S&P Capital IQ

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American International Group, Inc. NYSE:AIG

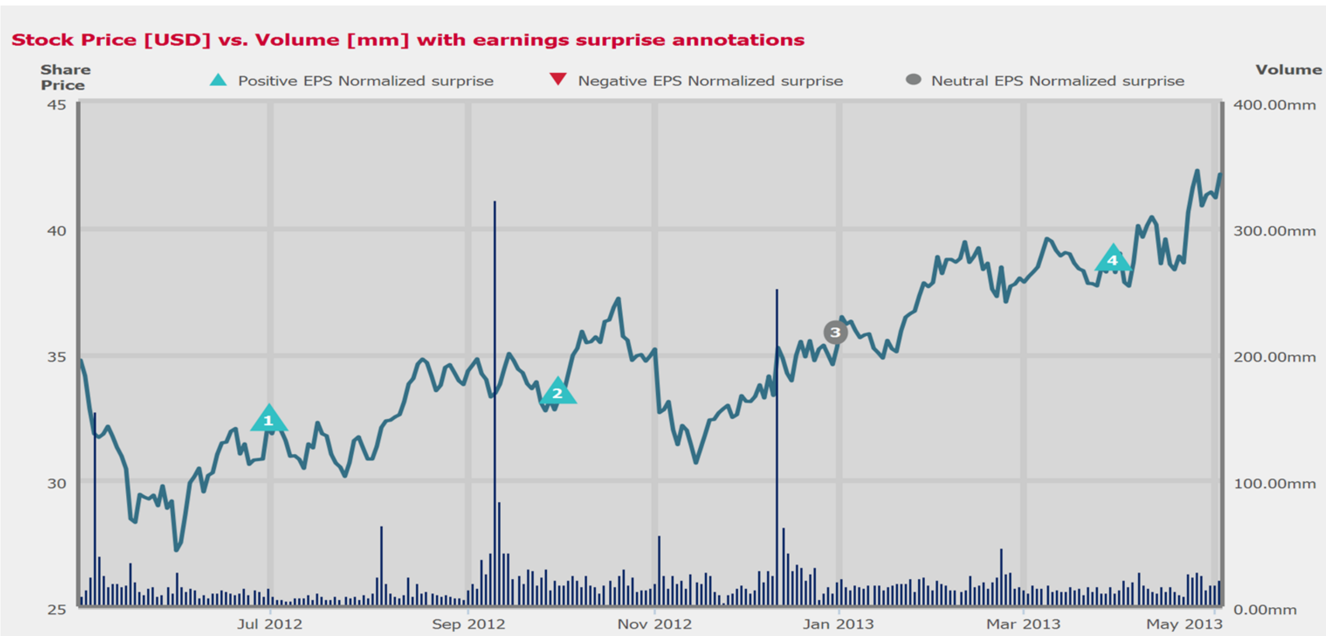
FQ2 2013 Earnings Call Transcripts

Friday, August 02, 2013 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2013-			-FQ3 2013-	-FY 2013-	-FY 2014-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.86	1.12	▲30.23	0.81	4.01	4.22
Revenue (mm)	8621.88	8347.00	▼(3.19 %)	8665.83	34442.43	39658.03

Currency: USD
Consensus as of Aug-02-2013 12:44 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2012	0.60	1.06	▲1 76.67 %
FQ3 2012	0.89	1.00	▲2 12.36 %
FQ4 2012	(0.07)	0.20	NM
FQ1 2013	0.88	1.34	▲3 52.27 %

Call Participants

EXECUTIVES

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David Lawrence Herzog
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Presentation

Operator

Good day, everyone, and welcome to the American International Group's Second Quarter Financial Results Conference Call. As a reminder, today's call is being recorded.

At this time, I'd like to turn the conference over to today's host, Ms. Liz Werner, Head of Investor Relations. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, and good morning, everyone. Welcome to AIG's discussion of our second quarter 2013 results.

Speaking today will be: Bob Benmosche, President and CEO; David Herzog, Chief Financial Officer; Peter Hancock, CEO of AIG Property Casualty; and Jay Wintrob, CEO of AIG Life and Retirement. Other members of senior management are also in the room and will be available for the question-and-answer period.

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 quarter 2013 Form 10-Q and our 2012 Form 10-K under Management's Discussion and Analysis 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 our financial supplement, which is available on AIG's website, www.aig.com.

Now I'd like to turn the call over to Bob. Bob?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Good morning, Liz, and everyone -- and thank you, Liz. And I'm on Slide 3. And clearly, as you can see another, and I'll be underlying the word "another" strong quarter for AIG. We continue to show consistency and we show very strong across-the-board earnings and fundamentals for all of our businesses.

And so 2 things that I know that you're focusing on that are not in the strong numbers, and that is what's going on with ILFC, so let me deal with that right up front. We're continuing to negotiate with the consortium, and keep in mind we don't have a buyer but we have a group that is buying ILFC. And so this is a very complicated transaction, first, the nature of the transaction and who are the people that we're with and who we're negotiating with and expecting to sell to. So we are continuing that dialogue. We're continuing those discussions. We did not receive the money on time. And now both sides are working on whether we -- and how we continue to do this. But we are focused on an IPO at this stage of the game, so that if they can come together and the money comes in, then, we will proceed. If not, we are preparing ourselves for later this year for an IPO, where we hope to be able to do a deconsolidating trade with ILFC.

We also were named a SIFI during the quarter, which allows us to now deal with the AIG Bank. We have retained the bank, but not because we wanted to keep the bank as a business, it's less than $1 billion so we felt it was time to close it. But we kept it such that we will be able to continue having the Federal Reserve in and getting started early with the Federal Reserve so that we're well prepared for when the SIFI designation comes in. It has come in. But we are not under CCAR until late next year, possibly, or even the first quarter of 2015. So we're still being regulated as a savings and loan holding company, and that's how it's proceeding. Although the auditing and the efforts working with the Federal Reserve is about getting ready for our SIFI period of time when we're regulated by those rules and regulations.

