S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ3 2015 Earnings Call Transcripts

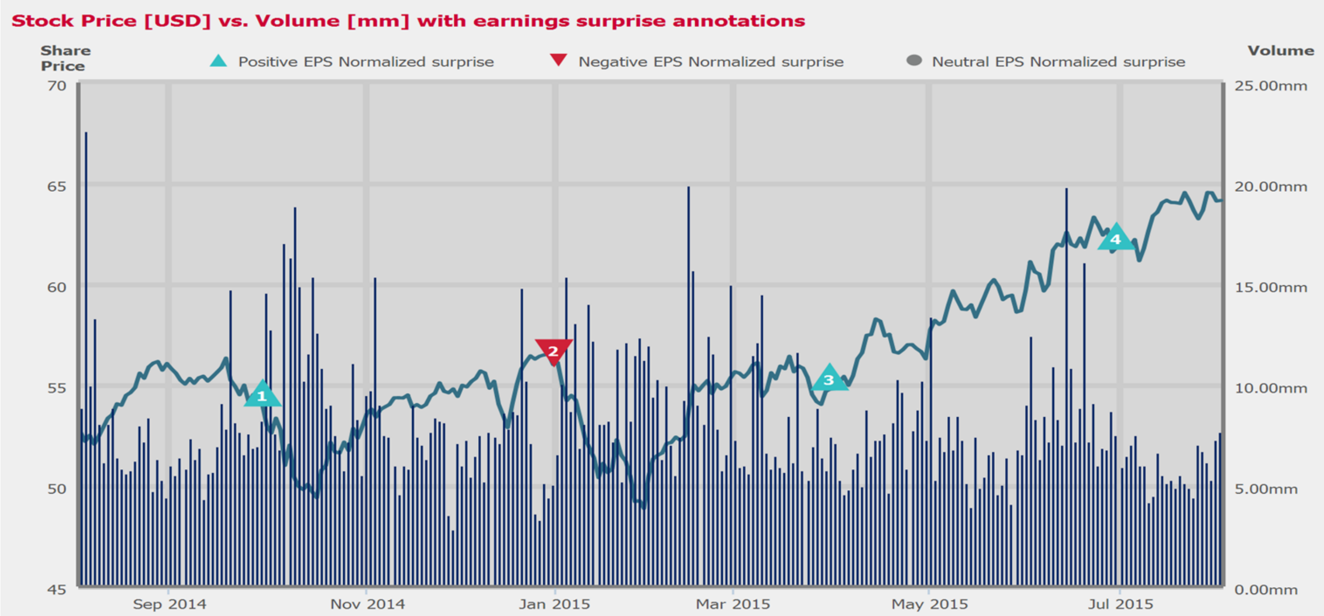
Tuesday, November 03, 2015 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2015-			-FQ4 2015-	-FY 2015-	-FY 2016-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.01	0.52	(48.51 %)	1.16	4.63	5.39
Revenue (mm)	14314.00	12822.00	(10.42 %)	14647.00	60635.00	60319.00

Currency: USD

Consensus as of Nov-03-2015 10:55 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2014	1.09	1.21	1 11.01 %
FQ4 2014	1.05	0.97	2 (7.62 %)
FQ1 2015	1.19	1.22	3 2.52 %
FQ2 2015	1.22	1.39	4 13.93 %

Call Participants

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John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

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Presentation

Operator

Good day, and welcome to AIG's Third Quarter Financial Results Conference Call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Liz Werner, Head of Investor Relations. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, and good morning, everyone. 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 circumstance. 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, second, and third quarter 2015 Form 10-Q and our 2014 Form 10-K under Management's Discussion and Analysis of Financial Conditions and Results of Operations and under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliations of such measures to the most comparable GAAP figures is included in our financial supplement, which is available on our website, www.aig.com.

With that, I'd like to turn our call over to our CEO, Peter Hancock. Peter?

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

Thanks, Liz. Good morning, everybody. Thank you very much for joining us. Last night, we announced significant actions to further transform AIG into a more streamlined organization, positioned to serve our clients with ever-greater agility.

I look forward to providing more details on our strategy and progress. But before I do, I'd like to comment on the recent letter we received from Carl Icahn.

The letter outlined a plan that includes separation of Life and P&C. Management and the board have carefully reviewed such a separation on many occasions, including in the recent past, and have concluded it did not make financial sense. We, of course, will meet with him to further share our conclusions and give him an opportunity to elaborate on his views. The views expressed suggest that AIG should be split into 3 businesses, that those businesses would no longer be subject to non-bank SIFI regulation. The assumed outcome is the ability to increase capital return to shareholders and the elimination of what are perceived to be excessive costs associated with non-bank SIFI regulations.

We see tremendous benefit from combining Life and P&C activities while we are continuing our efforts to reduce costs and complexity.

As additional context, AIG has been aggressively reshaping the company and has sold over 30 businesses for over $90 billion. There are no sacred cows, and we consider all avenues to improve shareholder returns.

Having said that, there are a number of issues associated with the separation of our Life and Property Casualty businesses. And this morning, I'll touch on 4 key considerations.

Number one, our non-bank SIFI status has not limited our ability to return capital. And since the beginning of 2012, we have returned over $26 billion to shareholders by repurchasing 35% of our outstanding shares.

