S&P Capital IQ

CONTENTS

American International Group, Inc. NYSE:AIG

FQ4 2017 Earnings Call Transcripts

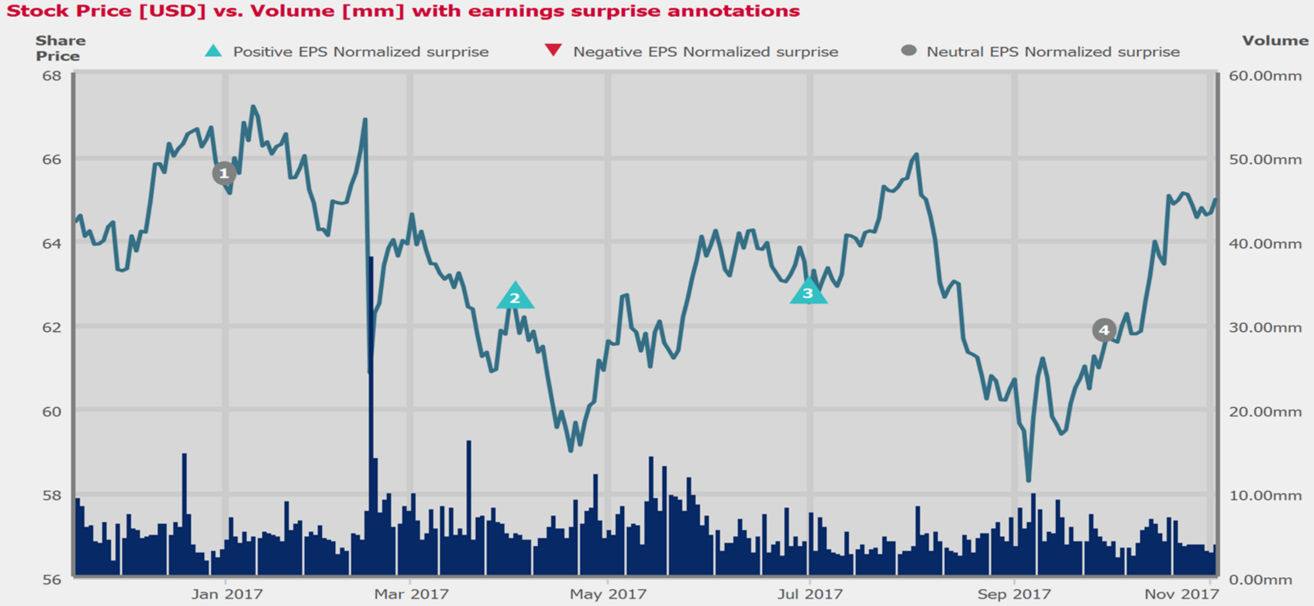
Friday, February 09, 2018 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.75	0.57	▼(24.00 %)	1.39	2.56	2.34
Revenue (mm)	12049.54	12635.00	▲4.86	11720.84	49273.23	49520.00

Currency: USD
Consensus as of Feb-09-2018 12:49 PM GMT

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



	- EPS NORMALIZED -		
	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	(0.57)	(2.72)	NM
FQ1 2017	1.07	1.36	▲27.10 %
FQ2 2017	1.20	1.53	▲27.50 %
FQ3 2017	(0.79)	(1.22)	NM

Call Participants

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Presentation

Operator

Good day, and welcome to AIG's Fourth Quarter 2017 Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead.

Elizabeth A. Werner
Head of Investor Relations and Vice President

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

Factors that could cause this include the factors described in our first, second and third 2017 Form 10-Q and our 2016 Form 10-K under Management's Discussion and Analysis of Financial Condition 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 reconciliation of such measures to the most comparable GAAP figures is included in the slides for today's presentation and our financial supplement, which are available on our website.

[Operator Instructions] This morning we'll have the opportunity to hear from our CEO, Brian Duperreault; our CFO, Sid Sankaran; and our CEO of General Insurance, Peter Zaffino; and our CEO of Life and Retirement, Kevin Hogan.

At this time, I'd like to turn the call over to Brian.

Brian Charles Duperreault
President, CEO & Director

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

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

The fourth quarter and full year were meaningfully impacted by catastrophes. California wildfires were largely in line with our third quarter estimate and the greatest contributor to our fourth quarter cat losses. Despite full year cat losses of $4.2 billion, our highest ever, AIG delivered $3.2 billion of adjusted pretax operating income.