We're also named a G-SIFI, again, having been regulated by the Federal Reserve. We are assuming that will be the lead in this effort as we think about global regulation. And we're going to continue to operate that way, looking at the Fed as the lead regulator working with the others. And hopefully, that will simplify this very complex regulatory world that we're now facing as a company.

As a result of the strong results of this quarter and quite frankly, all the preceding quarters, we had recommended to the Board of Directors. And after a review with the ratings agencies, who were required to give us their green flag, if you will, on capital management, the Board has approved a $0.10 dividend per share, as you saw, and also allowing us to begin to buy back shares with an authorization of $1 billion.

In addition to that, we said that those are priorities, but the capital management on debt is also important so we reduced our debt. And in fact, we reduced our expense, interest expense by about half the dividend that we're going to be paying out. So we've got about $300 million savings in interest, and we are talking about if the dividend continues at the rate we are talking about, talking about $600 million, basically, for the year. And we continue to see strong dividends from our subsidiaries, with $1.3 billion of dividends and they'll be paying some to the insurance company. Our parent liquidity, absent the bank lines which is on top of this, we have almost $11 billion in cash. So we are really very strong, both from a cash and capital point of view, as well as operating results.

Peter's going to talk about, in just a minute, the Property Casualty business. It is continuing a strong turnaround. You can see that in the accident year losses, the ability to get rate where it makes sense. We're still growing the top line in a very strong way. And you can see that our reserve is continuing to be maintained in roughly the levels we think is necessary. The only exception that Peter will talk about this is the add to the reserve for Storm Sandy, which as you know, was a very serious storm and a very complicated storm to deal with.

On the Mortgage Guaranty front, we'll talked about reengineering that business. We've said that we are now on our way with our new approach to risk selection. We think we've got a very good, well thought out, state-of-the-art process and in fact, that's in the numbers that you see now is it's emerging because about half of our premiums are coming from our performance premium risk selection capability. You'll also see new business coming in, so we have a strong risk selection model, we're continuing to show strong growth. And of course, in the legacy book, we are still seeing modest decline in our delinquency rates.

AIG Life and Retirement, again, a very strong performer over time and for the quarter. Variable annuity sales continued to be strong, as others struggled with what to do with that business. Our mutual funds, also, are very positive. Assets under management continued to grow, which is a key measure as you think about this business because you earn fees on assets under management. And so it's really a very simple method to say that if those are going down dramatically, eventually, your fees will start to go down. Here, we're seeing good growth and good net flows from our businesses.

A lot of questions about low interest rate. Isn't that a problem? Isn't that a problem? It must be a problem, well, I'm sure it's a problem. We have said to you quarter after quarter after quarter, I guess it sounds like I'm repeating myself and I apologize, but I do that once in a while. Clearly, the way that Jay's organization is dealing with this, and the way the investment department is dealing with it, we felt that it was within the realm of being able to manage it without severe problems. And you can see again, this quarter, looking at our crediting rates, Jay and his team has done an outstanding job of keeping our spreads pretty much what we need them to be.

And so in addition to that, and of course, we have low interest rates putting some pressure on us. You also get the opportunity with a well-designed book. You have the earnings benefiting from investment income during this quarter to offset some of that drag.

So bottom line is, we're having another great quarter. We're continuing to see strong fundamentals and we're optimistic about our future. So what I'm going to do now is turn it over to David who will take you through the details of the quarter. David?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Bob, and good morning, everyone. As Bob mentioned, we did deliver another strong operating quarter and we, importantly, continued to execute on our capital management objectives. With respect to ILFC, I would add that we continue to think of ILFC as a noncore asset. It remains as a held-for-sale asset, given our intent and our plan to monetize it through either a sale or an IPO, as Bob referenced.

On the operating front, we saw solid premium growth and positive pricing in our Property Casualty business, along with continued improvement in the accident year loss ratio. Peter will talk about that in a moment.

Life and Retirement continued to actively manage spread and it also benefited from strong investment returns. On the capital management front, we continue to optimize our capital structure and through the first half of the year, we've retired a little over $5.5 billion in debt, including $2.9 billion in face amount of debt in hybrids that we've either tendered for, called or repurchased. Of the total debt that we have retired, year-to-date, approximately $1.2 billion of that is associated with the direct investment book. Going forward, we will opportunistically execute on our share purchases, as well as debt capital management.

As Bob mentioned, we have reinstituted the dividend and have a further share buyback authorization, both of which point to our positive view of future profitability and capital generation.

Turning to Slide 4, second quarter operating earnings per share were $1.12, up 17% from a year ago. Operating ROE, which excludes AOCI from equity, was about 7.4% for the quarter. On a basis consistent with our long-term aspirational goals, which also excludes the deferred tax asset from equity as we tax-effect our operating earnings, operating ROE was about 150 basis points higher. Net income for the quarter was $2.7 billion, and includes net realized capital gains and the related DAC and loss recognition effects on those gains, certain legacy legal settlement gains of roughly $260 million net of tax and a deferred income tax valuation allowance release of approximately $700 million associated with our capital loss carryforwards. Inception to date, we've been able to recognize a little over 50% of the deferred tax asset on our capital loss carryforwards. Book value per share, excluding AOCI, was $61.25, up almost 11% from a year ago. Reported book value per share declined during the quarter to just over $66, reflecting the impact from the recent rise in interest rates.

