S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ4 2010 Earnings Call Transcripts

Friday, February 25, 2011 1:00 PM GMT

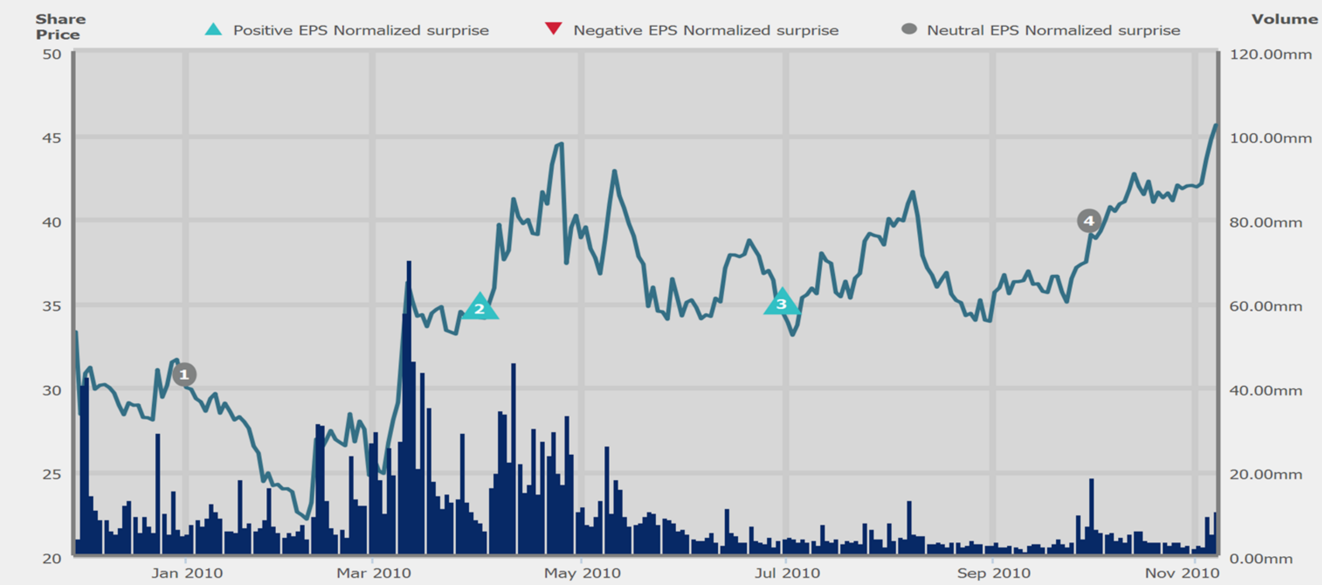
S&P Capital IQ Estimates

	-FQ4 2010-			-FQ1 2011-	-FY 2010-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	(14.02)	(16.20)	NM	0.25	(6.25)	(6.57)
Revenue (mm)	13988.84	17329.00	23.88	15030.08	66783.84	68525.00

Currency: USD

Consensus as of Feb-25-2011 10:28 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2009	(3.94)	(53.23)	NM
FQ1 2010	0.48	1.21	152.08 %
FQ2 2010	0.98	1.99	103.06 %
FQ3 2010	0.93	(1.47)	NM

Call Participants

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Independent Director

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Former Chief Financial Officer and Executive Vice President

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Presentation

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the AIG Fourth Quarter 2010 Financial Results Conference Call. [Operator Instructions] I would now like to turn our conference over to our host, Ms. Liz Werner. Please go ahead.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, operator. Good morning, and thank you, everyone, for joining us this morning. On the call today is our President and CEO, Bob Benmosche, who will take us through the first part of our presentation; followed by David Herzog, our CFO who will take you through the detailed deck which is available on our website. Bob and David are joined on this call by a number of folks on our management team. After we complete the presentation, we'll be happy to take your questions. If you're listening via phone and haven't already downloaded the presentation, it is available on our website, www.aig.com.

Before we get started, I'd like to remind you that today's presentation may concern forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Actual results may differ materially from these statements due to a variety of factors including the precautionary statements referenced in our discussion today and those included in our SEC filings, including without limitation, the Risk Factors Section of our 2010 Form 10-K. AIG is not under any obligation and expressly disclaims any obligation to update or alter any projection or other statement, whether written or oral, that may be made from time-to-time, whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the comparable GAAP figures are included therein or in the fourth quarter 2010 financial supplement available in the Investor Information section of our website. With that said and out of the way, let me turn it over to Bob. Bob?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Yes, thank you, Liz, and thank you all for joining us this morning. We're really delighted to have the opportunity to share with you today our financial results, some perspective on how we performed and where AIG stands today as a global financial institution. As we conclude the presentation, we'll be happy to take any of your questions.

As you all know, for more than two years, AIG has been focused on repaying the U.S. taxpayer for the support they extended to the company during the financial crisis. Six weeks ago, we were able to completely repay the Federal Reserve two years, and I need to stress, two years ahead of schedule, a huge milestone; one we achieved because of two things: The dedication of employees and the remarkable partnership of the Fed and the U.S. Treasury. I would like to start this call by saying thank you to all of these people and to the American people. We thank you for all that you have done.

We're on a path that we believe will allow the U.S. government to recoup its entire investment in AIG. As we look forward, as we now look at Slide 5, for those of you who have the slides, David will walk you through our fourth quarter results in more detail. But in simple terms, our fourth quarter net income attributable to AIG of $11.2 billion reflects $17.6 billion of divestitures, particularly the gains of AIA IPO and the sale of ALICO, and the $4.2 billion of reserve strengthening at Chartis. David will discuss our new non-GAAP financial measures and reserve strength later in the presentation as well. But I would like to say a few things about Chartis up front.

The reserve strengthening was the result of our in-depth review of reserves. We are committed to holding the right level of reserves based on a highly detailed thorough, thorough process. We continue to hold more statutory surplus than any P&C commercial insurance competitor in the U.S. market. Further, our reserves review updated our estimated losses for all years, including the more recent accident years of 2006 through 2009, years to which approximately 50% of the reserve strengthening, excluding asbestos, applied. Net premiums written remain healthy at Chartis and we continue to hold the line on pricing.