As I mentioned in past calls, my philosophy on reinsurance is that it is an important tool for AIG to best manage its portfolio of risks. It provides another set of eyes on our underwriting, helps to manage volatility and control loss exposure. Going forward, you can expect us to be a predictable buyer of reinsurance. You will hear more from Peter about our reinsurance strategy and the overall market environment in General Insurance, where we see rate improvement across a number of lines.

With respect to the international side of General Insurance, we took a hard look at our European Commercial portfolio. And similar to our U.S. approach, we've acted decisively and prudently. International Personal Insurance had a very strong year, and in fourth quarter, we completed the Japan merger that we've discussed with you on prior calls. Peter will talk more about our focused approach to managing our international business in his remarks.

As we closed out the year, I view 2017 as a starting point, where we laid the foundation with respect to people, structure and underwriting. We have completed our internal structural changes in both General Insurance and Life and Retirement. These changes better position our people in the market and simplify our structure, allowing for greater efficiencies. While the company has made a lot of progress on reducing expenses over the last couple of years, an organization of our size and scale needs to be a top quartile performer in both underwriting and expense management. We are committed to continuing to make meaningful progress in that direction in a prudent and thoughtful manner.

In 2017, our reserve and underwriting action set a baseline for General Insurance. As I've said before, 2018 is the year of the underwriter at AIG, and I'm committed to empowering underwriters and holding them accountable for driving profitable growth.

A couple of weeks ago, we announced the acquisition of Validus, a significant step forward in our strategy to deliver profitable growth. Validus shares our underwriting philosophy of taking prudent risk across products and distribution. As we stated when we announced the transaction, the talent and diversification Validus brings to AIG is financially accretive and value-enhancing. The company's business mix includes well-positioned companies providing new sources of growth for AIG.

This year, we're also taking another important step forward in our legacy strategy with the formation of DSA Re, a Bermuda company that will manage the majority of our runoff reserves. You'll hear more from Sid on DSA's priorities.

Lastly, our 2017 results reflect the impact of the tax bill on the remeasurement of our deferred tax asset, which was in line with previous expectations. We believe the tax bill will be an overall net positive for AIG over the long term and look forward to the benefits of additional economic growth.

Last quarter, I spoke to the urgency this management team has to execute on our strategic priorities. I'm confident in the changes that are taking place at AIG. They are providing positive momentum for the company and its performance going forward.

With that, I'll turn it over to Sid.

Siddhartha Sankaran
Executive VP & CFO

Thank you, Brian, and good morning, everyone. This morning, I'll comment on our fourth quarter financial results, the impact of tax reform, our progress with regards to our Legacy Portfolio and capital and liquidity.

Turning to Slide 4. You can see our results presented under our new organizational structure, which became effective during the fourth quarter. Personal Insurance is now being reported with Commercial Insurance as part of the General Insurance segment, and Institutional Markets is included with Life and Retirement. As shown in our recap financial supplement, we no longer present normalized ROE as a reporting metric. However, we continue to include the quarterly noteworthy items that you can use to derive normalized earnings, and they're shown on Slide 5.

We reported adjusted after-tax earnings per share of $0.57, which reflected total General Insurance catastrophe losses of $762 million and included $572 million for the Northern and Southern California wildfires as well as losses from U.S. storms. As a reminder, we provided a preliminary estimate of $500 million for the Northern California wildfires on our third quarter earnings call, and actual claims came in modestly lower than we expected.

Our third quarter estimates for Harvey, Irma and Maria are holding up well overall relative to our initial estimates.

The total catastrophe losses for the fourth quarter were split between $300 million in Commercial and $462 million in Personal Insurance.

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

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

Turning to Slide 7. Our General Insurance ultimate accident year loss ratio, as adjusted, was 63.0% for the full year or 1.4 points lower than last year on an ultimate basis. With respect to underlying progress in our portfolio, we see North America Commercial Insurance ultimate accident year loss ratios having improved by approximately 2 points year-on-year, which has been partially offset by deterioration in international Commercial Insurance loss ratios by a point.

I would note that our fourth quarter international Commercial loss ratios include a catch-up adjustment for the full year associated with our fourth quarter DDRs and claims review. Our full year loss ratios for international Commercial are more representative of the starting point for profitability going forward.

Our Personal Insurance loss ratios are now at our expectation, and we believe they are sustainable. Peter will comment more on pricing, underwriting and trends in his remarks.

Turning to Slide 8. The GAAP net loss per share of $7.33 for the fourth quarter includes a charge of $6.7 billion to remeasure our U.S. net operating losses and other balance sheet deferred tax assets at the new U.S. statutory tax rate of 21%. This remeasurement does not alter the amount of taxable earnings that can be sheltered by our net operating losses.

