I don't need to get back thorough it, but the Financial Lines, Property, Special Risks, we had some development, but I would ask you to take a look at the full year. If you look at the accident year loss ratio of the full year, that's more reflecting the overall performance. I think we will continue to try to take volatility out and not take as large of net and gross lines within our International portfolio.

But, overall, the accident years, if we look at the full 2017, we know we have improvement, but you look at the delta between that and North America, we still need to focus on improving our accident year loss ratios in North America as well.

<Q - Kai Pan>: Okay. My follow-up is on reinsurance and we see new programs, if 2017 CAT losses were repeat, what's your net loss and could you also give update on the Commercial quota share renewals?

<A - Brian Duperreault>: Looks like it's yours, Peter.

<A - Peter Zaffino>: Okay. Well, we've restructured the CAT reinsurance to include more aggregate cover. So, the attachment point dropped from $1.5B to $750mm with a corridor deductible, but that's an aggregate vs. an occurrence. And so you would take a lot of the frequency of events out and we have around – I don't want to give a specific number, but it'd be in the 40% to 60% less range for if we had the same exact CATs in 2017 reoccur in 2018. So, we've taken out a lot of the volatility of frequency, but also have a vertical cover in the event that we have a single large loss that we are protected at different return periods.

In terms of the quota share, Brian mentioned, I mentioned, we're taking a full-year look at all of our reinsurance placements and so we've begun with property at 1/1. We are not going to continue with quota share in the U.S. We're going to look at a variety of different alternatives in terms of how we want to structure reinsurance in our International portfolio in casualty as well as in North America. So, we'll continue to give you updates as we revisit all of our reinsurance placements throughout the year.

<Q - Elyse B. Greenspan>: My first question, pretty good – you guys had a pretty good improvement in the North America Commercial Lines underlying loss ratio in the quarter. I know within the International book, you kind of pointed to the full year as the starting point for 2018. Was there anything one-off in that number or is that something that we should use as kind of a base to model off of for the Commercial Lines results as we think about 2018 in North America?

<A - Brian Duperreault>: Look, there's always a one-off in there, but I'd say, use it as a baseline.

<Q - Elyse B. Greenspan>: Okay, great. And my second question, you guys set up this DSA Re vehicle. Is there any thoughts around that, that could potentially free up more capital for you guys, if you could just share some thoughts around that.

<A - Brian Duperreault>: Sid?

<A - Siddhartha Sankaran>: Sure. Obviously, as we said, we're pleased with the transaction, because we think having a single strong entity here to manage our runoff portfolios is going to give us a better optionality to manage the risk. And so, what I'd say to you is we're going to evaluate all our options and like all our major entities, we'll evaluate the business plans and capital targets as we go forward, but we do think that it gives us some financial flexibility going forward to better manage risk.

<Q - Erik Bass>: In Life and Retirement, you now have several charges related to systems enhancements leading to reserve refinements. Can you update us where you are in the systems investment process and if we should anticipate more refinements in the future?

<A - Brian Duperreault>: Kevin?

<A - Kevin T. Hogan>: Yes, thanks, Erik. We've been in the process of modernizing our actuarial systems in the retirement business and also the life business the last two to three years. We're essentially moving from one very modern platform to an even better platform. And as we are able to upgrade the detail of the models from time-to-time, there are some movements in the reserves. And so, while this shows up in earnings in Q4, relative to the size of the balance sheet, these are relatively modest adjustments.

I think what's important is, is that there's no change in our outlook to the profitability or attractiveness of this business and these are very sophisticated platforms. So, like I said, we're two to three years in. We have another year or two to go. We're constantly trying to improve our modeling and management of this business. And at this point in time, we can't suggest that there's anything else to come. We're continuing to work through the process.

<Q - Erik Bass>: Thank you.

<A - Brian Duperreault>: Anything else, Erik?

<Q - Erik Bass>: Yeah. In Group Retirement specifically, I mean you've made a number of investments there on the VALIC platform and are seeing a pick-up in new group acquisitions, but the flows remain negative. I guess what are the remaining hurdles you see to getting back to positive flows in that business?

<A - Kevin T. Hogan>: So, I think that there's two things. You have to recall that there was a period of time where we were not engaging in aggressive plan acquisition. We've reengaged in new plan acquisitions starting three, four years ago. And as you pointed out, we have made some significant digital investments, which are really paying off and improving both the plan sponsor and the participant experience.

So, I think that at the levels of plan acquisitions where we are now, we're continuing to see improvement year-on-year. We're continuing to expand our advisor force and expect that to grow. We will have little ways to go before we make up for the fact that we weren't acquiring plans for a while. So, our outlook for this business is very profitable business. We're still managing the yield compression and the margins remain strong.

<Q - Jon Paul Newsome>: You mentioned high-single-digit cash returns for Validus. How does that compare to your cost of capital as you calculated?

<A - Siddhartha Sankaran>: Well, I guess, we can always have a debate on all the methods to calculate cost of capital. I'd say, when we look at it, it would be above our weighted average cost of capital in terms of equity cost of capital, I can do all the fancy math I want, but generally my investors tell me it's 10%. So, we think it's a reasonable return here for our surplus cash and capital.

