S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ3 2014 Earnings Call Transcripts

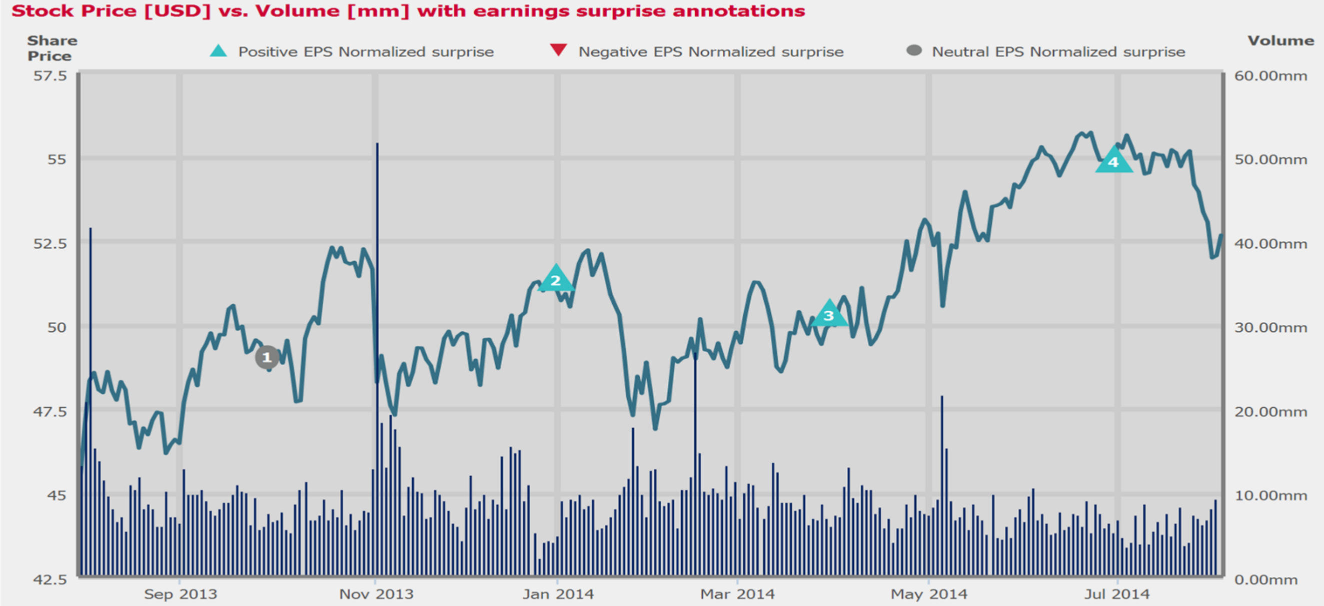
Tuesday, November 04, 2014 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2014-			-FQ4 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.09	1.21	▲11.01	1.14	4.66	4.92
Revenue (mm)	8558.11	8630.00	▲0.84	8711.67	34241.75	36290.33

Currency: USD

Consensus as of Nov-04-2014 11:46 AM GMT



- EPS NORMALIZED -			
	CONSENSUS	ACTUAL	SURPRISE
FQ3 2013	0.96	0.96	(1) 0.00 %
FQ4 2013	0.97	1.15	▲(2) 18.56 %
FQ1 2014	1.06	1.21	▲(3) 14.15 %
FQ2 2014	1.05	1.25	▲(4) 19.05 %

Call Participants

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Elizabeth A. Werner
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John Q. Doyle
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Presentation

Operator

Good day, everyone, and welcome to AIG's third quarter financial results conference call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Kim, and good morning, everyone. I'm pleased to introduce our speakers this morning. With us are Peter Hancock, our CEO; David Herzog, CFO; John Doyle, Head of Commercial; and Kevin Hogan, Head of Consumer. We also have other members of management available to participate in our Q&A session.

Before we start our prepared remarks, 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 2013 10-K and subsequent 10-Q under Management's Discussion and Analysis of Financial Condition and Results of Operations and also 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 are included in our financial supplement, which is available on our website, www.aig.com.

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

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

Good morning. Thank you, Liz, and thank you all for joining us this morning. Before we begin our discussion of the quarter, I'd like to say that I look forward to leading AIG, and I am confident in our team, the strength of our industry-leading balance sheet and the opportunities for our global businesses. AIG is well positioned to meet the needs of its broad customer base across the markets we pursue, and we'll continue our focus on balancing growth, profitability and risk to deliver exceptional returns to shareholders.

I'm pleased with the quarter's operating results and the continued execution of our capital management objectives. Through the first 9 months of the year, book value per share growth has exceeded 15%, a trend we expect to continue. This morning, my remarks will touch on 3 topics. The first is our new management structure and operating committee. The second is my immediate priorities, and I'll conclude with a brief update on Fed oversight.

First on management structure. Last quarter, I stated that you should not see abrupt changes in our strategies and objectives and that's still the case. The recently announced new operating committee creates a structure that facilitates further collaboration and reinforces the value of One AIG. This committee reports directly to me and represents the team that will be leading our strategic initiatives across products and geographies.

