S&P Capital IQ

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American International Group, Inc. NYSE:AIG

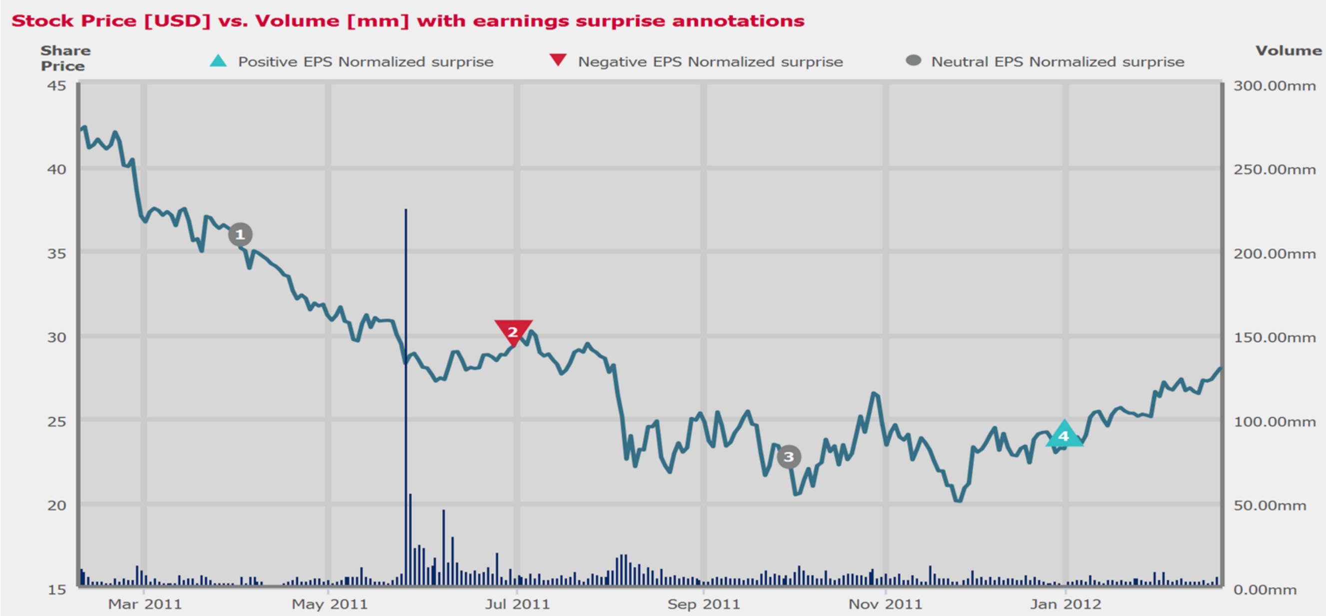
FQ1 2012 Earnings Call Transcripts

Friday, May 04, 2012 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2012-			-FQ2 2012-	-FY 2012-	-FY 2013-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.39	1.65	▲18.70	0.69	3.73	3.22
Revenue (mm)	9013.20	8688.00	▼(3.61 %)	9005.40	35400.20	36357.50

Currency: USD
Consensus as of May-04-2012 12:05 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2011	(0.09)	1.30	NM
FQ2 2011	0.96	0.69	▼1 (28.12 %)
FQ3 2011	(0.28)	(1.60)	NM
FQ4 2011	0.65	0.82	▲2 26.15 %

Call Participants

EXECUTIVES

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Former Chief Financial Officer and Executive Vice President

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Head of Investor Relations and Vice President

Jay Steven Wintrob
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Presentation

Operator

Good day, ladies and gentlemen. Welcome to today's American International Group's First Quarter 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.

Elizabeth A. Werner
Head of Investor Relations and Vice President

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

Factors that could cause this include the factors described in our first quarter 2012 10-Q and 2011 10-K under Management's Discussion and Analysis 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 reconciliations of such measures to the most comparable GAAP figures are included in our financial supplement, which is available on AIG's website, www.aig.com.

Before we go through the results, I want to remind you that we adopted the new DAC standard on a retroactive basis. Therefore, all prior period numbers in the 10-Q and financial supplement have been revised. In addition, we plan on filing a Form 8-K to recast our 2011 Form 10-K later today, also to reflect these changes. And now I'd like to turn our call over to our CEO, Bob Benmosche.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thanks, Liz, and good morning, everybody. I want to be brief because I want to leave time for David, Peter and Jay as they go through their parts of the report. But the most important message, I think, that comes out of the first quarter of 2012 is the strong organic growth of this company and the strength of our insurance businesses. And I think you could see with that performance alone that we're well on our way to achieve our aspirational goals, so we're gaining more and more confidence that we can continue to grow, grow effectively and grow profitably.

However, there's some other things that happened in this quarter, which I think are monumental. First is the fact of our ability to monetize non-core assets. As you saw, we sold another $6 billion of AIA, as well as our Blackstone interest. This is important because it allowed is to do a lot of things in the first quarter that gives us financial flexibility as we look to the future. So, for example, we were able to buy $3 billion of our shares when the Treasury made their offer in March. That's significant in my mind because one of the debates we have is the overhang and what effect the overhang has on our company. Conventional wisdom has been as long as Treasury has a large position, $29 is probably the ceiling for the stock.

We believe that our performance, and we keep growing this company the right way, we believe that earnings will actually be what determines the value of the stock. And I think our performance since then has demonstrated that at least the market has shown that. In addition to that, confidence in our company is growing, when you look at our CDS spreads and where we are today, in fact, in the 190s. So that's all part of how the market is reacting to what we did in March. But also we were able to pay down the SPV of $8.6 billion, so now we are free to deal with other non-core assets as we go forward.