As we have said numerous times in the last two years, we have adjusted our business mix to reduce risk and to yield more sustainable earnings. In particular, over the past several years, Chartis has deliberately and strategically shifted its mix of business away from lines like workers' compensation and excess casualty and toward higher margin, less capital-intensive segments such as consumer and specialty commercial businesses.

Let's move to Slide 6 for those of you who have the slides. So much has been accomplished to position AIG for the future. You already heard me say that we sold ALICO to MetLife, and an IPO with AIA. Those are the big ones. But since 2008, AIG has announced sales of 33 businesses and raised more than $57 billion in cash and securities. As a result of our success in raising cash, we completed our recapitalization and completely repaid the Federal Reserve of New York. Government investment in AIG today consists of the U.S. Treasury owning 92% common equity stake in AIG, which it expects sell off over time depending upon market conditions.

As a result, as we sit here today, AIG is a much simpler capital structure and a stronger balance sheet. Since the crisis began in 2008, AIG reduced net debt by more than $107 billion. We stabilized our credit ratings and accessed the capital markets. During the fourth quarter, AIG raised more than $5.5 billion of new non-government funding, including $2 billion in senior debt in our first bond sale since December of 2008. We also established a $500 million contingent liquidity facility and established bank credit facilities.

Let me talk a little bit about our success in derisking the company. The progress we have has been steady and significant. We've brought the notional amount of the legacy AIGFP derivative portfolio down by 62% from $940.7 billion at the end of '09 to $352.8 billion at the end of 2010. Perhaps more important, the liquidity risk of the FP portfolio is down some 97% from September of '08. The team there has done an outstanding job and we are committed to managing the remaining FP book on terms and on a timeline that is beneficial to our stakeholders.

Now let's move to Slide 7. Let's talk about the state of our business and our operations. Our key objectives are to position our franchises for sustainable growth, which means striking the right balance between growth, profit and risk. Led by Peter Hancock, we have done a lot of work to enhance enterprise risk management. We hired Sid Sankaran as our Chief Risk Officer, who is doing a terrific job. We escalate major decisions involving risks we take to the group risk committee, which Peter chairs. I am also a member, as are all of our business heads and senior functional heads.

As we continue to bring aboard word-class enterprise risk management professionals to support our efforts and develop sound comprehensive tools to evaluate risks and enhance value while supporting business growth. As I have said many times, our business performance shows a clear pattern. Our insurance businesses are well-positioned. Client retention rates are strong, surrender rates have improved to normal levels and in some cases, even better. Sales in distribution relationships are gaining momentum and employee turnover is well within the norm.

AIG consists predominantly of two core businesses: Chartis, one of the world's largest, most expensive property and casualty franchises; and SunAmerica Financial Group, one of the U.S.'s broadest life and Retirement Services franchises. These franchises are complemented by investments in other businesses that diversify our risk profile and will contribute to our success, such as our Aircraft Leasing business, ILFC and United Guaranty Corporation, our mortgage guarantee insurance business. Each of these franchises is well capitalized and benefits from the simplified and greatly delevered balance sheet of the post-structured AIG.

At Chartis, customer loyalty side is high and retention rates are up in the businesses where we want to grow, particularly our consumer and specialty segments. The Chartis team has brought to market more new products and services, while continuing to expand and enhance its existing offerings. The business has a powerful global platform and we are growing. Just recently, we launched the tender offer for the remaining outstanding shares of Fuji Fire & Marina which will further strengthen our position as the largest foreign-owned insurance group in Japan.

SunAmerica Financial Group includes American General, a leading life insurer, and SunAmerica, VALIC [The Variable Annuity Life Insurance Company] and Western National, all leading providers of retirement products in the U.S. At SunAmerica, we have focused on innovative products. We greatly enhanced distribution, which is key to the Retirement Services side of the business. We are thankful for the many distribution partners that stayed with us and have returned to us.

As many of you know, there is an enormous and underserved need in the U.S. Life and Retirement Services market, and we believe SunAmerica is well-positioned for the upcoming retirement boom. A few words on ILFC and UGC [United Guaranty Corporation]. Over the past two years, these companies have taken significant action to improve their balance sheets. ILFC returned to the capital markets last year, stabilized its funding portfolio and has strong cash flows. Beginning in March, ILFC raised more than $14 billion through a variety of funding sources and other liquidity initiatives, enabling it to pay off loans from AIG and indirectly, the U.S. government.

UGC, which was profitable in 2010, saw a lower first lien delinquencies and improved both its underwriting and claims operations to an extent that we believe it will benefit shareholders going forward. I commend the teams at all of our businesses for their unwavering focus on conducting business during the global recession and with all the noise surrounding AIG. I truly believe that AIG's greatest asset is our people. Our people believe in AIG. No matter the environment, they've focused on servicing their customers and preserving the value and power of great franchises.

Recently, we completed an employee survey in which 92% of the employees participated, an extraordinary percentage. They give the highest scores to teamwork and high standards for ethics and compliance, which was incredibly heartening. The resilience, integrity and commitment of our employees are at the heart of why I am proud to be part of AIG today.

As we move to Slide 8, we can see that as we build our recent accomplishments, we face new and exciting challenges. We are squarely focused on making AIG the world's most valuable insurance company. We will pursue that goal by leveraging our unmatched global presence, franchise, leadership and loyalty that comes from confidence that our customers have in AIG; focusing on profitable growth, growing our core insurance operations in particular; focusing on enhanced risk management framework; and effectively deploying our capital to the best opportunities. Our efforts are intrinsic to our delivering profitable, sustainable growth. We are committed to building on the extraordinary efforts over the last two years and as we continue to take the right steps to earn, enduring the confidence of our stakeholders.

David, I'd like to turn it over to you.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thanks, Bob, and good morning, everyone. Let's turn to Slide #10. As Bob highlighted, we reported fourth quarter of net income attributable to AIG of $11.2 billion. Here's a quick rundown of the results for the quarter. For Chartis, a $4 billion loss and a $1.1 billion loss for the year. These results are heavily affected by the prior-year loss reserve strengthening on long-tail lines of business of $4.2 billion in the quarter and catastrophe losses of roughly $1.1 billion for the year. At SunAmerica, we posted income of $1 billion for the quarter and generated $4 billion for the year.