The reduction in the tax rate also does not impact our foreign tax credits, which we expect to fully utilize before they expire. These credits will now shelter a larger amount of taxable income.

We expect that our adjusted effective tax rate will be approximately 21% to 22% for the full year of 2018, and our after-tax ROE should improve by approximately 150 basis points. The tax rate is slightly higher than the statutory rate, largely reflecting a higher blended rate on foreign earnings. We continue to believe that the overall impact from tax reform is a long-term net positive to our intrinsic value.

Our balance sheet and free cash flow remains strong. As shown on Slide 9, current liquidity at quarter-end was $7.3 billion. During the quarter, we received approximately $300 million of dividends from our Life Insurance companies as well as $2 billion from Legacy investments, including $1.1 billion from the sale of remaining life settlements contracts, which we disclosed last quarter. Outflows during the quarter included approximately $1.2 billion related to year-to-date true-up for tax-sharing payments to our P&C companies.

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

I would note as a result of the reduction in the statutory tax rate that I mentioned earlier, we reduced the deferred tax assets by approximately $400 million for our U.S. non-Life companies and about $500 million for our U.S. Life companies. This reduced the RBC ratios for each group by about 10 to 20 points. Our regulatory capital ratios remain strong and tax reform did not require us to downstream capital to any of our insurance subsidiaries. We expect approximately $5 billion in dividends and $1 billion of tax-sharing payments from our insurance subsidiaries in 2018. That is before any potential legacy-related activity and subject to our customary approvals.

We have continued to successfully execute on our Legacy strategy. As Brian noted earlier, we formed a Bermuda-domiciled legal entity, named DSA Reinsurance Company, Ltd., or DSA Re, to reinsure our Legacy Life and non-Life runoff lines. By combining these runoff lines into a single well-capitalized legal entity, we were able to achieve operating synergies and strong diversification of assets.

Legacy remains noncore and will be managed by a team with extensive runoff expertise. DSA Re will be a licensed reinsurer with approximately $37 billion or over 80% of Legacy total insurance reserves and will be backed by approximately $40 billion of invested assets managed by AIG investments. Our objective with respect to DSA Re remains to efficiently manage our Legacy liabilities, honor our policy and service obligations and maximize AIG's financial flexibility. The formation of this entity will allow us to accelerate these objectives.

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

To sum up, we continue to execute on plans to improve our results. We've demonstrated the value of maintaining a strong balance sheet and free cash flow profile, which gives us flexibility to execute on our strategic options.

Now I'd like to turn the call over to Peter.

Peter Zaffino
Chief Executive Officer of General Insurance

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

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

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

With respect to expenses, while our overall expenses declined 12% for the year, our expense ratio has remained flat as we've continued to reduce premiums as part of our remediation efforts. In 2018, we've identified additional opportunities to improve efficiency as we transition to a more decentralized model, while we further invest in talent within General Insurance.

Total net premiums written declined 9% for the quarter and 10% for the year, excluding FX. Divestitures accounted for 6 points of the full year decline, while the remainder primarily reflects remediation of underperforming lines. Going forward, in light of our reinsurance strategy and actions to manage the overall portfolio, we expect 2018 premium volume to be relatively flat with 2017 levels. While the General Insurance underlying accident year loss ratio improved year-over-year, we still have work that needs to be done across the Commercial lines.

Slides 12 and 13 provide additional insight into North America and international 2017 results. Last year, you saw the greatest impact from our remediation efforts in the North America Commercial, where accident year loss ratios began improving. In addition, in aggregate, fourth quarter North America Commercial claim trends have been favorable relative to our expectations. North America Personal Insurance net premiums written reflected growth in new travel business, which was offset by strategic divestitures and lower volumes and warranty.

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

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

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

Turning to Slide 14. Last quarter, we stated that one of our main priorities is to take a more strategic approach to reinsurance, building long-term relationships with our partners to manage future volatility. Our reinsurance philosophy is to take smaller net lines in Property and Casualty, reduce volatility and be consistent buyers of reinsurance.

During the January 1 reinsurance renewals, we began to execute on our strategy by reducing severity and frequency exposures to North American cat and net retention on our property per risk and also obtaining a new catastrophe cover for international cat. We expect these enhancements and anticipated changes for the remainder of the year will substantially reduce our risk of future volatility. Year-over-year, our PMLs are down 30% for the 1-in-100 and 1-in-250 events, and on a pro forma basis when we include the acquisition of the Validus, our PMLs will be approximately 20% lower than the prior year, positioning us to pursue other opportunities as they may arise.