So we still have AIA's position. We are still looking to find the right time to do an IPO for ILFC. And you can see that the Federal Reserve has started to sell down the Maiden Lane III portfolio.

Beyond capital management, which is important, but it's the core results of this company, which is more important. So if you look at Chartis, we see loss ratios improving. We see rate coming in and we see a better mix of our business. But keep in mind that, and I -- we sometimes forget it, when it comes to insurance businesses, it takes time to see these improvements emerge in our financials. We had lower CATs, which is good for the quarter. But more importantly, as you see our reserves continue to have modest movement where the movement this quarter was about 0.10%. When you consider the size of those reserves, that's nominal. So we really have had 5 quarters now of very good performance there. I know some people are still concerned about the reserves and that's why we're doing everything we can to provide you as much information as we can so you can see on the transparent way what we have and what we're dealing with.

SunAmerica continues to do well. You see the investment results are stronger as we invested that cash and keep reinvesting cash effectively. But more importantly, you see positive cash flows again in their various products. Annuity sales are up and the good news is we have a very well-positioned product. It's not aggressive in any one feature and we're very balanced in the features that we sell, and so we feel confident we're going to continue to see good growth, and Jay will talk about that. And of course, as you look at just the delinquency ratios and so on down the line, you see at UGC, those are improving, as well as our new business is growing. And we're growing with our new performance premium algorithm, which means that we're putting very good business on the books as we grow that. And in fact, they had made a profit in the first quarter of this year, so that's a good business for us.

So overall, all of our businesses are profitable. We're continuing to grow. We see growth improving over time, and our performance will improve over time. So what I'd like to do now is turn it over to David, who will take you through the numbers.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thanks, Bob. And good morning, everyone. In summarizing the quarter, the key theme that I would like to highlight is our continued execution around the drivers of value creation for our various stakeholders. We continue to execute on the core insurance growth opportunities across the franchise and just a few examples I would site include Chartis as it continues to successfully grow the consumer business, which was 41% of net premiums in the quarter, up from 37% a year ago and Chartis continues to drive for rate, particularly in the commercial lines. SunAmerica is benefiting from a more favorable variable annuity market that Bob referenced, and they also continue to be very disciplined in spread management. Then United Guaranty continues to grow faster than the industry, and pricing targets on their new business in excess of 20% return on their equity.

We continue to execute on capital management, as Bob referred to, including our share repurchase, sales of non-core assets, a $2 billion debt offering we repaid the SPV, which unencumbered, importantly, several billion dollars' worth of non-core assets that enhanced our financial flexibility. And lastly, we continue to execute on preparing for Fed readiness and for Fed oversight. Consistent with our comments last quarter, we still estimate that our Tier 1 common equity ratio under the Fed stress test is still close to 8%. We have a very large team of people focused on preparing for Fed oversight, including several subject matter experts. We're preparing as though AIG will be -- likely be designated SIFI, and held to a standard that can differentiate us and provide additional security to our many stakeholders, including our policyholders, our bondholders and our shareholders.

So now what I'd like to do is just step through the next couple of pages very quickly. If we turn to Page 4, you can see that our after-tax operating earnings were $3.1 billion, up almost 48%, or $1.65 per share, which was up 23% from last year's $1.34. Average shares outstanding a year ago reflect the recap that we completed in mid-January. Book value per share grew 30% to $57.68, or $53.85 x AOCI. Contributing to that was the DTA valuation allowance that we released in the fourth quarter. We had share repurchases and, again, our continued strong earnings growth. We had earnings in our investment in AIA and ML III, which I'll comment on more in a minute. But we also had our spreads narrowed by some 275 basis points in the quarter, which drove a mark-to-market or fair value CVA adjustment on the debt that we mark-to-market of about $580 million. In the quarter, we also on a GAAP net income basis had a DTA valuation allowance release of about $180 million related to utilization of SunAmerica capital loss carryforwards that resulted from some capital gains.

Let's turn to Page 5. Chartis operating earnings were over $1 billion and included catastrophe losses of about $80 million versus $1.7 billion in the year ago. SunAmerica's $1.3 billion of operating earnings reflected favorable investment spread and, importantly, had a very strong quick spread management effects. United Guaranty was profitable in the quarter and saw further decline in delinquency rates to 11.4% and, also importantly, average gross reserves per delinquency is still around $29,000. Non-core assets remain a compelling source of value for AIG. ILFC had pretax income of about $119 million in the quarter, relatively flat from a year ago. ILFC raised over $2 billion in the quarter, proceeds of which were used to reduce interest costs, eliminate a bank facility that had change of control provisions and to improve their liquidity.

AIA earnings included about a $580 million gain on the sale of the shares that we actually sold and another $1.2 billion in unrealized depreciation. Maiden Lane III had about $1.3 billion increase in fair value as a result of credit spreads. Our first quarter tax rate, effective tax rate, was around 25%. That's a little lower than usual and also was lower than the 35% statutory rate, in part because of the tax-exempt interest and the valuation allowance on the DTA on capital gains. Our first quarter operating income effective tax rate was about 30.8%, up from a little over 24% at the year ago, in part due to a higher level of income on things like AIA or ML III, which attract an operating tax rate of 35%. And so that compares to more modest levels of tax-exempt interest on our munis.

Let's turn to Slide 6. Our approach to capital management is fairly simple. Be ready. We are opportunistic in our sales of AIA and Blackstone in the quarter and we believe that it's absolutely critical to be ready when market opportunities present themselves. We have a solid foundation to build upon. Our leverage ratios remain strong, at 18.7% of debt and hybrids to total capital.