AIG is a company where 20 different businesses account for 80% of our revenue. It's critical that we take an integrated approach to managing our operations in order to best serve our customers and pursue new growth opportunities. We're looking to improve operating efficiency and decision making by eliminating layers in the organization. As an example, we're not filling my former position, and we're incorporating the Life and Retirement businesses into our global operating framework.

I'm grateful for the strong team that Jay developed over his many years at AIG, and I'm committed to the future growth of our Life and Retirement businesses. Jay's responsibilities will be largely assumed by Kevin Hogan who, as Head of Consumer, is focused on our global life opportunities and, as you know, has decades of experience in the life, personal lines and accident and health markets. John Doyle continues to oversee our commercial businesses and has assumed responsibility for UGC and our Institutional markets business. The diverse experience that Kevin and John bring to their respective roles allows them to be span breakers and encourage collaboration across all our disciplines on a global basis. Our 3 regional leaders are locally focused and have accountability for executing our strategies in conjunction with our local teams. Their local reach is designed to improve speed and effectiveness.

You'll see that technology and science are represented on the operating committee, which speaks to our commitment to their respective roles within AIG. Science continues to partner with all our functions to capitalize on data analytics and other scientific breakthroughs. Our investments in technology are essential to providing the solutions our customers demand with the greatest of efficiency and adaptability.

Now turning to my immediate priorities of culture, technology and value-based metrics. Starting with culture. To begin, I believe that a culture of collaboration is necessary to realize the true value of all that AIG has to offer. Few companies have the scope of businesses, customers and sheer data available to AIG. We believe our customer relationships are important and mutually beneficial. By working across the organization, we've tapped into opportunities that we may have overlooked under a more silent [ph] approach to running our businesses. The new management structure was another step to encourage collaboration, and we believe a culture of collaboration will drive future opportunities.

Turning to technology. You've heard me discuss science and technology to drive problem-solving and to reduce claims costs. Science is already paying dividends to us and is working across our businesses to provide critical insights and further data segmentation. Our OneClaim technology provides more enriched and consistent data to science, actuarial and others to drive better decision-making. We've taken another step forward by elevating the role of technology with the announced hiring of Phil Fasano, our new Chief Information Officer, who also reports directly to me. Under Phil's leadership, we expect to achieve our vision of providing a truly seamless technology experience to our customers, distribution partners and employees. Phil's most recent experience is at Kaiser Permanente, and he brings an extensive track record of improving systems and data management while creating innovative solutions.

Turning now to value-based metrics. I've talked about value-over-volume approach in our P&C companies, and going forward, you can expect a broader implementation of value-based metrics at AIG. The success at AIG PC has translated to improved results and effective capital allocation. A framework of assessing the economic value of all our products won't result in dramatic changes to our business mix, but is an important discipline for us to continue -- to continually access the highest return on our capital, taking into account risk and sustainable growth.

Now finally, Fed regulation. I'd like to speak about the ongoing importance of Fed regulation for AIG and how to consider the impact at this stage. We continue to work closely with the Fed and maintain a positive dialogue with the goal of providing the insights and information that are essential to operating as a well-regulated financial institution. It's too early to discuss CCAR requirements for a nonbank SIFI, and there are unique aspects to insurance companies that are noteworthy. As an example, in comparison to banks, insurance companies have significantly lower leverage and greater liquidity. Diversification of risk is the essence of insurers' existence while banks' risk profiles tend to be highly correlated to the economic cycle. Furthermore, primary insurers are far less interconnected to each other than the banking industry is. Our policyholder focus and the requirements of our existing regulatory bodies also has a meaningful impact on how we operate. We mention these differences to highlight the complexity involved in nonbank SIFI regulation. We continue to work with all our regulators globally and will provide more insights as they're available.

With that, I'd like to turn our call over to David to discuss the numbers and the quarter.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Peter, and good morning, everyone. This morning, I will review the highlights of the quarter's results, our capital management activity and our liquidity and capital position.

Turning to Slide 4. Our operating -- our after-tax operating income for the quarter was $1.7 billion, up 23% from a year earlier or $1.21 per diluted share. Our operating return on equity was 7.2%. Since our earnings are tax affected and we are not paying taxes to the U.S. government given our NOLs, our operating ROE, excluding the DTA from equity, was about 8.6%.

Reported net income of $2.2 billion included a nonoperating gain related to the previously announced settlement with Bank of America, which was about $570 million after tax. The after-tax impact of this gain reflected the benefit of utilizing substantially all of our remaining capital loss carryforwards. Partially offsetting this nonoperating gain was a loss on extinguishment of debt associated with our liability management actions during the third quarter.

Third quarter book value per share, excluding AOCI, was $69.28, up 11% from a year ago, largely driven by our earnings. The comparable book value metric on the same basis as the ROE, excluding DTA, is book value per share, excluding AOCI and DTA, which was $58.11 per share at the end of the third quarter, up 15% from a year earlier. However, this assumes that the DTA has no value. There is significant economic value in the DTA, which results from the monetization of the tax attributes in the form of cash to our holding company from tax sharing payments from our operating companies. In our view, the present value of these cash flows can be projected at somewhere between $7 and $8 per share.