Our recently announced acquisition of Validus is another example of a strong start to 2018. The acquisition brings valuable complementary businesses and allows us to expand our capabilities in 3D reinsurance, including access to the ILS market through AlphaCat, a Lloyd's platform, a commercial E&S surplus business and a crop insurer.

I've known the Validus leadership team for many years, and their underwriting expertise and track record speaks for itself. Given AIG's diversity and capital strength, I believe we'll be able to seek unique opportunities for profitable growth with Validus.

Last quarter, I said that I intend to run to our problems. We recently announced our organizational design and additions to leadership that will provide the foundation for improving our financial business results. Our new structure is composed of distinct end-to-end businesses that support transparency, accountability and process efficiencies.

Our core underwriting businesses will be led by Lex Baugh for North America, Chris Townsend for International and Gaurav Garg for Personal Insurance. Chris joins us in early March and will implement our new operating model across our international businesses to drive local decision-making and increased accountability. Tom Bolt recently joined us as Chief Underwriting Officer in January, and he will play a critical role in bringing quality and consistency to our underwriting guidelines and process and assisting us in advancing our analytical capabilities.

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

With that, I will turn the call over to Kevin.

Kevin T. Hogan
Executive VP and CEO of Life & Retirement

Thank you, Peter, and good morning, everyone. As you can see on Slide 16, Life and Retirement produced solid results for the quarter with $782 million in adjusted pretax income, despite approximately $90 million in adjustments, primarily for fixed and variable annuity products within Individual and Group Retirement due to ongoing modernization of our actuarial systems and related model refinements.

Our results for the year were strong with over $3.8 billion in adjusted pretax income and adjusted ROE of 12.4%. Total yields for our spread-based products benefited from significant increases in alternative and yield-enhancement income for the year. It is important to note, however, that our base yields continued to be compressed due to the reinvestment environment. Additionally, asset growth driven by strong equity markets continued to help partially mitigate the impact of the low rate environment on our results.

One of Life and Retirement's greatest strengths is the breadth of our product portfolio across our businesses, which served us particularly well in a year marked by industry sales challenges, especially in the individual annuity market. We emphasized growth in Life Insurance and Institutional Market sales and continued to maintain steady sales results for our Group Retirement business.

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

Now I will briefly discuss our results for the fourth quarter. Turning to Individual Retirement on Slide 17. Regulatory uncertainties and disruption have continued to significantly affect distributors, negatively impacting industry sales, particularly of variable annuity products. Although our sales of fixed and index annuities increased for the quarter, overall Individual Retirement net flows remained negative.

Individual Retirement's assets under administration were at historical highs at quarter-end, driven by equity market performance and positive index annuity net flows, which resulted in increased fee income. We continued our practice of active spread management, but as expected, we saw continued compression, reflecting current reinvestment conditions. This quarter, base net investment spreads benefited from unexpected accretion income for fixed annuities and growth in index annuities.

Turning to Group Retirement on Page 18. Our investments in VALIC to transform the plan sponsor and participant experience continue to pay off. New group acquisitions increased significantly for the year. Despite strong sales for the year, net flows declined as individual surrenders increased.

Similar to Individual Retirement, Group Retirement achieved record assets under administration and, despite disciplined rate management, experienced expected base yields compression. This quarter, base net investment spread benefited from unexpected accretion income and a cumulative update to cost of funds.

While we have seen recent increases in risk-free rates, spreads continue to be at historically tight levels.

Looking forward, across Individual and Group Retirement, absent significant changes in the overall rate environment, we continue to expect our base net spreads will decline by approximately 1 to 3 basis points per quarter. And as Sid mentioned, we would also expect returns in alternatives and securities carried at fair value to moderate to more historical levels, noting this impacts total yields, but not base yields nor spreads.

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

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

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

Now I would like to turn it back to Brian to open up the Q&A.

Brian Charles Duperreault
President, CEO & Director
Thank you, Kevin. Operator, let's go to questions.

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Jay Gelb from Barclays.

Jay H. Gelb
Barclays PLC, Research Division

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

Brian Charles Duperreault
President, CEO & Director

Shall I do this? You want to do that, Peter? Well, I think it's going to be a combination of things because that accident year loss ratio is a mix of -- mix in the portfolio. You have Casualty. You've got Property. You've got different combined ratios. You mix it together. Maybe you want more property, probably push your loss ratio down a bit, you're more casualty, it goes up. And I think you got to add the expense issue that I mentioned earlier. We've got to continue to work on our expense levels too. So it isn't just the loss ratio that's going to get us to our level that we want to get to in terms of returns. It's going to be a mix of business, and it's going to be an expense and loss combination. But we got -- we still have ways to go. I mean, we're not there yet, and I think we can clearly improve that. And we've got a bit of a tailwind, which is helping us in that effort. So that tells us we can get there a little faster. Hope that answers the question.