Operating results begin on Slide 5. Each of our insurance operating business reported operating income improvements over a year ago, driven by favorable fundamentals. And again, Peter and Jay will go into further detail. The direct investment book and Global Capital Markets benefited from positive marks in the quarter. The direct investment book earnings were driven by positive non-agency RMBS marks reflecting housing price appreciation, prepayments on the underlying collateral and spread tightening. Global Capital Markets also benefited from amortizations and market appreciation on the underlying covered securities of the legacy multisector CDS portfolio. This appreciation reduces the liability we carry on the related CDS.

Interest expense from the prior year declined, reflecting the interest savings from our liability management actions we've completed thus far. The corporate expenses, including the impact incurred during the quarter for continued infrastructure buildout were modestly higher than our expected run rate of about $225 million a quarter. There's roughly $20 million or so of corporate expenses related to our data center consolidation that winds down going into 2014.

Operating results for the quarter included a higher compensation expense related to the share-based legacy programs that are tied to changes in AIG stock price. AIG's stock prices improved about $6 a share, which translates into about $100 million of total compensation expense for the company.

The effective operating tax rate was almost 32%, slightly higher than our expected run rate, reflecting certain discrete items in the quarter. We continue to expect that the operating tax rate will be roughly in the 31% range for the second half of 2013. And as you may recall, we will not be paying any U.S. income taxes for some time given our NOLs, which we expect could provide annual liquidity to the parent of approximately $1 billion in 2014 and beyond.

Our capital position remains solid, and on Slide 6, you can see the current debt levels reflect the nearly $950 million in liability management actions completed in the quarter. During the quarter, we called our $750 million of our 6.45% hybrids. We called them at par and we purchased nearly $200 million of debt in the open market. Annualized interest savings from the debt we retired this quarter is a little over $60 million. And as Bob referenced, the total savings for the annual activities that we will have completed either through scheduled maturities, with the active debt capital management completed for the full year, will be about $300 million.

We received dividends from our insurance subsidiaries of $1.3 billion in the quarter or $2.7 billion year-to-date as shown on Slide 7. We continue to expect $4 billion to $5 million in annual dividends and distributions from our insurance subsidiaries. Parent company cash and unencumbered securities are approximately $11 billion at the end of the quarter reflect these distributions and liability management that I referenced earlier. This parental liquidity includes about $5.4 billion related to the direct investment book in Global Capital Markets, which is currently allocated towards future maturities and liabilities and also, contingent liquidity stress needs. Nearly 80% of the direct investment book's debt matures by the end of 2018.

And at this time, I'd like to turn the call over to Peter to comment further on our Property Casualty business. Peter?

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

Thank you, David. Good morning, everybody. AIG Property Casualty results in the second quarter reflect continued progress towards achieving our goals. Our second quarter results were driven by continued underwriting improvements and better-than-expected alternative investment returns.

Turning to Slide 8, net premiums written grew 4%, excluding the effects of movements in the yen, and the accounting changes for the excessive loss reinsurance premiums. Pricing increases and organic growth initiatives both contributed to this growth. We continue to expect modest net premium growth through the remainder of 2013 as we continue to write profitable new business.

Our accident year loss ratio, as adjusted, of 61.9% for the quarter improved by 2.9 points from the second quarter of 2012, and was slightly better than trend. The improvement is due to business mix shift, continued enhanced risk selection, loss mitigation initiatives and positive pricing. Importantly, we see no signs that the trend is changing.

Operating income was nearly $1.1 billion and included catastrophe losses of $316 million from flooding in Europe and the Americas, as well as U.S. tornadoes and hailstorms. Net unfavorable prior year reserve development for the quarter totaled $154 million, net of premium adjustments, largely from additional losses on storm Sandy of $142 million. These losses resulted from higher severities on a small number of existing large and complex commercial claim notifications. The increased severity was driven by a number of factors, including the extensive damage caused to properties in the Downtown Manhattan Metropolitan area.

On a year-to-date basis, net prior year development was favorable by $40 million, if you exclude development related to Storm Sandy, and was unfavorable by $102 million, including it.

Turning to Slide 9, Commercial's net premium written on a reported basis grew by 5.5% from a year ago or 3.6% excluding foreign exchange and the accounting change for excess of loss reinsurance. We saw growth in property, financial lines and specialty, which all benefited from improved retentions, new business and pricing.

In the U.S., we saw rate increases of 7.3% for the quarter, led by U.S. Casualty, with 9.4%. Property and financial lines in the U.S. reported positive rate of 5.7% and 6.8%, respectively. The market remains modestly more competitive outside of the U.S., but we continue to be encouraged by casualty pricing in the U.S., where rate is most needed. Our efforts to optimize mix, enhance risk selection, claims handling improvements and increased pricing have lowered the accident year loss ratio for Commercial to 62.2%, down over 5 points from the year-ago quarter.

Turning to Slide 10. Consumer net premiums written grew about 5%, excluding foreign exchange and the excess of loss reinsurance accounting change. Accidents and health experienced growth outside the U.S., particularly in individual A&H in Asia Pacific, as well as in direct marketing.

Net premiums written for our direct marketing business grew 5% for the second quarter of 2012 and accounted for 16% of total consumer net premiums written. Consumer acquisition ratios increased a little over 2 points from last year and reflected our investment in the profitable direct marketing channel and other channels. The bulk of these costs are non-deferrable under U.S. GAAP accounting rules. Personal lines benefited from improved margins related to our Japanese auto business and should continue to improve through the remainder of the year.

Slide 11 illustrates our investment portfolio mix. Second quarter net investment increased 14%, reflecting strong performance of equity partnership investments and fair value increases associated with PICC property casualty shares that were purchased during the second quarter and for which we elected the fair value option. As a result of our strong alternative investment return and the PICC gain, net investment income was about $150 million above our expected return.

