S&P Capital IQ

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American International Group, Inc. NYSE:AIG

FQ4 2016 Earnings Call Transcripts

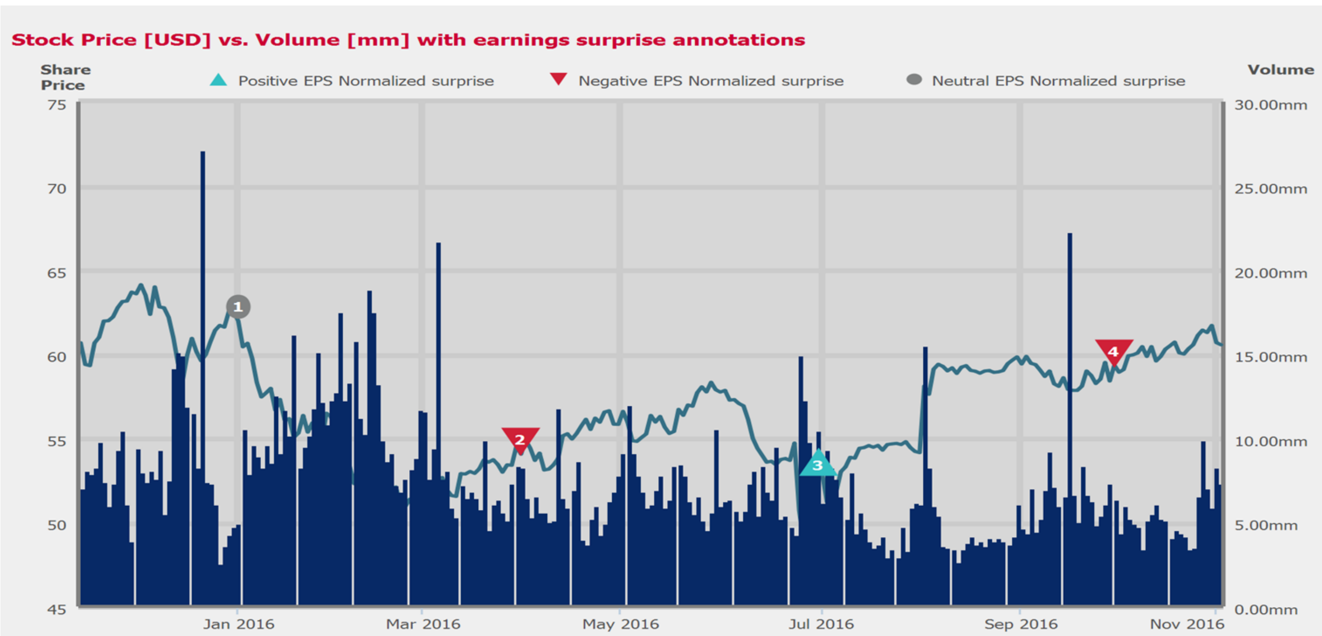
Wednesday, February 15, 2017 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-		
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	
EPS Normalized	(0.57)	(2.72)	NM	1.25	2.09	0.36	
Revenue (mm)	12325.00	13010.00	5.56	12234.00	51581.00	52367.00	

Currency: USD

Consensus as of Feb-15-2017 12:07 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	(0.93)	(1.10)	NM
FQ1 2016	1.00	0.65	1 (35.00 %)
FQ2 2016	0.94	0.98	2 4.26 %
FQ3 2016	1.21	1.00	3 (17.36 %)

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Presentation

Operator

Good day, and welcome to AIG's Fourth Quarter Financial Results Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over the Ms. Liz Werner. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you. Before we get started this morning, I'd like to remind you that today's representation may contain forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance or events. Actual performance and events may differ possibly materially from such forward-looking statements. Factors that could cause this include the factors described in our first, second and third Form 10-Q and our 2015 form 10-K and 2016 10-K to be released under Management's Discussion and Analysis of Financial Conditions and Results of Operations and under Risk Factors.

AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements whether as a result of new information, future events or otherwise.

Today's presentation may contain non-GAAP financial measures. The reconciliations of such measures to the most comparable GAAP measures are included in the slides for today's presentation and our financial supplement, both of which are available on our website.

The format for today's call will follow prior quarters. There'll be one question and one follow-up during our Q&A period. We will extend the Q&A period today, so that we can answer as many of your questions as possible. This morning, you'll get to hear from our leadership team and in particular, we'll lead with our CEO, Peter Hancock; Sid Sankaran, our CFO; Rob Schimek, CEO of Commercial; and Kevin Hogan; CEO of Consumer.

And with that, I would like to turn the call over to Peter.

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

Thank you, Liz, and good morning, everyone. Today, I will review our 2016 accomplishments and provide an updated outlook for 2017. But first, I'll speak to our recent announcement of an Adverse Development Cover with Berkshire Hathaway and our Q4 reserve strengthening.

Let me begin by providing some historical perspective on the Adverse Development Cover. We've evaluated ADCs from time to time and followed our 2015 reserve addition. We felt it was a strategic imperative to radically reduce reserve risk and improve earning sustainability. As that time, Doug, Rob and Sid were new to their roles, and I've asked them to carefully evaluate our business in force, new business underwriting and sources of alternative capital. As we've stated, reinsurance is a key component of our strategy and one outcome of their work with the agreement with Berkshire, which reinsures the vast majority of our U.S. casualty reserves and more importantly, exposures going back to more than 40 years. While Adverse Development Covers are not new to the industry, an agreement of this scope and scale is redefining. Berkshire is a knowledgeable partner with investment expertise and balance sheet strength, which are well matched with AIG's claims capabilities. The economics and the reduction in risk associated with this agreement will provide benefits for many years to come and pivot us towards the future AIG with lower risk of impairments to book value, higher quality earnings and ultimately, a lower cost of capital.

In the fourth quarter, we also announced a $5.6 billion tri--year reserve addition. As we reacted to emerging severity trends across lines and accident years. We chose to make more prudent reserve assumptions, which Sid will speak to. The trends we witnessed and reacted to this quarter were broad, and we believe are materially impacting the overall U.S. casualty market, which we see generally as rate inadequate. With new information, we gained insights. And for our excess business, claims emergence can take several years to become a apparent. In this case, what we have learned recently confirms our existing strategy to adjust volumes, limits and increase rate in our U.S. casualty book while maintaining our focus on most valued clients, many of whom have been with us for decades. We're confident that our actions will improve our underwriting consistency and profitability, and Rob will comment further on this in his remarks.

Looking back on 2016, as shown on Slide 4, there were significant accomplishments to improve profitability, return capital to shareholders and further sculpt the company. We surpassed our expense-reduction target and decreased 2016 expenses by over $1 billion or 10%. These cost reductions were based on a number of disciplined actions to provide sustainable operating efficiencies.

Capital return remains a commitment to this management team, and 2016 was no exception to our long track record. We returned over $13 billion in capital, again, exceeding our original target. We maintained our commitment to the $25 billion capital return target and our focus on doing so in a manner that ensured the continued confidence of our clients in our claims-paying ability. We recognize the great efforts and engagement of our rating agencies and regulators who have been so critical for the successful transformation of AIG, and we'll continue to work closely with them to serve all our stakeholders.

Our capital flexibility has been driven by our divestitures and legacy asset sales and the strength of our diverse insurance subsidiaries. Divesting businesses that are not part of our core insurance operations and selling legacy assets is consistent with our strategy to increase focus. Over the course of the year, we completed or announced 10 transactions that are expected to result in over $10 billion of liquidity. Most importantly, I'd like to highlight that 2016 accomplishments of our consumer and commercial businesses.

Consumer profitability grew and pretax operating earnings increased over 30% to over $3.8 billion. Profitability was driven by stable individual and Group Retirement earnings and strong growth in Personal Insurance. The Personal Insurance geographic strategy and underwriting margin expansion should continue to benefit future earnings, which Kevin will expand upon.

In our commercial businesses, you've heard from Rob this year that we've increased our focus on our most profitability product lines and clients. At the same time, we've maintained our leadership position in Financial Lines and expanded our multinational capabilities. As you consider our future progress, we would refer you to our new business modules, which are an important lens through which to view our future business strategy. Our modules provide greater transparency into how we measure our business, assign greater control and accountability to our managers and improve efficiency and profitability. We recognized that we've provided a significant amount of information this quarter, and we will be providing greater insight into our module strategies in the near future. The trends in our module ROEs as they stabilize will become a key measure for our business's performance internally and externally.

Turning to Slide 5, our actions this quarter increased the visibility in reaching our 2017 goal of 9.5% core insurance normalized ROE. While we have lowered our normalized ROE target by 50 basis points due to lost investment income, I believe this reduction is exceeded by the decline in our cost of capital resulting from the ADC, legacy dispositions, a reduction in U.S. housing market exposure through our UGC sales, reduced CAT volatility and lower fixed costs.