Number two. Rating agencies are the key determinant of how much capital is available for distribution, and they have given AIG significant credit for our scale and diversified business model. Rating agencies have noted the existing diversification benefit from our multi-line structure. Thus, we believe that less capital would be available for distribution to shareholders if we separated these businesses.

Number three. AIG is highly regulated throughout the world, independent from our regulation as a non-bank SIFI. The amount we spend on non-bank SIFI compliance is a fraction of our total regulatory compliance costs, $15 billion. The amount lost would depend on the scenario of which business or businesses may be spun out and their respective income projections.

In addition to the issues I just reviewed, including that a separation would result in less capital being available for distribution, separating AIG would increase certain expenses and would be a distraction from our cost-cutting initiatives.

Now let me discuss the quarter, our 4 main priorities and our focus on AIG's financial targets.

In the quarter, you saw that operating income was negatively affected by volatile capital markets. Even excluding the impact of the markets, our underlying results were mixed. You saw deterioration in certain U.S. Casualty lines, which John will speak to, but we were pleased with the growth in global property and Japan personal auto.

As you saw in our press release, our 4 priorities are to narrow our focus on businesses where we can grow profitably, drive for efficiency, grow through innovation and optimizing our data assets and return excess capital to shareholders. These actions are all consistent with our core objectives of improving ROE and increasing shareholder value.

In my shareholder letter, I stated that we would sculpt AIG's businesses to maximize return on our resource allocation and position the company for future growth opportunities. The announcements this quarter were part of a continuous transformation to streamline our businesses and exit subscale and low-return businesses and geographies.

We're ceasing to offer certain products like personal auto in countries where we lack the necessary scale, some 17 countries to date, including Russia and China. In the third quarter, we entered an agreement to sell our Central American operations and entered a partnership with a local buyer. Those geographies were not core to our targeted emerging growth countries, which are concentrated in larger markets where we have existing scale.

Managing expenses and reduced structural costs are a critical focus as they are within our control and a key driver of improving profitability. This quarter's announcement is targeted at reducing 23% of employees among the top 1,400 members of senior management. We believe these actions will also increase our speed of decision-making and agility.

In the quarter, we also announced actions to manage pension expense. We've been gathering momentum on our expense reduction, as evidenced by the almost 6% of general operating expense reductions year-to-date or 3% on an underlying basis.

These expense initiatives have been in flight for some time and require careful planning and execution. David will go through the numbers in greater detail, and we expect to deliver continued improvements that allow us to reach our 3% to 5% annual net expense reduction target.

To be clear, we're targeting net expense reductions. We've been investing and will continue to make investments that will give us a competitive advantage in an ever-changing landscape. The current mega trends that we see in artificial intelligence, digital, the Internet of Things and big data require us to make these investments with a constant eye on innovation in order to be relevant.

As you know, we believe investment in technology and innovation will give us a sustainable competitive advantage to deliver greater value to our customers. While we're rationalizing existing businesses, we are, at the same time, building capabilities through engineering services, technology and shared service centers. These investments allow us to deepen our customer relationships and operate with greater efficiency. They allow us to win business and retain clients and are evident in the numerous awards we receive globally.

We remain committed to an active capital management strategy that prioritizes return of capital to shareholders. Year-to-date, share repurchases have totaled more than $8 billion and will continue at current prices and below our estimate of intrinsic value. Our capital management actions and operational improvements support our book value and ROE targets. Through the first 9 months of this year, we've achieved 6.6% growth in book value per share, excluding AOCI and DTA and including dividend growth.

Dividends are one component of our capital return to shareholders, and I mentioned last quarter that we would account for this year's 124% growth in our quarterly dividend as part of our book value per share growth target. While we may fall a bit short this year, we continue to target a 10% growth rate in annual book value, excluding AOCI and DTA and including dividend growth through 2017. Through the 9 months, our 6.9% normalized ROE reflects 30 basis points of lost AerCap earnings as well as narrowing improvements in our commercial underwriting results. Despite this year's challenging comparisons, we believe that through 2017, we will reach our target of 50 basis points in annual ROE improvement, adjusting for AerCap's full year 2015 contribution of 15 -- 50 basis points.

You can expect that the sense of urgency in this quarter's actions will continue so that we reach our targets. The scale and diversity of AIG provide great flexibility and opportunity, and there's no one business or geography that determines our success. We have a clear alignment with our board, management and employees on our strategy, and you can expect that our focus will be on execution with urgency. I look forward to providing future updates on our actions and our progress of delivering sustainable value to our shareholders.

With that, I'd like to turn it over to David.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Peter, and good morning, everyone. This morning, I'll speak to our quarterly financial results, the details of restructuring charge and expense initiatives and our capital management activity.

Turning to Slide 4. You can see that our third quarter operating earnings per share was $0.52, down $0.67 per share from the same period in 2014. As shown on Slide 5, market volatility impacts on investment returns primarily drove the comparison, as sharply lower hedge fund performance, PICC mark-to-market losses and a decline in the fair value of asset-backed securities largely resulted in a reduction of about $0.64 per share compared to the third quarter last year. As a reminder, we report hedge fund returns on a 1-month lag and private equity returns on a 1-quarter lag.