For ILFC, a loss of just over $600 million for the quarter and a loss of nearly $700 million for the year. These results reflect the impairment charges of about $740 million for the quarter, $1.6 billion for the year, stemming from more active fleet and balance sheet management, in large part for the quarter due to recent announcements by one aircraft manufacturer with respect to forthcoming new aircraft with more fuel-efficient engines.

At UGC, as Bob pointed out, we posted $154 million profit for the quarter and almost $330 million of profit for the year, reflecting continued improvement in market conditions, lower levels of newly reported delinquencies in first lien products, a decline in claims and claims adjustment expense, all resulting in favorable prior-year loss development.

Let's turn to Slide 11. This page shows a reconciliation of our after-tax operating income to GAAP net income attributable to AIG. After-tax operating income or loss is a new non-GAAP measure we are using in place of adjusted net income that we formerly used. As you can see, many of the adjustments relate to our restructuring and divestiture activities that are winding down and are not part of the ongoing operations of the company going forward. In addition to excluding realized capital gains and losses, and derivatives not receiving hedge accounting treatment, we will now exclude the deferred acquisition cost effects of capital gains and losses much like other market participants and show the operating earnings as if there was no deferred tax asset valuation allowance. This makes our non-GAAP measure more comparable to others in the industry.

Let's turn to Slide 12. As a result of the recapitalizations, which happened after the quarter closed, our pro forma book value per share at year end is $46.80. As you can see with the recapitalization, we have greatly simplified our capital structure and reduced financial leverage. We have a Footnote 26 in our 10-K that shows a pro forma unaudited balance sheet showing the effects.

Let's turn to Slide 14, Chartis operating results. Chartis operating loss was $4 billion, as I earlier mentioned, before realized capital gains and losses and reflected the $4.2 billion reserve strengthening net of discount and loss-sensitive premium adjustments. The total reserve strengthening represents about 6.2% of AIG's total general insurance net liability for unpaid claims and claims adjustment expense of just over $68 billion reported at year-end. Major cats [catastrophe] in the quarter were about $203 million, while there were none in last year's fourth quarter. Partially offsetting the adverse reserve development and higher cats was net investment income of about $1.2 billion, up 40% from the fourth quarter of 2009, which included a large unusual item. Fourth quarter 2010 includes just over $300 million of partnership and mutual fund returns.

Let's now turn to Slide 15. As part of our annual in-depth reserve review, Chartis conducts hundreds of individual analyses for each class of business in its companies. Across AIG, this is a well-established process and with the assistance of third-party actuaries, our own actuarial teams assess the potential implications of new data, loss emergence across accident years during the quarter, new and emerging AIG-specific and industry loss trends, and where appropriate, we update and calibrate loss models using the best available current information. We updated our estimated net loss reserves for many accident years, including more recent accident years. As Bob mentioned, excluding asbestos, approximately 50% of the reserve strengthening related to accident years 2006 through 2009.

As you can see, there is a breakdown of the adverse development by major class of business on the slide and as you will note, four classes have contributed the majority of the adverse development over the last five years, with all remaining classes that make up nearly 93% of the net premiums written for 2010, contributing favorable development of just over $1 billion over the same five-year period.

We have continued to de-emphasize the four long-tail classes of business, as you can see at the bottom right of the slide, where we show that these four classes made up almost 22% of the premiums in 2007 and represents less than 7% in 2010. We are comfortable that our process resulted in our reasonable best estimates, which were further informed by third-party actuarial indications.

Let's turn to Slide 16. Chartis continues to deploy capital in higher margin segments and geographies and has made a significant change in geographic diversity with growth in the international markets. In the fourth quarter, worldwide net premiums increased 9.4%, but excluding the nearly $900 million of premiums relating to Fuji, which we now consolidate, worldwide premiums declined actually 3.3% during the period, this primarily due to challenging economic conditions, though some global regions are improving and the shift in business mix away from certain long-tail lines are cat exposed lines that are less profitable as Bob mentioned earlier.

We have had some good experiences in specialty markets and with our consumer lines and niche products, we continue to shift our mix of business. Pricing in 2010 was relatively stable and we compared favorably to the major U.S. pricing indices. The international share of overall Chartis net premiums increased steadily from approximately 35% in 2007 to nearly 50% in 2010. For example, the recent Fuji acquisition was very much in line with our strategic goal of increasing both consumer and international business. Let's turn to Slide 17.

The fourth quarter 2010 combined ratio was just over 160 points, including 49 points from reserve strengthening. In addition to the reserves, Chartis had higher expenses. The expenses were up 150 points due to higher acquisition costs from deliberate strategic shift to increase our consumer lines. As we acquire more Consumer business, we will experience higher expense ratios as acquisition costs associated with Consumer business are higher. However, the overall combined ratio in this business tends to be lower.

Let's turn to Slide 18. Investment income, as I mentioned earlier, increased just over 40% primarily due to the large unusual item in 2004, but we also had increased partnership income. We have reduced the Chartis municipal bond portfolio to approximately $36.3 billion net of the pre-funded municipal bonds. Current portfolio is high-quality with over 99% of the portfolio rated low-single A or better, and the majority of the portfolio is in revenue bonds. As part of our Chartis strategic asset allocation going forward, we continue to purchase taxable instruments in line with liquidity, duration, quality constraints, and importantly, that also meet our current risk return and tax objectives.

Let's turn to Slide 20, SunAmerica. With 2010 operating income of $4 billion, SunAmerica is well-positioned, profitable businesses and holds a number of enviable industry market share positions. SunAmerica essentially posted $1 billion of operating income each quarter in 2010 and has strengthened its dividend capacity to the parent company, an important component of our capital management going forward.