Beyond 2017, we would expect to see further ROE improvements. We expect to reach or exceed our expectations for expense reduction and capital return, subject to regulatory and rating agency considerations. You will continue to see improvements in our core businesses and further investments in people and technology. We believe the actions we took this quarter and the continuing steps to execute our strategy best position AIG for more stable and profitable long-term results.

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

Siddhartha Sankaran
Executive VP & CFO

Thank you, Peter, and good morning, everyone. This morning, I'll provide further details on our Adverse Development Cover, the fourth quarter reserve strengthening, our quarterly financial results and our outlook for 2017.

As we discussed with you at our Investor Day, our objective has been to be vigilant about managing reserve risk. As Peter mentioned, in Q2 of 2016, we initiated a process to evaluate an Adverse Development Cover, utilizing a third-party reinsurance broker and evaluating multiple markets and structures.

Slide 6 illustrates how we've transformed our reserve risk profile as a result of the ADC. Under the agreement, AIG will pay the first $25 billion of liabilities and then split the next $25 billion of payments, 80-20, up to a $50 billion limit. At the end of 2016, we held $16 billion of nominal reserves above the $25 billion attachment point, including the 4Q reserve addition. 80% of these reserves or $12.8 billion are ceded. The difference between the $12.8 billion of ceded reserves and the consideration paid, including interest, will result in an estimated $2.6 billion pretax deferred gain before discount in Q1 2017. This gain will be amortized over the estimated reinsurance recovery period.

In terms of our GAAP results, we are required to recognize 100% of any future favorable or adverse reserve development on the covered liabilities in our GAAP net income. The deferred gain on the ADC will be then adjusted for 80% of the impact as well as the amortization of this gain. Only 20% of any future potential reserve development will impact our operating income.

Turning to Page 7, you'll see that the agreement covers U.S. Casualty and Financial Lines, which accounts 80% of the adverse development we have realized over the past few years. Excluded from the cover is our international commercial business, certain retrospectively loss sensitive policies, short-tail commercial lines, personal lines and legacy reserves, which contributed approximately $700 million to the fourth quarter reserve addition. We expect this transaction will dramatically reduce operating earnings volatility and improve ROE in the long term.

As you know, we also review our reserves over the course of the fourth quarter. On Page 8, the fourth quarter actions we took were based on emerging trends and new claims data supporting a more cautious view in our assumptions. The adverse reserve development on covered reserves was $4.9 billion, the vast majority of which is U.S. Casualty. Of this amount, $2.5 billion was related to incurred loss development methodology and tail factor strengthening for the line subject to the ADC. The bottom chart illustrates the accident years impacted by the reserve strengthening. While we did see some large claims activity in Financial Lines, our performance in this business well exceeds our hurdle rates even after factoring in this development. So I'll focus my comments on the U.S. Casualty business.

Turning to Slide 9, there were 3 things we learned during the course of our reviews. First, in general, for U.S. Casualty, we saw an increase in frequency and severity of claims, which became more material in the third quarter and accelerated in the fourth quarter that caused us to increase our trend in loss development factors across those lines.

Second, in excess casualty, we saw an increase in both paid and incurred claims for recent accident years, particularly 2015. And while recent accident years remain very green, we felt it prudent to strengthen reserves for this new claims data.

Third, in certain lines where we've taken dramatic actions to reduce writings such as commercial auto and health care, loss cost continued to worsen, and we decided to book reserves higher in the range of estimated losses.

In summary, we believe in light of the reserve data, we've appropriately revised our assumptions to weigh more recent trends in setting the best estimate reserves.

Another important point is the setting of our loss mix in light of the recent trends. For the year, we added approximately $700 million to the 2016 accident year and included an additional $500 million in our outlook for the 2017 accident year, almost entirely in U.S. Casualty. We revised our methodology and philosophy to include a margin for the reasonable uncertainty around casualty loss trends, a shift from our historical approach. This refinement was further validated by Berkshire Hathaway's pricing of the ADC.

Rob will speak to the underwriting actions the commercial team has implemented in his remarks. The ADC transaction reserve strengthening, adjustments to loss picks [ph] and underwriting actions are important steps to position AIG for future profitability and improve earnings quality. Going forward, you can expect our future earnings to better reflect the profitability of new business under it.

Moving on to the quarter, we reported an operating loss per share of $2.72, which was largely driven by the prior year adverse development charge of $3.56 per share. As you'll hear later today, Consumer had a strong fourth quarter and delivered nearly $1 billion in pretax profits. Commercial results included not only the reserve development, but my previously referenced increase in our 2016 loss picks. We also recorded $233 million in catastrophe losses from Hurricane Matthew, which was in line with our expectations.

Turning to Page 11, you can see our progress versus our 2016 targets. While we exceeded our expense-reduction targets for the year and our planned pace on capital return, the reserve strengthening charge and increased loss picks set us back against our accident year loss ratio, book value growth and ROE targets. As we look forward, we have a higher degree of confidence in achieving sustainable improvement in each of these metrics and expect less volatility going forward.

Turning to Slide 12. As Peter stated, we reduced operating expenses by over $1 billion or 10% for the year. Including our actions taken to date, our annual run rate savings totaled $1.3 billion. Thus, we've effectively reached our 2-year targeted expense reduction a year ahead of plan, and we expect further reductions that will improve our ROE going forward.

Our balance sheet and free cash flow remains very strong. And as you can see on Slide 13, current liquidity at quarter end was $8.4 billion. We are ahead of plan, and our projections continue to support our target to return $25 billion of capital to shareholders. We will continue to return capital to shareholders prudently and with appropriate quarterly consultation with rating agencies and regulators.

During the quarter, we continued to execute against our capital return target and returned $3.3 billion of capital to shareholders, bringing the year-to-date total to $13.1 billion. Since quarter end and through February 14, we repurchased an additional $1.2 billion of common shares, leaving about $1.2 billion unused under the remaining authorization prior to yesterday's additional $3.5 billion authorization.

Notable items in the quarter include the $2.2 billion of cash proceeds received on closing the UGC sale as well as a preclosing dividend of $250 million received from UGC. We also received $1.1 billion of newly issued arch convertible nonvoting common equivalent preferred shares. Importantly, we completed the second of our planned life reinsurance transactions associated with XXX/AXXX in the fourth quarter. This is expected to result in additional parent liquidity, principally in the form of tax-sharing payments of $2.3 billion expected in 2017.

With respect to the plan to reduce hedge funds by about half by the end of 2017, our hedge fund reductions totaled $3.2 billion in 2016. This has freed up capital of approximately $1.1 billion in 2016 and an additional $500 million in 2017, which result in additional dividend payments to the holding company.

Finally, we expect the ADC transaction will receive approval from regulators to be recognized in our year-end 2016 statutory financials providing favorable risk-based capital treatment.

Turning to legacy on Slide 14, we are very pleased with the progress we've made in shrinking legacy this quarter and improving intrinsic value while carefully managing the impact to book value. In particular, the fourth quarter included the sale of our Korea IFC real estate complex and a portion of our life settlements portfolio.

Turning to Slide 15. At year-end, we have tax attribute DTAs totaling approximately $14.8 billion, of which, approximately 1 quarter related to foreign tax credits and 3 quarters related to net operating loss carryforwards. In addition, we had a net DTA for temporary differences in the amount of $5.9 billion. We are pleased with the progress we've made with respect to utilizing our foreign tax credits.

Slide 16 shows the changes in book value year-over-year. The chart illustrates the book value growth, including dividend growth, was 3% for the year. However, book value growth in core for the year was 7%, even after the impact of the reserve strengthening charge. We continue to expect strong book value growth and a more stable book value due to the ADC as we move forward. But as I have said before, we are making tradeoffs with respect to legacy in terms of recognizing immediate book value charges for future ROE improvements.

Slide 17 details our core normalized ROE for the year and our target for 2017. When you evaluate our new modules, you will see our view of return on economic capital. Some of our modules are meeting the cost of capital while others have more work to do, and Rob and Kevin will comment on that further in their remarks.

I also wanted to highlight, as part of our recast of modular results, we moved to a simpler method of normalizing our annual average loss expectation, also known as our AAL for CATs. We've historically incorporated a seasonality adjustment to estimate the quarterly allocations, but now we're allocating the AAL evenly across the 4 quarters. All of the historical periods reflect this change. Note that with the actions we have announced this quarter, including the ADC, we'd expect the future impact of normalizations to be moderated going forward.

