S&P Capital IQ

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American International Group, Inc. NYSE:AIG

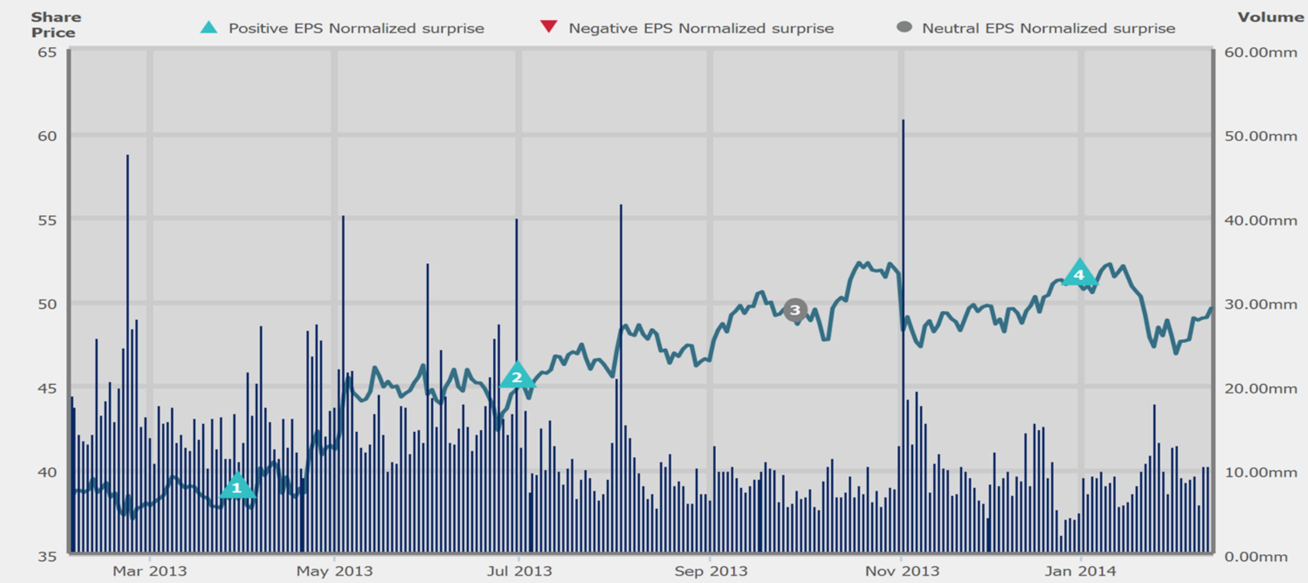
FQ1 2014 Earnings Call Transcripts

Tuesday, May 06, 2014 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.06	1.21	▲14.15	1.03	4.37	4.94
Revenue (mm)	8624.75	8230.00	▼(4.58 %)	9282.12	38229.50	38316.62

Currency: USD
Consensus as of May-06-2014 12:19 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.88	1.34	▲1 52.27 %
FQ2 2013	0.86	1.12	▲2 30.23 %
FQ3 2013	0.96	0.96	●3 0.00 %
FQ4 2013	0.97	1.15	▲4 18.56 %

Call Participants

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Legacy Chief Executive Officer

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Elizabeth A. Werner
Head of Investor Relations and Vice President

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Former Chief Executive Officer of Global Commercial Insurance

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

Peter D. Hancock
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Robert Herman Benmosche
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Presentation

Operator

Good day, and welcome to AIG's First Quarter Financial Results Conference Call. Today's conference is being recorded. At this time, I'd 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, and good morning, everyone. Before we get started this morning, I'd like to remind you that today's presentation may contain certain forward-looking statements which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance or events. Actual performance and events may differ, possibly materially, from such forward-looking statements. Factors that could cause this include the factors described in our first quarter Form 10-Q and our 2013 Form 10-K under Management's Discussion and Analysis of Financial Conditions and Results of Operations under -- and under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our financial supplement, which is available on our website, www.aig.com.

With that, I'd like to turn the call over to our senior management team, and we'll begin with comments from Bob Benmosche.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Thanks, Liz, and good morning, everybody. I want to start with ILFC and to comment on the 8-K we filed yesterday. And that is, all regulatory approvals have now been received, and so we're very confident that this transaction will in fact close in the second quarter, as we've talked to you previously. So that's a good note for the company going forward.

If you look at the quarter, you could see that our capital management continues to proceed in a very measured way, buying back shares and continuing to reduce our debt, which obviously improves our coverage ratio. Property Casualty had its second best quarter in the last 12 quarters. Unfortunately, the best quarter was the first quarter of last year, so we're comparing the second best quarter to the best quarter. So you see some decline. However, if you look at the accident year loss ratios and the other fundamentals, that business is -- continued to build a very strong foundation for the future.

Our Mortgage Guaranty business continues to do well with 62% of its premium now coming from our new underwriting capability, which really gives us high degree of confidence that if the market goes soft in the future -- and I know maybe we'll never see another soft market in housing, but if that day comes, we're confident we have a very strong profile of risk that we've taken on our books in Mortgage Guaranty.

And Life and Retirement continues to show very strong premiums in deposits, $7.1 billion for the quarter, but also very strong net flows. So it's not only what's coming in, it's what we're retaining. And so that business really is hitting on all cylinders.