Slide 21. Premiums, deposits and other considerations, or PDOC as we like to refer to them, decreased 6% from the fourth quarter of 2009, primarily due to lower fixed annuity sales. PDOC increased 6% for the full year, driven primarily by the diversified product portfolio, multi-channel distribution network and the work that the SunAmerica team did to re-engage relationships with distributors and producers. This increase is despite more than $830 million decrease in the Western National fixed annuity sales, which have been affected by low interest rates. For the first nine months of 2010, the most recent industry data available, industry-wide sales of fixed annuity declined 52%. Excluding Western National fixed annuity sales, SunAmerica's PDOC increased 15% for the quarter and 10% for the full year.

A couple of other observations. Western National maintained its number one ranking for fixed annuity sales in the bank channel and is well-positioned to capitalize on rising interest rates. Life insurance sales were up 18.6% for the quarter, primarily from independent distribution and improvements in career distribution productivity. Retirement deposits from VALIC reflect successful capture of individual deposits, a deliberate focus of the VALIC team over the last few years. SunAmerica retirement markets individual variable annuity deposits more than doubled in 2010 as a result of enhanced distribution, increased wholesaler productivity and product enhancements.

Let's turn to Slide 22. Net investment income is up primarily from higher interest income on the portfolio and improved partnership returns. SunAmerica's cash position is still significant and cash deployment remained a priority. The Maiden Lane II investment did well for the year, contributing over $500 million to our interest and dividend income, and we expect the redeployment of cash and short-term investments into longer term, higher-yielding securities will provide an opportunity to improve future earnings.

Now to Slide 23, net investment spreads. Despite a decrease in the base yield, spreads increased in the fourth quarter and the full year. Increases for both periods reflect improved partnership returns, as well as disciplined management of crediting rates. The increase for the full year was also driven by improvements in fees received relating to calls and prepayments of fixed income securities and mortgage loans.

Turning to Slide 25, a word or two about the AIGFP portfolio unwind. We've made continued and steady progress in managing the legacy AIGFP portfolio. This portfolio has been significantly wound down, derisked and is generating modest operating profits and providing positive liquidity. Contingent liquidity exposure was about $1.6 billion at year-end 2010, down over 90% from September 2008. Since September of 2008, we've reduced the outstanding portfolio trade positions by over 90% to roughly

3,900. The December 2010 trade count excludes approximately 4,800 positions that are non-derivative asset and liability positions whose management we transferred to the Direct Investment portfolios at AIG.

We reduced the notional amounts of the derivative portfolio by 82% to just over $350 billion at year end, including $11.5 billion of intercompany derivatives and almost $60 billion of super senior credit default swap. The risk characteristics of the portfolio had been significantly reduced.

And finally, turning to Slide 27, our deferred tax assets attributes. AIG has substantial deferred tax assets that are available to offset future tax obligations. We've laid out the gross attributes to gross assets and the basic framework for utilizing or realizing the tax assets. We have established a full valuation allowance on our DTAs [deferred tax asset], principally because of our limited ability in the past to project future operating profits of the right character. Over time, this will become much more straightforward and we will apply our framework for assessing the need for the valuation allowance

Economically, we currently expect to utilize the NOL, the non-life capital loss carryforwards and the foreign tax credit carryforwards over time. The life capital loss carryforward is more challenging given its size, expiration dates and dependency on market conditions. But again, I want to stress, we have a full valuation allowance established. So there is no risk to our GAAP equity.

Now, Liz, back to you.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Thank you, David. Operator, can we open up the lines or open up for questions right now?

Question and Answer

Operator

[Operator Instructions] Our first question comes from Donna Halverstadt from Goldman Sachs.

Donna Halverstadt
Goldman Sachs

I had two questions, two easy questions related to the Property Casualty business, one on the commercial line side, one of personal line side. With respect to your commercial lines business, if pre-crisis you were the 800-pound gorilla, how much do you think you weigh now, 200, 400, 700? How do you view your market position on the commercial line side?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'll answer and then turn it over to Chris, it's Bob Benmosche. I would say we're about 780 pounds. We're on our way back. I think that if you look at the franchise, what's important is that we've come through a horrible period of time where huge questions of the survivability of AIG, in particular, and yet if you look at our client retention, it's extremely strong. And it's strong because of the core competency of the people and of this company. And so we are seeing clients coming back. So I would say that we are clearly the leader here. And I think that's why we're starting to not write certain businesses because we have the confidence we can do that. And as the markets improve, I know we will come back to the markets. But, Chris, any more would you want to add to that?

Christopher S. Lynch
Independent Director

Yes, exactly what Bob said. And I would say during the period, it strengthened the organization, not only on our strategies and focusing on how we manage our capital, but also we became much closer to our customers and to our brokers, meeting with them constantly. And so we're close to our distribution. We're close to our business. Our global platform, which enables us to service customers' needs around the world, which includes underwriting, policy issuance claims, engineering services, differentiate us in the marketplace. And during that time period, we proved those franchise strengths and they just got stronger.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

One thing that we're doing that's not going to be obvious as much as we'd like for another couple of years is that we used to be an organization that had unlimited capital. And therefore, it was about top line growth. And now we're really looking at what our ROEs are by product, where on a risk-adjusted basis, we're making the right returns. So you'll see that over time, Chartis will be able to talk about combined ratios and ROEs in a much more refined way because we're no longer unlimited in our capital. We have to be more capital-light as we go forward.

Donna Halverstadt
Goldman Sachs

Great. And then I also had a question on the personal line side, and it's something I wonder about every time I see one of the very colorful ads. And it relates to your efforts to build your high-net worth personal lines business. And I think high-net worth folks are very, very happy to pay Chubb's high rates because they know that they won't be hassled if they ever have to file a claim. And with a bit of a historic reputation at least on the commercial line side for not being the quickest to pay claims, has that been a gating issue in terms of trying to build the high-net worth personal lines business?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Well, I think that, that may be historical reference to the perception of AIG on the claims side. That's clearly not the case today. One of the factoids that I've got and maybe Chris can verify it is that, if you look at the Forbes 400 list, I believe 1/3 of that list are clients of Chartis. And so when I meet my counterparts at the business council and other meetings around, there are many CEOs who proudly talk about being Chartis clients, satisfied with Chartis and confident in Chartis and confident in AIG. So I believe that if you look at our stats and who we're doing business with, we also have the large client base in the high-net worth category that are pleased with us.