Moving to 2017, we show the impact of the quarters action in our ROE target. Our 2017 target for core normalized ROE of 9.5% is driven by the lost investment income associated with our Adverse Development Cover. Considering the net impact of the Adverse Development Cover and the fourth quarter reserve strengthening, we would expect to free up approximately $2 billion of capital over time, subject to rating agency and regulatory considerations. We have not reflected this benefit in our current projections for 2017, as we do not anticipate revising our PC dividend forecast upward at this point in time. We expect to achieve a 10% normalized ROE in the not-too-distant future as we deliver our underwriting improvements, capital return and expense management.

To sum up, I'm confident that our actions taken put us on a path to better quality earnings, growth in earnings as we move forward. Our strong balance sheet, liquidity position and a free cash flow profile like no other in our industry leaves us very well positioned for the future.

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

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

Thank you, Sid, and good morning, everyone. Beginning on Slide 19, the fourth quarter marked the culmination of a truly transformational year for commercial with the completion of an extraordinary amount of change as part of the strategy we outlined at the beginning of 2016.

Today, I'll discuss 3 topics: the actions we've taken to significantly reduce future volatility, progress of our strategy to improve underwriting performance and the outlook for Commercials business modules. The Adverse Development Cover is a comprehensive transaction that was one of the several strategic reinsurance agreements we entered into over the past year. A key part of the agreement is that we retain full claims authority to honor our commitments with consistency of decision-making and service and our clients expect of AIG. As Sid mentioned, during 2016, we also increased current accident year loss estimates by approximately $700 million in response to the emerging trends reflected in our prior year reserve strengthenings bringing total loss picks for the 2016 accident year to a more conservative level that includes a margin of error, reflecting the long-tail nature of the U.S. Casualty business.

Looking toward the future, we're confident that the steps we took in 2016 to prioritize value creation and utilize more rigorous data and pricing tools will significantly enhance the quality of our portfolio.

Turning to Slide 20. The top line shows commercial's adjusted accident year loss ratio, including the effect of prior year development for each accident year. The bottom line shows the adjusted accident year loss ratio at the end of 2015 before reflecting the results of the 2016 reserved studies. You can see that our fourth quarter 2016 reserve strengthening positions us at a 2015 starting point that is 6.1 points higher than we reported this time last year. On that basis, we achieved 4.1 points of improvement in the adjusted accident year loss ratio in 2016 as a result of the changes in our mix of business and increasing improvements in our underwriting tools. We are targeting a 62% adjusted accident year loss ratio on a fourth quarter 2017 exit run rate basis representing an 8.8 point improvement over the 2-year period.

Today, U.S. Casualty represents just 21% of the Commercial business, down from 40% of the portfolio in 2011. We drove the most significant amount of that change in 2016, reducing U.S. Casualty's net premiums written by 39% compared to the prior year with a corresponding improvement in U.S. Casualty's adjusted accident year loss ratio of 5.5 points. As a result of our actions, commercial's full year 2016 adjusted accident year loss ratio for all business, excluding U.S. Casualty, was strong at 60.2%.

As Sid mentioned, we continue to experience significantly higher severity trends in commercial auto, medical malpractice and excess casualty in the United States. These businesses are parts of the lines we've been remediating and improving, and we've been shrinking our position in these underperforming areas for several years. While we acknowledge we have more work to do, we've managed the portfolio thoughtfully and with pace over the past year, while balancing the need for improved rate and our objective of preserving our valued client relationships.

Moving to Slide 21. We've illustrated the significant improvement in our mix of business, a key driver of the 4.1 point adjusted accident year loss ratio decline. We reduced the remediate and improve business by 34%, while also realizing a significant improvement in the adjusted accident year loss ratio in those subsegments. 93% of the fourth quarter commercial reserve strengthening was attributable to products in the remediate or improved product lines, making us confident that our underwriters are on with better tools and taking actions in the right parts of the portfolio.

The attractive grow and maintain business increased from 50% of the portfolio in 2015 to 60% of the business at the end of 2016, and we continue to see strong performance in our focused growth segments and multinational businesses. We are pleased that full year retention of our major clients, which represent our largest multiline relationships, remained relatively consistent with the prior year at 94%. The chart at the bottom of the page demonstrates the interconnected nature of our commercial business as the vast majority of our large clients purchase multiple products that vary in profitability. We've been carefully resculpting the portfolio to make holistic decisions that prioritize our most valuable client relationships. In 2017, we'll continue to focus on growing these profitable relationships that create intrinsic value for AIG.

Turning to Slide 22. Commercial's 2016 normalized ROE of 6% includes the increasing current accident year loss picks. We're targeting a normalized ROE of approximately 9% in 2017, reflecting lower capital due to the Adverse Development Cover and improved business mix in underwriting results, partly offset by lower net investment income. Commercial's full year adjusted accident year combined ratio of 95.8% was a 5-point improvement over 2015, which includes an increase of 3.9 points in the current accident year loss picks. The expense ratio declined 0.9 points, demonstrating that we've continued to manage expenses despite a lower premium base.

Turning to Slide 23. Notwithstanding the increasing current accident year loss picks, the 2016 normalized ROE for liability and financial lines was 8.8%, reflecting profitability in Financial Lines and the positive contribution net investment income has on long-tail business. The liabilities in Financial Lines full year adjusted accident year combined ratio of 99.7 increased 0.8 points over 2015, driven by a 5.7 points increase in current accident year loss picks, partially offset by a 2.3-point improvement in the expense ratio. The expense ratio benefited from improvements in general operating expenses and higher ceding commissions from reinsurers.

Fourth quarter net premiums written declined 22%, excluding FX with approximately 9 points driven by insurance and remainder by risk selection. In the U.S., casualty rates are inadequate, and we continue to stand firm in the competitive environment. Fourth quarter rates increased over 5.5 points, representing the fifth consecutive quarter with rate increases in excess of 3 points. For the full year, we reduced liabilities and Financial Lines net premiums written by $3.2 billion as part of our portfolio optimization efforts. The bar charts at the bottom left-hand side of the page clearly reflect our shift from U.S. Casualty towards a more valuable Financial Lines and international casualty businesses. We continue to view Financial Lines, in particular, as highly attractive and remain focused on building upon our strength as a market leader. With that said, we've demonstrated a healthy discipline to balance our growth ambitions in certain poor-performing subsegments of Financial Lines business where the rates are challenged.

Turning to Slide 24. As we noted during our Investor Day in November, we faced profitability challenges in Property and Special Risks. The 2016 normalized ROE of negative 0.2 was the result of 4 primary drivers we discussed throughout the year. Continued price erosion in parts of the property market, poorer-than-expected performance in programs, elevated attritional losses in Europe and the size of our average annual loss expectation for natural catastrophes.

We've taken a number of actions that will lead to ROE improvements in 2017. First, we've been more rigorous in our risk selection beginning in the second quarter of 2016 and extending through January 1 renewal season, which is particularly important in Europe. We'll continue to shift to highly engineered large limit and middle market risks, while we aggressively reduce exposures in commoditized excess and surplus lines where we simply don't agree with market behavior.

Second, we've substantially completed our mediation of our Programs business, which we discussed during last quarter's call. Third, we completed the sale of our stake in Ascot, a business that generated approximately $500 million in premiums, but earned a normalized ROE in 2016 on an AIG economic capital basis -- a normalized ROE of 0 in 2016 on an AIG economic capital basis. Finally, we've significantly reduced CAT risks. While 2016 was a relatively active CAT year, our experience was still better than our average annual loss expectation. We've continued to aggressively manage our CAT exposures and expanded our CAT reinsurance program effective January 1, 2017, to further reduce our average annual loss expectation.

Turning to the top line. Fourth quarter net premiums written declined 15% excluding FX, reflecting the improved risk selection in property rate declines of over 5 points, driven primarily by the U.S. excess and surplus lines business. We have the conviction to continue to opportunistically manage our property book as market conditions warrant.

The final observation I'd like to make is that as you can see on the bottom right side of the page, we've experienced a more stabilized level of severe losses with severe losses improving from 8.9 points in 2015 to 5.4 points in 2016. We continue to expect reduced loss volatility as a result of our engineering capabilities, risk selection efforts and reinsurance purchase during the second quarter of 2016. While we acknowledge we have work to do, we expect meaningful ROE improvement as a result of our plan in 2017.

In closing, our actions to reduce commercial volatility, increased use of data and tools and improvements in our business mix will result in a stronger more valuable portfolio. We're focused on execution, and I'm confident that we'll achieve our goals following a truly transformational 2016.

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

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

Thank you, Rob, and good morning, everyone. Consumer produced strong results for the quarter and for the year. For the year, we expanded normalized ROE by 190 points to 10.3%. We expect to maintain or exceed this level of normalized ROE in 2017. During 2016, we took actions in each of our modules and key geographic areas to create value.