And certainly, those assumptions, as we said, we think we've been cautious. And so, if we do any better than that, which certainly we're targeting, we think it's going to be something that people will be very pleased with in terms of overall return.

<Q - Jon Paul Newsome>: I want to ask a question about the net flows, particularly in the Individual Retirement with all the regulatory changes. Is it your view that or do you have a particular strategy that you think that the regulatory issues will moderate or – clearly, we've had a lot of adjustments from a marketing perspective in that business and I'd just like to have your perspective on it.

<A - Brian Duperreault>: Kevin?

<A - Kevin T. Hogan>: Yeah, sure. So, let's remember Q4 was still a period where the distribution environment – we work with independent distribution across the U.S. within the relatively earlier stages of embracing the DOL. And third quarter was the low point, but fourth quarter still sort of suffered from that. And rates were improving a bit. At the time, the equity markets were very strong.

And so, VAs really were under pressure. We're actually pleased with the VAs is that almost half of our sales right now or last quarter were a new product that we introduced with the daily income benefits, which is something that is targeted for the new distribution environment. So, whilst we're continuing to see a reduction in the new business there, we feel good about where we are positioned with the VA product branch.

We also introduced an advisory product. We're seeing improvements where we're focused on Index Annuities and Fixed Annuities. And Index Annuities, in particular, have kind of taken a place of the role that Variable played in some advisers' platform. And we've been working closely with our distribution partners relative to that.

I mean as the rate environment improves and as investors' outlook may evolve relative to attractive investments and these products vs. unbridled equity markets is what will predict the future environment. We think that what's most important is, is that we have a common standard of care relative to the fiduciary standard and suitability between investment and insurance products. And so, we believe that the future regulatory environment will move in that direction and that investors will respond to that and the distribution environment, most importantly, is stabilizing relative to their practices.

<Q - Larry Greenberg>: Peter, I think you said that we should expect General Insurance premium volume to be flat for 2018. Would you differentiate between domestic and International or is that a pretty good assumption for both of those?

<**A - Peter Zaffino**>: Larry, I would just assume that will be remaining flat across the globe and I wouldn't differentiate much between North America and International. The only thing I would say to that is that we're getting more rate in North America as I look from pivoting from Q4 to Q1. So, the rate seems to be sustaining. Some of the peak zone renewals that we have, those are coming up. So, again, I can't really forecast what's going to happen in the second and third quarter.

But if rate continues to improve and we have some of our bigger quarters in property with those type of rate increases, you could see a little bit more in North America.

<**Q - Larry Greenberg**>: Great. Thank you. And then, Brian, in terms of getting your expense ratios to top quartile, is that something that we should expect could be achieved in the next year or so or is that a multi-year process?

<**A - Brian Duperreault**>: Well, it's been a multi-year process so far.

<**Q - Larry Greenberg**>: Right.

<**A - Brian Duperreault**>: And I've got to give – say give credit. I mean this is all mostly happened before I arrived. And you've got to give him credit. I think when you go to a multi-year process, the harder nut is the one in front of you and I think it's probably more structural now and we have to think about it in a more structural way, which we will do. We've taken steps as you heard earlier and in putting our structure in a more intelligent position with General and Life being separate and then we'll go from there. But I can't tell you I'm going to get it done in a year.

<**Q - Adam Klauber**>: You said you're getting some good rate in the property book. Did that momentum continue into this year? And also, do you think the casualty rate environment is better today than it was a year ago in the U.S.?

<**A - Brian Duperreault**>: Peter?

<**A - Peter Zaffino**>: For the U.S. Property, what I had mentioned in my comments sequentially got better every month within Q4. January looks to be very consistent with that pattern. Don't have too much guidance beyond January. So, we are continuing to see rate increase. We are seeing rate increase within the casualty lines. It really just does vary. I mean certainly auto is the one that would be driving the most increase on a primary and excess basis.

But want to make sure that we're spending a lot of time thinking through like loss cost trends for the casualty lines, because rate increases required across most casualty lines just to stay constant with loss cost increases. So, we are seeing rate increase. I want to make sure that we're very conscientious of why that increase has to happen for loss cost increases, but we are seeing rate on the casualty book. And, again, early indications in Q1, that's consistent with what we saw at the end of the year.

<**Q - Adam Klauber**>: Okay, thanks. And one follow-up to that, have you seen a pick-up in the legal or is it a tougher legal environment today than it was say, three, four years ago, particularly in the casualty side?

<**A - Brian Duperreault**>: We're looking to each other like, I'm not sure. I don't think it's any worse. I mean, I think if you look at D&O, we've seen some different actions that have taken place. And you might say that there perhaps, it's a little worse, but with that – having said that, I can't really describe it that way, no.

<**Q - Thomas Gallagher**>: Brian, in terms of releasing reserves for North American Commercial P&C, should we take that more of a function of the less challenged lines being reviewed this quarter? And so, could we still see some volatility as you'd review more challenged lines in Q2 and Q3 of 2018 or do you expect less volatility than we saw in 2017?