We made $792 million in dividend payments to AIG Parent in the second quarter, and look forward to contributing our planned dividends to the holding company during the remainder of the year. The second quarter marked continued progress towards increasing the intrinsic value of AIG Property Casualty. Our shift to high-value business, combined with underwriting and claims practice improvements, exemplified how our focus on balancing growth, profitability and risk is helping to produce better margins. We maintain our commitment to capital efficiency and optimizing our risk profile.

As part of our continuing legal entity and capital restructuring efforts, we recently announced the planned merger of AIU and Fuji Fire and Farm Marine companies in Japan. We expect synergies from merging these large companies and will result in improved customer service, greater management efficiency, as well as to provide us with greater capital flexibility and expense savings.

In closing, I'm satisfied with our positive momentum, and I'm confident that the progress we made this quarter will continue.

Turning to Slide 12. Our Mortgage Guaranty business reported operating income of $73 million, which represented another quarter of improved profitability and growth in new business. Delinquency counts continued to fall, and in the second quarter, half of earned premiums related to high-quality business written after 2008. Mortgage Guaranty results for the quarter also benefited from $49 million of income associated with commutations, settlements and reserve releases. We believe UGC is well positioned to take advantage of the mortgage insurance market. The quality of the business written since 2008, improvements in home pricing and increasing home sales should drive future profitability and allow UGC to capitalize on its unique underwriting approach, risk-based pricing and strong capital position.

Now, I'd like to turn it over to Jay.

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

Thank you, Peter, and good morning, everyone. I'm going to begin on Slide 13, where you can see that AIG Life and Retirement delivered solid results this quarter, with operating income of $1.2 billion, up 23% from a year ago. This increase reflects growth in variable annuity fee income, effective spread management and higher investment returns. Premiums and deposits grew 24% from a year ago, largely due to individual variable annuity sales, which exceeded $2 billion in the quarter.

Net investment income increased 5% from the year-ago period driven, primarily, by higher returns in our alternative investment portfolio. Now this was partially offset by an $84 million fair value loss we reported on our investment in PICC Group shares this quarter, which we now hold at slightly above cost.

We continued our strategy of actively managing spreads in our interest-sensitive businesses. Our strong results this quarter enabled us to provide additional liquidity to AIG Parent. And as David mentioned, Life and Retirement paid $545 million in distributions to AIG in the quarter, and $1.9 billion during the first half of the year. We're on track to meet our expected dividend payments for the full year.

Assets under management grew 10% from a year ago, driven by increases across our business lines, with strong account value growth in individual variable annuities and group retirement, as well as additional institutional assets accumulated through our stable value wrap business.

Net flows increased substantially from the prior quarter and the year-ago period, reflecting robust sales of variable annuities and retail mutual funds. With the recent rise in interest rates, we saw the unrealized gain position in our general account partially erode, dampening the increase in AUM in the quarter. Rising interest rates, however, have a positive impact on sales and earnings in our interest-sensitive businesses in particular, which I'll elaborate on later in my comments.

To provide additional insight into the diversity of our businesses, this quarter -- on Page 13, we added disclosure on our assets under management by product line. Our scale and highly diverse business mix provide a strong platform for growth and enable us to perform well in various market environments.

Slide 14 further illustrates the diversity of our businesses based on earnings contribution. The solid performance this quarter reflects favorable trends across both the retail and institutional segments. The growth of our retirement income solutions business is a good example of our ability to be opportunistic while maintaining our pricing and risk management discipline. After significant de-risking of living benefit features beginning back in 2010, we continued to benefit from strong demand for our variable annuity product and remain comfortable with the current trajectory of our sales run rate. At quarter end, our variable annuity account value, including both fixed and separate accounts, was $32 billion in our retail or individual variable annuity business and $52 billion in our group variable annuity business. Because of our large presence in qualified plans in the group business, 69% of our total variable annuity AUM provide only a Guaranteed Minimum Death Benefit, with no guaranteed lifetime benefits. And in addition, 77% of our GMDB by account value is in the lower risk return of premium or roll ups that revert to return of premium at age 70. Of our $22 billion of variable annuities with guaranteed minimum withdrawal benefits, 59% are in benefits with strong de-risking features such as VIX Indexing of fees, volatility control fund requirements and required minimum allocations to fixed accounts. So the combination of our relatively small legacy block and enhanced risk control in our current features has allowed us to capitalize on opportunities when competitors have chosen or been forced to pull back from the market.

Now in addition, this quarter, we introduced a new suite of fixed index annuities with living benefits to further diversify and enhance our guaranteed income offerings. In our interest-sensitive businesses in both the retail and institutional segments, we continued our strategy of active spread management to enhance profitability. And with the recent rise in interest rates, we are seeing an acceleration in sales of our fixed annuities, which we reprice weekly. And we're encouraged by these initial indications, as it remains our view that a moderately rising rate environment will be positive for our operating fundamentals.

Slides 15 and 16 depict our investment portfolio composition, returns and yields. Overall base yields improved slightly in the quarter, benefiting from mortgage loan prepayments and increased accretion income, principally from structured securities. These were partially offset by the impact of investment purchases made at yields lower than the weighted average yield of the existing portfolio.

Our total or reported yield reflects strong alternative investment returns, partially offset by the fair value loss in PICC Group shares, which I mentioned earlier. The net spreads benefited from our active spread management actions, principally the lowering of renewal crediting rates and maintaining disciplined new business pricing. At the end of the second quarter, approximately 74% of our fixed annuity and universal life account values were at minimum guaranteed crediting rates and we remain focused on managing spreads actively.