So what I'd like to do now is turn it over to David who will take you through the financials.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Thank you, Bob, and good morning, everyone. As we disclosed yesterday in the 8-K that Bob referenced, we've now received all regulatory approvals required with respect to the sale of ILFC to AerCap. We do expect the transaction to close in the second quarter, again subject to the satisfaction of customary closing conditions. Upon closing, we expect to receive approximately $2.4 billion of cash, that is net of intercompany settlements, plus 97.6 million shares of AerCap stock, all of which will be held at the parent holding company and subject to lockup and other transfer provisions.

In the second quarter, we will update our stress test, our liquidity forecasts as well as our annual capital plan, and we'll discuss all of these with the rating agencies, the Federal Reserve and our Board of Directors to assess what actions we will take.

Now turning to our financials on Slide 4. After-tax operating income for the quarter was $1.8 billion with operating earnings per share of $1.21. Our operating return on equity was 7.5%. Since our earnings are tax affected and we are not paying tax to the U.S. government given our NOLs, our operating ROE, excluding the DTA from average equity, was about 180 basis points higher or about 9.3%. Book value per share, excluding AOCI, at the end of the quarter was $65.49, 10% higher than it was in the first quarter of 2013.

Our operating results begin on Slide 5. Peter and Jay will cover their respective businesses following my remarks.

The Direct Investment book, or the DIB, delivered another solid quarter with over $400 million of operating earnings, reflecting the mark-to-market appreciation. That can create some volatility from period-to-period as we had gains also from unwinding certain of our positions. We continue to expect these earnings to moderate over time as the portfolio winds down and the investments approach their expected recovery values. In addition, we may from time to time repackage certain of the DIB assets to be held at the parent company or in our operating companies.

We continue to proactively and opportunistically reduce the DIB's footprint. In fact, in the first quarter, we settled the $2.2 billion of redemptions and repurchases previously announced as well as initiated the make-whole call for the March 2015 maturities, which was completed yesterday. We used cash allocated to the DIB and Global Capital Markets that was set aside exactly for that purpose. At the end of the first quarter, we had $7.9 billion of net asset value in the DIB and Global Capital Markets. We expect this capital to be released to the parent over time as the maturities of the liabilities and the underlying assets and derivatives are monetized and settled.

Corporate expenses totaled approximately $243 million in the quarter, in line with our expectation of a $225 million to $250 million quarterly run rate for 2014. And they were down from a year ago, as expected.

Our reported operating effective tax rate for the quarter was 31.7%, also in line with our outlook for 2014.

Our strong capital position as of the end of the quarter is set forth on Slide 6. Our capital structure remains straightforward, and our leverage remains low. As I mentioned last quarter, we made good progress on our coverage ratios, which remains an area of focus for us that we continue to work on through opportunistic debt capital management and improving earnings profile, including the earnings profile of our core businesses.

From this strong capital position, we distributed $182 million in dividends to our shareholders and deployed $867 million towards the repurchase of approximately 17.4 million shares of common stock, leaving roughly $537 million remaining in our current share repurchase authorization. We were opportunistic and orderly in our share repurchase activity.

We received dividends and loan repayments from Life and Retirement of about $1.7 billion during the quarter, as shown on Slide 7. Included in this amount is roughly $300 million related to subprime settlements. Property Casualty is also on track to deliver its full year targeted dividend payments, although none was expected in the first quarter. We continue to expect $5 billion to $6 billion in dividends and distributions from our insurance subsidiaries this year. In addition to these dividends and distributions, we received tax sharing payments of about $300 million in the first quarter. We continue to expect to receive approximately $1 billion in tax sharing payments in 2014 and roughly $2 billion in 2015 as this comes from our statutory -- or our insurance companies and they continue to utilize their DTAs. These dividends and tax sharing payments, combined with our capital management activity that I mentioned earlier, resulted in parent cash, short-term investments and unencumbered securities of $11.2 billion as of the end of the quarter. Included in parental liquidity is $4.4 billion related to the DIB and Global Capital Markets, which is allocated for its future debt maturities and contingent liquidity stress needs. As we've indicated in the past, nearly 80% of the DIB's debt matures by the end of 2018.

So with that, I'd like to turn the call over to Peter for comments on Property Casualty.

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

Thank you, David, and good morning, everybody. Property Casualty’s first quarter results reflected our continued focus on underwriting discipline and risk selection. While we don't look at any one quarter as a trend, this was our second highest quarter of pretax operating income over the past 3 years. Our strategic initiatives and outlook remain unchanged, and we continue to focus on driving profitable growth and increasing returns.

Turning to Slide 8. AIG Property Casualty reported first quarter operating income of $1.2 billion. Net premiums written grew 3% from a year ago, excluding the effect of foreign exchange. We experienced strong new business growth across the majority of our commercial lines. However, casualty written premium volumes declined from a year ago on lower exposures and slower payroll growth at our large accounts. Pricing discipline drove our rate actions and our willingness to walk away from business where appropriate.

Property Casualty’s accident year loss ratio, as adjusted, was 63.2, flat from a year ago and higher than our long-term trend. Importantly, our view of a decline in the accident year loss ratio in 2014 has not changed. First quarter operating results were also impacted by 3 large consumer losses and strong alternative investment performance, which I'll address in my remarks.

The quarter included $162 million of net prior adverse development primarily related to our international financial lines business as well as certain specialty lines. We continue to review reserve quarterly and react quickly to any trends.

The quarter also included the $105 million benefit from a previously announced change in the discount rate for workers' compensation. This change was associated with the merger of our internal pooling arrangements effective January 1.