In the quarter, in addition to our restructuring charge, there were 3 noteworthy adjustments to GAAP net income that contributed to the GAAP net loss of $231 million compared to after-tax operating income of just shy of $700 million. These adjustments include net after-tax realized capital losses of about $260 million, principally related to other-than-temporary impairments on energy and emerging market investments; a FIN 48 tax provision of a little over $200 million associated with legacy cross-border financing transactions; and a $225 million after-tax loss on extinguishment of debt as we executed on economically attractive debt repurchases.

Our reported operating tax rate for the quarter was just shy of 20%, driven by lower -- a lower level of income and tax audit settlements during the quarter. The 9-month tax rate of 32% is in line with our expectations for the full year.

Turning to Slide 7. Total company general operating expenses were $2.7 billion in the third quarter and $8.4 billion year-to-date, down just over 10% for the quarter and 6% for the year. The reported comparisons reflect the benefits of the pension plan freeze as well as the effects of a strengthening U.S. dollar, but they also include expenses associated with the acquisitions of about $100 million year-to-date. In the third quarter, we froze our defined benefit plan while increasing our 401(k) contributions somewhat. These changes are effective January 1, 2016, as part of our efforts to better align our benefits offering to the market.

The combination of these actions are expected to reduce our annual benefits expense by approximately $100 million on a pretax basis. We expect roughly 75% of the run-rate savings to be reported in our Commercial and our Consumer lines of business, split fairly evenly, and the balance to be reported in the parent.

Excluding the impact of foreign exchange, the nonrecurring portion of the pension benefit and expenses from recent acquisitions, general operating expenses declined roughly 3%, both for the quarter and year-to-date compared to 2014. As Peter mentioned, we remain highly focused on our objectives of improving operating efficiencies in a sustainable way that will deliver earnings and ROE improvements and will enhance shareholder value. To that end, this quarter, we have incurred an initial pretax restructuring charge of $274 million pretax with an additional $225 million of restructuring charges to be recognized through 2017. We expect that the annual run rate general operating expense savings from these actions to amount to between $500 million and $600 million per year, once the initiatives are fully executed. This includes the $100 million of pension benefits I referenced earlier.

As you can see on Slide 8, we are executing on a plan to deliver $1 billion to $1.5 billion of reductions in net general operating expenses over the 3-year period ending December 2017. This would represent approximately 10% to 15% reduction to our total company general operating expenses based on the full year of 2014. The body of work to accomplish these savings is quite broad and can be broken down into 3 major categories: organizational simplification, operational efficiency and business rationalization, each of which are detailed on Slides 8, 9.

While a fair amount of work has been completed to-date against these initiatives, particularly as it relates to moving certain functions to lower-cost locations, simplifying our organizational structure and optimizing benefits, more work remains to be done.

Slide 10 represents our current capital structure. During the quarter, we deployed over $3.7 billion towards the purchase of approximately 61 million shares, and we also purchased an additional $600 million worth of shares in October, leaving it right at $2.9 billion of unused authorization.

We also continue to manage the cost and maturity profile of our debt. In July, we repurchased in cash tender offers roughly $3.7 billion in aggregate purchase price of the debt. During the third quarter, we also issued a total of about $3.2 billion in senior debt to fund the tender. We continue to be opportunistic in our debt/capital management, which is focused on the cost and maturity profile of the debt.

Cash flow to the holding company remains strong, as you can see on Slide 11. The company received total distributions from insurance subsidiaries of about $2.8 billion during the quarter, including over $500 million of tax-sharing payments. We expect the insurance company dividends and distributions to be roughly $1 billion in the fourth quarter.

Now with that, I'd like to turn the call over to John.

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Thank you, David, and good morning, everyone. Today, I'll discuss our Commercial Insurance segment's third quarter results, market trends and our strategic outlook.

Pretax operating income in the third quarter was $815 million, a decrease from $1.2 billion in the same period last year. As David highlighted earlier, the decrease in investment returns was the primary driver in the decline in Commercial's operating income.

In Property Casualty, as noted on Page 13, our underwriting results benefited from modest catastrophe losses in the quarter but were offset by an increase in current accident year losses, driven by higher loss expectations in commercial auto, Healthcare and environmental; higher-than-expected attritional losses in Property; and increased severe losses. For the 9 months, severe losses were comparable to last year. However, they were approximately $100 million higher than expected. About 1/4 of the period's severe losses were related to the Tianjin, China explosion. We expect modest accident year loss ratio improvement in the fourth quarter, which should continue into 2016. While short-tail results can be volatile in any given quarter, we remain confident that our strategies will drive sustainable improvement in the accident year loss ratio.

Our actuarial review work this quarter resulted in $186 million of net adverse prior-year reserve development associated with Healthcare and environmental reserves. The change in loss picks had an outsized impact on the third quarter accident year loss ratio as it fully reflects the year-to-date change in those loss picks. As a result, we have taken remediation action, including exiting certain classes of these businesses. We also had favorable prior-year reserve development of approximately $100 million in Property.

Going forward, you can expect us to continue our value-based management approach and reduce exposure to certain poorer-performing segments of U.S. Casualty, which, as you can see, shrunk by 10% in the third quarter.