Operating income, which is shown on Slide 5 reflects a 14% growth in insurance operating income from a year ago quarter. I will mention just a few noteworthy items and John and Kevin will provide more details on the operating results. In the quarter, our P&C business incurred approximately $227 million of net adverse prior year development stemming principally from accident years 2006 and prior and concentrated in the primary casualty lines, primary general liability, including construction defects and commercial auto. Overall, experience for accident years 2007 and subsequent was favorable, mainly due to the effects of reduced policy limits and re-underwriting of our excess casualty portfolio. Our Life and Retirement results benefited from net favorable unlocking adjustments of about $120 million as part of our normal annual review.

Collectively, the DIB and Global Capital Markets, or DIB GCM, delivered another solid quarter with over $350 million of operating earnings that was driven by market appreciation on legacy assets whose values may fluctuate as they move towards the ultimate recovery values that we expect. We continue to reduce the DIB GCM. In the third quarter, we redeemed about $2 billion of DIB debt due in 2016 and 2017, and in October, we redeemed another $2.4 billion of DIB debt due in 2018, in each case, using cash and short-term investments allocated to the DIB. We continue to expect that the actions that we will take will result in the release of the capital to parent over time as the maturities of liabilities and the underlying assets and derivative positions are monetized and settled. Recent improvements in risk profile and leverage led to the release of NAV to the parent, which will be taken into consideration in next year's capital planning.

With respect to our 46% equity pickup in AerCap's earnings, as I mentioned to you last quarter, we will have differences from time to time in our estimates and the actual results because of timing. Such differences will be trued up in the subsequent quarters as was the case this quarter with a positive true up of about $30 million related to the second quarter results. Corporate expenses were $280 million for the quarter and included a short-term incentive compensation accrual of just over $50 million. We will evaluate the level of our accrual in the fourth quarter based on the full year performance and true it up as necessary. Our reported operating effective tax rate for the quarter was roughly 34%, in line with the previous outlook of 33% to 34% for operating tax rates.

Our strong capital position as of the end of the quarter is shown on Slide 6. During the quarter, we utilized the remaining amount under our existing share repurchase authorization deploying roughly $1.5 billion towards repurchase of approximately 25 million shares of common stock. Following the end of the quarter, an additional 3.9 million shares were delivered to us in a full completion of the ASR, which was initiated in

September. We also distributed about $180 million in dividends to our shareholders during the quarter. In addition, our Board of Directors authorized an additional share repurchase authorization of $1.5 billion.

With respect to capital management, we continue to manage the cost of debt and our debt maturities. During the quarter, we purchased in tender offers certain high cost hybrid debt and senior debt securities at the parent for an average purchase price of about $2.5 billion. In unrelated transaction, we also issued $2.5 billion of debt comprised of $1 billion of 2.3% 5-year notes and $1.5 billion of 4.5% 30-year notes, and we issued an additional $750 million in the 4.5% 30-year notes in October. Additionally, in October, we repurchased $1.6 billion of principal amount of the 8.175% hybrid notes as part of our continued effort to reduce our high cost legacy debt.

Year-to-date annual net interest savings from these actions are approximately $160 million. The run rate for 2015 interest expense now is roughly $1.1 billion. We ended the quarter with financial leverage ratios, including the hybrids, of about 16.4% or 15.8% when giving effect to the October activity. We continue to be opportunistic in our debt capital management and expect that our improving earnings profile, particularly from our core insurance businesses, will continue to positively impact our coverage ratios going forward.

Cash flows for the holding company remain strong, as you can see on Slide 7. We received cash dividends and loan repayments from our insurance subsidiaries of $2.1 billion during the quarter, bringing year-to-date cash distributions to $5.4 billion. Third quarter cash distributions included $400 million from the Property Casualty companies and $1.7 billion from the Life and Retirement companies. Property Casualty also distributed about $400 million of securities, which are included in the AIG parent liquidity under unencumbered fixed maturity securities.

The cash distributions from the Life and Retirement included $465 million associated with the litigation settlement that I mentioned earlier and little over $480 million of proceeds from the sale of PICC shares to parent. We also received additional distributions from Life and Retirement of little over $600 million in October in the form of cash and securities. We ended 2013 with an RBC ratio of 568% in the Life and Retirement, and we look to distribute excess capital from Life and Retirement through the holding company to operate our -- those businesses with an RBC closer to 470%.

In addition to these distributions, we received tax sharing payments from our insurance businesses of a little over $300 million in the third quarter, bringing the total to $1.1 billion year-to-date. We expect to make small tax payments to some of our insurance companies in the fourth quarter to true up to actuals. Following the quarter, we paid $960 million associated with the previously announced 2008 class action settlement, which had previously been reserved. We expect continued strong cash flows from our operating companies, and we also expect 2015 tax sharing payments to be somewhere between $1.8 billion and $2 billion. And our current expectation is that our tax attribute DTA will be fully utilized by 2000 to -- 2020 to 2021.

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

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

Thank you, David, and good morning, everyone. AIG's Property Casualty results in the third quarter reflect execution against our strategic objectives and our continued focus on underwriting discipline and risk selection.