Operator

And our next question comes from Dan Johnson from Citadel.

Dan Johnson
Citadel Investment Group

Bob, could you talk a little bit about how the reserving process for this year differed from the one last year?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

The process is roughly the same. What you have are people, as they look at recent trends and patterns, are now realizing that these ,as we know in math, you could exponentially smooth things over time or you could look at vectors, which is more of a momentum of the moment. And they've started to look at the momentum of the moment. So for example, in workers' compensation, you have to begin to recognize that we're in a deep recession. We don't have a jobs recovery. We do know that people who feel ill during this period time will tend to go on disability or put in a workers' compensation claim. So more people claim, employers are less likely to argue it because there's a concern about jobs in their companies. And once people are out and if you look at disability carriers, as well as workers' compensation, you'll see they're out there longer. They don't come back to work as easily and so you have to accept that as we get into this analysis, that the recovery isn't as strong as we'd like to see it. And so, when you look at all of those factors, and also recognizing medical inflation, which was looked at, recognize that Medicare has decided to put more of the onus for medical costs back to the insurer, that sometimes was covered by Medicare as the government tries to look at its own costs for these entitlement programs. So all of these factors went into looking at what we had, and then making some conclusions that we have to make sure that we are realistic about what we think the future will be. And I think that's what happened this year versus last year. It's just the reality. It's another year of extended slow recovery in the United States economy, and that's how we came about it. It's as simple and as complex as what I just said.

Dan Johnson
Citadel Investment Group

Okay, understood. And how does that sort of reassessment of where current loss run rates are at? How does influence the pricing that the market should be seeing from AIG as a result of this re-evaluation of sort of the loss profile of business?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

Dan, it's Rob Schimek speaking. If you go back to what David said in his comments, the reserve strengthening really focused on four lines of business. You'll recall, those were asbestos, so this has no effect on pricing there. It's workers' compensation. And workers' compensation, in particular the guaranteed cost workers' compensation, we've already been in a mode where it's running at a combined ratio in excess of $100 million, and it has been and it is for the industry here in the U.S. more broadly. So I think our belief is, it's worse than we had initially believed but we never fooled ourselves into thinking that it was profitable in the first place. And so I think workers' compensation just continues to be highly under pressure. But as you go through the other lines of business that were drivers of the reserve strengthening, it was primary workers' compensation, excess workers' compensation, which really is not a significant premium volume for us these days, and it's excess casualty. Excess casualty continues to run as a profitable line, but I would say certainly approaching the demarcation point between profitable and under stressed from a profitability perspective. Those were the four lines that really drove the reserve strengthening and that's what I think the future effect would be.

Dan Johnson
Citadel Investment Group

Right. So is the takeaway that sort of a modest impact on pricing even though the loss assumption profile's changed, just because you're either not in those businesses like asbestos or you've greatly cut them back like excess workers' comp?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Yes, I think that's fair to say. But keep in mind that 93% of our premiums now are in products that were not affected by this reserve adjusting. So if you look at the significant drop-off over the last three years in workers' compensation, for example, we're down substantially in writing premium net products. So we still feel those areas where we get paid or the risk we take and the competency of the people that we have to work with customers, those are the areas where we feel, in working with those customers, we should get a fair return for what we're putting at risk. And those products that are not, we have now significantly reduced those, which is why you'll see a drop off in our premiums but it's not because of reputational issues. Our reputation is fine. Clients are satisfied. This recapitalization has closed any issue that our clients have had about, are we are going to make it? And so now, it a matter of can we afford to write the business at a loss and we feel we cannot.

Dan Johnson
Citadel Investment Group

That's very helpful. Finally, can I get the SunAmerica RBC number?

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

Yes, good morning, Dan, it's Jay Wintrob. We ended the year, the whole fleet is at 475% roughly.

Operator

And our next question comes from the line of Ed Spehar from Bank of America Merrill Lynch.

Edward A. Spehar
BofA Merrill Lynch, Research Division

First, new business margins seem to have improved materially in fixed annuities. And I'm wondering if you could comment on what your new business ROE in fixed annuities is today compared to last fall? And what's your appetite for growth in this business? And then, the second question is also on annuities. Could you talk more specifically about VA product enhancements that you reference in the release? And what type of share gains do you think are possible, especially considering that the market leaders have recently reduced the attractiveness of their products?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Let me turn it over to Jay. Why don't you go ahead and do that, Jay.

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

Sure. Currently, our new business pricing for fixed annuities is approximately 12.5% IRR after-tax. That's probably somewhere between 50 and 100 basis points higher than last fall, maybe 50 basis points higher. And the appetite exists, and I think we'll make progress, especially if rates stay roughly at these levels. They bounced up off their loads from the third quarter of 2010 and as you can see in the financial supplement, we did have good sequential growth in the fourth quarter; think that was directly related to the level of rates. And we continue to see momentum in the first quarter. Some of that is rate some of that is re-engaging distribution, as Bob and David mentioned in their prepared remarks. On the VA product enhancements, I think it's both the combination of enhancements we made really starting in '09 as well as last year, and again, re-engaging distribution. And I think there are opportunities. The enhancements we've made basically have been to provide people with the ability to get more of their money in the form of living benefits earlier, in exchange for a lower amount of living benefit withdrawal rate, if they ever go into claims, meaning if their account value runs out. That's been well received. We've got extreme flexibility on different compensation rates we pay and the different structures of the products: A shares, B shares, O shares. And quite frankly a lot of it, though, is really related to re-engaging what were historic, very strong relationships both at the firm level, and I'm sure you noted that we recently were reinstated at our largest VA distributor, at least historically, Edward Jones. But we've also been reinstated in all of our other VA distributor. But also more importantly, at the rep level, wholesaler to rep. And we have modestly grown our internal and external wholesaling force, and that will continue in 2011. As far as share gain opportunities, we don't have a targeted amount, Ed. But we observe what you've observed, which is as the business became very concentrated among the top three players, more so than ever before in history, some of those players have clearly pulled back, either because they've quite frankly, brought some of their product designs more in line with what our designs have looked like for the last 18 months or so. Some of the features are somewhat less generous to the customer, but also, I think, some of them have reconsidered the exact balance they want to have between variable annuities and other products they're selling. I think that's an opportunity for us and I would expect a lot of progress in 2011.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Okay. I guess on the fixed annuity side, I'm surprised that the IRR wasn't lower last fall, considering where, if we look at spreads between, I think sort of what the industry was investing at and what crediting rates were, it seems like there's been much more of an improvement in the IRR. Is the reason that wasn't that much of a change for you that back when margins were low, you just didn't participate and write as much business?