Let's turn to Slide 7. You can see the carrying values of the remaining non-core assets aggregate in excess of $20 billion that enhanced our overall financial flexibility. We note that the potential gains would be offset by our NOLs, thus utilizing or realizing the cash benefits of our DTAs.

Let's turn to Slide 8. You can see that the parent company liquidity exceeded $12 billion and that reflected the $3 billion in share buybacks in the quarter. In the first quarter, SunAmerica's dividends had no repayments to the parent, totaled some $1.6 billion, and that contributed to the SPV pay down, and Chartis contributed over $1 billion to the parent as well in the quarter. Ratings remained stable and our year-end RBC ratios exceeded our CMA requirements of 350% for Chartis and 435% for SunAmerica. In the aggregate, across Chartis U.S. and the SunAmerica companies, the amount of capital AIG is required to hold in the operating companies to meet the regulatory and rating agency requirements has not changed materially from 2011, and AIG's expected annual dividends from our operating companies is still in the $4 billion to $5 billion per year.

And in conclusion, again, I just want to highlight the theme of continued execution in our results, both capital management, operating improvements and our march towards our aspirational goals of a 10% ROE by 2015, which we remain committed to.

And at this point, I'd like to turn the call over to Peter for comments on Chartis.

Peter D. Hancock
Former Chief Executive Officer, President and Director

Thanks, David and good morning, everybody. I've got some slides on Chartis, but I want to just give you an overall view of the quarter, and so first quarter results reflect meaningful progress towards increasing the intrinsic value of our business. And I'm pleased to report that we're very much on track with regards to our 5-year plan. The current accident year loss ratio improved by several points from the effects of more profitable portfolio mix, stronger pricing and enhanced risk selection.

For the fifth consecutive quarter, reserve development was equal to or less than 0.1% of Chartis' total reserves, which were $67 billion as of quarter end. Catastrophe losses were immaterial, at about $80 million in the quarter, and the expense ratio increased, but that was consistent with our expectations as we grow higher-value less-capital-intensive businesses, which costs more to acquire and as we make strategic investments in talent and infrastructure. These investments are necessary to strengthen our competitive position and are expected to ultimately yield significant savings in the future.

Turning to Slide 9 of the presentation, it details Chartis' underwriting results and pretax operating income for the quarter. Chartis' accident year combined ratio, excluding catastrophes, was 100.4%, reflecting lower underlying loss ratios, offset by the increased expenses. Pretax operating income benefited from $1.2 billion in net investment income, a 4% increase compared to the prior year, and that's primarily due to higher interest income on fixed income securities, driven by redeployment of excess cash and short-term investments into high-yielding securities. This was partially offset by a decrease in partnership income due to equity market performance and a decrease in mutual fund income as a result of a lower level of mutual fund holdings, as part of Chartis' strategic asset allocation strategy.

The accident year loss ratio, excluding catastrophes, improved by 3.1 points compared to the first quarter of 2011 and 2.4 points from full year 2011 results. This result largely reflects meaningful progress in initiatives to shift the portfolio to higher-value products and geographies to improve business with marginal returns and use data and analytics more intelligently in the risk selection process.

During the first quarter, we brought together the global claims and operations and systems functions to create greater efficiency and reduce claims-related costs. The global claims initiative and the implementation of our proprietary claim system signifies steps we've taken towards improving claims handling. In addition, we're developing a much broader target operating model that will streamline processes and capabilities to deliver further loss ratio improvement and superior customer service in the future.

Consumer Insurance represented 41% of total net premiums in the quarter compared to 37% in the first quarter of 2011. 56% of total premiums were generated outside of the U.S., up from 55% in the first quarter of '11. We continue to expand in growth economy nations, which represented 11% of total first quarter 2012 net premiums, up from 10% in the first quarter of 2011. That represents an 8.5% annual growth rate.

We maintained our focus on driving improvement in pricing in terms and conditions. Rate changes in the U.S. and Canada increased approximately 5% across Chartis' diverse book of business. U.S. property and workers' comp experienced the most notable increases, at approximately 11% and 7%, respectively. While we're generally experiencing positive rate change across most products and regions, some markets continue to lag. Customer retention remains strong, but in line with expectations, given our business mix shift and improved risk selection initiatives.

Slide 10 summarizes top line results. Chartis' net premiums declined approximately 4.5% over the prior year period when adjusted for foreign exchange effects. The continued restructuring of our loss-sensitive business in casualty, which reduces premiums written but improves capital efficiency, accounted for 1.6% of that overall decline. An additional 1.6% of the variance was due to a large multi-year financial line policy written in the first quarter of 2011, which did not recur in the current year. The remainder of the decrease reflected our effort to improve underperforming lines, continue adherence to rate discipline and management of catastrophe-exposed business, specifically within commercial. This is consistent with Chartis' strategy to improve the loss ratio and to shed business that does not meet internal performance standards. Net prior year adverse reserve development was $66 million, driven by loss emergence in casualty, and increased activity from multi-year environmental liability policies written in older accident years.

This was also favorable development on prior-year natural catastrophes, mainly the Japan earthquake. Expense trends were consistent with our desired mix of business changes, particularly in consumer lines, which draw for lower more, stable loss ratios, increased acquisition costs from growing the consumer business and the change in mix in the commercial business, as well as investments related to international growth, which accounted for 2 points of the expense ratio increase in the quarter. Approximately 1.9 points of the increase related to nonrecurring items, including an increase in bad debt expense and a reduction in the PGAAP benefits for the full year acquisition. We continue to make strategic investments in systems, processes and talent, which we expect will yield greater savings and a stronger franchise in the years ahead.