To sum up, we're pleased with our solid earnings and distributions to parent for the first half the year. We'll remain focused on executing our growth strategies by leveraging our strong relationships with distribution partners to increase profitable sales of our broad product portfolio across all channels, while continuing to look for opportunities to grow our businesses where we can achieve the most attractive risk-adjusted returns.

And now I'll turn it back to Liz to open up the Q&A.

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

Question and Answer

Operator

[Operator Instructions] And we would take our first question from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

As the capital return story unfolds and you get dividends from your subs, maybe ILFC closes, I'm wondering in the conversations you've had with the rating agencies, what kind of mix of debt retirement versus share repurchase are you thinking to keep in good stead with them?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

We've not had that level of conversation. We go to the rating agencies when we have something specific to say we want to do, but as overarching, we continue to focus on. We've taken care of the dividend, doesn't mean we might want to increase that. But our focus is on debt and share buybacks. But David, do you want to comment?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, thanks, Bob. As we think about our capital management, we've discussed in the past a targeted capital structure and we're nearing that optimal mix of debt and capital. We still do have some expensive hybrids out that are of interest to us, but that'll occur over time. We have taken an approach with the agencies, with other various stakeholders with respect to our capital management, that we first raise the deployable capital, get it to the holding company, we then run through a rigorous set of internal stress tests and analytics and then, we consider the best way to deploy the capital. So we do not get out in front of ourselves with respect to spending it before we get it.

Joshua David Shanker
Deutsche Bank AG, Research Division

Understandable. And Peter, can you talk a little bit about where you are in Sandy in terms of approaching the full limit of your, I guess, your deductible for the reinsurance?

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

We haven't disclosed the attachment point on the reinsurance, but suffice it to say that we don't expect to pierce it. But on the other hand, we're not too far from it when you actually look at what we expect it ultimately to be. But in terms of where we are, in terms of the remaining tail, we're about 50% settled and about 1/3 paid cash out the door on the Sandy claims. But there's still a number of repairs underway as we speak. So it'll be probably another quarter before we really get to a final number.

Operator

And we would take our next question from Paul Newsome with Sandler O'Neill.

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

I was wondering if you could go just in a little bit more detail into the steps that allowed you to announce the dividend and the repurchase? And I guess, I'm surprised that you were able to do this before the ILFC transaction. So maybe if you could just talk a little bit more about how that process worked in terms of discussions with the regulators, as well as your own thinking? And what's left that's contingent, if anything, on capital management given the ILFC transaction?

Robert Herman Benmosche

Former Chief Executive Officer, President and Director

I'm not sure I understand the last question. You want to know how much more I'm going to do -- I'm not sure I would give you a specific answer, so let me give you a general answer. The way we did it, I know you're going to think I'm being trite, but I'm not. The fact is, you first get your fundamentals right. Make sure the company is operating well. Make sure all of the buckets of risk have been accounted for. And we have a very -- well, we need to improve our stress testing, we have to improve the systems, improve the process, improve the automation to be much more industrial-strength in terms of what we do. We have a process that we know works well. And so you really need to satisfy yourselves, as a management team, that we can afford to do capital management, that's number one. Number two, we then sit down with the rating agencies and walk them through what we want to do and then, give us their opinion based upon the information we've provided them and the track record we're showing them. And then, we spend considerable time with our Board of Directors, who want to make sure that we're not being premature in some of the things we want to do as a management team. And we've spent a great deal of time with the board, in detail, taking them through our -- the whole capital planning process, taking them through our stress testing. For example, our stress testing is basically modeled using a lot of the information from the Federal Reserve. But as I've said before, when you think about -- and I think it's a shame that America doesn't understand the amount of stress testing that is done at financial institutions to make sure -- forget about being too big to fail, they can't fail because of what they are required to maintain on their books. So for AIG, we go through a process that says, over the planning period of 2013 to '14, what would happen if we underperformed our profit budget by $23 billion? What happens during that same time if the S&P is down close to 700? What happens if the credit aspect of credit spreads, noninterest rate sensitive, but what happens if we have a period of low com[ph] and you pick any other periods you want. And so credit spreads widen dramatically about 400 basis points? And at the same time, what happens if unemployment doesn't go to 10 -- in the 10s but goes to 12.5%? And by the way, if that's not enough, what would happen to AIG if, in fact, housing prices were to drop 20% from here, knowing the amount of mortgages we have on our books, plus the mortgage insurance businesses as well? And by the way, since you're an insurance company, why don't you throw in Storm Sandy in there and make sure that you've got enough money to cover that storm at the same time? That's, in English, what a stress test is. And I've given it to you at 10,000 feet. And we showed the board that after all of that, we could maintain our CMA levels, maintain the risk-based capital in this company at those levels which are required for our ratings, I would think if that kind of scenario occurred, the states would be really pleased that we could at least meet our minimum regulatory requirements and work our way back up. We're not talking about minimums, we're talking about the CMA levels. And so based upon that, the board said we think it's sound for you to, at this time, proceed with your dividend and proceed with $1 billion share buyback. If ILFC closes or when ILFC closes, the board and -- will look at what we prepare, we will then update our stress test, update the information. We will share it with the board, we will share it with the rating agencies and based upon all of that, the board will make a decision. And so that's how the process works. I know people are asking, "Well, did the Fed approve?" But the Fed does not approve these things. The Fed oversees what we're doing and if the Fed felt, at any point in time, that we're doing something as a savings and loan holding company, they would go and say, "Look, I think you're being imprudent." But they don't approve things. Once we get under the CCAR test, however, then they will, in fact, look at our CCAR, look at the amount of capital we have and look at the process we have in place to calculate that information. And based upon the quality of our systems, and we have a runway to get there and we're working hard along that runway and that's why we wanted to -- actually, people said, "Are you nuts? Why would you want to start early?" It's because you want to get prepared so that you have an acceptable process. And it's a repeatable process such that the Fed is very comfortable that not only do you have numbers that say you're okay, but you have a process that says your numbers are okay. And that's all what we're working towards, and that's something at the end of '14 and into early '15. But for now it's making sure we'd live with the first half of what I've said and that is, we run the company in the right way and we're being prudent. Long-winded answer, I apoloize, but I know a lot of you are trying to figure out what happened here. And it's what we said all along, when we're ready we will.

