S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ1 2017 Earnings Call Transcripts

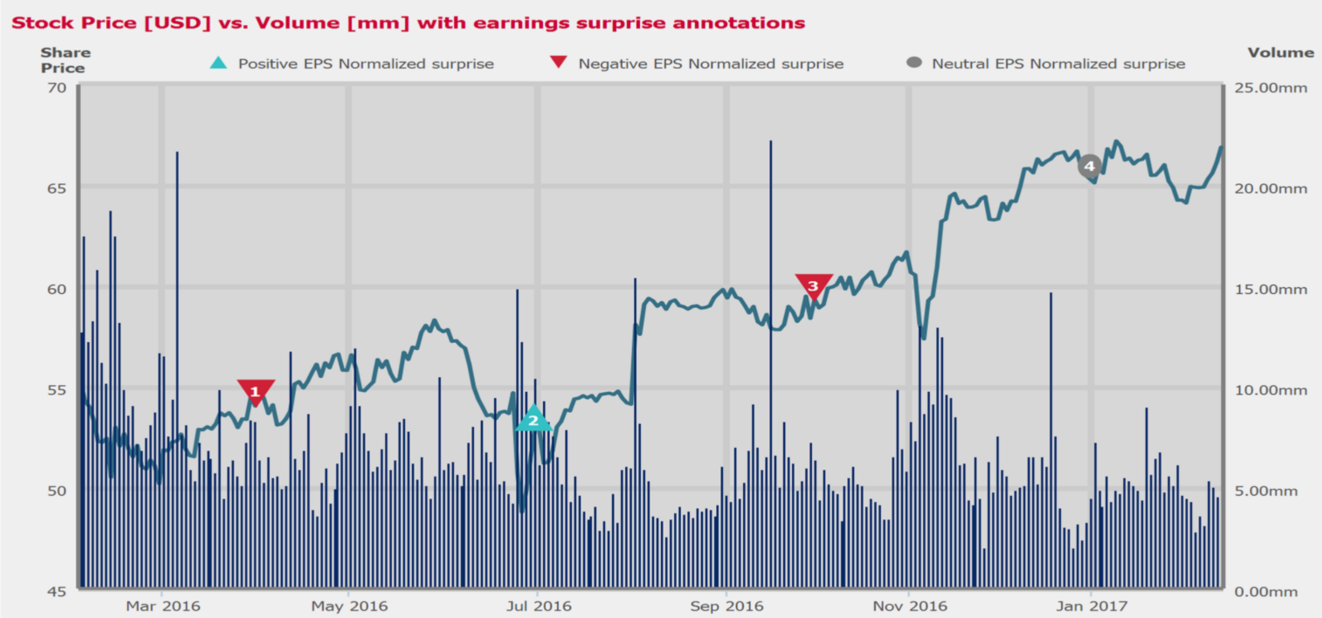
Thursday, May 04, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2017-			-FQ2 2017-	-FY 2017-	-FY 2018-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.07	1.36	▲27.10	1.19	4.83	5.79
Revenue (mm)	11326.00	12632.00	▲11.53	11179.00	48706.00	48622.00

Currency: USD

Consensus as of May-04-2017 1:10 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2016	1.00	0.65	▼1 (35.00 %)
FQ2 2016	0.94	0.98	▲2 4.26 %
FQ3 2016	1.21	1.00	▼3 (17.36 %)
FQ4 2016	(0.57)	(2.72)	NM

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Presentation

Operator

Good day, and welcome to the AIG's First 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. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Chris, and good morning, everyone. Before we begin, 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 performances and events may differ possibly materially from such forward-looking statements. Factors that could cause this include the factors described in our first quarter 10-Q to be filed later today and our 2016 Form 10-K under Management's Discussion and Analysis of Financial Conditions and Results of Operations and under Risk Factors. AIG is not under any obligation and disclaims any obligation to update any forward-looking statement, 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 of today's presentation and our financial supplements, both of which are available on our website.

The purpose of this morning's call is to speak to our quarterly results and our strategy. We appreciate and understand your interest in the status of our CEO succession process, and reiterate that the board is highly focused on the search. Today's call, however, will not be addressing any questions related to that search process.

The format for today's Q&A will be consistent with past calls with one question and one follow-up. At this time, I'd like to introduce our speakers, who are also joined by other members of management in the room. Peter Hancock, our CEO, will begin today's remarks; followed by Sid Sankaran, CFO; Rob Schimek, CEO of Commercial; and Kevin Hogan, CEO of Consumer.

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

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

Thank you, Liz, and good morning, everyone. Today, I'll speak to our strong financial results and key accomplishments from the quarter and our continued progress on the 2-year strategy outlined in January 2016.

The transformative actions we took over the last year was guided by our focus on building a sustainable business model and prioritizing intrinsic value by maintaining a disciplined balance between long-term growth, current profitability and enterprise risk. This quarter shows that our actions are delivering results, and we see momentum across all our core businesses.

Let me begin by first recognizing a few notable accomplishments in the quarter. Our Japan team completed significant preparation for our legal entity merger. And on April 1, we began operating our P&C business on a consolidated basis under FSA-approved premerger structure. We also closed on the sales of Fuji Life and certain insurance operations we sold to Fairfax.