Our expense ratio was essentially unchanged in the quarter, as expected, and we continue to progress with our Japan integration. Our investments in Japan and the benefits from the recent severance charges will emerge later in 2015.

Turning to Slide 9, we saw growth across commercial product lines outside of casualty. Global property led growth and net premiums written increased 12% adjusted for changes in our corporate CAT program. We saw new business growth in large limit and middle market business globally, particularly in Europe. And we continue to leverage our in-house engineering capabilities and execute on our global approach to capital allocation. We did see a more competitive market in U.S. CAT this quarter where there is overcapacity, and we were disciplined in our renewals.

Commercial Insurance pricing remained positive during the quarter and largely exceeded loss cost trends, though rate increases were slightly lower than what we saw in the fourth quarter. Global commercial rates increased 1.9% in the quarter. The U.S. market continued to lead in rate improvement with a 4.4% increase in the quarter. U.S. property led with a 5.9% increase, followed by U.S. financial lines, which was up 4.2%. U.S. casualty and U.S. specialty each had 4.1% rate increases.

The accident year loss ratio in Commercial improved 0.3 points from a year ago to 65.1, even with the low severe losses of a year ago as a result of our pricing actions, enhanced risk selection, technical underwriting and investments in claims handling. Notable improvement in casualty's accident year losses reflected the impact of rate increases and continued improvements in business mix. Casualty has been a leading contributor to our declining loss ratio and delivered a positive risk-adjusted profit this quarter.

We remain focused on retaining our most profitable business and refining our account quality scoring tools at an increasingly granular level. Severe commercial losses accounted for a 2.9-point impact to Commercial's loss ratio this quarter versus 1.2 points in the year ago quarter and were within a reasonable range of expectations.

Turning to Slide 10, net premiums written for Consumer Insurance increased 2%, excluding the effects of the yen exchange rate. In Consumer, we continue to focus on improved underwriting quality and targeted growth in key markets where we can achieve meaningful scale. As Kevin advances his strategy, we'll hear more about our plans. Similar to our learnings from our Commercial transformation, Consumer is being led to embrace transformation with an emphasis on value creation. Consumer continues to remain on track for modest improvements in both growth and profitability in 2014.

The Consumer accident year loss ratio increased 0.5 point from a year ago to 59.3, including 1.2 points arising from 3 individual fire losses in North America personal property. These losses were geographically dispersed and were predominantly older policies.

Our risk appetite and exposure to North American personal lines have been stable for some time. While large personal property losses are difficult to predict, this was the first time we experienced 3 personal lines losses in excess of $10 million each in a quarter or even in 1 year. In each of the prior 2 years, we experienced just 1 personal lines loss of over $10 million. Across the remaining Consumer business, we saw improved results in automobile, warranty and A&H, driven by underwriting actions and rates increases taken in the current and prior year.

Turning to Slide 11, operating results reflected a modestly lower level of net investment income, which resulted primarily from a lower invested asset base caused by the runoff of our reserve base, which has fallen from $68 billion in 2010 to $63 billion today. As I mentioned earlier, alternative returns exceeded our expectations by over $100 million. With respect to capital management, as planned we did not remit a dividend to the holding company during the quarter, but we did make tax payments of $188 million. We look forward to contributing our planned dividends during the remainder of the year.

Turning to Slide 12. Mortgage Guaranty's operating performance continues to improve with operating income for the quarter of $76 million. Mortgage Guaranty continues to benefit from its proprietary risk selection model and an improving housing market with 62% of earned premiums generated by high-quality business written after 2008. The delinquency ratio of 5.3% for the quarter continued to fall as the volume of new delinquencies is lower and cure rates improved.

The mortgage insurance market continues to evolve as the highest rated and leading U.S. mortgage insurer, United Guaranty, is well positioned to remain a disciplined and competitive market participant.

In closing, we continue to advance our strategic initiatives, work collaboratively across AIG businesses and further build value for all our stakeholders.

Now I'd like to turn the call over Jay to discuss Life and Retirement results.

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

Thank you, Peter, and good morning, to everyone. Beginning on Slide 13, the first quarter of 2014 was another record quarter for AIG's Life and Retirement business. The segment delivered over $1.4 billion of operating earnings, achieving the highest level of quarterly earnings in our history. Operating income was driven by strong growth in fee income and enhanced spread income. Higher account balances due to strong sales and equity market appreciation generated increased fee income. Interest rates for the businesses continue to benefit from disciplined pricing on new business, reduced renewal crediting rates and runoff of older business crediting relatively high interest rates. Our diversified portfolio of alternative investments, hedge funds and private equity, generated very strong returns during the quarter, contributing approximately $260 million of investment income above our targeted 10% annual returns. Fair value accounting for our investment in PICC Group common stock resulted in a $110 million decline in net investment income year-over-year.

In addition to strong earnings, Life and Retirement delivered $1.7 billion of dividends to the holding company in the first quarter, and we're on target to meet our dividend plan for 2014. We ended the quarter with shareholders' equity x AOCI of $34.6 billion, nearly $2 billion higher than a year ago. All-products, all-channels distribution platform continued to produce strong results. Retail sales were up 61% from the year ago period, reaching nearly $4.4 billion in the quarter. Sales of retirement income solutions products, including individual variable annuities and fixed index annuities, reached nearly $2.2 billion in the quarter, up 54% from the year ago period. Our guaranteed income options, effective marketing programs and materials and award-winning customer service continue to differentiate our offerings in the marketplace, while our innovative and competitive product design has improved the risk profile of these products. We remain comfortable with our level of sales and continue to achieve pricing IRRs in excess of our long-term targets.