Net premiums written declined just over 1%, excluding FX, and as a result of our continuing strategy to optimize the portfolio and maintain underwriting discipline in overly competitive markets. We continue to have strong growth and focused eye on the business where we see good returns and greater opportunity, such as large limit and middle market property, cyber risk and M&A insurance.

I would expect continued pressure on the top line growth given the overall rate environment. However, diversification and new sources of distributions, such as AIG-Ascot Re in Bermuda and the NSM acquisition, are now contributing to our top line.

General operating expenses declined from the year-ago quarter, but the GOE ratio increased as a result of lower net premiums earned and the impact of the NSM acquisition. The increase in acquisition cost was primarily driven by the impact of NSM.

Overall, rates declined by 1.4% in the quarter, driven by rate pressure in Property and across all lines in Asia Pacific and EMEA. Average rate change was positive in Casualty and essentially flat in Specialty and Financial Lines.

If you turn to Slide 14, Mortgage Guaranty's third quarter operating results were excellent, benefiting from improved loss experience due to lower expectation of delinquencies and higher cure rates. As you can also see, production volume was also strong in the quarter.

Although certain of our underwriting results in the quarter were disappointing, we remain confident in the underwriting improvements underway, and we expect to benefit from our further cost reduction efforts and capital efficiency initiatives. While there is a lot of work to do, it is clear to me that our investment and underwriting excellence, the application of science, and new technologies will improve client experience and make us a more efficient commercial insurer.

Thank you, and I'd now like to turn the call over to Kevin.

Kevin T. Hogan
Executive Vice President and Chief Executive Officer of Global Consumer Insurance

Thank you, John, and good morning, everyone. This morning, I'll discuss the trends in our Consumer Insurance businesses and comment on our strategic initiatives, including our ongoing work in Japan.

In the third quarter, our Consumer Insurance businesses generated pretax operating income of $657 million.

Turning to Slide 16. Pretax operating income for Retirement was $635 million for the quarter, reflecting the lower alternative investment income that David highlighted, a decline in base portfolio income and a lower net positive adjustment from the annual update of actuarial assumptions.

Base portfolio income for Retirement decreased as a result of lower reinvestment rates and lower invested assets, principally driven by significant dividends to AIG Parent over the last 12 months. We continue to expect base yields to decline 2 basis points to 4 basis points per quarter, given current interest rates.

Retirement saw good overall sales growth, both sequentially and year-over-year, particularly in Fixed Annuities. The key growth drivers were broader distribution of new product offerings, with fixed deferred annuity bank channel sales also benefiting from higher market interest rates as a result of widening credit spreads. We have continued to see good growth in index annuities, which we began breaking out on Page 31 of the financial supplement this quarter.

Net flows improved by almost $1.2 billion compared to the year-ago quarter across our businesses due to continued strong net flows in Retirement Income Solutions and improvements in net flows in Fixed Annuities and Group Retirement.

Slide 18 presents results for our global Life business. Life reported a pretax operating loss this quarter from lower alternative returns, mortality experience that was within pricing expectations but less favorable than the year-ago quarter, and a higher net negative adjustment from the update of actuarial assumptions.

Life premiums and deposits grew 8% from the same quarter a year ago, excluding the effects of foreign exchange, reflecting the continued growth in Japan and the acquisition of AIG Life Limited. The AIG Life Limited and Laya Healthcare acquisitions were also the primary driver of growth in Life general operating expenses.

Turning to Slide 19. Personal Insurance results this quarter were impacted by lower net investment income and modestly lower underwriting income, which included higher catastrophe losses, offset by favorable prior-year development.

Net premiums written grew 3.5% from the same quarter a year ago, excluding the effects of foreign exchange, driven by growth across all products with the exception of warranty service programs in the U.S., where new premiums reflect the increased deductible structure we instituted to improve performance in this portfolio. The overall expense ratio declined 0.2 points, as a decrease in the general operating expense ratio was partially offset by an increase in the acquisition ratio. The acquisition ratio increased primarily due to a profit-sharing arrangement in warranty service programs and higher acquisition costs in automobile, partially offset by lower Accident and Health direct marketing expenses.

The general operating expense ratio decreased, primarily reflecting the timing of investment and strategic initiatives together with an ongoing focus on cost efficiency.

In Japan, we continued to accelerate growth in our target markets while making significant progress in preparation for the legal merger. We have determined that work we have completed to date enables cost benefits even before legal merger, including the realignment of our marketing activities and simplification of our structure, leading to our decision to reduce emphasis on the actual merger date and extend the time line. By doing this, we can continue to enhance current performance, take actions to meet new regulatory requirements and reduce the amount of immediate investment required without jeopardizing the eventual merger.

To close, for our Consumer businesses, we remain focused on achieving profitable growth and effectively managing risk by executing on our customer-focused strategies, maintaining a prudent risk profile and targeting capital-efficient growth opportunities.

Now I'd like to turn it back to Liz to open up the Q&A.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Operator, can we open up our lines for Q&A, please?

Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Tom Gallagher with Credit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Peter, just following up on your commentary about the Icahn proposal and the 3-way breakup, you commented on Life insurance and Property Casualty, but not United Guaranty. Can you give us an update on your thoughts there, whether that's a business that you would consider divesting?