We're transforming Chartis' business to be a more profitable and inherently a more sustainable value portfolio. As a result, the expense ratio will be under pressure in the near term, but we expect it will be offset by improvements in the loss ratio, and that pressure will abate as we start to see infrastructure investments in 2012 and '13 yield savings in the following years. These actions will help us achieve a combined ratio in the mid-90s and a double-digit ROE by 2015. In the first quarter, Chartis continue to execute its capital management initiatives, making a $1 billion dividend payment, which exceeded plan to AIG. Our capital adequacy levels are strong and in line with rating agency expectations. Significantly, A.M. Best upgraded Chartis' outlook to stable from negative in the first quarter, which is in line with the views of S&P and Moody's. We made very good progress optimizing our reinsurance program in the quarter. We now define our risk appetite from a global prospective rather than locally, and we continue to rely on intercompany reinsurance to help maximize capital fungibility.

Chartis' catastrophe exposure management is enabling us to reduce externally seeded reinsurance, generating cost savings. As we have discussed in prior quarters, Chartis continues to grow its Consumer Insurance business in key regions as well as the portion derived from the direct marketing channel outside of the U.S.

In the first quarter, we had considerable success in consumer. All lines exhibited growth and direct marketing spend helped generate profitable returns. The accident and health business benefited from the implementation of its group benefit strategy from American General. Personal lines results reflect growth in warranty and personal property and importantly, Chartis closed on the Service Net acquisition in the quarter, significantly expanding our warranty customer acquisition and service platform.

Chartis continues to measure and refine the risk-adjusted profitability of all its businesses, and we're directing capital and resources to optimize profitability where we see opportunities. Our goal is to be the most valued insurance company in the world. The transformation underway in Chartis today and the progress we're seeing against our strategies gives me great confidence that we're going to succeed. Now let's turn it over to Jay.

Jay Steven Wintrob
Former EVP of Life & Retirement, CEO of AIG Life & Retirement and President of AIG Life & Retirement

Thanks a lot, Peter, and good morning, everybody. Turning first to Slide 11. SunAmerica delivered a solid first quarter with $1.3 billion in pretax operating income, strong sales across most product lines, positive net flows and improved base investment spreads. As David mentioned earlier, SunAmerica distributed $1.6 billion to AIG as a result of the ML II liquidation. In the quarter, we recognized income of $245 million on the ML II investment, essentially flat with the first quarter of 2011.

Going forward, SunAmerica's results will no longer include gains or losses from ML II. We saw strong sales growth in all of our product lines with the exception of fixed annuities. And as expected, our fixed annuity sales declined during the quarter due to the low interest rate environment, and we expect full year fixed annuity sales to remain below last year's levels. Variable annuity sales were a highlight in the quarter and were up 38%, as sales exceeded $1 billion in the quarter, a first since the financial crisis. The sales increase was driven by expanded distribution, increased wholesaler productivity and our competitive derisked product offerings.

Last year, we were the first in the industry to index our living benefit fees to market volatility, as measured by the VIX Index, reducing our exposure to changes in volatility. And during the first quarter of this year, we launched a new product offering with the volatility control fund that further reduces the risk related to market volatility, while offering a competitive benefit. The impact of strong equity markets in the first quarter decreased DAC amortization and guaranteed benefits expense by $52 million versus the first quarter of last year. Our variable annuity business is a relatively small piece of our balanced book of business. Separate account reserves were $50.7 billion at March 31 out of total reserves and mutual funds of $230 billion, of which $20 billion of reserves, or less than 9%, include living benefit guarantees. So we have the capacity, distribution capability, risk controls and financial discipline to capitalize on the growing demand in this market as some of our competitors are pulling back.

Sales of group retirement products increased 8%, driven by individual rollover deposits in the quarter. We expect rollover deposits to slow in the near term due to the impact of low interest rates. Retail life sales increased 7% in the quarter, principally due to growth in term life sales through independent distribution and our affiliated direct-to-consumer platform, Matrix Direct. Mutual fund sales continue to accelerate as a favorable equity market, and strong product performance drove new deposits. And as Bob mentioned, despite a $1.5 billion year-over-year decline in fixed annuity sales, our total net flows were positive for the fifth consecutive quarter, which highlights the advantages of our diversified product portfolio.

On April 12, we announced the reorganized structure designed to better serve the needs of our clients and promote accelerated profitable sales growth. Key aspects of the new structure are distinct product divisions, shared annuity and life operations platforms and a unified all-channel distribution organization with access to all SunAmerica products. We believe this organization structure will allow us to better leverage our competitive strengths, our diverse product manufacturing capabilities, our broad and strong distribution relationships and our experienced and talented leadership team.

On Slide 12, we show the general improvement in base investment yields and base net investment spreads over the past 4 quarters for Western National, our leading fixed annuity writer, and VALIC, our group retirement company. Base investment yield represents our investment yields, excluding the impact of alternative investment income, call and prepayment fee income and ML II fair value income. Base yields in the first quarter were up significantly over the prior year quarter due to the redeployment of cash during 2011. Base yields were also up sequentially, as this quarter we invested approximately $7.4 billion at a yield of 5.3% across all of SunAmerica, including a 15% allocation to non-agency residential mortgage-backed securities.

We continue to be opportunistic with our investments and structured securities in order to improve yields, increase net investment income and help offset the impact of a lower interest rate environment. Base net investment spreads were helped by the improvement in base yields and our ongoing active management of new and renewal crediting rates. And with respect to renewal rates at VALIC, we reset rates on a $16 billion block of business at the beginning of this year, which contributed to the sequential increase in base spreads of 24 basis points.