If you turn to Slide 8, you can see the third quarter Property Casualty income of $1.1 billion, up from a year ago, benefited from earned premium growth, improvement in the accident year loss ratio in both Commercial and Consumer businesses and higher net investment income. Reported net premium written grew 3% from the same period last year, also reflecting growth in both Commercial and Consumer Insurance. Similar to the year ago quarter, this quarter was a relatively benign CAT quarter with losses of $284 million from 8 different events. Net investment income growth reflected improved returns from alternative investments, which were roughly 10% on an annualized basis, better than our 8% expectation.

If you turn to Slide 9, Commercial Insurance reported net premium written growth of 5% versus the same period a year ago or 3% when adjusted for FX and additional premiums on our loss sensitive business. It was led by increases in our Property and Financial Lines businesses. Property net premiums written rose on increases in new business in the middle market and highly engineered risks. In addition, this growth benefited from improved retention on renewal business and changes to optimize our retention of more favorable risks. Financial Lines growth reflected new business increases of targeted growth products, such as multinational, small business and M&A, across all of our regions as well as favorable rate environment here in the United States.

Global commercial rates increased slightly in the quarter and were up 1.8% in the U.S. U.S. Financial Lines led with a 3.9% increase, followed by our specialty lines at 2.4% here in the U.S. while Casualty was up 2.2% in the United States. Property rates were down 2.3%. And overall, market conditions have been fairly stable and consistent with the second quarter.

With respect to rate trends, we believe it's our pricing strategy, our business mix and our focus on pricing each risk appropriately that gives us confidence in our accident year loss ratio trends and continued growth in risk-adjusted profitability. The accident year loss ratio, as adjusted in Commercial, improved by 1.4 points from the year ago quarter, primarily due to improvement in Financial Lines as a result of refined business mix and underwriting improvements as well as 0.6 point decline in severe losses from the year ago quarter. Our global property business continues to deliver positive risk-adjusted profitability even considering the recent elevated trends of severe losses.

Turning to Slide 10. Mortgage Guaranty reported another strong quarter of operating performance with operating income of $135 million. Mortgage Guaranty continues to benefit from improvement in its delinquency ratio and cure rates. UGC has become part of our Commercial Insurance business and remains an important core insurance operation for us given its strong returns and strategic insights into the residential mortgage market. To sum up, the commercial team continues to advance on its strategic initiatives, work collaboratively across all AIG businesses and further build value for all of our stakeholders.

Now I'd like to turn the call over to Kevin to discuss our Consumer PC and Life and Retirement businesses.

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

Thank you, John, and good morning, everyone. As Peter mentioned, we are bringing together our consumer-oriented businesses in both the Life and Retirement and Property Casualty segments to create a global consumer platform with broad distribution reach under common management. Both of these businesses are well positioned with strong leadership, deep management teams and a sustainable strategy. The third quarter represented strong results across all our Consumer businesses, including our significant Life and Retirement businesses, which I will address later.

In terms of PC Consumer, at our Japan Investor Day, we highlighted the uniqueness of our franchise, our data-oriented decision-making and our focused growth approach. Our progress this quarter was consistent with this message as we saw positive developments across our global businesses, underwriting improvements in lines where data drove pricing, and we achieved growth in a number of products.

I'll begin on Slide 11, where you can see net premiums written for consumer Property Casualty grew 2% from the same quarter a year ago, excluding the effects of foreign exchange. There were a number of businesses driving this quarter's top line, including attractive new business sales in Japan personal property, continued growth in AIG Fuji Life products and improved rates and retentions in our U.S. Private Client Group. We note that some of this growth was offset in the quarter due to changes we made in our U.S. warranty programs.

We remain positive about the growth potential going forward for Consumer PC, and we'll continue to pursue opportunities across select geographies and product lines. Importantly, we delivered better-than-expected underwriting results across our major products. The third quarter accident year loss ratio of 55 for Consumer is the lowest we have reported since we began to separately present Consumer PC results. In Japan, where our largest personal auto book resides, we continue to see favorable claims experience and realize the benefit of positive rate actions. This quarter's underwriting improvement was also positively impacted by the coverage actions we took a year ago in our U.S. warranty book.

Looking ahead to the fourth quarter, we have historically experienced a sequential increase in our loss ratio compared to the third quarter. That said, I believe the over 2-point improvement in our loss ratio year-to-date is based on sustainable underwriting and pricing actions that allows for continued underwriting profitability which in turn supports our competitive position in the marketplace and allows for ongoing investments in our Consumer franchise. The investments we are making in our infrastructure are evident in our general operating expense ratio, which rose 2.4 points from the same period in the prior year. The Japan integration costs were the greatest contributor to this increase and are ongoing. Our acquisition ratio was flat with the year ago quarter, largely reflecting the level of production growth.

Turning to Slide 13, the current Life and Retirement segment. I am pleased to report continued strong financial performance, generating $1.3 billion of operating earnings, 18% higher than the year ago quarter. Growth in earnings was driven by an increase in fee income on higher assets under management and higher net investment income due primarily to strong returns on alternative investments. Results also benefited from our continued focus on spread management and our disciplined approach to new business pricing across products.