Jay H. Gelb
Barclays PLC, Research Division

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

Brian Charles Duperreault
President, CEO & Director

Yes. Well, capital management, it's a key thing in what one does. We're blessed with having the kind of capital build-up that we have and how you deploy it. I said earlier, that, to me, the buybacks are a capital management tool. We'll use those, that management tool, when we think it's appropriate. But I would rather deal with our portfolio and the fact that there are pieces of it that I'd like to fill in. We have white space there. So that would be my priority. Our dividend process should be long term in nature, consistent with the kind of business we do, and that would be more of a more steady move, right, that I wouldn't think you'd make large-scale changes in your dividend approach. So it really gets down to, can I find opportunities to use the capital in a way that's accretive and structurally improving? And if I can't, we have the stock buyback as a tool.

Operator

Our next question comes from Brian Meredith from UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

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

Peter Zaffino
Chief Executive Officer of General Insurance

Well, we have mentioned that Tom recently arrived, and Chris will be joining us in early March. So we have the foundation for our core underwriting leadership. We actually have been hiring, actually, some significant talent at that next layer and the layer below. Ken Riegler, who just recently joined us, is taking a very prominent position within North America. Tim DeSett just joined us to run our North America field. And so we have been continuing to add very strong talent at the next layer. But we also have some really strong talent within the organization that now that we've announced the org structure, we've been putting people in positions where they can start to drive influence and improve on the accident year loss ratios in '18 and '19. So I'm really very encouraged by the number of people that have shown interest and want to join, and I'm really pleased with the progress that we've made to date.

Brian Charles Duperreault
President, CEO & Director

You got a follow-up, Brian?

Brian Robert Meredith
UBS Investment Bank, Research Division

Yes, yes. And I'm just curious, with the changes in the reinsurance program, the AALs that you guys have been providing, any change that we should think about going into '18?

Peter Zaffino
Chief Executive Officer of General Insurance

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

Operator

Our next question comes from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. This isn't a new issue, but one that I want to better understand. There's 2 different numbers, the DTA on the balance sheet and DTA you use for calculating book value per share. I know you guys took a big write-down related to the change in U.S. tax law, but there's a different change to both, $7 billion on the balance sheet and $4 billion on the calculation of book value per share. Can you explain a little bit the difference between those 2?

Brian Charles Duperreault
President, CEO & Director

Yes. Sid?

Siddhartha Sankaran
Executive VP & CFO

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

Brian Charles Duperreault
President, CEO & Director

Got a follow-up?

Joshua David Shanker
Deutsche Bank AG, Research Division

Yes. And in terms of -- there was a little bit of a reserve deficiency on recent years, offset by better results in prior years. Where do you stand on terms of the confidence in the end of your loss picks for this year? And do you feel those -- I mean, your predecessor said, "Sometimes we're going to be deficient. Sometimes we're going to be redundant. We have a very large book." Do you take that tact as well?

Brian Charles Duperreault
President, CEO & Director

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

Operator

Our next question comes from Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

My first question is on the international Commercial. Could you give me more detail about what kind of remediation efforts you're taking? And what's the time line of it relative to the North America Commercial? Just try to figure out, will we see the turnaround soon as we have seen in North America.

Brian Charles Duperreault
President, CEO & Director

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

Peter Zaffino
Chief Executive Officer of General Insurance

Yes. As Sid mentioned in his opening comments, we took a really hard look at the fourth quarter within international with a little bit more of a focus in Europe. And so some of the trends -- again, I don't need to get back through it, but the Financial Lines, Property, Special Risk, we had some development. But I would ask you to take a look at the full year. If you look at the accident year loss ratio of the full year, that's more reflecting the overall performance. I think we will continue to try to take volatility out, not take as large of net and gross lines within international portfolio. But overall, the accident years, if we look at the full 2017, we know we have improvement. But you look at the delta between that and North America, we still need to focus on improving our accident year loss ratios in North America as well.

Kai Pan
Morgan Stanley, Research Division

Okay. My follow-up is on reinsurance. And with your new programs, if 2017 cat loss were to repeat, what's your net loss? And could you also give updates on the Commercial quota share renewals?