Our investments team efficiently monetized $10 billion of general account assets to fund the premium associated with our ADC transaction with Berkshire Hathaway, and I'm pleased that we received the permitted practice to record the ADC agreement in 2016 for statutory reporting purposes.

Our London team completed a thorough Brexit analysis, and we announced our strategy to position us for a seamless transition in serving the European market. In each instance, execution was exceptional.

I also would like to note that we achieved our 2-year expense reduction target of $1.4 billion 3 quarters ahead of schedule. While discipline around expense management remains a priority, we continue to invest in our infrastructure and our talent, with a focus on AIG's long-term future.

AIG's talent base remains strong. Our employee retention rate is the same or better than it's been in the last 4 years, including for our top-performing employees and for those in key roles. We continue to attract top talent from other organizations, as we select from almost 800 applicants every day.

We're also pleased that our client retention remains at its historical high for major accounts.

In the first quarter, our core adjusted return on equity was 10.2%. Even after normalizing our results for strong investment returns and lower-than-expected catastrophes, our core normalized return on equity was 8.7%. We're on track to reach our full year 9.5% target. We remain committed to improving the profitability and intrinsic value of our core insurance businesses, which we now present in much greater detail in our modular reporting, reflecting our focus on transparency and accountability. We remain confident in our $25 billion capital return target, which implies an additional $7 billion in share repurchases and dividends for the remainder of the year.

As a reminder, we stated last quarter that the engagement of our rating agencies and regulators is critical to the successful transformation of AIG, and we will continue to work closely with them to serve all our stakeholders. Importantly, we believe the sustainability of our future earnings has improved meaningfully as a result of our previously announced agreement with Berkshire and the continued execution of our strategy.

Sid will provide more insight on the economics and accounting associated with the ADC agreement, which will provide benefits for many years to come through a lower risk of impairments to book value, higher earnings quality and, ultimately, a lower cost of capital.

The first quarter highlighted progress towards our financial targets while maintaining focus on delivering value to our clients. Rob will speak to the important feedback we received from our commercial clients at RIMS, and Kevin will provide an update on our diverse consumer businesses that are a source of valuable earnings stability for AIG. I'm very proud of the work accomplished by our talented team of AIG colleagues.

And with that, I'll now hand the call over to Sid Sankaran to discuss the financials.

Siddhartha Sankaran
Executive VP & CFO

Thank you, Peter, and good morning, everyone. This morning, I'll comment on our first quarter financial results, the impact of our Adverse Development Cover and capital return.

Turning to Slide 4. We reported operating earnings of $1.36 per share, driven by strong operating performance, favorable alternative investment return and lower-than-expected CAT losses. The quarter included a previously disclosed $102 million charge for the Ogden discount rate, which was reported as prior year adverse reserve development. This charge was partially offset by the $41 million amortization of our ADC net gain and $35 million in favorable reserve development for our Property and Special Risks segment.

Excluding Ogden and the amortization, there was no net reserve development of note in our long-tail liability in Financial Lines. Strong alternative investment performance and favorable equity markets benefited our headline commercial and consumer result. Even taking into account these excess investment returns, prior-year development and lower CAT, our normalized earnings were $1.15 per share.

Slide 5 presents the changes in our core normalized ROE year-over-year, which improved 120 basis points on an apples-to-apples basis. This comparison reflects the impact of the increase in commercial insurance loss pick in the second half of 2016 that would have resulted in a 100-basis-point ROE reduction, as they've been pushed back to January 1 of last year.

There was also a 50-basis-point benefit in the year-ago quarter from a favorable tax audit settlement. Our continued active capital management and operating improvements drove over 250 basis points of core ROE improvement year-over-year. Partially offsetting this improvement was the earnings impact of a decline in the size of our alternative investments portfolio and the sale of UGC, which reduced ROE by 110 basis points. These actions reduced our overall risk exposure, contributing to a lower cost of capital.

Going forward, we believe the continued benefits of our capital return, expense reductions and improved underwriting provide a path towards achieving our 9.5% core ROE target.

Slide 6 illustrates our continued discipline around operating expenses, which we reduced 10% year-over-year in constant dollars and excluding divestitures. We also recorded an additional nonoperating pretax restructuring charge of $181 million in the quarter, which was primarily comprised of employee severance charges. While we've achieved our targeted $1.4 billion in expense reduction well ahead of schedule, we remain committed to further efficiency.

Moving on to reserves. Actual versus expected claim activity was favorable this quarter, and we're comfortable with current trends. In particular, we are encouraged by the quarter's better-than-expected claims trends for primary workers' comp and excess casualty.

I'd also note that reserves covered by the ADC remained stable from year-end.

On Slide 7, we provided the accounting for the ADC in the quarter and in the future. The amortization of the previously disclosed $2.6 billion gain will be part of our operating earnings and will amount to approximately $60 million of quarterly favorable development. In the event of additional prior-year development, either favorable or adverse on the covered reserves, 20% will be reported in operating earnings, and 80% is reported below the line as an adjustment to the deferred gain, which is consistent with the economics of the ADC.

The ADC provides an approximately $5 billion reduction in commercial's economic capital. After considering last quarters after-tax reserve charge, we anticipate capital of approximately $2 billion will be freed up over time.