In addition to strong earnings, Life and Retirement declared nearly $2.4 billion in insurance company dividends in the quarter. Our dividend activity is reflective of strong statutory capital generation by the underlying business as well as our ongoing efforts to distribute excess capital to parent. Assets under management increased for the fifth consecutive quarter, reaching a record of $334 billion, 10% higher than a year ago. Growth in assets under management was driven by an 18% increase in separate account assets and reflected positive net flows in individual variable annuities, growth in our stable value wrap business and equity market appreciation.

In the third quarter, we achieved new records in our Retirement Income Solutions business, generating $2.9 billion in premiums and deposits and nearly $2 billion in net flows. Approximately half of the growth in Retirement Income Solutions sales came from index annuities, which have become an important offering in our suite of retirement products. Also reflected in third quarter earnings is the impact of our annual review of gross profit assumptions, which resulted in $120 million net positive adjustment to earnings, approximately equivalent to the level of adjustment made in the prior year period.

Our net adjustment this quarter was impacted by changes to investment spread assumptions. Although spreads have recently been under pressure, our actual experience has been more favorable than what we had assumed in our models, resulting in a positive adjustment in our Fixed Annuity and Group Retirement businesses this quarter. This was partially offset by adjustments in our individual Life business due to higher than previously assumed mortality, although still within our pricing assumptions as well as a loss recognition charge for discontinued long-term care business.

Slide 14 illustrates the diversified contribution to earnings from our Life and Retirement businesses. Excluding the adjustments made in both the third quarter of 2013 and 2014 for updated assumptions, Retirement Income Solutions' earnings increased 23% driven by higher fee and spread income. Also, excluding the adjustments, Fixed Annuity earnings increased 25%, benefiting from a reduction in our cost of funds and higher alternative investment income. Sales of Fixed Annuities will remain challenged in the low interest rate environment as we continue to maintain our new business pricing discipline. Also, excluding the adjustments for assumptions, Life and A&H earnings were also dampened by increased expenses related to initiatives to enhance distribution and improve operational efficiencies.

Institutional pretax operating income increased 31%, excluding the adjustments to assumptions, and benefited from higher fee income and higher alternative investment returns. Group Retirement continues to produce strong earnings based on higher fee income generated on increased assets under management which were up 5% from a year ago. However, we did experience a large group surrender as a result of normal competitive pressures in this business. Overall, we remain comfortable with our risk appetite across our Retail and Institutional businesses. We have maintained our disciplined approach to pricing and product design, which enables us to generate attractive returns on new business.

Slide 15 illustrates the performance of our spread businesses. The decline in base yields across product areas reflects the reinvestment of cash flows at rates that are lower than the overall portfolio rate. We remain focused on actions to control the cost of funds, including disciplined pricing of new business and active management of crediting rates on in-force business. We are also benefiting from outflows of older policies, which carry higher crediting rates than current rates offered. These efforts have paid off and in both Fixed Annuities and Group Retirement, we have consistently reduced our cost of funds over the last 12 months.

Slide 16 shows our Life and Retirement investment portfolio composition, which remained stable and continues to be highly rated and managed with discipline. Total net investment income fluctuates from period to period as can be seen in the alternatives line and other enhancements, reflecting the mark-to-market nature of certain investments. The increase in net investment income from a year ago quarter is primarily the result of higher returns on alternative investments. Performance of this asset class in the third quarter slightly exceeded our expectations of a 10% annualized return.

To close, it was another strong quarter for our Consumer businesses, and we remain focused on executing our strategy, maintaining a prudent risk profile and capitalizing on growth opportunities going forward.

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

Elizabeth A. Werner
Head of Investor Relations and Vice President
Thank you, Kevin. Operator, could we open up the lines for questions?

Question and Answer

Operator

[Operator Instructions] Our first question today is from Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

So first question on the buyback, it looks like you added another $1.5 billion to the regional authorization back in August '13 -- August 2013. So just wonder, is there any difference between like addition to the existing authorization versus a new one? Just wonder why you're taking this piecemeal approach like adding $1 billion to $2 billion each time and you quickly running out and have to add to it. And so that's my first question.

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

Well, I think that we feel that each quarter is a good cadence to reevaluate the capital adequacy of the company, the progress that we're making. And so we feel that $1.5 billion is a sizable commitment that we want to make sure that we deliver on. So I think that if we change our view on the frequency with which we should do that, then we'll certainly signal that to The Street.

Kai Pan
Morgan Stanley, Research Division

Okay. Then switch gear to the underwriting improvements, quite big improvements year-over-year, the core underwriting P&C margin. But if you look underneath, actually the U.S. Commercial line as well as international Consumer line, the combined rate -- underlying combined ratio have been pretty stable year-over-year. Given the pricing outlook in the U.S. as well as the ongoing restructuring, like programs in Japan, do you expect, like at least in the near term, that you would -- we will continue to see some improvements in these 2 segments?