In addition, I am delighted to report that in Japan, the intensive preparation for our legal entity merger is progressing well. Earlier this week, we announced adoption of FSA-approved premerger status as of April 1 this year and our target merger date of January 1, 2018. This is a major milestone in our transformation effort.

Slide 26 summarizes our progress in 2016. In individual retirement, we were proactive in taking pricing and product feature actions to navigate the low interest rate environment. We focused on value over volume, and we're not dependent on any one product line. Due to our broad product portfolio and deep distribution relationships, we achieved top 5 sales ranking across annuity lines, fixed, index and variable, a position we believe is unique in the industry.

Individual retirement's earnings for the year were strong with PTOI increasing by over 25%. For our Group Retirement business, VALIC, our investments to transform the plan sponsor and participant experience began to pay off. We significantly improved our results in winning new group plans and in retaining existing plans. Our net flows improved substantially, and we achieved the highest level of premiums and deposits since AIG's acquisition of VALIC.

Our life insurance business continued to make progress, executing our plan to enhance ROE. During the year, we completed the introduction of our new state-of-the-art administrative platform and new digital capabilities, revamped our product suite and substantially exited our U.S. life career distribution and service agent channels and group benefits business. Despite these exits, we maintained our sales levels by focusing on independent distribution and [ph] our direct-to-consumer platform. We achieved the top 5 ranking in term life sales, the first time we have held this position since 2007 and now lead the industry in term life sales in the direct channels.

Our growth in term life sales, strong underwriting discipline and increased focus on products without long duration interest rate guarantees created value in the low interest rate environment. Additionally, working with Charlie Shamieh and the legacy team, we closed 2 large reinsurance transactions during the year to address significant redundant reserves and are on track to meet our targets for the remaining transactions.

Our greatest improvement for the year was in our Personal Insurance business. Our focused strategy, which includes our geographic footprint reduction has resulted in significant expense savings and improved combined ratio and an increase in PTOI of over $600 million. As we've reduced our footprint, we've increased our investments in markets and customer segments where we have a competitive advantage and favorable future prospects. This includes our high net worth business, the Private Client Group in the U.S., where we've had healthy growth and new business for the last few years and have recently expanded our offerings overseas. We also made investments to deliver a digital experience to our customers in a number of our fastest-growing markets, including Korea, China for outbound travel business and South Africa where we have introduced innovative offerings in partnerships with the Virgin Group. We believe that the actions we took in 2016 will position our Personal Insurance business for future growth in our select markets and customer segments.

We also continued to make progress transforming our business in Japan while producing solid operating results for the year. Japan's overall underwriting results was strong, and its normalized ROE for the year based on our internal capital lens was 10.8%.

We continued to take actions during the year to streamline processes, focus marketing, increased productivity and reduce headcount and expenses. As I mentioned earlier, we secured crucial regulatory approval of a targeted merger date of January 1, 2018. We also announced in November that we had entered into an agreement to sell Fuji Life, allowing us to focus on our strong P&C position. We have taken actions across our balanced portfolio of consumer businesses to create value and position us as industry leaders in our target markets.

Now I will briefly discuss the results of the quarter. Turning to individual retirement on Slide 27. In the quarter, we saw lower sales and net flows from a year ago. This reflected the ongoing industry-wide slowdown in variable annuity sales from the uncertainty caused by the DOL fiduciary rule and lower Fixed Annuity sales due to the sustained low interest rate environment. In the face of these challenges, we continued our disciplined approach with respect to product pricing, product features and asset quality. We maintained our base in net investment spread for Fixed Annuities as well as for variable and index annuities.

Turning to Group Retirement on Page 28. Deposits increased in the quarter, but were offset by higher surrenders that resulted in overall declining net flows. Despite disciplined rate management, base net investment spread for Group Retirement declined, primarily due to low reinvestment rates. Further, as we mentioned on the third quarter call, we did expect to see higher planned conversions in the fourth quarter, including large case group surrenders as a standard for the defined contribution market at year-end.

Before moving to our life insurance business, I'll speak briefly as to recent developments with respect to the DOL fiduciary rule. On February 3, President Trump issued a memo requiring the DOL to review the rule and determine whether it will adversely impact the ability of retirement savers to access information and financial advice. Accordingly, the DOL announced that it would consider legal options for postponing the applicability date of the rule while it considers the issues raised in the memo. We are closely following further developments.

For our individual retirement business, we remained actively engage with our distribution partners to ensure that we will continue to meet their needs as they respond to the evolving status of the implementation.

Let's now move to life insurance on Slide 29. Premiums and deposits grew, primarily driven by our international business. In our U.S. business, overall sales remain largely in line with the prior year period despite our narrowed distribution focus. Life insurance PTOI was negatively impacted in the quarter by reserve increases in our individual group and international business lines totaling approximately $45 million, over half of which was driven by administration system conversions in the U.S.

Turning to Slide 30. Personal Insurance reported another strong quarter of operating performance. The operating improvement reflected our strategic actions to reduce expenses and focused marketing activities as well as continued operating benefits from investments in Japan and other select markets. Results reflect a favorable prior year loss reserve development and lower-than-expected attritional losses in key markets, partially offset by higher catastrophe losses. We believe we have additional opportunities to improve underwriting results, although we do not expect progress to be linear quarter-to-quarter.

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

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

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

Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Ryan Tunis with JPMorgan (sic) [Crédit Suisse].

Ryan James Tunis
Crédit Suisse AG, Research Division

Tunis with Crédit Suisse. I had one question, and then John Nadel on a follow-up. But I guess just trying to understand why the 60% is unattainable in 2017 at 93% of the premium -- at 93% of the charge on premium that you already plan to improve or remediate. Why is it that we can't just push a little bit harder on that premium in '17 and get to the 60% if that was always a pretty important part of getting there?

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

Ryan, it's Rob Schimek. So I'll point a couple of things. First of all, I want to point you to Page 20 and just remind you that the 66.7% that you're seeing on that page includes 3.9 points of higher accident year loss ratio that we booked, particularly relating to the long-tail line. So as I said in my comments and Sid said in his comments, there is a margin for error that we booked into the long-tail commercial lines that we had not previously recorded. The second observation I'd make for you is that, as I show on Slide 21, the nature of our business is a very interconnected nature when we think about it from a perspective of a client. So I've shown you a table at the bottom of Page 21 that shows that 90% of our major clients, major account clients are clients that have revenues of over $500 million. They are long-term clients, 18-year relationships, but that our relationships cross across not just one line of business, but multiple lines of the business with varying degrees of profitability. And our main objective is to protect the valued client relationships and make sure that we can think of them holistically not as an individual product, but instead, as an individual client. And then I guess, the third point I'd make more for you is don't lose track of the fact that in our improvements that we've committed to, we did not make any expectation for you on expense ratio other than we would be able to maintain it flat. And in 2016, you can see that we did improve the overall commercial expense ratio by almost 1 point. So the 66.7% that you're seeing is loss ratio only. If you thought about it in the context of combined ratio, it's about a 5-point improvement over the prior year and it includes about 4 points of higher accident year loss ratio. If you drill that down and put it into the U.S. Casualty business, that actually translates to about an 11-point increase in our accident year loss ratio for U.S. Casualty business. And what we're really doing there is recognizing that we don't want to leave you 3 years from now seeing us book an increase in prior year development for the actions we took in 2016.

John Matthew Nadel
Crédit Suisse AG, Research Division

And this is John Nadel with a follow-up. I guess, my question is for Peter, and I'm focused on Slide 17. It looks like the impact of the reserve charge is driving nearly 100 basis point increase in the ROE, all else equal. And that appears to be simply because you've taken the equity down. If I look at the ROE impacts, excluding that, you're dropping your ROE target by about 150 basis points. Is that how you and the board and your incentive plans will capture the impact, meaning the gross 150 basis point reduction in ROE will be the more prevalent measure? And then secondly around that, are there areas within the total portfolio of businesses where you can find the incremental earnings to help offset that pressure, whether it's via incremental expense saves, capital return? Or is it just a function of investors need to believe in and discount a lower cost of capital?