Approximately 51% of SunAmerica's annuity and universal life account values are now at minimum guarantees, up from 45% at the end of the fourth quarter. Nearly 70% of total annuity in universal life account values have minimum guaranteed crediting rates of 3% or lower. Last quarter, we provided information on the potential impact of a continued low interest rate environment on our operating lines. We indicated then that we would expect a negative pretax earnings impact of less than $10 million this year and $65 million to $80 million next year. Given our current new money rate, our disciplined approach to pricing and active managing of crediting rates, our view on the potential impact remains unchanged. And with that, I'll turn it back over to David to wrap us up.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Jay. And before I go over to Liz on -- to kickoff Q&A, just I would remind everybody on Page 13 of the highlights of United Guaranty, the highlights of which I covered in my opening remarks. So Liz, back to you.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Operator, can we open the lines for Q&A at this time?

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Andy Dinnhaupt from Frankin Mutual.

Andrew Dinnhaupt

I had 2 questions on ML III. The first is on Page 15, where you breakout the composition. Could you just tell us where the MAX CDO that was recently sold, which category that fell into? And then secondly, in your 10-Q you disclosed that the ML III assets were pledged against the direct investment book. Does that hinder your ability to execute further sales in the ML III assets?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'm going to turn it over to Bill Dooley. But first of all, ML III is being sold by the Federal Reserve and they go through the positions as they see fit, and it's up to the Federal Reserve to decide how they want it liquidated. MAX was the biggest one in the portfolio and the most complex, from our point of view, so it was -- in our view, it was a very successful sale. And as we think about those sales, we could also be a buyer, so, for the insurance companies. We saw some value in the sale of MAX. And in fact, we bought $600 million of the positions in the insurance companies as part of our investment portfolio. So we don't see anything that -- here at AIG that would represent a constraint on the Federal Reserve to sell ML III assets. And to the extent we can get the price we think makes sense, we would be a buyer. But, Bill, you want to talk about the pledge and the fact that this occurs, how that flows through in terms of cash?

William N. Dooley
Executive Vice President of Investments

Sure. First of all, Maiden Lane III is an unencumbered asset of the parent company. And once it's monetized, a substantial portion can go into the financial flexibility of the firm. So that means the liquidity management, leverage management and the ongoing capital management that we're doing. So as Bob just said, the flexibility is tremendous because of our opportunity to -- if we like the asset, if we like the price and we do know something about these assets. As everyone knows that they were also eligible for the insurance companies to be bought at the same time.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

And I think the bottom line here is that we had talked to everybody a year ago on the pre -- re-IPO that we were looking at 2014 second half as the beginning of receiving cash out of ML III. And we talked about ML II, our cash wouldn't come until 2015 possibly. So we're seeing all that come in and what this basically says is we won't have to wait till 2014 second half to begin to deal with the liquidity opportunities this will create for us. So again, that plus the paying down of the SPV a year early gives us enormous flexibility we did not think we would have until the middle to the end of next year at the earliest, and so we're already there.

Operator

We'll take one from Andrew Kligerman from UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

Could you -- having said earlier in the call that you're preparing AIG that it's likely to be a non-bank SIFI, can you address the degree of capital management that you'd like to do given that over the next year? And then secondly, with regard to variable annuities, you did a strong $1 billion-plus in VA deposits. Other guys [ph] in that business are doing $3 billion to $5-plus billion. What's your appetite there? Do you want to get into that top 3 and do $3 billion to $5 billion per quarter?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'm going to let Jay talk about his appetite because I think he needs to talk about the product design. I think the question by itself, Andrew, would not make much sense to us. We talked about how we priced in the ROEs and the risk management that's around our products. So I'll let Jay do that. Why don't you that first, Jay? So we'll get that one first, and then we'll talk about capital management second.

Jay Steven Wintrob
Former EVP of Life & Retirement, CEO of AIG Life & Retirement and President of AIG Life & Retirement

Sure. Thanks, Bob. I think the most important thing, Andrew, is that we have spent a lot of time over the past couple of years of reducing the risk in our variable annuity product. First, as I mentioned, with time, the variable annuity rider fees to changes in the VIX to reduce exposure to volatility, requiring a portion of the assets to be invested in bonds or in the fixed account, or on the equity side being invested in certain asset allocation models. And then just this year, our latest component, which was the volatility control fund being a part of the product in order to obtain the living benefit feature. We continue to feel good about how the product is structured and the pricing returns that we're getting. At the same time, I think if you look at our benefit roll-up rates and our withdrawal rates and our age at which you can take withdrawals, they are not overly aggressive in any respect. And our fees remain certainly at the high end for the industry. Having said all of that, as we've been reinstated in certain distribution channels, we built up our internal and external wholesaling force and improved the productivity of our wholesalers. You've seen sales increase, and we continue to have an appetite to do that, assuming we can do it with products that have terms and conditions and costs that we're comfortable with. We've also invested a lot and continue to invest in our risk management and our hedging program and our more general risk management. So I would say that our internal goal is to continue to build up our distribution consistent with our sales opportunities. If that moves us up in sales, so be it. We don't intend to target any ranking level. But depending on external circumstances, including how aggressive some of our competitors are, we may continue to move up in those rankings. And I do continue to see our variable annuity momentum, in terms of sales and flows, to be strong. So I hope that's helpful in response to your question.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

And the other piece I would add to it is that if you look at our year-over-year flows, we are concerned about fixed annuities at these low interest rate levels. We don't want to build a large book at low interest rates and then be concerned about disintermediation if and when we see an uptick in rates, and especially if there's a rapid uptick in rates. So that you'll see a decline in sales and that's one we are being very strong in terms of maintaining balance on getting our return and being careful what we put on our books. So it's really about the fixed annuity more so than the variable annuity that we'd be most concerned about. Coming back to SIFI and capital, the key that's being regulated by the Fed and the impact to capital management is you better have a very good, well-documented process. So you have to know what you're doing, how you're doing it, show and demonstrate can you do it, and we believe we've got a team that's excellent. We're working through that, and we're pretty confident if and when the Fed arrives that we will have the process in place that will allow them to judge whether we have any constraints on our ability to continue capital management. So we won't know till they get here. We won't know till we run their systems and they verify what we've done. But we feel pretty comfortable that we're in pretty good shape and that we don't see any significant impact to our ability other than to comply with their rules and regulations and timeframes.