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

Well, Tom, thank you for the question. So UGC is a business which was for sale for virtually nothing back in the crisis days. And since then, we've invested in it, modernized it and taken it from #5 to #1 in its industry, and it's performing very well today. We've kept it as a very modular unit, so it gives us strategic flexibility. But today, it is a core business, making a significant contribution to the company. But over time, we are always flexible if the right opportunity to monetize assets was to come along. But today, it's core, contributing, and we enjoy certain operational synergies with it. It originates whole loans for our investment portfolio and gives us, I think, a source of attractive returns in the mortgage market. So we don't announce or preannounce any strategic actions, and so no further comment on the topic.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got you. And then just a follow-up related to that business, I guess for David. In terms of your capital framework, are you currently holding a significant capital buffer related to the ownership of United Guaranty? Can you comment as to how that overall works into your capital position?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes. The -- Tom, the capital that we hold for that business is much more manageable by AIG given our broad balance sheet, our ability to fund the capital needs through internal reinsurance. And likewise, we did a recent CAT bond that was also a very capital-efficient transaction for us. So I wouldn't characterize it as a buffer. We're holding adequate capital, and we have adequate capital flexibility with respect to that business.

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

And I think the important capital constraint on this is the [indiscernible] capital constraint. So that's really the right lens to view the capital adequacy for UGC's current book of business and future growth prospects.

Operator

And we'll take our next question from John Nadel with Piper Jaffray.

[Technical Difficulty]

Elizabeth A. Werner
Head of Investor Relations and Vice President

I guess, operator, do we have a problem with the line?

Operator

It looks like -- I do not know. Let me try again. We'll go to our next question with Jay Cohen with Bank of America Merrill Lynch.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Okay, thank you.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Just 2 questions. First, for John. John, at the beginning of the year, I seem to recall you thinking that you would have a pretty decent improvement in the underlying loss ratio in the Commercial business, and you really haven't seen that. I'm wondering why. Has it been pricing? Has it been loss activity? What's the reasons behind the lack of improvement?

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Sure, Jay. As you know, over the course of the last several years, we've had meaningful improvements in our accident year loss ratio. I think since the beginning of 2011, about 8.5 points of accident year loss ratio improvement. So we've done well over time. But it has flattened out this year, and I think really driven by 2 different things. One is higher-than-expected short-tail losses. I commented briefly on the severe losses in the quarter. And then we saw generally higher severity than we had expected in transportation, commercial auto, in environmental and in Healthcare. So as you saw, we took action in the quarter with remediation plans in place from an underwriting point of view, moved some segments of those lines into runoff as well, but took the opportunity to strengthen current accident year reserves. So as I said, I do expect some modest improvement. Not what we had expected earlier in the year given what's happened in those markets, those segments, but we do expect a bit of loss ratio improvement in the fourth quarter and again next year. Costs will, in this market, become increasingly important as well. So that remains an important lever for us as we go forward.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Great. And I guess next one for...

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Jay, I would -- this is David. I would just add to -- and John, you may want to comment. We -- with respect to the current accident year loss catch-up, so there was some of that in the quarter as well. You may want to...

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Yes, I commented that in my earlier remarks. But in Healthcare and in commercial auto, when we strengthen the loss picks in the quarter, it goes back to 1, 1. So it's got an outsized impact on the current quarter reported results.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, I was looking at the 9 months. It's probably better to look at that, I imagine.

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Right.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

The other question's for Peter. Peter, you mentioned that being designated as SIFI has not held you back from repurchasing shares. At the same time, I would suspect that, that designation has caused AIG to hold excess capital simply because you don't understand what the actual rules are going to be because they haven't been fully announced yet. Is that the case? Are you holding some excess capital than you would normally have because of the SIFI designation?

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

The answer is definitively no. I think that the right way to look at this, if you -- we are among about 30 SIFIs, banks and non-banks, and we anticipated this designation before we exited the government's cradle and, therefore, executed massive deleveraging and divestitures of precisely the activities which the SIFI regulations were designed to eliminate. So whether it's ILFC, whether it's American General Finance or other activities, our consumer finance businesses, which required short-term funding. So we don't have run risk in terms of short-term [indiscernible]. We eliminated the derivatives book. So unlike other SIFIs that are, today, in a deleveraging and divestiture mode, we got that done by the end of 2011. So it's the -- it's simply not the binding constraint. The rating agencies are the critical binding constraint that we -- governs our buyback pace. And the longer they get comfortable with the stability of our operating model and our ability to execute on it, the more and more they will give us capacity to use capital more efficiently than we have in the past. But it's definitively not either current or anticipated SIFI capital rules.

Operator

And we'll take our next question from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

So Peter, can we talk a little about headcount, understanding the roles that the people who are technically positioned at the holdco have relative to what their functions would be allocated to the subs? I mean -- and not to say that we're trying to take those positions down, but rather understanding the nature of the hiring of people who are holdco personnel.

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

So very few people are actually employed in the holdco per se. So I think that just sort of read more into your question perhaps, how do we view shared services? We have a number of very sizable shared service centers, which perform a range of services, from operations, technology, claims and other activities and finance, that are in low-cost locations, both in the United States and overseas, and we've been moving roughly 2,000 jobs to those low-cost centers per year. And so this is a very substantial shift in the headcount mix and the cost per unit of headcount. You had an increase in the total headcount during this transition period because you have to mirror the job. You can't just flip the switch overnight. And so you have a doubling up of a number of these jobs. The pace of that migration, which started about 3.5 years ago, has gone from about 1,600 migrations in 2014 to about 2,000 this year. So it's a very substantial shift in the way the company has provided services to create scale and rationalization of a very diffused operational environment and has improved controls and provides the platform for future automation of what were very manual processes that were decentralized and had a lot of redundancy. So I don't know whether that helps answer your question, but that's the sort of the basic headcount story.