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

I think that the -- you picked up the right trends. We continue to see good steady improvement in the accident year loss ratio in the Commercial sector, in particular. I think that the pace of that improvement may face some headwinds, especially in the U.S. But I think that the successful diversification to international markets offset some of that headway. In the Consumer space, we've, as Kevin has mentioned, made some significant progress to lower accident year loss ratios. But the challenge there is investment in infrastructure and, in particular, the integration of the Fuji Fire, Marine and AIU entities in Japan, which will be ongoing for several quarters to come. So I think that while we feel confident in our long-term goal of combined ratios south of 95, the timing on that is not something that we are giving guidance on because we want to maintain flexibility as we execute on these major initiatives.

Operator

And moving on, we'll take a question from Josh Stirling from Sanford Bernstein.

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

I was hoping though to dig in a bit, maybe with John or Charlie, to talk about your reserves. For context, I mean obviously we're all happy that you're releasing reserves the more recent years, but the charge you took for the older years really held back your headline combined ratio this quarter. And after releasing reserves last quarter, I was personally surprised. And so you mentioned in the Q, I think, a few things, the New York labor law charge -- New York labor law claims, large construction defects, some changes to how you handle -- or how you reserve for mass tort for legacy years as well as some more recent commercial auto. And I'm wondering if you can help us unpack this a bit. We'd love to understand how material each of these are, what's driving each and -- sort of fundamentally or should we look at these as idiosyncratic challenges where you're sort of seeing case reserve development from maybe some of the larger claims. Or is this a sign of weaker IBNR that you guys are still addressing? And more broadly on this point, is this a result of new facts? Or is this a function of new processes for the actuaries? And do you think by now -- or I guess the question is when should we expect the -- your actuarial processes to be stable so that you're not necessarily having changes except for when you see deterioration or improvements in the underlying business?

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

Hey, Josh, thanks. It's John Doyle. You know what? Just quickly, on the favorable side, we did see some favorable development in Financial Lines, also in Canada, I mean more recent years in Canada and had favorable developments in CATs as well on the quarter. Some of the older issues, more legacy issues that you referred to were construction defect, New York labor law. On the CD side, we saw emergence in some new states that were inconsistent with the review we had done in prior -- in the prior year in the third quarter. And then in commercial auto, it was more recent with the uptick in the economy. I think consistent with what some others have reported, we saw both an increase in frequency and severity in the 2010 and -- to 2013 accident years. We have updated our risk selection models and pricing models in commercial auto to reflect the changes and have gotten some price of late. Maybe I'll ask Charlie to talk a little bit about some of the older development in particular.

Charles S. Shamieh
Legacy Chief Executive Officer

Josh, I'd only add to what John said that, of course, in CD space over 50% of reported claims come in, in development years 2007 to 2010. And so the action -- that's why you're seeing most of it in the earlier accident years. In the excess casualty line, to give you a sense of it, the mass tort claims are very slow to develop. We see about 40% to 50% developing after 10 years. But the most substantive favorable thing that we can point to is this: there's been a very material reduction in policy limits on an occurrence basis, which is really the risk that we would be most concerned about in reserving. And that, for example, exceeded $50 million in the years '97 to '01 and has since been reduced to below $30 million since 2011. And that's something that's very substantive that we can point to, which gives us a lot more confidence in the stability of the excess casualty reserves.

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

That's helpful, that's helpful color. I guess if I just ask one other question, maybe more for Peter or David. Peter, in particular, I mean, we -- I loved your characterization of the goals of the firm to deliver exceptional returns, and as you know, we think that's possible. But to do that, AIG clearly needs to finally put its legacy reserves issues to bed. And if you look at peers, typically, folks intentionally book conservative reserves and then consistently release reserves over time to be able to manage these issues without -- and sort of keep investors from sort of overly focusing on historic challenges and making sure that you have a certain amount of conservatism in the business fronts for surprises. And I guess the big question for you and then I'll let you guys go, do you agree that ought to be your goal? And if it is -- and if you believe that and you would like to look like your peers, where are we in the financial and actuarial process of getting the reserves strength up and getting the balance sheet to be in a position where you can -- where you're sufficiently paid up for all of the old legacy issues and you can finally put the legacy of under-reserving behind you?

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

Well, I respect our peers' practices, but we view our own practices as very much committed to a true north of giving our best estimates of reserves with the information that we have at hand. We don't try and squirrel away reserves for a rainy day. So what you see is what you get. It may lead to a little bit more quarterly EPS volatility than everybody would like from the outside, but we think that the long-term sustainability of our strategy is what is most important. And that comes from facing the truth on a timely basis, good news and bad news. And I think that that's a philosophical belief that I'd like to underpin the way we manage our business throughout. We want to create sustainable long-term growth, and that requires us to face the truth on a timely basis, good news or bad.