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

So I think that the 90 basis points that you see on Page 17 is just the mechanical effect of the impact on GAAP equity. But from a point of view, how we steer the ship and how the board thinks about value creation, we look at the much bigger reduction in required economic capital that comes from the ADC. So the ADC reduces the reserve uncertainty so much more than the book equity reflects that there's actually bigger than 90% improvement in the return on economic equity, but that will take time to come through because we need to work closely with our regulators before we dividend up from the subsidiaries. So I think that there's no doubt in my mind that this transaction and the net of the ADC and the reserve charge is accretive to value. But I think that the timing of how it comes to GAAP ROE is another. It takes a little bit longer. So we've obviously got a component of it that reflects the reduced investment income, that's another piece that needs to be understood. But I think that taken as a whole between the 2 actions of the prior development and the ADC, it's a significantly accretive to value. And I think if you work your way through the capital framework that we used in the new module disclosure you'll see with much greater transparency how we manage the difference between economic capital and statutory capital, the so-called difference in the frictional capital. You can see how this will work its way through, especially due to a forecast ROE in 2018, by which many of these timing mismatches will sort of come out in the wash.

Operator

And we will take our next question from Kai Pan.

Kai Pan
Morgan Stanley, Research Division

First question on the reserve charge. I just wonder how much the increase of the accident year loss ratio pick is coming from this so-called emerging trend in third quarter and fourth quarter versus -- so you're adding another layers for margin of safety because you mentioned the trend actually impacting overall U.S. Casualty market, but we haven't seen large reserve charges at the industry level. Just wondering if this is AIG-specific issue or is it more industry concern?

Siddhartha Sankaran
Executive VP & CFO

Well, Kai, it's Sid. I'll open and then I'll hand it over to Rob. First of all, I would say we don't explicitly break it out that way and it differs dramatically by line of business when you look at U.S. Casualty. I will say, the general effect of our reserve strengthening is to more -- as I said in my remarks, more heavily weight the trend towards recent accident years and in lines like commercial auto where you're seeing dramatically higher trend for the industry, we would be strengthening both reserves and loss picks to reflect that new data. Rob, maybe you want to comment a little bit about how you think about the overall portfolio and loss picks in general?

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

Kai, let me suggest to you this way of thinking about it. I want to make sure I get this point across for everyone anyway. Success for the management of our Commercial portfolio begins with getting the proper segment selection. We've got to get the right mix of business year, and the mix of the business is going to drive our view of overall profitability for the Commercial portfolio. We've identified the U.S. excess in surplus lines property business as well as the U.S. Casualty business as the segments of our portfolio that are the most challenged, and we were absolutely correct in that assessment. 86% of our fourth quarter reserve charge was attributable back to U.S. Casualty. Today, U.S. Casualty's 21% of the commercial portfolio, and we feel confident about the remaining 79% of the portfolio, which is running at an adjusted accident year loss ratio of 60.2%. So to give you a better sense of sort of the situation we face is I want to take you back to 2004, where effectively, we were a commercial casualty portfolio that wrote some other business. And what I mean by that is there are $15 billion of U.S. Casualty business, representing 58% of our total portfolio. In 2016, we wrote $3.3 billion of net written premiums, representing just 21% of our commercial portfolio. And by the way, in 2017, we anticipate writing about $2.5 billion of net written premium in commercial casualty. So I think we've accomplished 4 really important things. I'll bring this back to that margin question here in a moment, but more important things in 2016. First, we reduced the

U.S. Casualty book by 39% in a single year compared to our annual decline of about 8% per year from 2004 through 2015. Second, we achieved more rate in U.S. Casualty than any other part of the portfolio, about 5.5% in the fourth quarter, as I said in my prepared remarks. And third, in January, we began working with Swiss Re as part of the reinsurance agreement that we announced, who not only share in the risks, but work with us as a partner to bring data, tools and additional expertise to design kind of a long-term path for sustainable progress in U.S. Casualty. So we're absolutely committed to serving our valued clients with the U.S. Casualty solution, but it's got to create value for them and for us at the same time. But finally, I'd say, and very importantly, the increase in the loss picks for the remaining book that we've talked about here for U.S. Casualty is about 11 points, and it's about 11 points on the U.S. Casualty portfolio. So we describe it as 3.9 points across our overall portfolio. So walking into the year, we were booking U.S. Casualty at a level that was about 11 points less. Now some of that increase is really just responding to what it is we learned in our reserve studies that we conducted that increased the 2015, 2014 loss picks. Another piece of what we've recorded recognizes the fact that we just don't want to repeat having prior year development come out of 2016 when we look back at this year, several years into the future. So I don't have a precise breakout for you of how to think about the additional $700 million in terms of how much of it is margin for error, but I would tell you we've captured everything we learned for 2015 and prior and established what we think is a prudent margin for error given the long-tail nature of the U.S. Casualty risks.

Kai Pan
Morgan Stanley, Research Division

Great. My follow-up question on the capital management front, you reaffirmed your $25 billion capital management goal. If we remember in your Investor Day in November, you pointed to you have a sort of potentially $2 billion to $7 billion additional funding sources that are above this like capital management goal. So I just wonder, given the reserve charge and some rating agency or regulatory considerations, is the $25 billion more of a floor we're sitting now?

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

I'll give you an initial answer, and then I'll hand it over to Sid. The Adverse Development Cover, as I said earlier, dramatically reduces the amount of economic capital at risk. The timing of regulatory capital relief is not immediate. And so while we continue to reaffirm our confidence around the $25 billion, we want to work very closely with both regulators and rating agencies on any further capital actions and make sure that we have a demonstrable track record of repeatable earnings before we would consider adding to that in 2018. So I think that we still feel very confident about the free cash flow of the company and the ability to free up capital through divestitures on the Legacy side as well as improved operating earnings. But the most important thing to remember is the net of the Adverse Development Cover and if the prior year development is accretive to capital, both on an economic capital basis today and what we think ultimately will be true of statutory capital from '18. So I think that we feel very good about the long-term capital position of the company.

Siddhartha Sankaran
Executive VP & CFO

And Kai, I'd just add what gives us confidence in our 2017 projections as we highlighted at Investor Day and you heard in many of my remarks today, when you sum up the accomplishments we've had in terms of non-core Legacy asset sales, life reinsurance transactions, our asset allocation shift, and then of course, operating subsidiary dividends and tax sharing payments, the aggregate of those have us squarely on track with regards to funding our capital return.

Operator

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

Jay H. Gelb
Barclays PLC, Research Division

The biggest topic on the mind of investors that I've received is what will A.M. Best's reaction be to the 4Q set of announcements? The A.M. Best rating for AIG is currently at A with a negative outlook. What's your sense on timing in terms of what we'll hear from A.M. Best in terms of whether they affirm at A or downgrade to A-?

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

I will take that. I've tried to be very clear for several years that our concern about claims paying ability is paramount to the trust that our clients have in us and that the rating agencies, including A.M. Best are important arbiters of that. We have revealed to you and them a lot of new information in the face of the last few days. And so we expect it to take some time to digest this and see the balancing ins and outs in terms of radical reduction in reserve risk while amendment to current profitability levels to see how that nets out in terms of impact on ratings. But we've made it very clear to all rating agencies that with the extremely strong holding company liquidity position, we put the financial strength of the subsidiaries at the top of the hierarchy of goals in the immediate term to maintain utter confidence in our claims paying ability. So I'm very hopeful that we'll achieve good outcome with all the rating agencies, including A.M. Best. But they should probably comment on timing as opposed to us.

Jay H. Gelb
Barclays PLC, Research Division

I appreciate that. My follow-up question is regarding Street estimates for 2016 -- for 2017, 2018. Street is at $5.34 for 2017 and $6.45 for 2018. I appreciate your perspective on core ROE. But my own perspective is that Street estimates are just way too high for the next 2 years. Do you have any perspective on that? I mean, can we help level-set this a little?

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

I don't want to comment on Street estimates. They are often based on different methodologies. What I do think is that we've given The Street a lot more granularity of modular information to do a bottom-up analysis of earnings quality and review those estimates in the light of all the new information that we've disclosed. So I think probably best to defer that after The Street has had a chance to digest the significant additional information that they have received.

Operator

We'll take our next question from Randy Binner with FBR Capital Markets.

Randolph Binner
FBR Capital Markets & Co., Research Division

I had a question about the $10.2 billion consideration to National Indemnity. How is that funded? And what is the timing for funding that consideration to National Indemnity?

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

I'm not sure that we'd want to comment on that. But it's funded by divestitures of general account assets. We have a very liquid general account asset base and it's just part of our normal course of asset liability management. This is something, which is accomplished. But I think that the important thing from point of view forward earnings estimates is that we have given you, I think, a clear indication of how much forgone net investment income will carry in 2017 as a result of the sale of those assets and transfer of those funds. So Sid, if you want to comment on that, it's fine.

Siddhartha Sankaran
Executive VP & CFO

Yes, the only other thing I'd add is we expect to finish that financing very shortly. So that's all I'd add, Peter.