Joshua David Shanker
Deutsche Bank AG, Research Division

It's a good answer. And if we think 3 years out, how does the headcount look at AIG compared to where it looks today?

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

I think that there will be fewer people because a lot of those jobs will eventually be replaced by automation. We also, beyond the headcount numbers that you see, have a very substantial number of contractors, and that number will also decline. So between contractors and headcount in total, we expect that number to be substantially lower. And our technology would be a bigger part of the spend, and the scalable infrastructure that gives us will lower our unit costs substantially.

Operator

And we'll take our next question from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

First for John, if I could. Can you quantify the true-ups on the current accident year? So maybe give us a current accident quarter loss ratio in Commercial.

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

If I understand your question, I think it was about a 2-point impact, the loss pick impact in the quarter relating to Healthcare, auto and environmental as well.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Great. And then you talked about NSM in the release as well. How much of an impact did that have on the expense ratio in Commercial?

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Modest, but I think -- were you talking about acquisition or geo?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Yes, the acquisition was the one that bumped up, and I think you've mentioned that in the release.

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

Yes, so a combination of growth in programs and a higher acquisition rate, and then writing less Casualty business in the U.S., much of which is net of commission, drove the increase in acquisition cost.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

And so the NSM piece, is that going to be a permanent increase in the acquisition expense? Or does that -- somehow, is there something onetime-ish because of the acquisition timing that caused that?

John Q. Doyle
Former Chief Executive Officer of Global Commercial Insurance

No. No, there was nothing onetime-ish about it. We've had a long history of being a leader in the program business in the United States. We -- it's consistent with our strategy on how we go down market in the U.S. and focus on niche classes with unique products. NSM gives us access to distribution, to agency distribution that we otherwise don't have, and our program strategy does the same thing. We've done business with them for a long, long time. And so there is nothing kind of one-off-ish about the results in the quarter. It's a higher-value, greater risk-adjusted profitability in that segment relative to the U.S. Casualty business. So the trade-offs are about risk-adjusted bottom line results between those 2 units.

Michael Steven Nannizzi

Goldman Sachs Group Inc., Research Division

Okay. And I guess -- and then sort of shifting over to Japan for a second. Kevin, you mentioned extending the time line on the merger. I guess that's the integration of the brands there. Can you just remind us how much is that impacting the expense ratio in Consumer? And when should we start to see that come through on the expense side?

Kevin T. Hogan
Executive Vice President and Chief Executive Officer of Global Consumer Insurance

Thanks, Mike. As we've consistently said with respect to the merger in Japan, the timeline is something that is determined by external as well as our own events. And the reality is that recently, there has been a new regulatory requirement to change the earthquake rates on certain of the property products. And in anticipation of that, we've really been focusing on trying to understand how can we extract benefits from the investments that we've made to date even before the actual legal merger date. We've invested quite a lot in a series of common products and a front-end that serves both the agency businesses and also our footprint strategy across the businesses. And so even though the actual merger date itself may have to be pushed out a little bit because of this regulatory requirement, we do expect some of the early benefits to start emerging as early as next year. We recently announced that we're refocusing our direct marketing activities of supplemental health insurance in Fuji Life, which is really something that is facilitated by this, and that we'll start winding down activities in American Home. And this is a good example of the type of simplification of our organizational structure and our marketing activities that the investments that we have made in preparation for the merger will allow. So this allows us to reduce a little bit the emphasis on expenses in the preparation for the merger itself as well as extracting benefits earlier. So we anticipate that the benefits -- we're still investing in preparation for the legal merger, so we're not going to be at the run rate we expect to be in 3 to 5 years immediately. But we'll start to see less pressure on expenses as of next year.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

And then, I mean, just generally looking across the 2, I guess it looks like you're seeing -- you've talked a lot about improvements on the general operating side. We've seen some of that come through a little bit, but it's being more than offset by a higher acquisition expense ratio. And so I'm just trying to figure out, when -- what should those be? What should the expense line look like? What are you internally going to be happy with? And I would just generally say I think it would be helpful, instead of just looking at the expenses and profitability on a year-over-year basis when discussing results, thinking about them relative to where you want them to be and kind of what your plan is to get there over a reasonable period of time. And that would be helpful.

Kevin T. Hogan
Executive Vice President and Chief Executive Officer of Global Consumer Insurance

So I understand the points, Mike, and we have loss ratios in the various businesses that we believe are competitive and sustainable, and it is the expense and the acquisition costs that we're focusing on. As Peter mentioned, and in fact, if you go back to the Investor Day we held last year, we introduced the Market Maturity Model, where essentially we're identifying what are the appropriate products and channels to be in, in which territories. And we've taken action. We've actually moved away from writing new business in 17 territories for automobile, as an example, where we just didn't have scale. We're doing the same thing with respect to personal property and focusing our investments in the places where we can generate scale. And we recognize that we have to match that world-class loss ratio with an appropriate expense structure, and we are taking steps to do so. On the acquisition cost, I'll just add that really, what's driving the acquisition cost is the change in the warranty services structure in the states, where we did introduce a substantial deductible change to the program, as we explained a year or so ago. And that is bringing down the loss ratio, which then has the effect of increasing our profit-sharing arrangements, and that's what's really driving the specific acquisition ratio.