Operator

Our next question today comes from Jay Cohen from Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Two questions. The first is on the DIB. You had said that you were able to extract some capital out of the DIB. I think it was about $1 billion. I'm going to double check that. But more importantly, going forward, should we expect to see, given the actions you're taking, continued extraction of capital from the DIB?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Jay, It's David. Thank you. You're correct. We released about $1 billion in the quarter. And as I said in my remarks, we do expect to release DIB capital. It may be in the form of cash. It may be in the form of securities or other assets over time, which the key is to release the assets, the net assets from the DIB, get them to the parent for monetization. I would expect -- we would expect that over the period of time between now and 2018, roughly 90% -- 80% to 90% of the NAV to be released. That's largely in line with the run-off of the liabilities, the debt that's there. We have assets and liquidity and investments, short-term investments to cover that -- those maturities at par when due, even under stress. So that's the - that's sort of the glide path. That is more heavily weighted towards 2018, which is reflective of the concentration of maturities in that year. So that's consistent with what we have seen from the past. So hopefully, that's helpful.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes. Maybe -- if you continue to take the actions you're taking though, I assume it would be a little quicker than what you've just laid out.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

It may be, but I'm giving you what is our best estimate at the time. But again, we continue to be very opportunistic in looking at the wind-down activities and run-off activities of the DIB.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Okay, fair enough. The second question on the Consumer business. The expense ratio, as advertised, is elevated this year. When do you expect to see that expense ratio level off and then begin to come down? If you can give us a bit of a forecast for that.

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

Yes, okay. Thanks, Jay. As Peter mentions, an important part of the elevation in expenses is due to the integration of Fuji Fire and Marine in Japan. And as we explained at our Tokyo Investor Day, a merger process in Japan is quite a bit different than other places around the world, where a great deal of activity has to go into preparing for the actual legal merger, including allocating a single set of products across the companies for Day 1, having all of the systems investments in UAT is done, et cetera. And so I think that we really need to look at this as a continuation of the successful acquisition and introduction of Fuji Fire and Marine. And as we previously indicated, we are anticipating a little bit less than half of the $250 million that we had previously announced this year with the remaining going forward. And as Peter pointed out, we need to look at the long-term opportunities for the efficiencies in this business. At the same time also driving up some of the expenses are accruals for profit shares on the warranty business in the U.S., which has a dramatically improved profile after the program restructuring that we undertook last year.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

So it's elevated a little bit because of that this quarter?

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

The difference from year-o-year of last year versus this year is because of the profit share accruals. But primarily, the Japan integration is really the largest number driving the expenses. We would expect to see a continued elevated expense as we integrate the businesses in Japan due to the unique process that exist in Japan.

Operator

We'll go to Tom Gallagher from Credit Suisse next.

Thomas George Gallagher
Crédit Suisse AG, Research Division

First question is related to a comment in your Q, which says AIG Property Casualty will seek approval from authorities to update the discount rate to reflect the then current level of interest rates. I just want to get some clarification on that. I know last year, in 4Q, you took an interest rate-related charge related to workers' comp, but it was offset by some other adjustments. But should we take that comment to expect that you're going to take another low interest rate-related charge related to workers' comp in 4Q?

Charles S. Shamieh
Legacy Chief Executive Officer

It's Charlie here. I'd just say that last year on our excess workers' comp and our primary workers' comp business, where we submitted to you the non-tabular rate, we disclosed that we changed the basis to basically follow a use of the forward treasury curve with a liquidity premium. And if you just compare the rates as of year-end '13 with the rate as of September 30, that reduction alone would get you to a number that maybe is $250 million to $350 million lower if rates stay at their levels by the end of the year. So we are just really disclosing the mechanical application of that basis for discounting.

Thomas George Gallagher
Crédit Suisse AG, Research Division

So Charlie, if rates are at year-end where they are now, it would be a $250 million to $350 million charge that you would take related to that, where rates are relative to the original forward curve assumption. Is that...

Charles S. Shamieh
Legacy Chief Executive Officer

That's correct. That's purely the effect of the drop in treasuries.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. The other question I had was related to the expense ratio on the Commercial side, both in North American and international was lower this quarter. That actually looked pretty good, and it was in contrast to the Consumer business. Is that a trendable number? Or -- I know there was some reference in the Q to bad debt expense improving, so I didn't know if there was any noise there. Or is that a trendable expense rate on the Commercial side?

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

Yes, I think the noise, Tom, was from last year. We've -- we have taken some steps, as Peter indicated in his opening comments, to operate a bit more efficiently. It gone through a program of work during the course of this year to reflect some of the organizational changes that we were anticipating. And so we do have fewer folks on the team than we did at the beginning of the year and more focused and better aligned with the opportunities we have around the world. I don't expect meaningful expense improvement in Commercial next year, but we have made some efforts to improve the result this year.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Okay. And then just last question. Kevin, just in terms of the spreads in the Life and Retirement business, those have held up pretty well. Can you comment on the level of flexibility that you have on the crediting rate side? Obviously, core yields will go down if rates remain where they are today. So just -- can you give us some color as to spread visibility just given flexibility you have on the crediting rate side?

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

Yes, sure. So in the fixed portfolios, I think we still have flexibility on about 28% of the reserves, and we remain disciplined in that respect, Tom.

Operator

Our next question today is from Mike Nannizzi from Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Just a couple questions here. Peter, just -- you mentioned the authorization and the quarterly frequency of revisiting it. Should we take that to mean that this is kind of a perceived run rate for sort of quarterly authorizations?