Later in the call, you'll hear from Rob as to how the ADC affected the ROE of the liability and Financial Lines segment.

Our balance sheet and free cash flow remain very strong. And as you can see on Slide 8, current liquidity at quarter-end was $7.3 billion. During the quarter, we received $2.8 billion of distributions from our insurance companies, which were largely related to $2.6 billion of tax payments from the life companies associated with the XXX/AXXX life reinsurance agreement entered into at the end of the year.

In April, we also received approximately $390 million of dividends from our life insurance company that had been declared during the first quarter.

In our Legacy segment, we sold 460 life settlements contracts, representing approximately 14% of the remaining death benefit. These sales did not have a net impact on current liquidity, as the proceeds were used to pay down the related intercompany loan. We ended the quarter with a carrying value on the remaining life settlements portfolio of $2.1 billion and a remaining loan balance of approximately $850 million following the completion of this sale.

Cumulative capital release and cash flow from Legacy have exceeded our expectations. We are well on track to release an additional $1.9 billion of Legacy capital to reach our 2-year $9 billion target.

We continue to execute against our capital return target and returned $3.9 billion of capital to shareholders in the quarter. From quarter-end through May 3, we repurchased an additional $1.1 billion of common shares, leaving about $3.8 billion unused under our remaining authorizations. Note, this figure includes yesterday's additional $2.5 billion authorization.

Through May 3, we have returned $18.1 billion to shareholders towards our $25 billion target. We will continue to return capital to shareholders prudently, and with appropriate quarterly consultation with rating agencies and regulators.

Looking to the full year, we expect dividends from our insurance subsidiaries to total $4.5 billion, inclusive of the dividends received thus far. We also expect tax-sharing payments of approximately $3 billion, including the tax payments received during the first quarter. Tax payments are slightly below our original projections, reflecting a tax payment reconciliation to be made to the Property Casualty company related to the fourth quarter 2016 reserve strengthening. This shortfall has been offset by higher cash from dispositions and Legacy.

Capital ratios in our insurance subsidiaries continue to be strong. The year-end 2016 RBC ratio for the fleet of U.S. life companies was 509%. Following the completion of the life reinsurance transaction, the ratio of the parent company, AGC Life, is a good representation of the regulatory capitalization of its life subsidiary. The year-end 2016 RBC ratio for domestic P&C companies was 411% after giving effect to the permitted practice of recording the ADC at year-end.

Turning to Slide 9. Book value per share ex-AOCI grew 2% during the quarter, and was up 1% on an adjusted basis. We continue to expect improving core book value per share growth and greater book value stability given the ADC. But as I've said before, we make trade-offs with respect to Legacy in terms of recognizing immediate book value charges for future improvement and intrinsic value.

To sum up, we continue to execute on our strategy and expect to reach our 2017 financial targets. The modular reporting provides our businesses with transparency, and our business leaders are focused on managing for value and sustainable earnings growth, as evidenced by the ROE improvement across our modules. Our strong balance sheet, liquidity position, improving core earnings and free cash flow profile distinguish us from others in our industry and leave us extremely well positioned for the future.

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

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

Thank you, Sid, and good morning, everyone. During the first quarter, we continued to take significant actions to improve commercial's underwriting performance. Today, I will discuss our decisions to prioritize intrinsic value, our confidence in achieving our goals and areas of focus for the remainder of the year.

Turning to Slide 11, commercial's normalized ROE increased from 6% for the full year 2016 to 6.3% for the first quarter of 2017, reflecting improving performance in many of our businesses, expense management and better investment returns. The improvement was partially offset by discrete tax items in liability and Financial Lines, which increased commercial's first quarter effective tax rate to 36% compared to the 31% effective tax rate that we still expect for the full year. Commercial's ROE improvement does not yet include the full $5.1 billion capital benefit derived from the Adverse Development Cover, which closed during the quarter. We're confident that second quarter normalized ROE will continue to improve, reflecting the reversal of the tax item over the remainder of the year and the capital benefit of the ADC for the entire quarter. We've taken actions to reduce volatility and capital consumption in line with our emphasis on improving overall economic value for our stakeholders. Some examples of where we've prioritized value creation over improving the adjusted accident year loss ratio include the sale of Ascot, reduction of the attachment points for our property CAT program and a more conservative loss pick for U.S. Casualty.

While value creation is our primary objective, we remain focused on delivering our adjusted accident year loss ratio target.

During the quarter, commercial's adjusted accident year combined ratio of 95.8% improved 1.8 points after adjusting the first quarter of 2016 for the increase in loss picks recorded in the second half of last year. We reduced net premiums written by 14%, excluding foreign exchange and divestitures. 4% of the decline was related to the increased use of reinsurance and property. The remaining 10% of the decline was driven by the growing momentum of our underwriting strategy, particularly in Continental Europe, where approximately 45% of the business renews on January 1. Having completed a full year of our underwriting strategy, we expect our rate of change in premiums to moderate for the remainder of the year.

Moving to expenses. We delivered $283 million in savings over the prior-year quarter. The acquisition ratio benefited from the sale of Ascot, a high-commission business, and ceding commissions from reinsurers. Effective expense management has provided us with the confidence that our bench ratio will remain competitive, even as net premiums earned decline following our underwriting actions.