Operator

And we would take our next question from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. I guess just to follow-up on that last one. So while the Fed didn't explicitly approve this, you obviously had discussions with them prior to making this announcement.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

We informed the Fed of everything we're doing, of any consequence so that they are aware of any issues we have that they -- so they don't read about it in the paper. And so yes, they're our regulator. They're aware of all of our -- they're in many of our meetings, they are in many of my leadership meetings attending. So this is important, that you keep your regulator understanding what you're doing and you are very transparent with that regulator. And so they're aware of not only this but everything else we're doing. And by the way, Jay, the key is the rating agencies. And that's where, right now, that's where we go and if the rating agencies said, "We're having some concern with what you're doing," I can assure you, we would not have done it.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Exactly. Second question, I know the details of any prior year development will come out in the Q. But Peter, I'm wondering if you could talk, excluding Sandy, the Sandy development, what you saw? Were there any particular lines where there was material adverse development?

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

No, it was very benign. Everything was immaterial in the context of our results. So I don't know whether, John, you have any bigger comments?

John Doyle

Yes, I certainly agree with the way Peter described it. We had some movement up and down, I guess, within Casualty. Some loss sensitive adjustments that were offset by premium accruals. But outside of that, we had a bit of adverse development in a construction defect-related claims out of the program that's been in runoff for a number of years, largely around legal expenses. But inconsequential, immaterial, relative to the total.

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

And we had -- a slight favorable in Japan consumer.

Operator

And we would take our next question from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Can you give us a sense of how long you think it would take to complete the $1 billion buyback authorization?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I would appreciate giving you all advanced notice, but we will continue to do what's prudent and we'll continue to evaluate different options and different techniques. And so for now we'll let you know when we're done, and we'll keep you posted as we buyback and what the average price per share is.

Jay H. Gelb
Barclays PLC, Research Division

In terms of future buybacks on top of this authorization, is there anything -- does the sale or IPO of ILFC need to be complete before we can expect additional buybacks to this authorization?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

What I said when I was asked the other question, we look at our capital, we look at our results, we look at how we are faring, we do our stress testing. We update our stress testing throughout the year and we would continue to do what we think is prudent for AIG. And so if ILFC were to close, and depending upon what kind of transaction we do, we would factor that into our thinking.

Jay H. Gelb
Barclays PLC, Research Division

Okay. And then for Peter. Based on the first half results, it still appears that there's 5 to 10 points of combined ratio improvement that's needed to get to that 90% to 95% calendar year goal by 2015. What's your confidence level in achieving that?

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

Well, I think that I sort of listed out the various initiatives that have led to the trend in accident year loss ratio improvement that we've had now for 10 quarters. And I think that there's no sign that any of those initiatives are sort of experiencing diminishing returns. So eventually, obviously, we will experience diminishing returns, but we're making good progress on all of them. The actuaries take time to recognize initiatives that are emerging in the loss triangles but may not be confirmed with enough statistical significance yet. So we have sort of some line of sight into the sort of future momentum. Obviously, pricing is outside of our control, but again, as I mentioned, where we felt there was the greatest pricing inadequacy in the U.S. casualty lines, we continue to see quite good pricing trends. And in Europe, where the pricing has been a bit softer, we already had pretty decent adequacy. So I see no change in my level of confidence that we will accomplish that target.

Jay H. Gelb
Barclays PLC, Research Division

Right. And then, in the meantime, does that also mean you have confidence in the adequacy of AIG's overall Property Casualty reserve position?

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

Yes.

Operator

And we would take our next question from Jamie Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

The first question is on the P&C business. Your expense ratio picked up a little bit sequentially. And I think you've talked in the past about expenses being elevated in the near term as you're investing in the business, but then starting to improve sometime in 2014 and beyond. Are you still comfortable with that? And then, on the ILFC transaction, I don't think there is a breakup fee. And when you talk about deconsolidation -- deconsolidating trade, I'm assuming you're implying over a 50% sale, but I just want to make sure that, that's correct? And the last question is on the fixed annuity business. We've seen industry sales improve as rates have gone up. Your sales, sequentially, were actually down and your surrenders were up, not sure if that because the block is aging or what's going on there?

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

Well, as I've said before on expenses, yes, we are spending on infrastructure and a number of analytical resources, data improvements that are integral to our improved risk selection and claims handling. And so we're seeing benefits in the loss ratio, offset by increases in the GOE ratio. And we continue to invest in acquisition costs. So the overall expense ratio remains elevated. I have expected GOE ratio to come down, as you point out, in the sort of mid-2014 period. And so a lot of the heavy lifting in terms of investments will start to tail off in that period. The one area that I would point out where there may be slightly more delayed expense benefits is what I announced in the comments earlier, which is the merger savings between AIU and Fuji Fire and Marine, which is a very substantial merger integration effort that will take some time to do because -- to execute because of the sheer scale of it. It's, between the 2 companies, almost 6,000 people, so very substantial.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Jay, why don't you cover the fixed annuity comment? And then, turn it over to David who will finish up with the question on ILFC.