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

It's partially true. And I think you can see that the third quarter of last year was, I believe, the low point for our fixed annuity sales. And as you also saw, fourth quarter was an improvement, principally due to rates and just demand. But we had marginally raised our IRR targets, as I mentioned in the last call, six months or so. So I would say we've been pretty disciplined, stayed the course, but our price for IRRs has probably only come up again between 50 and 100 basis points in the last six to nine months.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

And keep in mind that what Jay and his team have here in the fixed annuity arena is a great deal of flexibility, with the banks in particular, to trade-off distribution revenue for client crediting rate. So they have a very flexible product, and they have a team of people that work with our distribution to do that. Secondly, they really have a strong competitive advantage in terms of the way they process the business. I would say that the team have, and we talked about off-shoring, but they offshore to Amarillo, Texas. And I will tell you, the team and the design and the way they function there gives them a very, very competitive advantage in terms of what their costs are per annuity. So between the volume and the plant and the way they operate, it's a huge opportunity for them to get that kind of return and maintain their discipline with the clients.

Operator

Our next question comes from the line of Andrew Kligerman from UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

I'd I like to get some outlook on SunAmerica, Chartis and ILFC. So let me start with SunAmerica. In the retirement area, the general operating expenses spiked 78% year-over-year and 44% q-over-q to $257 million. In the life operations, DAC amortization, $256 million, was up 47% year-over-year and 21% q-over-q. I'm wondering if there was just something unusual going on in the quarter and where the outlook might be? So let met leave that question there. Now moving on to Chartis. Overall, even after that big pre-announced prior-year reserve development, if we look at the loss ratio, x cat, x prior-year developments, we're sitting at 109%. And it looks like the expense ratio is four to five points higher than what we would normally see. It looks like the loss ratios and it's emanating out of commercial in both international and domestic. Now the loss ratio is at least four points and it's normally been -- is that the outlook that we should be looking for, a 109% combined ratio in all of Chartis? And then lastly, ILFC. So ILFC lost $606 million in the quarter. It's the worst quarter I've seen through the whole crisis. So I'm kind of wondering, I know that the quote in one of the write-ups, many write-ups last night that AIG expects that the availability of newer, more efficient engines may reduce the demand for certain aircraft in its fleet. I don't know, it seems that there'd be a lot new efficient engines and improvement over many years and suddenly we see a $606 million loss in the quarter. What can we expect going forward from ILFC in terms of earnings?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Let's me start with the ILFC and we'll work our way back. Clearly, when Airbus came out with their new engine announcement, we have to take a look at our legacy aircraft. And one of the things we are doing at ILFC is that up until now we have not, and that is to begin to deal with the average age of the fleet and begin to recognize the need to sell some of the legacy aircraft over time. The cost of that, as they examine what they think the ability to re-lease -- new leases on these aircraft when the leases now expire, looking at what would happen in terms of those rates and the cash flow analysis and so on, resulted in looking at a set of older aircraft that would say that what we're carrying that aircraft now in terms of what its values would be over time did not correct. And so therefore, if we had to take an accounting adjustment to reflect the fact that with these new aircrafts coming out of Airbus, we think we had to take a charge. So that's just prudent. We did that. And we anticipate as we get into 2011, you will not see the historical earnings that were coming out of ILFC because we're now having a more realistic view of that earnings relative to getting rid of legacy aircraft. And also as you know, we've matched our funding. So we're not playing the yield curve of borrowing short and lending long and getting caught with a $12 billion hold that we had a couple of years ago. So this is on the right road. There are plans for this year so that we can deal with good profit and we're not going get into any kind of a prognosis of profit today. But clearly, we see them being profitable and working through the legacy aircraft at the same time. So that's a positive. I'm going to have Rob talk about expenses because clearly, as we get into the fourth quarter, there were actually some unusual expenses related to what we could DAC and could not DAC and so some other things. So, Rob, why don't you just.

Andrew Kligerman
UBS Investment Bank, Research Division

Yes, and Bob, just finishing on the ILFC, so I should feel pretty comfortable then that you've assessed the environment for aircraft, and that we wouldn't expect charges like this at least anytime in the next couple of quarters?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I think that I can't tell you there won't be charges, but I believe in conjunction with it, there are with how we're dealing with the legacy aircraft that we have on our books. But that would be part of -- I don't think you're going to see this kind of one big whack coming out. This would be business as we evolve going forward but I don't see it as a big lump coming through. And so I think you'll see basically, ILFC and UGC in my mind, once we get going in here over the next few years, on some kind of normalized basis, the two businesses could earn about $1 billion for us. And we view them as important diversifications of risk, they're investments we're in. We would monetize those investments where we got the right price for them, more so, for ILFC than UGC, quite frankly. But for now we operate them and do no harm and continue to build value over time, and that's what we're doing. We're not taking any big risk and we're not going out on a limb, but we will continually buy aircrafts, continually insure new mortgages, continue to run this business in an appropriate way.