While we've been disciplined in our spending, we have also prioritized the development of key infrastructure. Investments in our attractive and growing multinational business has delivered a comprehensive technology platform, improved client service levels in over 10,000 multinational programs and the issuance of over 2,000 underlying policies at or prior to the inception date in 90 countries during this quarter alone.

Turning to Slide 12. We focused on mix of business to improve our underwriting results, having reduced U.S. Casualty net premiums from a peak of approximately $15 billion in 2004 to approximately $3 billion at year-end 2016. More recently, we focused on improving risk selection at the policy level using increasingly sophisticated pricing tools. Our sector and risk selection strategies, coupled with more conservative U.S. casualty loss picks, have laid the foundation for sustainable future earnings.

Commercial's first quarter adjusted accident year loss ratio of 65.5% improved 1.2 points from the full year 2016 and 2.2 points from the prior-year quarter after adjusting the first quarter of 2016 for the increase in loss picks. We continue to be focused on our 4.7 point-adjusted accident year loss ratio improvement target on a fourth quarter 2017 exit run-rate basis and expect approximately 3 of those points to be driven by business mix changes that have already been executed.

On Slide 13, we presented the dispersion chart that we established to provide a view of improvements in business mix over the course of our 2-year strategy. I'll make 3 observations for you. First, the quality of our premiums written has continued to improve, which we saw for the full year in 2016 and now in the first quarter of 2017. Today, grow and maintain business represents 62% of the commercial portfolio, with an adjusted accident year loss ratio of 55%.

Second, the premiums we earned in 2016 were heavily influenced by the business we wrote in 2015, which preceded the inception of our 2-year plan. For those lines where we actively reduced our 2016 volumes, such as U.S. Casualty, 2015 premiums had an even more disproportionate effect on earnings.

Third, over time, our higher-quality 2016 and 2017 business will earn into our results, which we're confident will yield an improved adjusted accident year loss ratio.

Shifting to the bottom of the slide. In addition to improving the quality of the business we're writing, we've also reduced the CAT risk within the portfolio. Our average annual loss expectation for CAT declined by $200 million between 2015 and 2017, and we expect capital consumed related to CAT risk to decline by $600 million in 2017. That improvement is part of an ongoing effort to focus not just on the adjusted accident year loss ratio, which excludes CAT, but on the overall economic result for AIG.

Notwithstanding the significant amount of change that we've implemented, we continue to be regarded as a leading underwriter and business partner for our clients. During the recent RIMS conference, we were recognized by our clients as the #1 carrier in 12 out of 20 product lines in the 2017 National Underwriter Risk Manager Choice Awards, a strong recognition of our commitment to the market, partnership with our clients and the underwriting talent of this organization.

Turning to Slide 14. The liability and Financial Lines normalized ROE of 7.7% includes 100 basis points of adverse impact from the discrete tax items that are expected to reverse over the remainder of the year, and does not yet include the full $5.1 billion capital benefit of the ADC. We're confident that second quarter normalized ROE will improve as a result of the reversal of the tax item and the full benefit of the ADC, providing a clearer view of the profitable Financial Lines business and the significant contribution of investment income to long-tail lines. The adjusted accident year loss ratio of 72.5% improved 0.8 points versus the full year 2016 and 2.4 points versus the prior-year quarter after adjusting the first quarter 2016 for the increase in loss picks.

As Sid mentioned, quarterly claims trends were favorable in contrast to last year's adverse trends, particularly in primary workers' compensation and excess casualty.

We experienced growth in profitable Financial Lines segments, including cyber, offset by targeted risk selection in U.S. Casualty. We continued practicing pricing discipline in U.S. Casualty, with the first quarter representing the sixth consecutive quarter of rate increases in excess of 3 points. Financial Lines rates were relatively flat in both the U.S. and globally.

Moving to Slide 15. During our fourth quarter call, we outlined the actions to address the profitability challenges in Property and Special Risks. The first quarter normalized ROE of 3.5% continues to be below our target, which shows a meaningful improvement in performance that we expect will continue. First quarter CAT losses were better than our average annual loss expectation and prior year, reflecting our efforts to deemphasize our U.S. Excess and Surplus Lines business, as we've shifted towards less CAT-prone international property and more highly engineered large limit and middle-market risk.

First quarter severe losses were at the lowest level in the past 15 quarters, reflecting the proactive decision to be made to expand reinsurance, investments in engineering and underwriting actions to address accounts with disproportionate amount of risk. We are pleased that the severe loss ratio declined from 5.7 points in the prior-year quarter to 2.5 points this quarter. While we do not expect severe loss activity to be consistent on a quarterly basis, we do believe loss experience will improve versus trends in recent years as a result of our efforts to mitigate volatility.

Turning to top line. Property and Special Risks net premium written declined 20%, excluding foreign exchange and divestitures. Property reinsurance and underwriting discipline were the 2 primary drivers of the change accounting for 9% and 11% of the decline, respectively. While U.S. Property rate declines of approximately 2% moderated somewhat during the quarter, competition continued to be driven by the Excess and Surplus Lines business.

Our business mix strategy remains heavily focused on growth in our engineered large limit and middle-market segments and in our profitable specialty businesses, such as credit line.