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

Great, thanks. And Jimmy, I think your presumption is correct. Being the largest in the fixed annuities, we probably have the biggest book and the block is aging. And that's, as expected, leading to higher surrenders, which because the vast majority of those surrenders are from contracts with high guaranteed minimum interest rates, 3% and above in some cases, that's actually a very good thing from a profitability standpoint. We did see some interesting competitors come in early in the quarter and increased their sales. We stuck with our pricing discipline, as we always do. And having said that, late in the quarter and through the month of July, as I mentioned earlier, we have begun to see an acceleration in sales of fixed annuities now that rates have spiked up. So the block is behaving as expected and again, the vast majority of what's surrendering is at high guaranteed minimum interest rates.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I would just follow up -- and we've said this, I believe, on a previous call and that is, that Jay and his team are holding to a very strong discipline because when you think about rising interest rates, and I don't need to -- if you look at book values this quarter, you all understand it clearly, of what can happen with rising interest rates. You don't want to have a very tightly priced fixed annuity book sitting at these rates right now. And if you do see a couple of hundred basis points rise, that would be very helpful for AIG and for Jay's business. But if you have a large block of low interest rate annuities, fixed annuities in that kind of environment, you could see some extensive dis-intermediation. And so part of our hedging strategy is to make sure we don't have an oversized book at these levels that we have to worry about rates going up and what happens to that block. So I think right now we see rising interest rates, at least, for the first couple of hundred basis points, as a big positive for the company.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

And Jimmy, it's David. With respect to your ILFC question, as I've said in my remarks, ILFC is a noncore asset. And we will pursue our plan to dispose of it, either through a sale or through an IPO. And with respect to the sale, again -- and you would ask about the breakup fee, the deposit is not a breakup fee but you could -- we will protect our rights to that deposit. So that's all I would say with respect to that. Then, with respect to the 51%, yes, that is the level at which we de-consolidate and we, of course, would evaluate market conditions and valuations, et cetera, at the time of an IPO to optimize the value of that monetization for the benefit of AIG and our stakeholders. So we haven't set any sort of a notion, but we'll optimize the value.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And then, protecting, I don't understand what protecting the rights on the deposits means. Maybe you could just...

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Well, we just -- I'm not going to say any more than that, just we'll protect them. It's not a breakup fee, which was your question. And we'll pursue our rights under the terms of the contract.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

All right, that's what I thought. And maybe if I can just ask one more. I think Peter mentioned that the actuaries are being somewhat conservative in their loss fix so I'm assuming that that's implying that there's some level of cushion in your reserving. Is that the right read? And if that is the case, then, how do you reconcile that with the fact that if you look at the last 6 quarters, you've had -- I think 4 of those quarters, where you've had actually adverse development?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

What he said was, what he said was -- let me be really clear, that until you see the emergence of a pattern that the actuaries are comfortable with, is not a short-term lift but in fact, that's what we call vectors in math. But you tend to look at it over an extended period of time so you'll have a clear pattern. Until that emerges, they're not going to make some early judgments. The judgments they make are what they believe is the best estimate and the most accurate estimate based on the data that they're seeing. So they want to see more of the reservable period before they make any judgment. So that's what he said. And so don't misinterpret it.

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

And I'd also add that the reserve adjustments that you witnessed in the last 2.5 years have been largely related to older accident years. And I've been talking about accident year loss ratios and the impact of new underwriting guidelines and risk selection techniques. So they will take longer to emerge, and so I think they're really separate issues.

Operator

And we would take our next question from Josh Stirling with Sanford Bernstein.

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

So a question on capital returns. When you began this journey, you guided to $25 billion to $30 billion of capital management, so I'm -- rough math, I think you're somewhere around $9 billion to $14 billion remaining by 2015. As you're now finally being allowed to act like a normal company, should investors expect measured regular and recurring buybacks like we see at your peers, or is this something where we should expect this to be opportunistic and episodic as we've seen over the couple of couple of years?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I'm going to turn it over to David, but I would say that our first -- and really, we said dividend capital management, but our first priority is to find businesses that may be strategic and make sense for AIG and are not closed blocks but growing blocks. So we like to continue to invest our money in those businesses. We're going to continue to look at the best way to deploy our capital with the stock price as you saw last night, where it's got, and you have our book value and you see what's going on. Obviously, as you get closer and closer to book, you want to think more carefully about what you're doing -- if you get over booked, you think a lot about what you want to do. So I think all of that as an overarching concept which is not new to any of you. David, why don't you talk about the particulars on our aspirational goals?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, sure. Thanks, Josh. And just, again, to recap, we've done a total to-date of about -- a little over $18 billion, with the $13 billion of equity we did last year, equity buyback. A little over $3 billion of debt capital management going after some of the callable, very expensive hybrids. The recent share buyback we just announced on the authorization and then, a couple of years' worth of the dividend, they sort of add up to $18 billion. And you're right, it's -- so we've got $7 billion to $12 billion to go and I think what the -- the fundamental foundation, as we've said, is we've raised the deployable capital to the holding company, and a very important part of that is the dividend flows that both Jay and Peter referred to, is raise the deployable capital. In addition to that, we have the ILFC proceeds that will -- that are unencumbered at the holding company. And I also referenced in my comments about the tax sharing payments that in '14, should be in the $1 billion range and they grow from there, and they are annual after that. So you can see a path, and we can see a path, to raising the deployable capital and the net of that is input to the framework that Bob laid out in terms of how we and how the board and the various stakeholders think about how we go about deployment.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

It could be lumpy.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, it's likely going to -- again, it's going to be opportunistic as we have done in the past. It going -- we will be prudent. And I think Bob laid out a very clear framework for how we think about it and how you should think about it.