Fixed Annuities sales more than doubled from the year ago period to $960 million. Our cost-efficient, flexible annuity administration platform and deep, long-term relationships with financial institutions enable us to remain the #1 provider of fixed annuities through the bank channel, a position we've held for the past 18 years. We saw a slight decline in Fixed Annuities sales on a sequential basis, reflecting our strategy of maintaining disciplined pricing in response to declining interest rates, which occurred over the course of the quarter. At the end of the first quarter, assets under management reached $324 billion, up 9% from a year ago, driven by strong retail investment product net flows, higher separate account balances and greater institutional assets. Net inflows in our retail products and Group Retirement businesses were $1 billion in the quarter, up substantially from a year ago. This improvement was driven by strong growth in sales in Retirement Income Solutions, retail mutual funds and Fixed Annuities, as just discussed. Our stable value wrap business accounted for a $13 billion increase in AUM from the year-ago period, reflecting the deepening and broadening of our client relationships in that business. Overall we're pleased with the growth in assets under management we're seeing across the portfolio of businesses.

Slide 14 provides the components of operating income for our Retail and Institutional businesses. Line of business comparisons to the year ago quarter were adversely affected by the fair value accounting for PICC mentioned earlier. Excluding this impact, Retail and Institutional operating income each increased by 10% versus the year ago quarter. Retail operating income benefited from growth in fee income from Retirement Income Solutions and enhanced spread income from Fixed Annuities. Institutional operating results were driven by increased contribution from Group Retirement from both higher fee income and enhanced spread income in that line of business.

Over the past 4 years, we've redesigned our products to reduce risk to AIG. In our Retirement Income Solutions business, approximately 0.75 of our $25.3 billion of variable annuities with guaranteed minimum withdrawal benefits include benefits with strong de-risking features such as the VIX Index-ing of our rider fees and volatility control funds. In addition, we require minimum allocations to the fixed account which also reduces risk. While we see competitors increasing their presence in this market, consumer demand for variable annuities remains very strong. We're also benefiting from growth in indexed annuities as a result of improved product features, a low interest rate environment and our strong bank distribution presence.

Slide 15 shows our trends in yields and spreads. Base yield in the quarter was 5.32%, up from 5.3% in the prior year quarter and up from 5.29% in the fourth quarter of 2014. The increase primarily reflects the contribution from participation income on a commercial mortgage loan sale and redemption income on a preferred stock holding in the quarter, which more than offset the impact of lower new money reinvestment rates. We continue to actively manage crediting rates on our in-force block and remain disciplined in our new business pricing, as demonstrated by the decline in the cost of funds for both our fixed annuities and Group Retirement business. As a result, net spreads expanded for both Fixed Annuities and Group Retirement sequentially and from the year ago period. At the end of the first quarter, 72% of our Fixed Annuity and universal life account values were at minimum guaranteed crediting rates.

Slide 16 shows our investment portfolio composition and returns and reflects the benefit to net investment income of strong alternative investment performance in the quarter, as mentioned earlier.

So to sum up, we're off to a good start to the year with strong earnings and distributions to AIG. We plan to continue executing on our strategic initiatives, which include growing our distribution organization and increasing the productivity of our wholesalers, affiliated agents and financial advisors. We're successfully leveraging our strong relationships with distribution partners to increase penetration of our broad retail product portfolio, build on our market-leading positions and offer competitive and profitable retirement income solutions. We also look to continue opportunities to grow our Institutional businesses where we can achieve the most attractive risk-adjusted returns.

And with that, I'll turn it back to Liz to open up for Q&A.

Elizabeth A. Werner
Head of Investor Relations and Vice President
Thanks, John. Operator, could we open up the lines?

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Randy Binner with FBR.

Randolph Binner
FBR Capital Markets & Co., Research Division

In the opening commentary, Bob said that the buyback in the quarter was measured. And so, I was wondering how to think about how we can expect for kind of a run rate there. Should we think of this as something we can run rate? Or could you let that go more going forward?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I think the word measured is not necessarily for the quarter but generally speaking as we go through this period of time the Federal Reserve coming in and really working with us on being prepared for an official CCAR down the road once it's defined by the Fed, that you want to make sure that you do things in a steady hand, and that's all that was referring to. So I think as we look through the rest of the year, we have a capital plan. We'll review that capital plan and update our stress testing, as we do internally. Again, it's not the official Federal Reserve stress test. But as we update ourselves, we'll keep an eye on that capital plan. Once ILFC actually closes and we have the money in hand, we'll take a second look at it. So it's just doing things in a very measured way, both for the Federal Reserve and, quite frankly, to the rating agencies. We want to make sure that we satisfy especially the coverage ratio for them as they're asking us to do, and we're in constant dialogue with them. So that's all that meant.

Randolph Binner
FBR Capital Markets & Co., Research Division

Great. And then the follow-up would be if you have any kind of updated comments on the process with the Fed. And in particular, there's been recent introduction of bipartisan legislation in both the House and the Senate looking to clarify the Fed's interpretation of Section 171 of Dodd-Frank. And so, wondering if you have any commentary on how that might affect the process.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Yes, I think what you see going on is an attempt to rationalize what's been said, insurance companies versus banks. So I think that the Collins Amendment and such is something that needs to be worked through so that we -- the Federal Reserve can clearly take a look at what we do here and at the insurance companies. And look, you all understand that our liabilities are very different, and the way they behave is very different as we begin to match the assets and liabilities. And our focus is really long-term solvency to make sure we live up to the promises that we make to our clients, and that's a big deal. And not to say that banks don't do that as well, but it's a different business and a different structure. So I think that pretty much -- I hope that covers more broadly. And I think we're continuing to work with everybody to make sure that -- not only in the U.S. but around the world to make sure we're adhering to and part of the design of appropriate regulation.