Randolph Binner
FBR Capital Markets & Co., Research Division

So the assets go and the investment income goes with it. And then I guess, the follow-up I have just on this topic is on the Page 6 description of the arrangement with NICO. The $12.8 billion ceded, is that actually ceded now? Or is that kind of continually ceded when losses come through?

Siddhartha Sankaran
Executive VP & CFO

Now? Sorry, Randy, do you want to clarify your question there just to make sure that we understand?

Randolph Binner
FBR Capital Markets & Co., Research Division

So the $12.8 billion of ceded nominal reserves, I just want to make sure I'm understanding this correct, that you're actually ceding those assets and liabilities now and that's where we should think about the consideration, part of the consideration coming from.

Siddhartha Sankaran
Executive VP & CFO

Yes, I'll just point you back to my prepared remarks, Randy. Remember, I noted that we have $41 billion of nominal reserves, right, at year-end. So that's where you get the ceded amount. You take the $41 billion, you subtract the $25 billion, which is $16 billion, and then you apply the 80% to get the ceded reserve number. Obviously, as you know from our filing of the contract, that obviously ultimately gets paid out via Berkshire Hathaway on a paid basis, right? But yes, they're ceded immediately.

Operator

And we'll take our next question from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I'm wondering if you can help walk us through the line items that changed the disclosure. At the end of last year, you said that you closed out 2015 with a 66.2% loss ratio accident year. And that's been revised down to a 64.7%. I'm wondering on an apples-to-apples basis, what's the 2016 numbers are? And can you define the difference between the exit run rate loss ratio you're closing out '16 with versus the reported number?

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

Rob, why don't you go through that?

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

Yes. So Josh, let me begin just following on Page 20, thinking about the green line, that's what you're asking me about. And we're going to focus on the line that says 2015, 64.7%. So when you saw that line item in 2015, it was 66.2%. The primary adjustments that have been made to that line item are, first, as you know, we sold UGC. We had a reinsurance agreement that now works with UGC and that benefits the commercial business moving forward. But in order to not make me look good on a year-over-year basis, we pushed that back to all periods so that -- so we've actually adjusted down what was the 2015 loss ratio reflecting the benefit of UGC into 2015. We're showing that on Page 20 in Footnote #2. And you can actually that the benefit is 0.4 points in 2016 -- in 2015. It was actually -- and just for comparison purposes, it's 0.8 points in 2016. So apples-to-apples basis, what you get is 0.8 point in benefit in 2016.

And we didn't want 0.8 point benefit to compare against the old 66.2%, so we brought the old 66.2% down by 0.4 points, which was what the effect would have been in the prior year. The second big item is that, as you know, we exited some businesses in 2016. I announced there was an exit in February that included primarily our buffer trucking business and our pollution legal liability business in the United States and Canada. Those businesses were exited in 2016 and they've now been transferred over to Legacy. Many people worried that I would actually flatter my current loss ratio by simply moving things over to Legacy. In this period of very transparent presentation here to you, we've actually also restated 2015 to remove the losses that were in 2015 associated with those same lines that have been exited. So actually, I get no benefit in the comparison year-over-year, 2016 versus 2015, for the fact that I exited businesses that have now been transferred over to Legacy and to Charlie Shamieh's team. So overall, the 66.4% pulls out, the losses associated with businesses that I exited in '16 that we didn't want to leave in 2015 so that I would look flattered. And then the second thing it pulls out is the benefit of UGC, which should be shown on an apples-to-apples basis. I think those 2 things actually show you that overall, we are trying to make sure that I don't flatter myself at all in the year-over-year comparison because net-net, even though the exits should have benefited me in 2016 in the comparison, we basically pulled it out of both periods. Does that makes sense?

Joshua David Shanker
Deutsche Bank AG, Research Division

Year-over-year, I mean, it benefits you on an absolute number but not on the year-over-year comparison.

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

Exactly, Josh. So we did the right thing. And we don't worry about trying to look good on a year-over-year basis by flattering ourselves by leaving the old loss ratio high and bringing the current loss ratio down. Sid can comment further.

Siddhartha Sankaran
Executive VP & CFO

Yes, Josh, I think it's Page 33 of the financial supplement, we've actually split out specifically the UGC impact so that there's very clear transparency.

Joshua David Shanker
Deutsche Bank AG, Research Division

I did see that. And then on the difference between an exit run rate and an accident year closeout number, are we going to close out 2017 at a 65% but say the exit rate is a 62%? And I guess, the answer would be, well, what are we in 2016, the difference between the exit run rate and the closeout number?

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

Yes. So Josh, what I'm saying to you there is that the fourth quarter, we believe, will be a 62%. Obviously, for the full year '16, we were at a 66.7%. So you can imagine that I'm not going to be able to bring Q1 down to the 62%. And in order to have a full year of 62%, it's going to be the average of the 4 quarters. So just recognizing that the fourth quarter, we expect to be at 62%. And that we expect that move to 62% to occur throughout the course of 2017.

Operator

And we'll take our next question from Thomas Gallagher with Evercore ISI.

Thomas George Gallagher
Evercore ISI, Research Division

Rob, just following up on that conversation. So if the exit run rate on the commercial loss ratio is really around 67% and the goal is to get to 62%, that's 5 points of improvement from an exit rate standpoint.

I think from what you were guiding previously, the '16 to '17 delta was more like 2 points. How are you going to get that extra 3 points? Is there -- can you reconcile that?

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

Yes. So Tom, the first thing I want to point people to is that when I committed we would deliver in 2016 in general, there were a lot of doubters about it. They said actually, "You won't be able to deliver 4 points, you're starting flat-footed." We delivered 4.1 points of improvement in the loss ratio and for good measure, another 0.9 point in the expense ratio for 5 points of underwriting improvement. And coming into 2017, we've got a lot of momentum. So the Swiss Re reinsurance deal is already in place. That will benefit 2017. We made a lot of changes from an underwriting perspective in 2016, which have not yet been recognized as earned premium until 2017. In one of the research reports that I read from last night, there was a good comment about that. If you look at our reduction in net written premium, you can actually see that we significantly reduced our net written premium in the remediate and in the improved parts of our portfolio. But that doesn't yet reflect in earned premium until largely 2017. So again, a lot of momentum moving from 2016 into 2017 from those 2 items. And the remainder of the actions that we've got planned for the year, we feel confident we'll deliver the 62% loss ratio. I think overall, what people would have doubted we could have achieved with a 6-point improvement in the loss ratio between 2015 and 2017, I'd say I want you to have confidence. We've already delivered 4 points of it. And we believe we're geared up to deliver well over 4 points of it again in 2017 from the actions we've already taken. So I think we'll over-deliver on a relative basis, apples-to-apples basis.

Thomas George Gallagher
Evercore ISI, Research Division

Okay. And then if I could shift to capital return. The caveat of subject to future profit improvement in terms of getting to your $25 billion 2-year plan, can you comment on -- can you provide some perspective on what this means? Are we talking about no significant adverse development in P&C? Would that constitute as future profit improvement? Or are we talking about you actually need to show accident year loss ratio improvement in P&C to be able to achieve your capital return plan? Anyway, that's my question there.

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

I think it's fair to say that if you look at the underwriting actions that Rob's team has executed in 2016, it's a radical reshaping of the mix of business that makes projections more challenging. And I'm quite empathetic to all of you, but also the rating agencies as they try and project out 2017, '18, '19 earnings. But I am confident that once they analyze the additional disclosures we've met, if we meet the expectations that we have we just laid out, then that will more than satisfy all stakeholders that we have a very solid earnings base, very solid liquidity position, very solid capital ratios both at a subsidiary level and at a holding company level that more than supports the current rating. But we don't want to jump the gun on that. And we think it's really important to pace ourselves and bring all stakeholders along on that journey of underlying -- understanding the underlying earnings powers of this company as we've reshaped the earnings mix.

Operator

We'll take our next question from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

I just have a follow-up question kind of on getting to that 62% target in 2017. As we think about a higher kind of inflation level just overall for the industry, can you just kind of express confidence that the picks that you're now using for 2017 kind of play out that scenario and that if inflation levels do increase, that you can get to this 62% level by the end of the year?