In closing, I'm pleased with the progress we've demonstrated improving the mix and underlying performance of the commercial business during the first quarter. Our team is executing well, and I'm confident that we've taken significant actions that will continue to be reflected in our results over the remainder of the year.

With that, I'll turn the call over to Kevin.

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

Thank you, Rob, and good morning, everyone. As you can see, on Slide 17, consumer produced strong results for the quarter. We earned over $1 billion in pretax operating income and expanded normalized ROE to 10.9%.

We continued to take actions in each of our modules and key geographic areas to create value. In individual retirement, we faced a challenging sales environment due to DOL uncertainty and aggressive competition in certain product lines. We maintained our discipline and focused on value over volume. We are not dependent on any one product type due to our top-tier market position across annuity lines.

For our Group Retirement business, VALIC, our investments to transform the plan sponsor and participant experience, continued to pay off. We significantly improved our results on winning new group plans, increasing our premiums and deposits.

Our Life Insurance business continued to make progress, executing our plan to enhance ROE. During 2016, we completed the introduction of a new administrative platform and digital capabilities, revamped our product suite and substantially exited our U.S. life career distribution channel, service agent channel and subscale group benefits business.

Despite these exits and lower general operating expenses, we increased our quarter-over-quarter life sales.

In our Personal Insurance business, our results reflect sustained execution of strategic and portfolio actions to enhance returns and reduce total expenses. As we've narrowed our focus, we've increased our investments in markets and customer segments, where we have a competitive advantage and favorable future prospects. We further expanded our portfolio of unique partnership arrangements and have continued to leverage commercial's multinational platform and AIG's broad client relationships.

For example, during the quarter, we were selected by a leading ride-share provider, who was an existing commercial client to provide coverage for their fleet in a major Asian country over 11,000 vehicles and growing. In addition, we secured the global travel insurance and assistance program for one of the world's largest airlines, affirmation of our growing position as a market leader in this sector.

We also continued to make progress transforming our business in Japan while producing strong operating results. We introduced premerger operation status on April 3, and we are preparing for the legal entity merger, which continues on track for January 1, 2018.

On April 30, we also completed the sale of AIG Fuji Life modestly ahead of schedule, allowing us to focus on our strong P&C position.

Now I will briefly discuss the results for the quarter. Before covering the individual businesses, I would note that pretax operating income for each of the consumer modules benefited from higher income from alternative investments.

Turning to Individual Retirement on Slide 18, we saw lower sales and net flows from a year ago. In the face of industry sales challenges, we continued our disciplined approach with respect to product pricing, product features and asset quality. Our policy fee income and spreads remain solid.

Turning to Group Retirement on Page 19. Deposits increased in the quarter, but were offset by higher surrenders that resulted in overall declining net flows, including one large surrender related to health care consolidation. Despite disciplined rate management, base net investment spread declined year-over-year, primarily due to lower onetime prepayments on commercial mortgage loans.

Looking forward, absent significant changes in the overall rate environment, we expect our net spreads across retirement will decline by approximately 1 to 3 basis points per quarter.

Let's now move to Life Insurance on Slide 20. Premiums and deposits grew, and we increased sales in our U.S. Our mortality experience was also well within pricing expectations.

Turning to Slide 21. Personal Insurance's results highlight the actions taken to reduce expenses and refocus direct marketing activities. We are also seeing the benefits from investments in Japan and other select markets.

Relative to Japan, I would like to make 2 comments. First, ahead of our legal merger, the expense levels quarter-to-quarter will have some incremental variability. And second, the profile of our book of business in Japan results in a relatively small equity base, which can lead to quarter-to-quarter volatility in ROE. We do not expect current ROE levels to continue. The increase in the Personal Insurance accident year loss ratio as adjusted includes a single severe loss this quarter versus no severe losses last year. We had slightly lower catastrophe losses this quarter, including in Japan, which notably had no catastrophe events, while the first quarter of 2016 reflected a favorable prior-year development.

In Personal Insurance, we believe we have additional opportunities to improve underwriting results, although we do not expect progress to be linear quarter-to-quarter.

To close, I'm pleased with the progress we are making against our strategic priorities across all of our modules, and we remain focused on continuing to execute on our plan.

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

Elizabeth A. Werner
Head of Investor Relations and Vice President
Chris, we'd like to open the line now to Q&A. [Operator Instructions]

Question and Answer

Operator

[Operator Instructions] We'll now take our first question, which comes from Tom Gallagher of Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

So first question, I guess, for Peter or Sid. Just considering you're reiterating your capital plan, can you give a little perspective on whether you think this is a point of negotiation or contention as it relates to ratings, in particular A.M. Best? I assume by reiteration of the target that you don't think that's necessarily the big issue as it relates to maintaining that rating. Can you provide some perspective on that?

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

Well, I think the first point I would make, Tom, is that we've been very clear with respect to ratings that protecting the rating of the subsidiaries is the most important objective in protecting value. And as we disclosed in my prepared remarks, both our capital levels and holding company liquidity remain extremely strong when you look at us and look across to competitors. So our main message is we're going to continue to be prudent and return capital in consultation with regulators and rating agencies. But given current balance sheet strength, we remain optimistic on resolving those rating outcomes over the course of the quarter.