Operator

And we'll take our next question from John Nadel with Piper Jaffray.

John Matthew Nadel
Piper Jaffray Companies, Research Division

And I apologize for that earlier. I wanted to start on DIB and GCM. Given the volatility this quarter -- and I know a couple of quarters ago you collapsed DIB and GCM into a single line item, but I was hoping that you could give us a sense for what its actual contribution was in the quarter. I know you articulated what the shortfall was versus your expectation. And then can you also update us on where the NAV of DIB and GCM was at the end of the quarter?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

We're -- Gary (sic) [John], thanks. It's David. The -- we don't -- we haven't updated the NAV disclosure at this time. You might -- we also did not -- during the quarter did not free up any additional capital from it. So it wouldn't be materially different than it was in prior disclosures. So I would just point you to that.

John Matthew Nadel
Piper Jaffray Companies, Research Division

And in the actual quarter, David, what was the -- was it a negative contribution?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, hold on one second. Yes, it was -- just call it breakeven for the quarter.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Okay. And then just a quick follow-up on the $500 million to $600 million expense save run rate by the end of 2017. Is that -- should we be thinking about 100% of that being a bottom line impact? Or is there some level of reinvestment that we should be expecting against that number?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

It'll -- that'll be a net number. Obviously, there could be some additional reinvestments that we do along the way, but the way to think about the $500 million to $600 million, again along the themes that Peter talked about earlier about driving efficiency, about half of the savings will come from an efficiency play as well as the business rationalization, and there could be some -- Peter, you want to add?

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

Yes. No, I think that we made the decision to talk about the 3% to 5% or $1 billion to $1.5 billion expense number target as a net number. So it's inclusive of substantial and growing investments in technology and growth initiatives. So the number that was cited earlier, the $300 million to $500 million -- I mean the $500 million, $600 million is related to the specific actions in our announced restructuring charge. So it's really a component of the broader net target.

John Matthew Nadel
Piper Jaffray Companies, Research Division

Understood. And then one last one, and that's just on the Fed and SIFI and capital standards and how you're being governed today. I mean, for a number of years -- and Bob used to talk about the embracement of the Fed and their involvement in effectively everything you guys do. I'm just trying to understand, what is it at this point? Do they give tacit approval of your capital actions? And if they do, Peter, what is it based off of? What's the -- what are the primary couple of metrics that we can look at, at least today, that give us a sense for what the Fed is looking at?

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

Well, as I mentioned earlier, the Fed and any anticipated rules that they may come up with from a capital perspective have absolutely no bearing on our capital returns. The one area where I'd say that they are watching very carefully is to make sure that our internal governance process is up to the highest possible standards so that when we do decide to take capital actions that, that is not a management shooting from the hip, it's management documenting why they decided to do what they do, getting the board fully onboard with that decision and documenting the board's approval. So it's our own true north of what we think makes sense. And as I mentioned in the earlier question, the binding constraint today is the attitude of the rating agencies. And so where we have incurred additional compliance costs as a result of the Fed's involvement is around improving governance and operational risk as opposed to capital. As I mentioned earlier, we delevered the company and simplified the risk profile so much in order to exit early from the government's assistance program that it's just simply not an issue for us. It's a huge issue for others, and that's why this issue gets so much public discussion. They haven't delevered their balance sheets yet.

John Matthew Nadel
Piper Jaffray Companies, Research Division

And then lastly, I know -- just following up on the rating agency as sort of the primary governor. Obviously, one quarter doesn't necessarily change things too dramatically. But do you think the rating agencies buy into a bunch of the adjustments that you guys are citing here when it comes to thinking about interest coverage?

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

I think that interest coverage has been an issue in the past. I think that we've done a lot to change the debt profile by replacing high-coupon debt with fresh local bond debt but, most importantly, replacing short-term debt with very long-term debt. So today, we have very little exposure to refinancing risk at all. And the other thing is that we make less and less of a distinction between financial and operating leverage. Some of our key competitors have perhaps a better interest coverage ratio but a whole lot more leverage in their operating companies than we do. So I think that there's no single ratio that the rating agencies fixate on. It's a broader set of issues that they look at in terms of our risk management governance and our commitment to using the right kind of criteria for prioritizing business in terms of looking at risk-adjusted returns as opposed to simply volumes. So the value versus volume is starting to take root in the culture of the company in a way that I think has been noticed by the rating agencies. But the biggest issue with the rating agencies is seeing a longer track record of stability in the group structure. We had to massively overcapitalize the company in the immediate emergence from the Fed assistance as a result of the fact that there was no track record of the group as it stood. We had sold so many companies in the immediate aftermath that they wanted to see some stability. And so that's why it's very important that we maintain a steady process of simplification as opposed to any radical abruptness [ph], which is simply attract more capital against the uncertainties.