Andrew Kligerman
UBS Investment Bank, Research Division

So Bob, looking at the assets you've outlined, $6 billion-plus worth of ML III, something on ILFC, $8 billion worth of AIA, you don't see that as constrained at all over the next 12 months?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

What I'm saying is that if the Fed arrives and when they determine they're our regulator, then they will decide. We don't see the constraint, but we have to go through their stress test process and their review and their audits to make sure that we're okay. And I think that the constraint might be more time in our view, but could be wrong. But we're thinking it's more about when we could do things, not if we could do things, especially when they go through the company for the very first time.

Andrew Kligerman
UBS Investment Bank, Research Division

Right. So in the meantime, you're moving forward with capital management?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

In the meantime, we see no constraint right now to our capital management. We're going to continue to look at our capital, look at our non-core assets. The selling of ILFC is not only about capital management, it's about recognizing it's a non-core business. It has a huge debt load and it's a business that doesn't fit the insurance business and so we feel that that's a business we should not be in. And to the extent it provides us a lot more capital, that's great because it helps us with capital management, but it's also about derisking the company and that's another aspect of it. So it's -- in combination, we're doing things that makes the most sense for this company, its credit ratings and our future.

Operator

The next question comes from Keith Walsh from Citi.

Keith F. Walsh
Citigroup Inc, Research Division

First question for Peter, just thinking about with respect to Chartis, can you just talk about how you think about allocation of capital to each line of business, how that's communicated down to the troops, the underwriters? And then how that's reflected in their compensation?

Peter D. Hancock
Former Chief Executive Officer, President and Director

Well, the first thing is that we think about capital through an economic lens first, but recognize that life in an insurance company with multiple constraints is a little bit more complex than that. So we look at multiple binding constraints, whether they be rating agency view of capital or regulatory view of capital. But we start with our true north, which is an economic view of risk, which drives the amount of capital needed to support that risk. Secondly, consistent with our reorganization, we think about it globally. So the commercial lines run by John Doyle has under him individuals responsible for the global allocation of capital. So George Stratts, for instance, running global property, thinks about optimal capital allocation to where he's getting fairly compensated for the exposure we're taking. We measure performance using risk-adjusted profitability, which is ROE minus a cost of capital, times the amount of capital deployed. That metric is still in its early stages of implementation, but we have it calculated at a fairly granular level, and it's increasingly being used as a measure of people's success. In terms of incentives, we think that the right way to incentivize people in this business is over the medium to long term, so any single period risk-adjusted profit number needs to be put in a broader context. We're, in particular, looking at changes and improvement as opposed to the absolute number. But we feel that there's been much more rapid uptake over this framework for thinking about how to properly balance growth, profitability and risk towards growing value than I could ever have hoped. So I'm very pleased with the progress.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Let me just make one other comment on the compensation part. And it's something that if you looked at the composition program here at AIG, the variable portion of the compensation for the underwriters that you're talking about is actually, unfortunately, too small. It's mostly a fixed income. You have very little variable comp and we need to -- as we've become much more performance-based, we're actually trying to increase that a little bit as we go forward. So we don't see that as a big incentive one way or the other. It's really about the quality of the way you do your job. So you don't have the kind of leverage that you're used to seeing in your own businesses.

Keith F. Walsh
Citigroup Inc, Research Division

And then just second question for John Doyle, if he's there. Retention rate trends in the commercial lines, specifically the U.S. commercial business, if you could just talk to that a little bit.

John Doyle

Sure, Keith. Retention's in line with expectations for us. After the first quarter, as you know, we've been shedding certain segments of underperforming business. So, very low retentions in segments of our commercial casualty business. I would say client retention remains very high, but we've been continuing to reduce our CAT exposures and increasing price in property CAT pretty aggressively over the course of several quarters now. So we're retaining more of those customers, but reducing exposure there. Outside of that, retention remains within historical norms. As Peter mentioned earlier, we continue to see good rate improvement and good momentum on the pricing side. Property rates in the U.S. are up double-digits. They're up more than that in parts of Southeast Asia, casualty rates, up in single-digits in the United States. Some product areas and some geographies lagging a bit, probably most notably Continental Europe and Latin America. But, really, even in those geographies we've seen an improvement over where we were in the fourth quarter. You may have noted we did take down the topline in Europe in the first quarter. It's a big renewal cycle for Continental Europe, and that was some corrective underwriting action we took in primary casualty. So momentum's good. Retention's where we want it to be given the pricing environment, and we took some aggressive action to improve the portfolio. So roughly a 3.7 point improvement in the accident year loss ratio in the first quarter.

Operator

Our next question comes from Michael Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just picking up on Keith's question a little bit. I see the -- I guess for John and Peter, the mix shift and the impact it had on the expense ratio, but as you move along this path, given the expense investments you're making in the mix shift towards higher-expense, lower-loss business, when should Chartis begin to see underlying action in your profitability? And I guess along those lines, Peter, you mentioned the aspirational goals were here 100-ish. Where do we have to be at year-end for you to feel confident that we're on track to get to the aspirational goals by 2015? And one follow-up if I can.