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

With respect to the Chartis combined ratio in the quarter, I think you could break it down into a couple of pieces that might be more helpful to you in your analysis. If you remove the prior-year development from the quarter, that's about 49 points, as David said in his comments earlier. Recall that whenever you strengthen prior-year's, you also need to revisit what effect does the strengthening of the prior-year have on your current accident year loss ratio for those same lines of business. So for example, in the primary workers' compensation line of business where we strengthened reserves, we also had to increase our current accident year loss ratio there. In addition to that in the fourth quarter, we had some additional attritional losses, we would call them more significant property losses, for example, that are not cat, that also increased our current accident year loss ratio. So in general, you're seeing the effects of any increases in the current accident year loss ratio that we recorded in the fourth quarter. And remember, since the first three quarters, we're already historically recorded on the books. If we want to change our loss pick for, for example, to workers' compensation line of business, we've got to change it retroactive, year-to-date, all in the fourth quarter, which is exactly what we did. So in total, I think you'll see about four points of the increase in the current quarter combined ratio really driven by the fact that we increased the current accident year in the fourth quarter retroactively, as well as any additional in particular property losses that we encountered. And as you know that'll be lumpy on a quarter-over-quarter basis. In addition to those increases in the current accident year loss ratio I just described, we also had $200 million of natural catastrophe losses during the quarter, largely coming from the Australian floods and the Arizona hailstorms. And we also encountered probably about $100 million worth of large losses that didn't meet our criteria for characterizing it as a natural catastrophe. But nevertheless, we would consider those to be severe losses. Frequently losses like that are somewhere in the $5 million to $20 million range in terms of size, so not meeting the threshold for natural catastrophe. So there were a number of items that I just described that I think significantly impact the fourth quarter accident year combined ratio that I think you'd want to factor into your analysis. With respect to expenses, nothing has changed with respect to our view about the need to very actively manage and aggressively manage our expenses. With that said, as David said in his comments, you will see an increase in expenses as we continue to shift the mix of business from some of the commercial-type products to more of the consumer-type products. We provide some pretty decent views of that for you in the financial supplement. You can get an idea of what our shifts of business have looked like over the last couple of years, in particular. Pages 23 and 24 of the financial supplement might be helpful to you to get a visual view of how we're deliberately and strategically changing the mix of business. And then also as Bob said, as we go through the fourth quarter every year, we conduct our DAC study, re-evaluating what can be deferred versus our historical calculation. And as is normally the case, when premium volumes are declining, you will end up with a situation where some of your previously DAC-able expenses may not qualify to be DAC-able because we perform a time study and try to evaluate the true expenses that varied with the actual production of the new business. So I think those are the primary drivers that would help you to get a better handle on what you were seeing in the fourth quarter.

Andrew Kligerman
UBS Investment Bank, Research Division

Yes, that was really helpful. The loss ratio in particular was helpful. But on the expenses, the DAC, I mean would that really explain just, I'm kind of scrambling around pages, but for example, a move in Chartis from 28% expense ratio to 35%, 3Q to 4Q? I mean it just, I don't know, the premium, maybe that explains part of it but I mean just tell me where you think it's going to be going forward. Did we see the normal number?

Robert S. Schimek
Executive Vice President and Chief Executive Officer of Commercial

No. There's other things that I didn't go as far as I probably could. Let's stay with this for a second. So as I said to you earlier, we're very in-tune with making sure we maintain the proper expense structure within Chartis. In the fourth quarter, we did have a headcount reduction in the United States. So along with that headcount reduction does come severance costs, so you're seeing that as another element of expenses in the fourth quarter. And in addition to that just more broadly, we are in the process, and particularly on the international side of the house, of doing a number of very important initiatives, including Solvency II in Europe. We're right in the middle of that as we speak. And that incurs a reasonably significant amount of additional expense. And we're also in the process of putting in a new financial infrastructure on a global basis. As a matter of fact, in the third quarter of 2010, in the United States we went live with the SAP platform and we're in the process of rolling that out across the globe. So as you can imagine, that's an extremely major initiative as we move forward. And quite frankly, other major initiatives even include putting in place a single global claims platform across all regions of the Chartis operation. So those are other drivers that are going on. I think we are investing smartly and strategically in making sure that we've got the sustainable platform for the future.

Andrew Kligerman
UBS Investment Bank, Research Division

That was helpful. I'll follow up offline for more detail. But it seems like that number will likely come down.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Agreed. Jay?

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

Yes, Andrew, on your question about the expense increases at SunAmerica; first, you're right both sequentially and year-over-year they've increased. Similar reasons, I think the year-over-year increase is about $94 million. The biggest piece of that is a guarantee fund assessment, accrual that was put up related to Executive Life of New York, which is just under $60 million. We also had higher long-term compensation expense in the business. All of this expense is tied to the performance-based, stock-based compensation that's been distributed and as the stock has performed, the accounting impact on expenses has gone up. That's roughly in the neighborhood of about $35 million in the aggregate. And then there was one legal accrual put up related to an old investment position that was finally settled, which was the third-largest piece, about $20 million. So those are the three big pieces for the expense increase. You asked about the increase in DAC amortization in the Life segment. If you take a look at Page 41 of the financial supplement, there's a footnote there, Footnote 7 ties back to the Page 27, which is where you see the increase. Basically you've got a trade-off in geography due to an unlocking related to our UL [universal life] and the Deferred Annuity business in American General. Fee income increased about $58 million, while at the same time, also the benefits and claims incurred decreased another $21 million. And substantially all of that was offset by an increase in DAC amortization related to that of roughly the same amount, $86 million. So it really ties into that unlocking on certain assumptions and it was really a change in geography, more fee income, lower policyholder benefits to the positive and higher DAC amortization offsetting it.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Operator, we'd like to take one more question. But since we're near the top of the hour, we're going to have to call some of the other folks back. So if we could take our last question and we'll have just brief closing remarks.

Operator

Our next question comes from the line of Tom Gallagher with Credit Suisse.