Thomas George Gallagher
Evercore ISI, Research Division

Okay, that's helpful. And then just as a follow-up. There was pretty favorable earnings in other operations despite losing UGC. And the same question on Legacy or the same issue on Legacy earnings came in fairly favorable. Can you just comment on the drivers of the earnings strength in those segments?

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

Yes. So let's take them separately. When you think of the other line item, you've got to think about a few different things: first, institutional markets; secondly, you're going to think about our liquidity portfolio and our debt that remains unallocated in parent; third, general operating expenses; and then fourth, dispositions from the core portfolio. So when you look at other, you're always going to have a little bit of volatility from some of the items in the fourth bucket, which is the dispositions that, in some cases, may be in stock or other form. And of course, also, in the other line item, you see, I think, a trend from first quarter last year to first quarter this year on the expense reduction line. Speaking of Legacy, obviously, there, you have to mark-to-market volatility that occurs every quarter. We had strong performance in fair value assets. We give you both the as-reported and normalized so that you can get a longer-term expectation on that one.

Operator

We'll now move to our next question, which comes from Larry Greenberg of Janney.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

I guess this is for Rob. Rob, when you think about your loss -- underlying loss ratio objective for the year, where you are today perhaps relative to the beginning of the year, it seems like the Property and Specialty line made a bit more progress in the first quarter, at least than I would've thought, and maybe the liability line a little bit less progress. Can you just comment on where we are today individually for those lines relative to where you might have been thinking a few months ago?

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

Larry, with respect to liability and Financial Line, following our fourth quarter reserve strengthening, we strengthened our loss pick significantly for U.S. Casualty. And so I think we're making a trade-off all the time. While I want to improve my adjusted accident year loss ratio and achieve my target, my #1 priority is to make sure that we're creating a sustainable and long-term view of the right place to book our U.S. Casualty reserves. And so ultimately, we've increased the loss picks in U.S. Casualty significantly, above and beyond where we would have been in 2015 and even more for 2016. And so I think that's the primary message there. I will say we made huge changes in mix of business there. And I continue to feel that we will continue to see the results out of liability and Financial Lines that we expected. Ultimately, I think as a takeaway for you, you can expect that we booked our U.S. Casualty loss picks at a level of approximately 15 points higher in 2017 than where they were being booked in 2015, to give you an idea of the change that we've made. With respect to Property and Special Risks, remember that in the Special Risks side of the equation, we have made some changes with respect to our Programs business and have made the decision late last year to exit a number of those programs. Those exits happened across the latter part of last year, and they'll benefit us throughout the course of 2017. But those exits did not happen until late in the year in 2016 and early in 2017. On property, we continue to think about all elements of our property risk. We think about managing the attritional loss ratio, the severe loss ratio and the level of property CAT that we're absorbing. And so I've tried to provide you on Slide 13 a view of the improvements that we've made, not just in what we call our dispersion of our business across the portfolio, but also the improvements that we've made in our CAT losses, too. And I think a lot of times, people forget that I'm making trade-offs every day. I give up premiums that would have benefit my attritional loss ratio in order to reduce the level of catastrophe losses. And my overall objective here, if we're simply trying to maximize the intrinsic value of the organization without making adjusted accident year loss ratio, is a singular focus of the team. With that said, I think we're still on track for our targeted improvement in the adjusted accident year loss ratio.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Great. And then just any more color you can provide on -- you made some comments that primary comp and excess casualty loss trends were a little bit better. Any more color you could provide on that?

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

Well, as you would expect, we do -- we're very active in managing our view of reserves, looking at our actual versus expected. When you look at that in a lot of granularity, line of business by line of business, as much as possible, geography by geography. The challenge with it is we're really 3 months into the year. And so it's too early to make any assessments about what we think this means. But the main takeaway that I would give is that it gives us confidence that the level of reserves that we booked in 2016 appears to be resulting in a claims experience for 2017 that's absolutely within our expectations.

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

Yes. So the only thing I'd add to Rob's comment is, as you know, when we concluded our DVR in the fourth quarter last year, we took strengthening in both those lines. And so from the data that's emerged, both in this quarter and the second half of the year, we feel they're coming in more favorable than, say, for excess casualty a cautious view that we took in the fourth quarter on loss trends in very green years. But as Rob said, we're reassured. We don't react to this. We monitor it very carefully, and we'll continue to provide you guys with transparency going forward each quarter.

Operator

We'll now move to our next question, which comes from Meyer Shields of Keefe, Bruyette, & Woods, Inc.

Meyer Shields

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

A question for Rob, I guess. I'm looking at Slide 13, and, obviously, I think the overall improvement is clear, but we're not seeing much improvement in sets 2B and 3. I don't know if you can talk to that a little bit?

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

Yes. Thanks, Meyer. The first thing I'd say is we will never take the amount of premium, for example, in product set 3 down to 0. Just to give you an example, that's where a lot of our U.S. Casualty business sits. And as you know, we've managed that mix of business down significantly, but we continue to be and we'll continue to be a strong provider of those types of products to our clients when we think about a client relationship holistically. With that said, I think the real important part for you about what we'll do in product set 2B and 3 is really around individual risk selection here. So that's where the improving sophistication of our pricing tools enable us to make differentiated decisions about which risks we're keeping in products sets 2B and 3. My overall objective would be, I would love to improve the loss ratio there even if I'm not making significant change in how much business sits there. I kind of like my mix of business today pretty much, but I'd love to continue to see improvement in the loss ratio. But we prudently book those loss ratios in those product set 2B and 3 accounts, so that we're not creating adverse development for future periods.