Operator

We'll take our next question from Jay Gelb with Barclays.

Jay H. Gelb
Barclays PLC, Research Division

For Peter, the 97% underlying combined ratio, would you view that as a starting point that the Property Casualty business can improve over the course of the year? I just want to clarify that first.

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

Yes, I do see an improvement in the combined ratio during the course of the year based on -- our forecasts of normalized trend. So yes.

Jay H. Gelb
Barclays PLC, Research Division

All right, that's great. And then, there appears to be a persistent drag on the reserving. I believe we're in the fourth quarter in a row of persistent reserve strengthening. When do you feel that drag will be over?

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

So we do a quarterly review of separate segment of the reserves that are, in particular, subject to longer tails and harder-to-predict loss cost trends and that each quarter is looked at independently of the one before. So the cards fall where they fall based on new information that emerges, and we do it with our internal actuarial team as well as external review. The fact that you've had 4 quarters in a row to me is statistically not very significant, and the numbers relative to the total reserve of over $60 billion are relatively modest. The particular prior year development in this quarter was from 2 principal sources, the international financial lines, which is a very profitable business we like. And so, while there have been some gradual increase in torte temperature in a number of foreign jurisdictions, that's something which we gradually adjust our pricing to, but we feel very comfortable with the return on risk of our business and, if anything, see that as exporting the need for more insurance from the U.S. to other jurisdictions. So there's a sort of some positive there. The other piece relates to a large surety loss that occurred, and it was a -- it really came to us last year, so that's why it's a prior year. But it's a transaction that was underwritten about 4 years ago that involved a company that went into bankruptcy. So -- but I don't see it as indicative of reserve weaknesses. It's just a one-off event.

Jay H. Gelb
Barclays PLC, Research Division

How big was the surety loss?

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

$89 million.

Jay H. Gelb
Barclays PLC, Research Division

$89 million. Okay, Peter, I think it is significant from a comparison standpoint at least. We're just not seeing this drag from other large P&C companies. For Dave Herzog, given all the $2.5 billion of cash upfront from ILFC, the $5 billion to $6 billion of dividends from the P&C business and substantial dividends also coming from the life company, I just want to get a sense of why AIG wouldn't accelerate the buyback even taking into account that we're in the course of coming up on a CCAR analysis.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Well, I think what Bob said is -- that captures the essence of how we are approaching capital management. With respect to ILFC, as I said in my opening remarks and Bob said, we are going to go through a process of actually close the transaction. We're going to update our stress tests that are -- that -- you can look at that as sort of normal course. That's what we will be subject to at some point. Although we're not today, we will be. So we're following the -- an orderly process with the Fed. We'll update those results. We'll review those results with the rating agency, with the Fed itself and with our Board of Directors. And so again, I -- and then we'll update our capital plan. I think it's important to note that it's not appropriate to put in a capital plan -- capital actions that are based upon contingent funding.

Others that have tried that did not like the result. So we've learned from that, from -- we've learned from others. So capital plan will be updated in normal course, and then we'll review that update of capital plan again with those various stakeholders and then take appropriate action. Again, I think our approach to capital management has been consistent, steady, orderly, and those are dimensions that we believe are balancing the various stakeholders, including the Fed, including rating agencies, including our own management, Board of Directors. So we're moving at an appropriate pace given the environment and given the onboarding of the Fed. So again, you saw what we did in the first quarter, and that is relative to what we did in the fourth quarter. And so I think we're comfortable with the pace we're on.

Jay H. Gelb
Barclays PLC, Research Division

Great. I hope at 80% of book, we view that as a compelling opportunity for buybacks.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

And the answer is yes, we get that.

Operator

We'll take our next question from Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Peter, I just wanted to ask a little bit about the North America Commercial business. It looks like the year-over-year improvement there slowed a bit in the first quarter. And given the written rate gains that you're earning through and movement towards what I would assume is a lower loss ratio property book and even taking into consideration the severity losses that were effectively flat year-over-year, trying to understand what the margin -- kind of whether we hit a speed bump up or what happened in the first quarter or if there's something I'm missing there.

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

I'm going to give that to John Doyle to answer.

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

What I would point out is that we continue to see underwriting improvement in our U.S. Casualty business. As Peter mentioned, Casualty produced a risk-adjusted profit for us in the first quarter for the first time since we've been using that as our primary performance metric. And it was -- more notable than that was that our U.S. Casualty business was also RAP-positive in the quarter, so we feel good about that. Having said that, we saw some pressure on the top line in the first quarter. The CAT property market got considerably more competitive in the quarter, so we sacrificed some volume in a quarter where, in some cases, we're up from some accounts. We also moved up on some programs to retain some relationships on some business that we thought was within an appropriate margin. And then in Casualty, there was some pressure on the top line. As Peter mentioned, ratable exposures on large accounts. But also, there was also some pressure from DBA business, which is the work comp play cover for U.S. contractors doing business largely in Iraq and Afghanistan. And with the wind down of a lot of the work there, we saw some pressure there. We did see decent growth in the other segments and continued to grow outside of get CAT property in the United States.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. So, I mean, so should we expect some kind of reversion of the -- to what we saw in prior quarters in terms of margin expansion there? Or how should we -- we've just seen that a lot of the really big opportunity to push for excess rate over a loss trend might have -- the low-hanging fruit might be behind us. Just trying to understand, just given what we're seeing elsewhere, how should we think about margin expansion in the North America Commercial business from here just given that's really the management of the margin improvement across the company?