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

Yes. Elyse, I'll just say again that if you think about the 4 points of increased loss picks we've recorded in 2016, I'm referring to the 3.9 points of increase, if you take that to the lines that are likely to have the inflation you're referring to, it will be the long-tail U.S. Casualty risks in particular. Those lines actually we've increased the loss pick. If you sort of drill down through modularity, it's 3.9 points to total commercial, it's 5.7 points to liabilities and Financial Lines, but it's 11 points if you drill all the way down to U.S. Casualty. So the U.S. Casualty increase in loss picks of 11 points higher is intending to reflect the lessons learned from 2015 and prior to the reserve studies and any of the expectations we would have regarding inflation. And that's really the message I've been trying to deliver. To the point that I was just talking about achieving the improvement between '16 and '17, I pointed out 2 really important items. We've got Swiss Re deal that's already in place and you've got the underwriting improvements that we already took last year. But I'll just make one last observation. Because we so significantly increased the loss picks in U.S. Casualty to the extent that in our mix of business, we further reduce our concentration in U.S. Casualty, the benefit that we get between 2016's loss reserves or 2016's loss picks and 2017 because of a lower level of concentration of these very high loss pick businesses, we benefit even more significantly. Those are the 3 primary drivers that get you from the 66.7% to the 62% that you see on Page 20 of our presentation.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

And then in terms of the capital return plan, the contract with Berkshire was retroactive. So you guys did -- you guys are transferring over some reserves that were already sitting on your balance sheet in excess of $7 billion. How do you think about the amount of capital freed up there? And how does that -- it seems like today, you reaffirmed the $25 billion plan. But could something like that potentially be additive to the $25 billion?

Siddhartha Sankaran
Executive VP & CFO

Yes, Elyse, it's Sid here. I'll point you to my earlier remarks. We've estimated that we've improved our overall capital position by approximately $2 billion when you combine the ADC netting with our reserve strengthening this quarter. But we anticipate that, that capital will be deployed over time, as I said. And so again, it just reaffirms that we have strong confidence in our capital and liquidity positions, as Peter mentioned, as we execute on our target.

Operator

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

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

Focusing again on the commercial business, it looks like, and I'm looking at Page 20 like most people are, that if something happens from a business perspective, and probably around 2013, that got you off on your projections as well as what your business. Could you talk about sort of what was happening there from a business perspective and how that's different today? Who was in charge back then and that kind of thing?

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

So there's been a fair amount of change frankly in terms of who was in charge of the businesses that have reflected this. And as you can imagine, given the long-standing client relationships and long-standing presence in lines of business that were affected, you have a lot of inertia. So I think that as Rob mentioned earlier on, we had a $15 billion casualty book, which was at the beginning of the period. And then that's now down prospectively in '17 to about $2.5 billion. So that reduction didn't happen overnight. And so during this period of time, we were shrinking a book of business, which frankly looks a lot better with high interest rates, where you can live with a higher combined ratio if you've got decent net investment income. And in that 2013 period, if you remember, you've got 2 things: continued quantitative easing and therefore very low interest rates, making that a much less attractive business; and a recovery in the economy, so you start to have a lot more miles driven and a lot more economic activity and therefore an uptick in frequency and severity of losses. So you've got a sort of cyclical element hurting you on the loss cost trends and a continued challenge on the net investment income. So I think that there's an inflection point there which confirmed our initial instincts that the reduction in the casualty lines was the right strategy. But the sense of urgency around that picked up as the continued low interest rate environment persisted in the subsequent years and as the loss cost trends accelerated even more with higher jury awards and so on in the most recent accident years. So I think that we've made a lot of change in terms of individuals and process. But we've also tried to learn what is external to AIG that we need to adapt to, lower interest rates, higher loss cost trends and what is internal in terms of lessons learned, in terms of improved linkage between claims, underwriting and actuarial and getting the right alignment of those functions. And so we believe that the team that we have today is the right one to continue to reshape the mix of business around our most profitable clients. And I think that, that's probably the most important change in mindset is to really start to analyze client profitability, not just business line profitability. And that is something we have but better tools, better governance and a better understanding of today.

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

So I just want to make sure I understand the answer properly. It sounds like what you're saying is that you correctly identified the claims inflation inflection and other issues at that time but simply did not shrink the book fast enough to -- as you would have liked in hindsight. Is that right?

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

I think that hindsight is something which I'd say you need more time to look back on this the right way. What we've done is retained over 92% of our best clients. If we had tried to shrink it faster, that number might have been a whole lot lower and that might have cost us a lot more in terms of profitable Financial Lines and other lines of business. So we were shrinking the commercial business with an annualized rate of about -- the casualty business at about an 11% annualized rate. And then we accelerated that to over 30% in the last 12 months. I don't think if we'd done it that aggressively back then, we would have done it as elegantly. And I do think that we've got much better tools, much better governance around managing those client relationships. And of course, if you remember back then, the recent history of AIG's challenges in the financial crisis were still fresh in people's mind. So I think abrupt changes in our underwriting appetite would have had more disruption then than that it does today.

Operator

We'll take our next question from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

So first, just to comment, you did change the disclosure. And I think it makes it very difficult to compare results, so I hope -- especially when you're not really posting the updated results in advance. So if you are changing disclosure in the future, I think you should actually at least provide the historical numbers a few days or a week or 2 weeks in advance. And then obviously, it would reduce confusion a lot. In terms of my question, I'm just trying to understand your comments on the Berkshire Hathaway contract, which seemed pretty positive on it reducing your cost of equity. Obviously, it does reduce volatility in GAAP results. But that's only because you're paying $10 billion upfront for about $20 billion of coverage. And you're doing it several years in advance of any contribution from Berkshire Hathaway. So also you're still on the hook for the tail. So if you can quantify how much the deal is releasing in terms of -- or if it is releasing any GAAP or stat [ph] capital, whether you see any impact from this on your tax asset and also what the duration is of the claims payment period on this book.

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

So I think that the most important thing to see is as of to date, the reserved number, you've got about $9 billion of additional risk capacity that is for Berkshire's account, which has an economic risk reduction to us that will make sure that any subsequent adverse development is shared 80-20 between us and them. So there's substantial risk transfer to them that is quite beyond any kind of accounting impact. In fact, if anything, the accounting is quite adverse compared to the economics because of the deferred nature of the recognizing of the gain on the ADC versus the immediate recognition of any subsequent PYD on the book. So I think that this is anything but an accounting-driven exercise. This, as we always do, prioritizes improvement in intrinsic value and reduction in economic risk. And you rightly point out that there is, of course, a tail risk as there is in all of our businesses. And I think that we need to evaluate that carefully. And we have the benefit of our own judgment as well as those of third parties to estimate the full range of outcomes for future claims. But I think that we feel that this is a very substantial reduction in the reserve risk, which should give people more confidence around the book value of the firm and the earnings trajectory. But I don't know whether, Sid, you want to elaborate on the mechanics of the...

Siddhartha Sankaran
Executive VP & CFO

Yes. First of all, we're sympathetic that this is obviously complex transaction and Liz and the team will be available to walk you guys through this in more detail. But on an economic basis, the way you need to think about this is think of us, Jimmy, as transferring the assets, we receive a reinsurance recoverable, right, that has a very sizable present value, okay? We release capital up until the limit, right, and that are the economics of the transaction. Separate from that, of course, when I talk about netting this and freeing up capital, you have the prior year development and you have the tax effect of that prior year development, of course. So those are the ins and outs of both the reserve and the economics of the transaction. So don't think of the $10 billion without thinking of the reinsurance recoverable. And on a nominal basis, right, that $10 billion is granted and there's ceded nominal reserves of $12.8 billion plus the capital free-up. That's how you...

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

No, I understand. And I actually think that the transaction is relatively simple in terms of how it works. I'm just trying to see if you can quantify some of these numbers. But what's the claims duration of the book? Do you have a sense? Or what's your best estimate of that?

Siddhartha Sankaran
Executive VP & CFO

Yes, we're not going to provide an overall duration in terms of the detailed cash flows. But my rough approximation I would give you is about 10 years. And so you have some cash flows that are going to be several years out. And then some that are going to be way out in the tail, of course. So that's how we think about it when we do the PV. But rough math, I would use 10 years.

Operator

We'll take our next question from Gary Ransom with Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I had a question on reserves. At the Investor Day, Peter, you expressed some animosity toward the idea of a reserve cookie jar. And now we're talking about a margin of error. And I would just observe that one actuary's margin of error is another actuary's cookie jar. Am I to understand that adding this margin of error is a change in your reserve philosophy?

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

I would say that when you have an ADC of the scale and scope that we have, which we did not have on Investor Day, we have downsized the strategic significance of reserve risk by 80%. And so the subjectivity that is inevitable in any kind of reserve estimation that would lead you to judge where you are on that the spectrum of conservatism just has a dramatically lower effect both on historical reserves, and then given the dramatic reduction in new business written that Rob has explained, over 30% year-on-year, it just is not a big issue going forward. And so I'd rather just leave it at that. I don't know whether, Sid, you'd like to elaborate?