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

Okay, that's helpful. And, Sid, can you talk about the time line for recognizing the capital relief from the ADC?

Siddhartha Sankaran
Executive VP & CFO

Yes. Thanks for the question, Meyer. We haven't provided any guidance. I would expect it -- as a base case assumption, I would expect it to emerge over time, over a long period of time. And obviously, as circumstances evolve and our conversations get farther, we'll update you further.

Operator

We'll now move to our next question, which comes from Gary Ransom of Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

This question is for Rob. I appreciate all the actions you're taking to improve the loss ratio, but I don't look at the 62% target as the final destination. At a CAT load expense ratio maybe it's high 90s. And you can correct me if I'm wrong on that, but it seems like there's more to be done. And given the lags and the actions you took in '16 to improve '17, my question is this: what are you doing now that can help perpetuate the loss ratio improvement beyond 2017?

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

Yes. So, Gary, the first thing I'd say is that we're investing heavily and have been investing heavily in improving the underwriting tools for the organization. So I mentioned in my prepared remarks the increasing sophistication of our underwriting tools, and I'm quite proud of the progress that we're making in that space. I agree with you that our adjusted accident year loss ratio target is not our end destination, but I will tell you that we are really trying to think about this in the context of overall intrinsic value. And so we're making the trade-off of attritional loss ratio, year loss ratio, CAT loss ratio, but also managing how much capital we consume. And so I think all of those elements are really important for us. I'll also mention to you that under Peter's leadership, as you would expect, we've undertaken a lot of efforts to continue to be focused on our strategy for what happens beyond 2017. And so in our 2018 through 2022 strategy, we have been working with an outside partner to help us to continue to refine smarter, more effective, more -- kind of more attractive ways to both serve our clients, but deliver a result that is a superior result for our stakeholders.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Just a quick follow-up. Is there anything in the process so far that you've learned that has been more effective in generating improvement or something that stands out as a bigger factor?

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

I would tell you that we absolutely have gained the confidence that we're able to make decisions on multiline clients without jeopardizing the overall client relationship. We found that our clients have been very loyal, that our brokers have provided us with excellent support, and that the relationship that we have is particularly effective. I will also say that one really important takeaway for us is we've been spending a lot of time on enforcing -- reinforcing the capabilities and the power of the link between underwriting claims and our actuarial function to make sure that we're getting the feedback loop to work as effectively as possible, as quickly as possible so we're feeding those insights back into our underwriting actions and, hopefully, making smarter decisions in the forefront rather than having to deal with them later on years later.

Operator

We'll now move to our next question, which comes from Josh Shanker of Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

Rob, you gave some details about severe loss and how you're mitigating that over time. But I still think 40 is probably exceptionally low. Back maybe 4 years ago, you gave a little guidance that 150 per quarter was probably possibly normal. Could you expand on that right now? Where are we? I'm sure you have a budget when you think about severe losses in the quarter.

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

Josh, as I said in my prepared remarks, our level of severe losses is not going to be consistent quarter-over-quarter. So I agree that there will be variability in that number. We've taken material steps, however, to reduce that severe loss volatility, including the fact that we buy reinsurance that's expressly targeting this level of volatility. And understand that when we buy that reinsurance, we're giving up premium, as it's actually causing our attritional loss ratio to go higher, because we're trading off, protecting against the volatility of severe losses and accepting a somewhat higher level of attritional losses. So you have to make sure you include that in your equation. But the severe loss volatility is being improved through our use of reinsurance. We absolutely expect the trend in severe losses to continue to improve in the levels that we'd experienced prior to 2016. Just to give you perspective, our fourth quarter average in severe losses is now $84 million. And I think there's also another quick point to recognize, which is we define severe losses in a nonscientific way. We define them at a $10 million threshold. And so something could trip into severe losses or be in attritional losses just by being a little bit higher or a little bit lower. So I don't want to overly draw distinction to the difference between what we're doing in severe losses and attritional, but I really want to put an exclamation on the point -- exclamation point on the observation that we're actively managing all levels of property risk, whether it's our attritional losses, our severe losses, the CAT losses. And ultimately, our objective is to cover our costs of capital. But as I mentioned in my prepared remarks, we expect to reduce our level of capital consumption in property by approximately $600 million in 2017 because we're also actively managing the level of catastrophe risk. And again, we're paying premiums that would otherwise help our attritional loss ratio to improve that catastrophic loss result that we're getting.

Joshua David Shanker

Deutsche Bank AG, Research Division

Well, if you do decide to give a budgeted number, it'd be helpful. And my second question is a quick follow-up. I guess, the $450 million of 2016 charges you took in the fourth quarter, $200 million of it related to 1Q '16, can you tell us how much 4Q '16 prior-period losses related to 2Q '16 and 3Q '16?