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

Yes, I think that there are some exceptional items that were driven by our internal capital optimization, in particular the overcapitalization of the Life and Retirement subsidiaries. So there's some rather elevated dividend up from those entities to the holding company. But on the other hand, there are other items that free up capital as well in future quarters. So I don't think we've stabilized to the point where the capital actions in any given quarter are good predictor of the next quarter. We want to maintain flexibility pending approval of upstreaming dividends and frankly the market environment. So in contrast to dividend policy, I think we want to maintain flexibility on our capital management and maintain excellent upward trend in credit perception with all of the stakeholders, regulators as well as rating agencies. And as we think about the opportunities for capital, we really do have a hierarchy of priorities: first, fueling organic growth, and we see some excellent opportunities for organic growth in our core businesses; second, inorganic, and we made a modest acquisition this summer, which added capabilities to our international Life business; and finally, obviously, returning it to shareholders in the form of buybacks. But I think that as we evaluate those choices, we will -- are weighing out the accretive nature of all 3 before we decide how much to do in any given quarter.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. But I mean should we be looking at the authorization as sort of a quarterly true-up for what you expect over the next few months?

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

I think that, for the most part, we like to deliver on what we promise. And I think barring unusual circumstances during that quarter, we want to maintain a cadence of we -- do what we say and we say what we do. It's -- and I think that a lot of companies, I guess, make larger buyback authorizations and then take a long time to execute them, and I think we'd rather be more immediate in our response.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it, great. And then just on international Commercial, it looked like that was an area that performed pretty well in the quarter, some -- certainly on the expense side as well as the loss side. Anything unusual there this quarter? Or is that sort of an average quarter, a quarter without incident that we should think about?

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

Yes. I think, Mike, it's mostly around short-tail loss improvement in the quarter versus the prior year. We had a pretty sizable severe loss in Asia last year in the third quarter that didn't recur. But obviously, play that as it lies each and every quarter, so it's not necessarily straight line, but we see good momentum on our international Commercial business. We saw pretty good growth in Asia in the third quarter, pretty good growth across most of Europe and the Middle East. So we're pleased with the progress there.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

And then last one, just on, David, the subsidiary dividends. You mentioned the tax sharing payments. Any update on what to expect for sub-dividends in '15?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

We've not -- good question. We have not yet updated that guidance or that outlook, so to speak. But again, they remain strong. And I think the important aspect here is what I commented on with respect to the Life and Retirement and migrating the RBC from its prior year at 568% to a normalized operating range around 470%. And so some of that excess capital may come out in the near term, which could influence the run rate for next year. But the key is to get it up to the holding company, where it is the most fungible and flexible. So we will be updating that in the course of discussions in the -- as part of our fourth quarter.

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

And I would just add on the comment that John made on international Commercial that we're seeing the benefits of the leadership that John has exercised over the last 3 years to take a holistic approach globally to risk appetite and using our best expertise in a collaborative manner across borders. Our international operations had -- historically had much different risk appetite than our U.S. domestic. And so I think our customers are really seeing One AIG around the world and rewarding us, I think, with a better mix of business internationally as a result. So we're really punching at our weight in all countries as opposed to just in the U.S.

Operator

Moving on, we'll hear from Josh Shanker from Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

If I look at the operating results for the quarter, you had a 34% tax rate in 3Q. When I look at your competitors, a lot of them have tried just certain arrangements to bring down their tax rate as much as possible, but there's not a lot of incentive at this point for AIG to do so. With -- though tax laws changing worldwide, if we fast-forward 5 years into the future when the DTA is less valuable to you than it is today, will AIG be at a disadvantage to its competitors in terms of their tax rates versus yours?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Josh, it's David. I think we'll evaluate our tax planning strategies over the course of the next several years. At this point, we've been very mindful of the expiry dates on the various deferred tax assets that we have be it the NOLs, the foreign tax credits. I think you've seen us be very proactive and effective at realizing the benefits of our capital loss carryforward. So I think from that, you could infer that we will be prudent in trying to optimize the total cost of operations. And so I don't want to comment any further than that. So we're mindful of it, and we understand the value of the DTAs. And we're -- we'll manage the tax rate appropriately.

Joshua David Shanker
Deutsche Bank AG, Research Division

And following up on Josh Stirling's questions on reserves. I -- is this a business-as-usual quarter the -- for the actuaries? And is the $0.5 billion in reserve subsidization for reserves more than 10 years old, is that a risk that AIG shareholders should be willing to bear on an every few quarters basis? Or should we think of this as an exceptional quarter? And are the actuaries compensated to get the numbers right?

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

As I said earlier, I think we compensate and incentivize our actuaries to do the very best they can to come up with their best estimate. We are investing heavily in giving them better and better tools to do so. And I'm pleased with the progress they have made in what is a very challenging job to estimate long-tail businesses that we inherit from fairly old accident years. And so over time, I think that we will see the noise narrow as long as the tort environment and macroeconomic factors that also drive trends and updated estimates stay relatively stable. But we are committed to updating on a timely basis and using our best judgment to come up with best estimate and delivering that news to you as it happens. And so we're in this together.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Operator, could we end the call on the hour since we've reached the top of the hour. And I'd like to reach out to everybody still in the queue and invite you to follow up with us after this call so we can get back to you on all your questions. And thank you, everyone, for dialing in this morning.

Operator
And that does conclude our conference today. Thank you all for your participation.