John Matthew Nadel
Piper Jaffray Companies, Research Division

That's really helpful. And your point on operating versus financial debt is definitely not lost on me.

Operator

And we'll take our next question from Gary Ransom with Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I had a question on UGC. The -- you mentioned [indiscernible] as being the constraint on capital, but the IAIS has come out with new capital or possible capital requirements from the HLA that seem to be higher than [indiscernible]. And I understand that this is not done yet. They're -- still would need to be adopted, but that does that higher capital constraint potentially make you think differently about UGC, it's capital requirements and what its long-term future is at AIG?

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

No. It's interesting. On the one hand, what you say is correct. But the other hand, the present value reserves, and so it actually becomes a more benign regime than the [indiscernible]. So [indiscernible] is the binding constraint because it does not -- present value reserves.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. And just another -- a question on Fuji also. I think the way we thought about Fuji and the expense reduction has been, in essence, a cliff reduction when the merger actually happens. Are you telling us now that that's a more a gradual improvement and there's still a cliff somewhere out there? Or how would we expect to see that ultimately?

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

I'll let Kevin take that.

Kevin T. Hogan
Executive Vice President and Chief Executive Officer of Global Consumer Insurance

Yes, thanks, Gary. The answer is yes. We have previously characterized the benefits of merger as essentially a cliff after the legal merger date. But we did recognize that our responsibility is to try to extract benefits as early as possible. And we consistently review how it is that we can benefit from the investments that we're making, and we have identified that we can take steps now to begin to extract benefits earlier than what we had previously anticipated. After the legal merger, of course, there will be further benefits because we will be able to wind down duplication of systems and product ranges. But in the meantime, we are able to make progress on combining certain marketing activities and management activities.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. And just if I could just sneak in one more. On the restructuring charge, is there a -- is this reaching down into Commercial, Property Casualty people? Is this -- I mean, is this changing -- is this kind of higher-level services that are being affected? Or is this somehow reorganizing what's going down on the -- in the trenches, so to speak?

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

So as I mentioned earlier, this is really targeting senior leaders, the top 1,400 of the firm. No area of the firm is left untouched, but it's certainly not as just simply a pro rata. It's a thoughtful and selective, very targeted approach which has been worked on for over 9 months with great attention to how the future mix of business will require leaders. And I'd like to add that these are leaders that have contributed hugely to the transition of the company. And we -- just with a more focused, narrower strategy going forward, we just need fewer generals on the field. And so these are quite talented and highly paid individuals. We just simply need fewer cooks in the kitchen.

Operator

And we'll take our next question from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

David and -- or Peter, I wonder if you could quantify what the covariance benefit is that the rating agencies give you for the diversification. Or give us some perspective so we can kind of think about it.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Hang on one second. It's -- I think it's the S&P, the explicit diversification benefits. I don't know that we have disclosed publicly, but it is quite substantial. It's north of $5 billion in diversification benefits classified that way.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And the second question is, Peter, if I look at your corporate expenses, it ran, call it, around $1 billion a year. And I think you've kind of referred -- you said that there's not a lot of people at the holding company. What is that corporate expense? I know some of it is the incentive comp program, so I guess that directly relates down to the subsidiaries. How much of it is truly corporate versus stuff that kind of can be pushed down?

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

David, why don't you take that?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

I'm sorry, can you clarify the question again? [Indiscernible]...

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes, yes. So if I look at what you disclosed, a corporate expense number, right, not including interest, right? And if I look at that, I know you've run some incentive comp adjustments within that number. I'm just curious, what of that is actually true corporate kind of expenses, regulatory, whatever, versus stuff that's really related to the operating units?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

That is primarily corporate-related, governance-related activities. There are -- there is some amount of regulatory in there, obviously, and there's a portion of finance in there, but we do push down quite a bit of expenses. The IT expenses are on a consumption basis. So it is a mixture. It's not the -- one or the other.

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

Yes, I think philosophically, we want to move to a consumption-based transfer pricing mechanism throughout the company, but we are still in a hybrid of historical legacy approaches of allocated cost and historical cost approaches. So it's a transition to a much more market-driven approach internally to provide appropriate incentives to outsource where it makes sense and in-source where it makes sense. But I think that's hopefully helpful for you to see where we are.

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes. So I guess you're saying that corporate expense line, there is some that could theoretically, when you do go to a consumption-based approach, that would be pushed down to the operating segments?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

On a consumption basis. But it is also subject to the same expense reduction initiatives that we've outlined. And what -- and some of what we did this quarter will in fact be evident in that line.

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

Generally speaking, we tried very hard to make sure that our front-line businesses are focused on growing marginal profitability and not confusing marginal with fully loaded, where fixed costs are just arbitrary allocated. So we've tried to keep fixed cost in more centralized pools where we have accountable executives to reduce those fixed costs to lower the breakeven point for businesses that are subscale but need to grow. We don't want to confuse the strategic signals as to whether it's a unit-cost problem or whether it's a lack-of-scale problem. And that's one of the reasons why we don't just do arbitrary allocations. So that's our approach.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Operator, I think we're at the top of the hour. So I'd like to thank everyone for joining us this morning, and we will certainly get back to anyone who still has questions and was remaining in the queue. Thank you.

Operator
And this concludes today's conference. Thank you for your participation. You may now disconnect.