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

Well, I'm not sure it ever feels like low-hanging fruit to me because there's lots of competitors out in the market. But...

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Fair enough.

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

And I would also mention to you that it's not just about price. Risk selection is an important driver for our underwriting improvement, and we continue to refine some of our techniques and use a lot of the analytical capabilities that we brought on to the team over the course of the last couple of years to improve. But as Peter mentioned -- I pointed out CAT property, but Peter mentioned in his prepared remarks most of the other lines of business rates continued to exceed loss cost trends. So -- and as he also mentioned, we do expect continued loss ratio improvement when you normalize for the severe losses during the course of this year.

Operator

We'll take our next question from Larry Greenberg with Janney Capital.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Peter, I think you -- when talking about severe losses in commercial lines, you said $186 million was within a reasonable range. I'm wondering what the range is that you're using today. And should we expect that range to be increasing over time as it seems like you're continuing to emphasize Property over Casualty in your growth plans?

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

This is John. Let me -- I'll jump in on that again. Severe losses for Commercial were $145 million. The number you referenced included the 3 consumer losses that Peter referred to. It's within a range of reasonable expectations. What I would say is it's slightly higher than a number we would expect. But it's going to be lumpy. Of course, we're not going to see quarter-to-quarter a predictable number of these losses. One of the losses, in fact, came in on March 31, right, so just as an indication. But -- and if Property continues to grow as a percentage of the book, we'll see more contribute from that line of business over time.

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

Yes, the most unusual aspect in terms of severe losses, as I mentioned, is in Consumer where we had these 3 rather unusual fires. But in terms of the last few quarters, I was reassured by the fact that most of the severe losses were from property policies written some time ago. So it's not as a result of new exposure. Yes, we are growing our Property business, but there's no evidence that, that is the cause of the elevated severe losses that we had in the last 3 quarters. Over time, yes, as the book grows, it will become a bit more lumpy. But no, I think it's better diversified today than it's ever been before, diversifying away from U.S. CAT to a more internationally balanced global Property portfolio.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Okay, great. And then also, can you provide us any visibility on the other Property Casualty segment, which no premiums but throws off roughly 40% of your Property Casualty earnings? And perhaps some sort of breakdown between what the run off piece of that is, the time line for what that associated tail is, and then how much of it is just purely investment income that doesn't get allocated to the commercial and personal segments.

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

Well, the first is -- I'll work backwards. Your last comment is a substantial element in that line item, which is the excess investment income. We use the transfer pricing mechanism between that Other segment and the Consumer/Commercial, which looks at the risk-free rate plus the liquidity premium, which is roughly 50 basis points. Early investment returns over and above that is shown in our Other segment, and we've been fortunate the asset management group has done an excellent job of getting better returns than that. And so that shows up in that segment. But we also have a number of runoff portfolios, excess workers' comp, some environmental policies and asbestos that didn't -- which is going to be running off over several years and ultimately will free up capital to be redeployed in either dividends or growth in the rest of the business.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

So when the runoff is complete, do you still expect to have an Other segment? I mean, I know we're talking years down the road probably.

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

I think it's certainly not at that scale. And I think that perhaps an Other segment might be consolidated for all of AIG because we have a number of runoff assets at the holding company like the DIB and so on. So I think that hopefully, at some point, the total amount of runoff assets in the whole company are a footnote that doesn't receive as much attention as they do today. But today, between those of the holding company and those that are in P&C, it's still a fair amount of trapped capital which ultimately will get redeployed productively.

Operator

We'll take our next question from Meyer Shields with KBW Management.

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

When we look at the international Commercial segment, I'm looking at last year, you've had sort of an underlying loss ratio that's been in the low 50s in the first half the year and below 50% range in the back half of the year. Is there some sort of seasonality? Or does the sequential improvement from 4Q to the first quarter actually represent something sustainable?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Just to make sure we...

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

Yes, I didn't hear your question. Was it -- did you say Commercial or Consumer at the beginning?

Meyer Shields

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

I'm sorry, international Commercial.

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

Yes, [indiscernible].

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

[Indiscernible].

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

Yes, we -- the severe loss that John mentioned that came in at the very end of the quarter was an international one, and I think that it largely is severe losses shifting from domestic to international. But I think that...

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

Right, we disclosed it in the [indiscernible] on Page 17 the severe loss numbers for international Commercial. And you can see the growth there from the first 2 quarters of last year being very low to an elevated level as the -- as we -- for Q3, Q4 and the first quarter this year.

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

Okay, so we shouldn't expect the same sort of seasonality going forward?

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

No, I think we had very low in the first half of last year and elevated in the last 3 quarters.

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

Okay, that's helpful.