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

That's helpful. If I might switch to Peter. You guys have made, really, some relatively dramatic progress actually in your loss ratios, in combined ratios, in P&C, Commercial, and it's great to see that playing out. The question I would ask is as you sort of continue the journey to get to low 90s combined ratio, the Consumer lines don't seem to be sort of going the same direction. And it looks like maybe there's some noise in the quarter, but just generally, I wonder if you can give us some more color on the relative magnitude of some of the key levers and sort of how you think about the status of the initiatives on that side of the house?

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

Sure. So the big noise in the quarter is the yen exchange rate. So that there's a very, very big portion of our Consumer business in Japan, and so you need to strip that out before you even think about it. There's, I think, some significant opportunities in Japan to improve profitability, as we talked about, in terms of both the expenses but also, as we sort of reinvigorate the brand in Japan. So outside of Japan, there's another sort of one-off item that came through the loss ratio but not net income, which is in one very large extended warranty program, where there is an offsetting profit-sharing agreement that is not an issue of geography on the income statement. So that's a one-off adjustment you need to make when you look at the loss ratio in the second quarter. And beyond that, I think that the emerging market story is very positive in terms of long-term profitability and growth. But the startup costs of that are quite substantial, so that adds to the expense ratio. And we talked many times about the direct marketing business, which we feel has excellent lifetime profitability over customer relationships, but has pretty unfavorable GAAP accounting. So we want to take a measured approach to how much of that we do, but we'd like it from a marginal ROE point of view over the lifetime of the customer relations based on the persistency that we've been seeing in that book. And so we'll be doing that in a number of additional countries. So I think, in general, we see continued growth in consumer. I think we have opportunities to focus more than we do today. We operate in 90 countries and so I think that, that will bring some efficiency gains and the convergence to common technology platforms will make it also more efficient.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Operator, I think since we're getting close to 9:00, we'll only be able to take one more question, but please reach out after the call with your additional questions and we will certainly do our best to follow up as soon as possible.

Operator

And we'll take our final question from Mark Finkelstein with Evercore.

A. Mark Finkelstein
Evercore ISI, Research Division

Maybe I'll start with Peter on International Commercial. The numbers were just a little bit lighter than I had expected, maybe user error. But I guess, the way I would frame up the question is, and I get the point about kind of less need for rate than you have in North America. But are you satisfied with these margins? And do you feel like you need to improve them on a core basis in terms of achieving your overall targets?

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

I think, again, there's a little bit of a foreign exchange element in terms of the top line there. And there is continued opportunities for streamlining our technology and reaping the full benefits of legal entity consolidation. As you may know, at the end of last year, we consolidated all 25 European countries into 1 legal entity. And that's starting to give us efficiencies, but on the capital efficiency, that hasn't fully come through. But in general, the International business has a better ROE because of its shorter tail, less dependent on investment income. And I'd say that the success of our Property business, Commercial Property business internationally has been very pleasing. We're seeing a good take-up rate of our highly engineered property activities, further diversifying our book away from over-concentration in U.S. Commercial Property. So I don't know whether, John, you want to elaborate on your level of satisfaction with the International operations?

John Doyle

Yes, I see an opportunity for us to continue to grow that business. Peter mentioned the FX pressure from Japan that, obviously, had an impact on the top line in the quarter. But we saw, outside of Japan, the rest of Asia, 18% growth in the quarter; Middle East and Africa, 19% growth; 27% growth in Latin America. Obviously, those are smaller parts of our overall Commercial Insurance franchise. And in terms of pricing or rate adequacy, on a major line basis, right? So if you think of it from a Property, Casualty, financial lines and specialty point of view, all of our major regions outside of the United States in those major lines cover the cost to capital currently. There are some opportunities for margin improvement. And obviously, there are some smaller lines that, in any given jurisdiction, have some profitability challenges that we'll always be dealing with. There were some cats in the quarter right, as well, I mean, Argentina, a modest amount; in Australia and then the flooding in Europe as well. So all of those events had an impact on the bottom line in the quarter. So we think we're very well positioned outside of the United States and inside the United States. But we see good opportunities for profitable growth all throughout the rest of the world.

A. Mark Finkelstein
Evercore ISI, Research Division

Okay. Maybe a question on the DIB. I think every quarter, I look at the model and what you guys produced in at least for the last 4 or 5, I feel like the DIB has beat my expectations pretty widely in a lot of cases. And I guess, you've got 80% of the maturities coming within 2018, I think you said. Maybe the way to ask the question is, how far do you think we are from that so-called intrinsic value? And is there any framework for how to think about DIB earnings going forward?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Brian, you want to cover that for us as we close down the call?

Brian T. Schreiber
Former Chief Strategy Officer, Head of Corporate Mktg & Communications and Executive VP

Sure, I'd be happy to. And again, the performance of the DIB is not going to be linear. We've had market conditions that have allowed us to recognize the gains you've seen over the last few quarters. And as we talked about it, we gave some rough idea as to what we think the pull to intrinsic is. At the end of the last quarter, we said it was around $5 billion, a little under $5 billion. We had approximately $750 million or so of gains and we've also sold some assets in the DIB to the operating companies. So those gains in the sale of those assets reduced that future upside. So if you think about it now, at around $4.1 billion, $4.2 billion, that's probably where we are. But another way to think about it is, if you look at the DIB capital, the NAV of the DIB and you look at the composition of the assets, you could think about it as having roughly a 10% return on that capital over time. And again, that's probably the simplest way to think about if you're trying to model. And this will come in again, over time, we could have down quarters -- again, a lot of it depends on the markets but I think, from the sort of 2018 period forward, you're probably looking at 6 to 8 years before you see a bulk of that capital start freeing up and coming through.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Okay. Thank you, everyone, again for joining us this morning. And certainly, if you have any follow-up questions, please reach out. We look forward to speaking with you next quarter.

Operator
And that does conclude today's conference. Ladies and gentlemen, we'd like to thank you for your participation. You may now disconnect.