Brian Charles Duperreault
President, CEO & Director

Looks like they're yours, Peter.

Peter Zaffino
Chief Executive Officer of General Insurance

Okay. Well, we restructured the cat reinsurance to include more aggregate cover. So the attachment point dropped from $1.5 billion to $750 million with a corridor deductible, but that's an aggregate versus an occurrence. And so you would take a lot of the frequency of events out, and we have around -- I don't want to give a specific number, but it'd be in the 40% to 60% less range for if we had the same exact cats in 2017 reoccur in '18. So we've taken a lot of the volatility of frequency but also have a vertical cover in the event that we have a single large loss, that we are protected at different return periods. In terms of the quota share, Brian's mentioned, I mentioned, we're taking a full year look at all of our reinsurance placements. And so we've begun with Property at 1/1. We are not going to continue with a quota share in the U.S. We're going to look at a variety of different alternatives in terms of how we want to structure reinsurance in our international portfolio in Casualty as well as in North America. So we'll continue to give you updates as we revisit all of our reinsurance placements throughout the year.

Operator

Our next question comes from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, pretty good -- you guys have pretty good improvement in the North America Commercial line's underlying loss ratio in the quarter. I know within the international book you kind of pointed to the full year as the starting point for '18. Was there anything one-off in that number? Or is that something that we should use as kind of a base to model off of for the Commercial lines results as we think about 2018 in North America?

Brian Charles Duperreault
President, CEO & Director

Look, there's always a one-off in there, but I'd say, use it as a baseline.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay, great. And my second question, you guys set up this DSA Re vehicle. Is there any thoughts around that, that could potentially free up more capital for you guys? If you can just share some thoughts around that.

Brian Charles Duperreault
President, CEO & Director

Sid?

Siddhartha Sankaran
Executive VP & CFO

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

Operator

Our next question comes from Erik Bass from Autonomous Research.

Erik James Bass
Autonomous Research LLP

In Life and Retirement, you've now had several charges related to systems enhancements leading to reserve refinements. Can you just update us where you are in the systems investment process and if we should anticipate more refinements in the future?

Brian Charles Duperreault
President, CEO & Director

Kevin?

Kevin T. Hogan
Executive VP and CEO of Life & Retirement

Yes. Thanks, Erik. We've been in the process of modernizing our actuarial systems in the Retirement business and also the Life business for the last 2 to 3 years. We're essentially moving from one very modern platform to an even better platform. And as we are able to upgrade the detail of the models from time to time, there are some movements in the reserves. And so while this shows up in earnings in the fourth quarter, relative to the size of the balance sheet, these are relatively modest adjustments. I think what's important is that there's no change in our outlook to the profitability or attractiveness of this business. And these are very sophisticated platforms. So like I said, we're 2 to 3 years in. We have another year or 2 to go. We're constantly trying to improve our modeling and management of this business. And at this point in time, we can't stress that there's anything else to come, we're continuing to work through the process.

Erik James Bass
Autonomous Research LLP

Yes. In Group Retirement, specifically, you've made a number of investments there in the VALIC platform and are seeing a pickup in new group acquisitions, but the flows remain negative. I guess what are remaining hurdles you see to getting back to positive flows in that business?

Kevin T. Hogan
Executive VP and CEO of Life & Retirement

So I think that there's 2 things. You have to recall that there was a period of time where we were not engaging in aggressive plan acquisition. We've reengaged in new plan acquisitions starting 3, 4 years ago. And as you pointed out, we have made some significant digital investments, which are really paying off in improving both the plan sponsor and the participant experience. So I think that at the levels of plan acquisitions where we are now, we're continuing to see improvement year-on-year. We're continuing to expand our adviser force and expect that to grow. We will have a little ways to go before we make up for the fact that we weren't acquiring plans for a while. So our outlook for this business is very profitable business. We're still managing the yields compression, and the margins remain strong.

Operator

Our next question comes from Paul Newsome of Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

You mentioned high single-digit cash returns for Validus. How does that compare to your cost of capital as you calculate it?

Brian Charles Duperreault
President, CEO & Director

Well, I guess we can always have a debate on all the methods to calculate cost of capital and say it's -- when we look at it, it would be above our weighted average cost of capital in terms of equity cost of capital. I can do all the fancy math I want, but generally, my investors tell me it's 10%. So we think it's a reasonable return here for our surplus cash and capital. And certainly, if there's -- those assumptions, as we said, we think we've been cautious. And so if we do any better than that, which certainly we're targeting, we think it's going to be something that people will be very pleased with in terms of overall return.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

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

Brian Charles Duperreault
President, CEO & Director

Kevin?