Peter D. Hancock
Former Chief Executive Officer, President and Director

Well, I think that there's some one-off items that make the recent short-term trend and the expense ratio inconsistent with what my longer-term trend expectation would be. So I'd expect the expense ratio towards the end of the year to be between 32% and 33%. But to be honest, we are absolutely focused not on targeting a specific expense ratio. We're really looking at the ROE and making the right trade-off between stable loss ratio improvement and whatever it takes to spend to get that, in terms of infrastructure, distribution, to get the best mix of sustainable business. So the infrastructure investments that are sort of heavy in nature are going to sort of peak in mid-2013. We've talked about that consistently over the last year and the benefits from those will be long-term cost advantages and scalability of platforms through better shared services and so on. But importantly, I look at the large amount of expense that's in claims that's classified within the loss ratio, and I really want to be agnostic about whether a cost is classified as loss ratio or expense ratio. I'm not trying to -- given the huge variety of businesses that we have, benchmarking our expense ratio against others is very hard to do. And so the bottom line on the risk-adjusted basis is a much better way to judge whether we're making progress. And we feel very good about our ability to deliver the target ROE by 2015.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then Bob, if I can follow up on the asset -- non-core asset question. So if you were to sell -- if you actually were to sell some part of the non-core assets that you showed on Slide 7, is your kind of baseline expectation that you would be able to deploy all of that capital that you generate from those sales?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I think we're going to take a look at what is when we do it and what's available and what makes the most sense for our shareholders, and that's what we'll do. I can't give anymore color than that. I think so far, if you look at what we've done so far, I think we got a pretty good track record of putting our money where it makes the most sense.

Operator

I'll take our next question from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

2 questions. One, can we talk a little bit about the moving pieces in the direct investment book, so we can think about how we should model that going forward? And second, with regard to ILFC, were there planes taken offline this quarter? And it appears to be there are no charges associated. But can you talk about the value of the fleets and how you're feeling about that?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

David, why don't you take the first question and then...

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, Josh, could you maybe clarify what you're interested in, in the direct investment book? What piece of it?

Joshua David Shanker
Deutsche Bank AG, Research Division

Obviously, there was the credit-related loss this quarter. Is that related to rising interest rates? How should we think about that modeling going forward?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, fair point, a good -- that was the CBA. It went to our credit spreads. So again, directionally, if you look at what's happening with our credit spreads, we had our credit spreads came in 275 this quarter and we had a $580-million hit in that book. Now, again, so what that means is our credit spreads came in much more than the credit spreads of the assets that we've invested in. So the whole book is -- or that piece of the book is mark-to-market. So we had a disproportionate improvement in ours, which is good news. I mean, it's terrific. The credit spreads are tightening. So that's the biggest driver of it.

Joshua David Shanker
Deutsche Bank AG, Research Division

On an operating basis, though, without the Blackstone gain, it would have been a much more bigger hit to operating income. Is this an exceptional quarter, you think, in terms of magnitude?

David Lawrence Herzog

Former Chief Financial Officer and Executive Vice President

You mean the terms of the CVA? I think you can -- I would think it's -- there's going to be volatility in that number in that mark. So I think that's the way you have to look at and map it back.

Joshua David Shanker
Deutsche Bank AG, Research Division

Okay, and then ILFC fleet values and what happened this quarter, particularly related to my last...

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Yes, let me just answer that. Briefly, the planes have been repossessed and actually released and all the accounting, everything else pretty much is done in this quarter. So I think you'll see some drag in the remaining 3 quarters as we go through this. But the team did an outstanding job of getting those planes back. Some of them were not released, but they were actually put in the part-out. As you know, we bought the part-out company, which gives us an option where if we don't think we can get a good price for planes, we don't have to be stuck with them on the ground. We have a chance to get good value out of just taking them apart and selling them through that AeroTurbine organization. So I think overall, a quick reaction to all the numbers are in the first quarter that you can see other than a drag a little bit in terms of income going forward.

Joshua David Shanker
Deutsche Bank AG, Research Division

And no negative cost from the parting out?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

That's correct. Josh, it's David, just to -- I want to add on to what Bob said with respect to Malev. There was no impairment in the quarter or last quarter with respect to Malev. Those planes, we had those planes valued accordingly in anticipation of that. So we did have some impairment charges this quarter, but it did not relate to Malev.

Operator

The next question comes from Josh Stirling from Sanford Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

The one -- 2 questions, one, if I can with -- for David and then another for Peter. The question for David, if we go back to Slide 7, it would be -- which is the asset values and sort of how we should think about potential future divestitures not from timing, but from a valuation perspective? Thinking about the taxes, can you give us some guidance as to either the tax bases we should be using when we model this out ourselves? Or simplistically just, say, if the transactions were done at current carried values, what the actual -- what -- not the cash proceeds would be, because you've told us they'd be offset by NOLs, but the actual book value impact would be because I don't know that we can actually calculate what the DTA usage would be, given that we don't know the tax bases?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, that's fair point. On ILFC, we covered this last quarter, but it's a helpful reminder. That simple example that we used last quarter is if we sold it at book value, and book value's book value. We laid that out, $7.5 billion -- basically $7.5 billion. Example is, we said it's -- and it has a very low tax basis. So effectively, the book tax expense that would be recorded is that essentially, the proceeds times the tax rate, that's the book tax and it's -- it will be offset with NOL. So effectively, you're accelerating the utilization of those NOLs, so there's no cash out the door for that tax expense. And then the book basis, as you can see, AIA and ML III are both fair value options, so they're on the books for what they're on the books for. So AIA's carried at this point, at the end of the quarter, was $8.2 billion and the tax expense would be the tax expense, and then it's again utilization of our DTAs. So you have -- we will have a book tax expense when we sell these, but we will not have a cash tax expense when we sell these. Is that helpful?