<**A - Brian Duperreault**>: Well, yeah, we look at all of the reserves, I mean really, I mean it's not – I mean we have a detailed review of – in the scheduled way, if we see a problem, we pull it forward. We look at everything. So, I wouldn't characterize this as these were the easy ones. We look at all. I said earlier, I think 2017, to me, is a good starting point. I feel confident and I said that before in the reserve process in the way we look at the business.

So, you never can predict what's going to happen next year. I'm not going to do that, but I feel confident in our understanding of what this portfolio is all about, where the issues are and what we need to address.

<**Q - Thomas Gallagher**>: Got it. And then, just a follow-up. Is there anything different about the process you're going to implement to review reserves, if you think about when you first joined, presumably you'd want to do a deeper dive or is it exactly the same process in terms of whether you're doing it all internally, using any outside consultants and anything different about the process as we think about 2018?

<**A - Brian Duperreault**>: That's another good – interesting question. So, we do use outside consultants or actuarial firms. So, we have several looks at it and that always gives you comfort, particularly if you are within kind of their tolerances and ranges. And I think we've gotten closer to the mean in that regard or maybe even above it a little bit, so we've – that's a standard process for us. Reserves are a lot easier when you make money. It's a lot easier.

And I think ours – I tell everybody, how are we going to our reserves to improve? Make money. Make money. And that, I think attention to the portfolio, addressing the issues and addressing them early, so you nip things in the bud, reducing the volatility, so that you don't have a lot of business that just out-of-line premium to exposures. So, if it goes wrong, it can exacerbate. So, those are the things. It's a portfolio management. And I guess, in that regard, yeah, there's been some changes there, but not in the technique of actually looking at the reserves.

<**Q - Meyer Shields**>: On a high level, I guess, between the purchase of much more reinsurance on property and the non-renewal of the casualty quota share, it seems like casualty is going to represent a much higher percentage of earned premiums in 2018 than it did in 2017. Can you walk us through conceptually what that implies for the underlying loss ratio?

<**A - Brian Duperreault**>: You cut off at that last piece. I didn't hear that last statement, the last question. Could you just repeat that last sentence?

<**Q - Meyer Shields**>: I'm just trying to understand what that anticipated mix shift implies for the underlying, the accident year ex-CAT loss ratio?

<**A - Brian Duperreault**>: Well, let me start. I think Peter can add to it. When we look at reinsurance, I mean we're looking at a lot of different things with respect to reinsurance. Some of it is – is it -- are we doing it for volatility reasons? Are we doing it for capital reasons? Are we doing it for issues around analysis, et cetera? So, we looked at our entire portfolio and is the relationship between us and the reinsurer, one, where we are truly providing benefits to both? And so, those are the decisions around all the lines of business, whether it's casualty or property.

Obviously, our casualty loss ratios tend to be a little higher, but – because they have less volatility. So, you're going to have a mix change in the loss ratio just naturally between the two. The more important question is, do we feel that the portfolio itself, whether it's casualty or property producing the kind of returns? And that doesn't change. If that doesn't change, we have to deal with the profitability of that book on a gross basis and so, we're not changing our approach to improvement. We know we've got more to do in casualty and we're going to do it.

But – and the property has had issues, particularly in Europe where we have to address those as well. So, it's a mix of the business question, but underlying all that is are we attacking the portfolio intelligently? And I think we are.

<**Q - Meyer Shields**>: Okay, that's helpful. Second question, can you give us a sense, I know it varies tremendously, but an overall sense of the loss trends that are embedded in your casualty reserves that you're on?

<**A - Brian Duperreault**>: Sense of loss trends, well, I guess, that's Peter.

<**A - Peter Zaffino**>: Well, I can tell you in terms of how we're looking at the pricing. When we look at some of the loss cost trends in pricing again, I had mentioned before that we contemplate that on the primary and then the excess. And so, on the primary, it ranges from 3% or 4% up to 8% and again, auto being at the upper-end. And from an excess basis, looking at the same lines of business, it can go up to almost 10% on the loss cost trends, again auto being one at the upper-end, but there's other lines of business that fall within that.

And so, we make sure that as we're looking to pricing and looking at some of our historical experience, we contemplate all of that in terms of looking at how we're going to position the portfolio throughout 2018. As I say, we're getting ready and we're looking at loss cost trends. So, I don't see anything dramatically changing based on our observations.

<Q - Jay A. Cohen>: [ph] Let's just say (56:55) saving the best for last, right?

<A - Brian Duperreault>: Absolutely.

<Q - Jay A. Cohen>: Question for Sid actually. Financial leverage, are you near where you want to be at this point or do you need to take some action on the debt side?

<A - Siddhartha Sankaran>: No, I think if you look at our balance sheet, our cash flow profile, we're roughly comfortable with where we are in financial leverage. We're obviously going to keep evaluating that as we go through the year, but I think if you look at the balance sheet, it's extremely strong from a capital liquidity and leverage standpoint