Kevin T. Hogan
Executive VP and CEO of Life & Retirement

Yes, sure. So let's remember the fourth quarter was still a period where the distribution environment, we work with independent distribution across the U.S., was in the relatively earlier stages of embracing the DOL. And third quarter was the low point, but fourth quarter still sort of suffered from that. And the rates were improving a bit at the time. The equity markets were very strong. And so VAs, really, were under pressure. We're actually pleased with the VAs, about -- almost half of our sales right now or last quarter, were a new product that we introduced with a daily income benefit, which is something that is targeted for the new distribution environment. So whilst we're continuing to see a reduction in the new business there, we feel good about where we are positioned with the VA product branch. We also introduced an advisory product. We're seeing improvements where we focus on index annuities and fixed annuities, and index annuities, in particular, have kind of taken the place of the role that variable played in some advisers' platform. And we've been working closely with our distribution partners relative to that. I mean, as the rate environment improves and as investors' outlook may evolve relative to attractive investments in these products versus unbridled equity markets is what will predict the future environment. We think that what's most important is that we have a common standard of care relative to the fiduciary standard and suitability between investment and insurance products. And so we believe that the future regulatory environment will move in that direction and that investors will respond to that, and the distribution environment, most importantly, is stabilizing relative to their practices.

Operator

Our next question comes from Larry Greenberg from Janney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Peter, I think you said that we should expect General Insurance premium volume to be flat for 2018. Would you differentiate between domestic or international and international? Or is that a pretty good assumption for both of those?

Peter Zaffino
Chief Executive Officer of General Insurance

Larry, I would just assume that we'll be remaining flat across the globe, and I wouldn't differentiate much between North America and international. The only thing I would say to that is that we are getting more rate in North America as I look from pivoting from the fourth quarter to the first quarter. So the rate seems to be sustaining, some of the peak zone renewals that we have, those are coming up. So again, I can't really forecast what's going to happen in the second and third quarter. But if rate continues to improve and we have some of our bigger quarters in Property with those type of rate increases, you could see a little bit more in North America.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Great. And then, Brian, in terms of getting your expense ratios to top quartile, is that something that we should expect could be achieved in the next year or so? Or is that a multiyear process?

Brian Charles Duperreault

President, CEO & Director

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

Operator

Our next question comes from Adam Klauber of William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

You said you're getting some good rate in the Property book. Did that momentum continue into this year? And also, do you think the Casualty rate environment is better today than it was a year ago in the U.S.?

Brian Charles Duperreault
President, CEO & Director

Peter?

Peter Zaffino
Chief Executive Officer of General Insurance

So the U.S. Property, what I had mention in my comments, sequentially got better every month within the fourth quarter. January looks to be very consistent with that pattern. Don't have too much guidance beyond January. So we are continuing to see rate increase. We are seeing rate increase within the Casualty lines. It really just does vary. I mean, certainly, auto is the one that would be driving the most increase on a primary and excess basis. But want to make sure that we're spending a lot of time thinking through like lost cost trends for the Casualty lines because rate increase is required across most Casualty lines just to stay constant with lost cost increases. So we are seeing rate increase. I want to make sure that we're very conscientious of why that increase has to happen for lost cost increases, but we are seeing rate on the Casualty book. And again, early indications in the first quarter is that's consistent with what we saw at the end of the year.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And one follow-up to that. Have you seen a pickup in the legal? Or is it a tougher legal environment today than it was, say, 3, 4 years ago on the -- particularly on the Casualty side?

Brian Charles Duperreault
President, CEO & Director

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

Operator

Our next question comes from Tom Gallagher of Evercore.

Thomas George Gallagher
Evercore ISI, Research Division

Brian, in terms of releasing reserves for North American Commercial P&C, should we take that more of a function of the less challenged lines being reviewed this quarter? And so could we still see some volatility as you review your more challenged lines in 2Q and 3Q of '18? Or do you expect less volatility than we saw in '17?

Brian Charles Duperreault
President, CEO & Director

Well, yes. I mean, we look at all the reserves, I mean, really. I mean, it's not -- I mean, we have a detailed review of -- in a scheduled way. If we see a problem, we pull it forward. I mean, we look at everything. So I wouldn't characterize this as these were the easy ones. We look at all. I said earlier, I think '17, to me, is a good starting point. I feel confident and I said that before in the reserve process and the way we look at the business. So you never can predict what's going to happen next year. I'm not going to do that. But I feel confident in our understanding of what this portfolio is all about, where the issues are and what we need to address.