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

That's helpful color. I'm just -- is the AIA tax basis and Maiden Lane III tax basis, are these the values approaching the fair value, which is I think what I heard you just say?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, we've -- on AIA, we've already taken the book tax expense. So I think it's the way to think about it. The tax basis is less than that because of the timing of when we were filing tax returns, et cetera, but it's -- again, I think, from a utilization standpoint, the way to model it is just think about the fair value. That's the easiest way to think about it.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

That's helpful and in ML III, maybe you're probably still in a loss position?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

I don't know that that's the case. But for modeling purposes, I would use the book value.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

Okay, that's helpful. And just if I could follow-up on Andy's good question about the changes to ML III and its involvement with the direct investment book. Should we look at that as you guys have -- actually already having an unencumbered other assets, which were at the holding company at year-end, which were effectively pledged to the direct investment book? And so in some fashion, you've already sort of started to get liquidity from the ML III by pledging it against other -- against those obligations?

Jay Steven Wintrob
Former EVP of Life & Retirement, CEO of AIG Life & Retirement and President of AIG Life & Retirement

Yes, I think the way to look at it is that when we extinguished the remaining SPV preferred, we used the DIB as a vehicle to do that. So for effectively $1.5 billion, we were able to add about $3.5 billion of asset value, and that's excluding the Met -- escrow to the DIB. So the asset is unencumbered. It's not in a regulated insurance company or anything like that. And as it is monetized, depending on what the needs of the DIB or the parent are, we will determine how much excess value there is. It's our expectation that there will be a substantial portion of Maiden Lane III that would be available for a variety of corporate purposes, including maximizing our financial flexibility.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

That's great, very helpful. And then if I could just overstate my welcome and ask Peter, very much appreciate sort of the strategic color on long-term growth strategy and mix management, loss ratio objectives and expenses. I'm wondering if you can give us some sort of color from the underwriting trenches of the kind of stuff you guys are actually doing today to take away sort of historical underperforming business to get where you need it, just so we can sort of go to the level of sort of understanding what really you -- what you really are asking, expecting of your underwriters and sort of where we are in the execution of the story?

Peter D. Hancock
Former Chief Executive Officer, President and Director

Well, I think that the first thing is that we are giving clear direction to our underwriters as to how to make the trade-off between value and volume. And to do so with a view to optimizing customer relationships that we've had for decades. And that means going to our customers early and really helping them work with us to use our capital in a way that is most valued by them, so in the lines where we have the most distinctive capabilities. And I think one good anecdote that happened in the first quarter was a long-standing manufacturing customer of ours in the U.S. that was up for a large property renewal, where we were the lead, and they expected contingent business interruption to be included in the language, as it always had been. But with the events in Thailand and in Japan highlighting the very real risk to the supply chain, we were unwilling to do the renewal without much greater detail on that supply chain risk. So we wanted to have it excluded. It was a real tipping point moment, where the customer eventually backed down. We had the exclusion, but importantly, we agreed to work together with them over the next year to really understand the risk of their supply chain, so that we could include it next year, but also charge for it and help them figure out what the right retention would be on that risk. So I think that our underwriters feel they have the empowerment from management to say no when that's the right thing to do, and to use the most sophisticated analytical tools to really help the customer manage their risk in the most sustainable way possible. So I'm seeing lots of nice examples where I think people are very aligned to make the right trade-offs.

Operator

And we'll take our final question from Tom Gallagher from Credit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I just wanted to ask a quick follow-up on the ML III question. I guess based on the way it's worded in the Q, it's saying it's allocated to the MIP book. My question is really, is it the full $7 billion or so that -- and is that backing MIP debt right now? Or is this somehow an equity cushion within the MIP book? Like I just want to understand how we should think about that. And then, I guess, my follow-up is, as the stake gets monetized over the next year, can you just give some general sense for how much you think could be used for capital management if it did occur this year in a more immediate way versus that, which would have to remain for liquidity purposes within the MIP book?

Jay Steven Wintrob
Former EVP of Life & Retirement, CEO of AIG Life & Retirement and President of AIG Life & Retirement

Sure. First, there are no specific assets in the DIB or MIP that are specifically pledged against debt. There's a pool of assets and those assets will generate cash flows that we believe will be more than adequate to meet the needs of the DIB. When ML III is monetized, we will then determine using a number of sort of tests that we look at what the appropriate level of capital and liquidity for the DIB is. To the extent there is excess capital in the DIB, we should be able to use that freely apparent based on whatever opportunities we feel will maximize shareholder value. It is our expectation based on our numbers now that a portion of the Maiden Lane III assets will remain in the DIB, but that there should be a substantial portion of excess value that we'll be able to have discretion over how we use.

Thomas George Gallagher
Crédit Suisse AG, Research Division

That's very clear, thank you. And then just last follow-up, I guess, for David. The $8.2 billion of cash in short term at the holding company now and in addition, you have low financial leverage, can you talk about on a more near-term basis what your position is for ability to manage capital? Should we think about some portion of the $8 billion of cash in short-term as available and potential leverage? Or can you give a little color around that?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Look, we constantly are looking at what we have and what -- and making sure that the biggest constraint we have amongst ourselves is to do what makes the most sense to continue to show strength in our credit ratings and how we use the money here, and we will continue to look and examine what we have and we will do what is most prudent at the time. So I don't know it until I know it, until everybody around this table says that, that makes sense to do. So that's about all I can tell you.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, operator. I think we're going to wrap it up for now. I appreciate everyone dialing in. And certainly, if you have any follow-up questions at all, don't hesitate to give us a call.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thank you all.

Operator
Once again, ladies and gentlemen, that concludes today's conference. We appreciate your participation today.