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

[Indiscernible]

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

Right. Unrelated question. How should we think about the process-related expenses for regulation, I guess the AIG unique regulation in the insurance space? Is that likely to increase or decrease from what we're seeing currently?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Now I think that you've seen it baked in a little bit with our numbers. I mean, you -- we talk about our expenses and when are they coming down. We, for example, have maybe close to 300 people dedicated full time to working on our stress testing. Could be as much as 1,000 people supporting them at various points in time. It's already in the run rate, it's already in the numbers, we're already in the process of investing huge moneys in technologies, which we've been able to build a real strategic state-of-the-art system on the investment side and the asset side. We're now putting the team together on building the liabilities and pooling them in a very high-tech kind of way. So that money is in the run rate. It's been in the run rate for, I would say, at least 2.5 years. I mean, we started off, if you'll recall, with Fed-ready, then it's welcome to the Fed. And it's no longer Fed-ready, Fed's here and we need to start really modernizing and putting a lot of money in it, after which it has been in the run rate for quite a while.

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

Yes, I think the big investments are so quite separate from regulation Fed related to merger integration of AIU and Fuji Fire and Marine in Japan. That's a big spend this year.

Operator

We'll take our next question from Jay Cohen with Bank of America.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Yes, a couple of questions. The first is that the G&A expense within P&C was quite a bit lower than it had been running. It was lower in every single segment. Should we be reading into this improvement? And this is the -- just the -- not the ratio, but the aggregate number was down quite a bit from the fourth quarter. Should we read into that?

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

You could, but I don't think you would be interpreting it right. It's -- but you got to do the FX adjustment because it's very sizable yen expenses. So they'll look lower with a lower translation. But we are making progress on expenses. But as I alluded to, we won't see the full benefit until 2015 as we work our way through the merger integration costs in Japan. I have to say that we had a slightly lighter project spend in Japan in the first quarter than I had planned, and we'll see that come through in the second and third quarter at a slightly higher pace. But the full year plan for spending in Japan is on track.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

What about the drop in the U.S.? I assume that -- there is something to that? Again, fourth quarter and the first quarter, both in Commercial and Consumer, that overhead number came down quite a bit.

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

So in the fourth quarter of 2013, we had higher comp-related expenses within the both the U.S. and international businesses. They're not -- that wasn't repeated in the first quarter of this year.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Got it. Second question, on ILFC. I fully understand how you're approaching this from a capital management standpoint, you clearly don't want to put the cart before the horse. You have said in the past several things on ILFC. One, you said that the sale of ILFC would be a credit-positive event for the company, that it was transformational to some extent. You also suggested that the capital that unlocked or that you received when you sell ILFC, in your view, should be free and clear, that it wasn't supporting any other businesses. Do you still stand by those statements?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, it's David. Yes, both, the short answer. Listen, getting -- ILFC has total liabilities of about $25 billion, $26 billion, and that number sits today on our balance sheet in liabilities held for sale. There's no question that the rating agencies will see the actual closing of that sale as credit positive, they have as much as said so. And the capital that -- whether it's the shares of AerCap or the cash that we receive, that will sit at the holding company unencumbered, not backing any other business or liability. And our judgment process will be, as I set forth, in terms of how we're going to go about evaluating what we will do with those proceeds. Bob, I don't know if you want to add anything.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Yes, I guess just keep in mind that I think the ILFC management team over the last 4 years has done a herculean job of turning around the business where we had not dealt with legacy aircraft as appropriately as we should. It did not have the right financing in terms of duration matching against the purchasing of planes and so on. So there's a huge amount of work that went on cleaning it up, building a really strong new airplane purchase book. But if you look at the planes, the neo, we were right out in front of that. And congratulations to the executives that got that going. So the neo 320. So we have a really strong order book. We have really done a wonderful job of cleaning up our finances and dealing with older aircraft that needed to be sold or parted out and so on. So you when you put the 2 companies together, we view it as a very strong property. And for now, we're getting some cash immediately, which is important. We do have, as David said, have a lock upon it. But we also see the future of this over the next several years as being extremely positive. And so we're going to make the right economic decision for the company and our shareholders. And over the next 2 or 3 years, we'll see what's there and make a decision based upon how AIG is trading, where we are vis-à-vis book value. We're expecting improvement in our operating earnings as we go forward, improvement in our ROE as we go forward. So if that all comes together, we'll have a better view of how we'll deal with this non-core asset, which we think has a lot of promise over more than a 1- or 1.5-year kind of time frame.

Operator

We'll take our next question from Brian Meredith with UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

Two from here. First, just on the Property Casualty insurance interest and dividend income in the quarter, I know you said that part of the reason for the reduction was the lower invested asset balance, but it was really a substantial decrease. Was there anything else unusual going on there, FX or something, would have impacted the decline from the fourth quarter?

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

There wasn't anything substantial. As we said, the alternative investments were -- strongly performed. But our overall interest and dividends -- interest receipts were in line with our expectations.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, because I was looking and it sounds like $80 million sequentially. And maybe there's now a case that's kind of what you're talking about with the other, the one that...

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

Yes, there's the $15 million of AIDC [ph] mark-to-market and then $60-odd million of other just declines in interest returns, interest yields.

Brian Robert Meredith
UBS Investment Bank, Research Division

Okay, great. And then my second question is for Peter, John. I'm just curious, the severe loss activity we're seeing, could any of that be attributed to some of the changes you've made in your reinsurance program? And then kind of as an addendum to that, is there any way to kind of get a sense of what the benefit the changes in the reinsurance program have had to your underlying combineds in the P&C area?