Elizabeth A. Werner
Head of Investor Relations and Vice President

Josh, I think we're going to get back to you on that, but I appreciate the question. I think we have actually a pretty long queue right now, and I kind of want to get through as many as possible. But we will call you right back after the call.

Operator

We'll now take our next question, which comes from Jay Gelb of Barclays.

Jay H. Gelb
Barclays PLC, Research Division

Given the pending appointment of a new CEO, I was hoping the executives on the call could give us a sense if there's any change in the way you're going about approaching your targets for this year and beyond.

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

Well, thanks for the question, Jay. As you could imagine, we don't comment on hypotheticals, and our team is focused on executing against our plan. I think what I can tell you is our management team and our board are aligned on the strategic objectives that we're outlining and executing on this quarter. If you just look at the progress and the metrics you see this quarter and through the call, $5 billion of capital return, exceeding our $1.4 billion expense reduction target 3 quarters early, module PTOI going up across the board and a path towards our 9.5% core ROE target. So I would say, collectively, we're pleased, and we're looking forward to updating you further in the next quarter on that.

Jay H. Gelb
Barclays PLC, Research Division

All right. And then a separate issue for Rob. Based on the new disclosures, it looks like Europe is a pretty significant profitability challenge. Any sense on when that or if it could improve?

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

Jay, as I mentioned, one thing about Europe is the January 1 renewal date is a particularly important renewal date in Europe. So obviously, we made significant improvements there, but you won't see those in the first quarter. You'll see them throughout the rest of the year. The second point I'll make is that Europe is where we recorded the Ogden change in the discount rate. And so there was a $100 million, approximately, number coming out the Ogden discount rate, I think those 2 items. And then, I guess, I'll also observe, this is a big part of the way Peter has instilled our way of thinking about intrinsic value is that we surely operate in a different interest rate environment in Europe than we do in the United States, in some places with negative interest rates. And so, therefore, our view on cost of capital in Europe is also somewhat different than our view of cost of capital in the U.S.

Jay H. Gelb
Barclays PLC, Research Division

I appreciate that. And Peter, I just wanted to mention, we really appreciate all your hard work, and wish you well in your future endeavors.

Peter D. Hancock

Former Chief Executive Officer, President and Director

Thank you.

Operator

We'll now take our next question, which comes from Kai Pan of Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

First question to follow up for Rob is you mentioned that 3 points of the loss ratio improvement already implemented in 2016. Why they haven't shown up in the 2.2 improvement in the first quarter? And what additional would be done to complete the 4.7 by year-end, the point improvement?

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

Kai, the -- remember that we described our 4.7 point improvement in the adjusted accident year loss ratio as an exit run rate. That's because we acknowledge that we may have been able to take the action in 2016, for example, but the only thing we can't do is hurry up and earn those actions. And so therefore, there are actions that we took at the end of 2016 and at the end -- and in the beginning of 2017, for which, as the year goes on, the degree of improvement that's reflected in our earnings will continue to increase. So we continue to have confidence that the changes that we've made, in particular in mix of business, will drive the 3 points, as I described in my prepared remarks. With respect to the remaining 1.7 points of improvement, it's a variety of factors that include our underwriting actions that we do we're using our improved underwriting risk selection tools for. It includes growth in some of the parts of the business where we're continuing to have excellent success, including, for example, our multinational business, our highly engineered Property business or our Financial Lines business. And it also includes the fact that there are simply underwriting actions that need to be taken across the portfolio that as we go through the remainder of 2017, we'll have the opportunity to revisit anything that we were not able to get to in 2016, simply because of the timing of our announcements of our 2-year plan.

Kai Pan
Morgan Stanley, Research Division

Great. As a follow-up, at least on the expense side, you already achieved your $1.4 billion run rate. And in the first quarter, you took another $180 million service charge. Will that provide sort of additional upside to the expense savings target? Or from a different angle, is that -- do you need more expense savings just offset the declining in the commercial premiums to keep the expense ratio flat?

Siddhartha Sankaran
Executive VP & CFO

Yes. Kai, it's Sid. Just 2 responses. Yes, of course, that restructuring charge, which is AIG-wide, will provide future offset in our run rate expense. And I think you can go back and look at our total restructuring charges and look at our run rate and see that we have a pretty good track record of getting the expense out. Secondly, with respect to commercial, certainly, a portion of that restructuring charge applies to commercial. And yes, we are focused on further efficiencies in commercial to ensure that, that expense ratio stays roughly flat while we produce the top line in line with our strategy.

Operator

We will take our final question now, which comes from Jay Cohen of Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Saving the best for last. Just a math question, probably for Sid. Sid, can you talk maybe about the timing of the buybacks in the first quarter? It just felt as if the average share count should have been lower if the buybacks has been done over the course of the quarter?

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

Yes, Jay. I appreciate the question. We obviously don't comment on the details of our share repurchase program or timing. But I think I would always encourage you, we obviously have a long track record of capital return, look at it over a long time period, many years. I think you always see there's going to be volatility quarter-to-quarter, but we won't comment beyond that.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Great. Thank you, everyone. We appreciate you joining us this morning, and please reach out and we will follow up with you to finish all these questions. Thank you.

Operator
Thank you. Ladies and gentlemen, that concludes today's conference call. Thank you for your participation. You may now disconnect.