Thomas George Gallagher

Crédit Suisse AG, Research Division

And these both for David. The holding company liquidity, I think your plan has been $8.5 billion to $10 billion. I believe you raised north of $5 billion, if I add up the credit facilities plus the debt in 4Q. Can you just comment on where you stand there and what the mix would be in terms of the form of capital, in terms of getting to the plan going forward? And then the second question I had is on AIGFP. I know there's been commentary that the unwind is coming to a close. Can you talk a little bit about what does that practically mean? And will we begin to see -- is there a source of earnings actually coming from this business in its sort of steady-state form? Is there redundant capital when I consider your ownership of your stake of Maiden Lane III, which I believe is being carried at $6 billion, and eventually could you get to that $6 billion?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

I would point you to Page 53 in the K. You're right, the $8.5 billion to $10 billion was what we had been targeting as part of our third quarter filing in the Q, and that was our objective. And frankly, we overachieved. As you'll see on Page 53 there is about $14.5 billion of cash and contingent credit capacity. We lay out the component parts of that. You'll see in the footnotes there, we're using a piece of that for supplementing capital positions in certain of our operating companies. And again, I would expect that we would maintain the credit facilities, the contingent capital facilities and then that number will vary in the, perhaps, in the $10 billion to $12 billion range, but again that's our current thinking on that.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So you're over your initially stated goal, right now?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes. What we do as part of the recapitalization and part of our enhanced risk management is we developed stress tests and put ourselves through a series of stress tests to inform our views about where we would end up and what we would need to do. And that was, frankly, part of the criteria to close out the recap, and we've achieved against those. And part of the reason for those stress tests is they give us a forward-looking view in terms of risk scenarios, and then we'll adjust the level of liquidity and capital at the holding company, which is why I mentioned the importance of having dividend capacity coming out of our operating companies as part of what I would call a normal operating environment, normal relationship between a holding company and operating company.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it. And then on FP?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'll turn it over to Bill Dooley, why don't you...

William N. Dooley
Executive Vice President of Investments

Yes, Tom. Let me just do how we start the unwind of the portfolio. When we started to unwind it back in the fall of '08, we looked at the overall positions and we decided to look at the most complex, the ones that had the most optionality to them and the most that could give us any type of a contingent liquidity risk on those portfolios. So we went out and attacked them first. And at the same time, we then tried to eliminate the various books that they were in to get the books off the table. And then we went after and closed down certain of the companies where they're located. So we did Japan and we did Hong Kong to get out of the various regulatory environments. And over that period of time, not only were we successful in derisking the books and getting out of some of these very complex trades, we also were able to create additional liquidity. And at the same time, we also had positive P&L through that effort. What we've done now recently is instead of looking at what the complex trades are in the portfolio, because there are very few of them, if any left today, we're now concentrating on what we want to keep in remain co. And because there is value left in both the derivative book and the asset books that remain in FP, and we want to create that value or generate that value over the period of the next couple of years. Now in order to do that, we had to take people from FP, historical FP employees, and we put them into AIG. So we've taken asset people and moved them into AIG. We're taking certain of the liability people and moving them into AIG. And on top of that we've moved their operations and risk group into AIG to continue running the risk and operating systems of financial products. So there won't be any type of disconnection from how we've been managing it forward like this. At the same time, they're also here to enhance some of our own processes as well. So we're getting two for one on that instance, okay. But the key risk that we've had in the business is the contingent liquidity risk and that, as we've disclosed in the paper, is somewhat just around $2 billion, somewhat below $2 billion. So when you look at the graphs and you see the trade countdown and the notional count go down, and the volatility go down, they're all in keeping with what I've just stated as far as derisking the portfolio. The portfolio is still going to be continued to be derisked along what I've just said probably through the end of the second quarter, and then at that point in time the remain co portfolio is where we expect the emergence of profit and additional liquidity.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So Bill, if that's the case, will you guys start breaking this out as its own segment again? Because I assume when you put it into corporate other runoff that this would be a continual unwind?

William N. Dooley
Executive Vice President of Investments

No, because the pieces that I've already moved underneath the governance of AIG Inc. on the asset, so we took the asset portfolio with the liabilities in FP and we placed that in with the MIP [Matched Investment Program], which was an AIG corporate portfolio. And those portfolios are being managed jointly. The derivative portfolio will stay within a structure of FP because the derivative portfolio can't move around. But the derivative portfolio historically has been hedged, and that's really where the volatility number comes from. And we have the people that have hedged that portfolio successfully. So I'm not looking at that as any risk at all. We're expecting some profitability, as I said, to come out of that portfolio.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Will you be able -- so the Maiden Lane interest that is owned by FP at least on the way it's presented by you, is that something we should think about coming back to you over time when it eventually is liquefied in terms of the structure?

William N. Dooley
Executive Vice President of Investments

I don't believe the...

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

It is not.

William N. Dooley
Executive Vice President of Investments

It's not in FP.

Thomas George Gallagher
Crédit Suisse AG, Research Division

The way it's reported right now, it's an asset in FP or at least, the last time you showed a balance sheet.

William N. Dooley
Executive Vice President of Investments

No.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Tom, it's David. It's reported in the parent and other. I believe we've given some disclosure in terms of where it is, but it's impaired. It's a part of AIGFP per se, it's on the parent company balance sheet. Tom, that's Maiden Lane III; Maiden Lane II is owned by the SunAmerica.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Right. Maiden Lane III, my comment was the last time you showed a balance sheet for FP, that was an asset on it.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes. That was part of the parent company. I don't believe that was the FP balance sheet standalone.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Okay, I think that covers it pretty much today. I wanted to just follow-up with what Bill just said, and that is that FP today really represents all of it, a lot, lot more upside than downside. It's very well managed and very well controlled as is risk overall in the company. So we have clearly strengthened risk management over the last year and a half and continue to strengthen it. So as a group, we're really looking at all of our risks and making sure, as David said, we have sufficient liquidity, CMAs and so on between the business to make sure money is moving appropriately. Our primary goal is to make sure the insurance companies continue to be well rated and highly rated, and that's how we can continue to add customers and retain customers going forward. So we're in pretty good shape. I appreciate all of you taking the time this morning and this is the first of many calls we'll have on a go-forward basis. Any of you having any other issues, give us a buzz. Liz?

Elizabeth A. Werner
Head of Investor Relations and Vice President

Yes, operator, to everyone who's still on the line, we will certainly get back to everyone who is in queue and answer all your questions. Don't hesitate to reach out to us, if you have more. And thank you all for joining us this morning.

Operator
Ladies and gentlemen, this conference will be available for replay after 10:30 today through March 11. You may access AT&T Executive Replay System at anytime by dialing 1 (800) 475-6701 and entering the access code 193123. International participants may dial (320) 365-3844 and enter in the access code of 193123. That does conclude our conference for today. Thank you for your participation and using the AT&T Executive TeleConference Service. You may now disconnect.