Siddhartha Sankaran
Executive VP & CFO

Yes. First comment I'd make, Gary, is we've obviously commented before on some of the terminology and we have the highest standards around our financial reporting process and our reserving process. So I'd leave that for you, number one. Secondly, the way that I would ask you to think about this in totality is, first, we understand some of the frustrations people have had around historical reserve strengthening. And secondly, we have not been happy with our historical reserve risk outcomes either. And the way to think about this is the combination of the Adverse Development Cover, a reserve strengthening, the adjustment to our loss picks and the dramatic shift in the underwriting that Rob referred to in terms of the business mix. The total of that, there's more to change the reserve risk profile and eliminate that historical trend than anything from a risk perspective could. And that was how we thought about this when we think about reserve risk.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Just one other thing on the timing of the recognition of these adverse trends in the third and fourth quarter. Are we also to think that you did not see anything along those lines in, say, late 2015 or early 2016?

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

So I would point out that while we have been considering an Adverse Development Cover for some time and we initiated our exploration of this at the beginning of the year, it was only once we concluded our reserve studies after Christmas that it became clear to us that this was a transaction that made excellent economic sense. So we do have a back-ended reserving process. And so it was really after Christmas that it became very clear that, that was the right thing to do. And I think that we made a lot of changes that, I think, positively improved our ability to identify trends in the resegmentation of our reserving. We went to a smaller number of more coherent modular reserving segments that gave us a higher signal-to-noise ratio that gave us more confidence in our decisions.

Siddhartha Sankaran
Executive VP & CFO

Yes, Gary, it's Sid. I'd only add a couple of points. First, in the areas where we did see adverse actual versus expected trends, as we talked about at Investor Day, which was particularly programs, we think we acted rapidly and transparently. And you saw us obviously strengthen the reserves in programs when we saw those actual versus expected trends. For some of the lines that we discussed, we obviously saw trends accelerate into the fourth quarter and some of those on very green lines, like I said, in particular, excess casualty in 2015 is a green line, and you need a full year of seasoning. We are comfortable with that with the amount of work we did, as Peter alluded to, in the segmentation of our analysis, the granularity and the effort we put in, particularly given the work we initiated around an ADC in the second quarter and continuing through the year that we've done a more thorough analysis of the reserve portfolio at this point in time. And we are very comfortable with where we are.

Operator

We'll take our next question from Amit Kumar with Macquarie.

Amit Kumar
Macquarie Research

Just, I guess, 2 quick follow-ups to prior questions. Number one, going back to the ratings agency discussion, and I'm still not clear. All else being equal, would a change by A.M. Best alter your plans to return to $25 billion? Or will it not?

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

I think that, first and foremost, I'd say that we have every hope and expectation there will not be a change and we will do everything we can to prevent a change. So we see that as a critical element to our strategy. Secondly, they would make their change based on, I'm sure, a multitude of criteria that would maybe include capital planning but also the geography of that capital, where is it between the holding company and the operating subsidiaries. And it's the rating of the operating subsidiaries that we care about most because that's what affects our claims paying ability to our clients. And that's the stakeholder base that we care about most. So I think that we would look at all actions, including amendments to the capital to make sure that, that rating is defended. But we have a lot of capital flexibility, as we've pointed out, that would allow us to continue to serve all our stakeholders in a way that's balanced and sustainable.

Amit Kumar
Macquarie Research

Okay. The second and final question is, Peter, this goes back probably to 2015 when there was a lot of discussion around too big to succeed, et cetera. And at that time, we had a SIFI lens to the discussion. It's 2017. If you think about the tone and the content of conference calls, we rarely talk about the consumer insurance business, if at all. I was wondering, how does the Board of Directors -- I mean, you feel about revisiting the separation of business entity discussion, keeping the SIFI discussion apart? It seems we talk about the same issues on every call. And many other pieces of the business are not getting their sort of fair share of discussions or air time. So how do you feel about revisiting the discussion to separate P&C from other pieces?

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

I think that we've been very clear that there are strong tax reasons but also very strong diversification reasons why the current mix of business makes all the sense in the world. And this quarter, above all quarters, would remind people of value of diversification as we look back at 2016's excellent results from the consumer business and the fact that the personal insurance has had a major swing to profitability. So I think that my hope is that our dialogue with you becomes much more balanced as we reduce the uncertainties and in particular, around reserving that has plagued the discussion and allows the sort of skew to be so heavily focused around the U.S. Casualty business and to be a more balanced discussion about what I think is a mix of business across consumer and commercial that is focused on our most profitable segments, geographies and client segments that creates sustainable earnings. So I think that we are in the process of reshaping this company. We have done a lot to make it less complex. And so in direction, we are all in favor of resculpting this company and making it smaller or more focused. We did not think a 3-way split to avoid SIFI regulation was the optimal way to unlock value for shareholders. So I think we feel very strongly that, that was the right decision. But we continue to resculpt this company to be more focused, easier to manage and easier to explain. And I do think that this ADC cover is a pivotal moment in taking one of the biggest question marks around the valuation and the risk profile of the company off the table, so we can focus on the operating earnings engine of the core portfolio and how that's emerging as a leading franchise.

Operator

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

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

Peter, I think in the past, you've given an ROE target for the operating segments, and then the total company. And I know here, you've given the 9.5% for the core operating. Maybe I missed it, but is there an ROE target? I know you gave what your freed-up capital expectation is from Legacy. But is there an ROE target for Legacy?

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

No. The target for Legacy is all around the release of capital. So they're trying to release capital and shrink as effectively as possible with a view to how much they impair book value and enhance intrinsic value. So their gating factor is the speed at which they can release capital at a price that is accretive to intrinsic. And I'm delighted to point out how much they've done this last year to do that. And most recently in the last quarter, the Life settlements was a major illiquid asset in the Legacy book, which was sold at a level that was accretive to intrinsic value in our view. And they will continue to do that. But I think that holding them accountable to ROE is the wrong metric because it really doesn't get at what's really going on here, which is shrinking that so that we can redeploy that capital in our core businesses to grow them and return any excess to shareholders. So that's the way we measure it. And if you think about the hierarchy of goals I talked about at Investor Day, it helps you sort of map it into that to see how it all drives growth of intrinsic.

Lawrence David Greenberg
Janney Montgomery Scott LLC, Research Division

And then just a follow-up for Rob, and I'm looking at Page 21. The first category, the grow category, saw a 10-point deterioration in the accident year loss ratio. And I'm just wondering if you could give us a little bit of color on that degree of deterioration.

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

So Larry, the first thing is that while we present this in a way to try to keep it simple, I want you to really understand that Peter marches out this team to the tune of intrinsic value. So we are here trying to look even beyond the loss ratio and even beyond the expense ratio, but we're looking at risk-adjusted profitability in the context to the way we really run the day-to-day decisions inside of the commercial business. So while this is a simplistic presentation of what happens to loss ratio, I'd say, within the attractive parts of the business, what I want you to know is that we are making tradeoffs every day, recognizing that while the loss ratio might look attractive, the ROE or the intrinsic value might not. So a classic example of that would be that one of the primary drivers behind why our grow part of this portfolio on Slide 21 declined in size, it's largely attributable to property business. And while the loss ratio without natural catastrophes, so the adjusted accident year loss ratio for property may look attractive, when we add on the acquisition costs and we add on the average annual loss expectation, and then we think about the capital consumption, so we have -- all of the rest of this map behind the scenes, we believe that we're making tradeoffs that are even more sophisticated than what you see here on the simple view of Page 21. And so I absolutely believe that we've made the right decision at every element of these product sets that are shown on this page. And that to the extent that we shrunk or that the accident year loss ratio deteriorated, recognized that, that is intensity attributable to shifting business and generally with things where we're remaking behind-the-scenes decisions on intrinsic value.

Operator

And that concludes today's question-and-answer session. Mr. Peter Hancock, at this time, I will return the conference back to you for any additional or closing remarks.

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

Well, I would like to thank everybody for their patience and good questions. We've had a lot of information to digest. And we take the feedback that we wish we had gotten to you earlier to digest quicker. But I think that I'd like to end this with a comment about the team, the management team. If you look back at the last 12 months, I think you'll see that this team has been extremely active in reshaping this company and making it a more focused and more sustainable source of earnings as well as serving our clients better. And I couldn't be prouder of how the team has worked together under a great deal of pressure to deliver these results. And so I have a great deal of confidence in their ability to deliver the '17 prospective results that we have discussed today as well. And I think that the additional disclosure that we have given you gives you a better sense of the multidimensional nature of their roles as they optimize our mix of business of both geographic, by product, by customer segment. And I think that, as I speak to our shareholders that may be listening, I think that the leadership team that we have assembled is really very, very well suited to completing this out. So I want to give them a shout-out for the accomplishments they've made. And so thank you very much for your attention today. And I look forward to following up with you individually in the weeks to come.

Operator

And this concludes today's call. Thank you for your participation. You may now disconnect.