Thomas George Gallagher
Evercore ISI, Research Division

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

Brian Charles Duperreault
President, CEO & Director

That's another good -- interesting question. So we do use outside consultants or actuarial firms. So we have several looks at it, and that always gives you comfort, particularly if you are within kind of their tolerances and ranges. And I think we've gotten closer to the mean in that regard or maybe above it a little bit. But that's a standard process for us. You make -- reserves are a lot easier when you make money. It's a lot easier. And I think ours -- I tell everybody, how are we going to get our reserves to improve? Make money, make money. And that, I think attention to the portfolio, addressing the issues and addressing them early so you nip things in the bud, reducing the volatility so that you don't have a lot of business that just out-of-line premium to exposure, so if it goes wrong, it can exacerbate. So those are the things. It's a portfolio management. And I guess in that regard, yes, there has been some changes there, but not in the technique of actually looking at the reserves.

Operator

Our next question comes from Meyer Shields from Keefe, Bruyette, & Woods.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

On a high level, I guess, between the purchase of much more reinsurance on Property and the nonrenewal of the Casualty quota share, it seems like Casualty is going to represent a much higher percentage of earned premiums in '18 than it did in 2017. Can you walk us through, conceptually, what that implies for the underlying loss ratio?

Brian Charles Duperreault
President, CEO & Director

You cut off at that last piece. I didn't hear that last statement, the last question. Could you just repeat that last sentence?

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

I'm just trying to understand what that anticipated mix shift implies for the underlying -- the accident year ex cat loss ratio?

Brian Charles Duperreault

President, CEO & Director

Well, let me start. I think Peter can add to it. When we make -- when we look at reinsurance, I mean, we're looking at a lot of different things with respect to reinsurance. Some of it is, are we doing it for volatility reasons, are we doing it for capital reasons, are we doing it for issues around analysis, et cetera. So we look at our entire portfolio. And is the relationship between us and the reinsurer one where we are truly providing benefits to both? And so that's -- those are the decisions around all the lines of business, whether it's Casualty or Property. Obviously, our Casualty loss ratios tend to be a little higher but -- because they have less volatility. So you're going to have a mix change in the loss ratio just naturally between the 2. The more important question is, do we feel that the portfolio itself, whether it's Casualty or Property, are producing the kind of returns? Yet that doesn't change whether you -- that doesn't change. We have to deal with the profitability of that book on a gross basis, and so we're not changing our approach to improvement. We know we've got more to do in Casualty, and we're going to do it. But -- and the Property has had issues, particularly in Europe where we have to address those as well. So it is a mix of business question, but underlying all that is, are we attacking the portfolio intelligently? And I think we are.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's helpful. Second question, can you give us a sense -- I know it varies tremendously, but an overall sense of the loss trends that are embedded in your Casualty reserve that you're in?

Brian Charles Duperreault
President, CEO & Director

Sense of loss trends? Well, I guess that's Peter.

Peter Zaffino
Chief Executive Officer of General Insurance

Well, I can tell you in terms of how we're looking at the pricing. When we look at some of the loss cost trends in pricing, again, I'd mentioned before that we contemplate that on the primary and then the excess. And so on the primary, it ranges from 3 or 4 up to 8 and, again, auto being at the upper end. And from an excess basis, looking at the same lines of business, it can go up to almost 10 on the loss cost trend, again, auto being the one at the upper end. But there's other lines of business that fall within that. And so we make sure that as we're looking to pricing and looking at some of our historical experience, we contemplate all that in terms of looking at how we're going to position the portfolio throughout 2018. And as I said, we're getting rate, and we're looking at loss cost trends. So I don't see anything dramatically changing based on our observations.

Operator

Our last question comes from Jay Cohen.

Brian Charles Duperreault
President, CEO & Director

Jay, I guess you're our last guy, so fire away.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

You're supposed to say, saving the best for last, right?

Brian Charles Duperreault
President, CEO & Director

Absolutely, Jay.

Jay Adam Cohen

BofA Merrill Lynch, Research Division

Question for Sid, actually. Financial leverage, are you near where you want to be at this point? Or do you need to take some action on the debt side?

Siddhartha Sankaran
Executive VP & CFO

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

Brian Charles Duperreault
President, CEO & Director

All right, Jay. Well, thanks everybody for dialing in. And thanks to my colleagues for great work, and we got a great year ahead us. Thank you all.

Operator
This concludes today's call. Thank you for your participation. You may now disconnect.