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

Well, our international net exposure or non-U.S. net exposure did increase as a result of changes in reinsurance fees. We continue to back out that decision to take more net and remain confident that it's, well, the right economic decision for us. Last year in the first quarter, we saw an unusually low level of severe losses about $60 million in losses, and this year it was close to more normal rate. So -- but, I mean, as I mentioned before, as a percentage of our total portfolio, our high-limit Property business globally is a bigger part of our Commercial Insurance operation. So we do expect, at least in the near term, those exposures to increase.

Operator

We'll take our next question from Josh Stirling with Sanford Bernstein.

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

So let me start with a question for Kevin. So we've started to see improving Consumer margins. I -- you've talked about your initiatives in auto, warranty and accident health. And I was wondering if you could -- you've been here about 6 months, and the company's Consumer businesses started to change about 18 months ago. I'm wondering if you can give us sort of a little bit of a story as to sort of how the focus in Consumer is shifting and maybe some concrete examples of specific changes and sort of specifically on things like pricing and underwriting. I'm kind of curious, are you pulling these levers hard enough to get your business to -- down to the target of a low 90s combined?

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

Okay. Well, thanks, Josh. As I mentioned, last time, we are playing in Consumer essentially with a similar playbook to what has been very successful in the Commercial side, really focusing on underwriting discipline. We're using similar tools in terms of global raters, regular portfolio reviews, et cetera. And then the big portfolios of Japan and of the U.S. in the last 2 years, we've taken substantial actions not only in terms of rate adequacy but also changing certain terms and conditions in the underwriting aspects of the portfolio. And as you mentioned, those 3 underwriting actions are starting to pull through, particularly in the automobile and the accident and health areas. Outside of the 2 big portfolios in the U.S. and Japan, we're managing some important growth-related initiatives in some of the world's fastest-growing markets, the SBE [ph] portfolios. And from those areas, as we're using the appropriate technical tools from the start, we're starting off from, let's say, standpoint of a sound technical base. There were a number of challenges in the portfolios that we are re-underwriting our way through, including the accident and health business in the United States, which is still a bit of a drag on our growth, but we are establishing a sustainable portfolio. And so I would say we're partially through the re-underwriting process, but we have a sound base on which now to focus on growth.

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

That's great. And so a question for Peter and -- or perhaps Charlie around the actuarial and reserving. So you guys have been investing to drive an actuarial transformation along with everything else you've been doing, and I'm wondering if you can give us a sense for what more you need to do to bring your actuarial data and processes to best-in-class. And then if we think about them sort of discretely your reserves in 3 buckets, sort of pre-'04 legacy reserves from the financial crisis here and then, say, the more recent business that you guys have written yourselves since 2010 or '11, for each of these 3 buckets, could you give us a sense of your confidence level and sort of where you think the puts and takes and, say, strengths and weaknesses might be in the current mix?

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

Okay, Charlie, I'll leave that one to you.

Charles S. Shamieh
Legacy Chief Executive Officer

Josh, firstly on technology, I'd say before you get technology, the key thing, and Peter mentioned a bit of this in relation to the international financial lines, is the strengthening. Since there's a lot of work that we're doing to get very granular information with the claims department, because we do see evidence of earlier settlements of claims on a paid and an incurred basis, which is a good thing. We have much richer, case reserve information than we ever had before. And so a lot of the actuarial methodologies are being adapted for that. And so we believe our reserves reflect the best estimates for that. But that does -- causes a lot of difficulties in looking at historical patterns and the triangles because [indiscernible] is actively affecting those trends, and we think that will be beneficial to us in ultimate loss cost eventually. In terms of technology, we are -- Bob mentioned this earlier as part of the stress testing work and the capital management work that we're doing. We are putting the liabilities on to fairly expanded industrial-strength platform for income statement and balance sheet projections. And these are industry tools that help us not just look at point estimates but also uncertainties in those estimates and what drives those uncertainties. In terms of the confidence in the 3 buckets that you mentioned, I believe we have confidence in every one of those buckets. We set them through our best estimates regardless of which accident year we're looking at. If we see emergence now that we had previously not expected, we will react to it in the quarter. And one of the drivers in international financial lines was in isolated pockets in Europe in our professional indemnity, where we saw a much longer tail than we have ever seen before back to 2005, as early as 2005 in some cases, and we're reacting to that. So I wouldn't give you a differentiated answer. The process we're following looks at everything every quarter in a very detailed dive into the long-tail process. We have claims reviews and underwriting. And also, ERN [ph] involvement in the validation process, at least once annually for the long-tail process.

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

That's great. So -- and then so this quarter, with the international financial, it sounds like you must have had some late emergence, sort of latency you didn't expect, and then the surety was basically an individual claim that came through. It sounds like this is much more a case of you guys responding to the data as opposed to, say, changing your approaches and sort of doing a study or something like that. [Indiscernible]?

Charles S. Shamieh
Legacy Chief Executive Officer

I think that's very fair. International financial lines is really isolated to 2 buckets. Peter mentioned them earlier, but Australia and New Zealand in the excess layers. And in CI and CNO [ph] specifically. And it -- I would say the frequency and the severity affected this environment in Australia in particular was higher than we had previously built into our price. But as Peter said, that remains for us a very profitable portfolio. And then the European CI I mentioned, we had isolated pockets of individual countries in Europe where we saw much later emergence for our claims [indiscernible]l.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you. Operator, at this time, we'd like to close the call and follow up with any additional questions when we get up to our desks. Thank you, everyone, for joining us today, and we appreciate your attention.

Operator
That concludes today's conference. We appreciate your participation.