CONTENTS

American International Group, Inc. NYSE:AIG

FQ3 2011 Earnings Call Transcripts

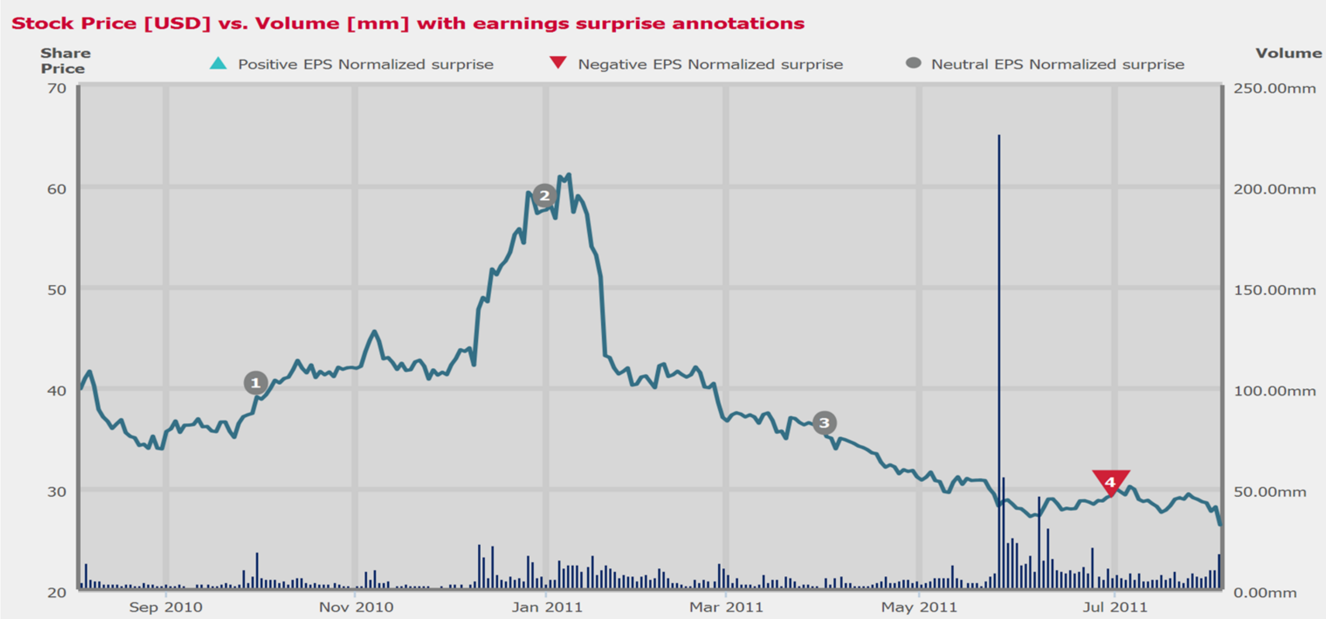
Friday, November 04, 2011 12:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2011-			-FQ4 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.28)	(1.60)	NM	0.71	1.20	2.84
Revenue (mm)	13552.26	12716.00	(6.17 %)	13583.35	50917.50	52511.80

Currency: USD

Consensus as of Nov-04-2011 11:22 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2010	0.93	(1.47)	NM
FQ4 2010	(14.02)	(16.20)	NM
FQ1 2011	(0.09)	1.30	NM
FQ2 2011	0.96	0.69	(28.12 %)

Call Participants

EXECUTIVES

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

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Elizabeth A. Werner
Head of Investor Relations and Vice President

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

John Doyle

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

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

ANALYSTS

Edward A. Spehar
BofA Merrill Lynch, Research Division

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Joshua David Shanker
Deutsche Bank AG, Research Division

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Thomas George Gallagher
Crédit Suisse AG, Research Division

Presentation

Operator

Good day, and welcome to American International Group's Third Quarter Financial Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead, ma'am.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, and good morning, everyone. Before we get started, I would like to remind you that today's presentation may contain forward-looking statements, which are based on management's current expectations and are subject to uncertainty and changes in circumstances. Any forward-looking statements are not guarantees of future performance or events. Actual performance and events may differ possibly materially from such forward-looking statements.

Factors that could cause this include the factors described in our 2010 10-K and subsequent 10-Qs under Management's Discussion and Analysis under Risk Factors. AIG is not under any obligation and expressly disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

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

With that, let's begin our call today, and I'm going to turn it over to Bob Benmosche our CEO.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Okay. Thanks, Liz. For our company, we're operating as if the Federal Reserve will be our regulator. We don't know what will happen. But it's important we operate as if the Fed will be our regulator. As part of that, we have to do stress testing and so we constantly look at our company, what the issues are and we said, what would happen? What would happen if the equity markets fell apart? What would happen if -- significantly, on the S&P, what would happen if the spreads blew out, serious issues in the fixed income markets especially mortgages? And then we said, what would happen if currency started to create issues for us and throw on top of that, a big hurricane maybe in the Northeast? And what would happen if you have some typhoons running around Asia? And so that's how we did our stress test. We update it all the time, and we had the opportunity in the third quarter to see what happens when our stress test becomes somewhat of a reality. And so there's a question about AIG, our strength and how we would handle that kind of perfect storm, which is what we've just come through. And I can assure that we're in very good shape. Our liquidity now is sitting at $15.3 billion, up from the last quarter. And big concerns we've gotten during the roadshow and for many of you over time is what's going to happen to FP Reminco and the assets, I should say, not Reminco, what would happen under these scenarios? And clearly, our collateral calls were basically flat. There was no issue whatsoever in terms of cash demands. So we're in pretty good shape.

So let's talk about the $4.8 billion of noncash losses of 3 items. I'm going to start with Maiden Lane III. Maiden Lane III we're down $1 billion, but the cash flows continue to be strong. So this is just the anomalies of the market at this point in time. Keep in mind, we've gone from $45 billion in the beginning, the Fed balance is down to $18 billion. It's paying down cash flows of about $5-plus billion a year for Maiden Lane III and Maiden Lane II combined. This is Maiden Lane II and III combined in these numbers. And so we see 2014 still as a year in which AIG will begin to receive back its $6 billion investment before we begin to split the upside with the Fed after that period of time. So Maiden Lane III does cause some noise in the numbers, no question. But economically, we see that as continuing to be strong.

Also AIA, we took a $2.3 billion drop in the book -- in the carrying value of AIA, marking it to market. And keep in mind, as it relates to AIA, the SPV that we have from the AIA ALICO SPV is now down to $8.3 billion. The collateral against the $8.3 billion is Maiden Lane III, ILFC and AIA.

We also have about $1.5 billion in cash sitting in the SPV from the sale of ALICO to MetLife, and that cash again will come out of escrow over the next year, another $1 billion, I believe, and then the rest of it in 2013. It leaves us $6.8 billion left on the SPV. We are taking our time to look at that $6.8 billion, and we're deciding what is the best way to handle paying that down such that we maximize value for the AIG shareholders. So whether it's to sell AIA now or later, whether it's to wait for the IPO of ILFC, if it works out in the markets in the future. As you know ILFC is not core, we're looking to monetize that at the right time for the right values. So we're going to take our time, and I guess that's the only way I want to continually stress it. Time to make sure that we're maximizing value for the AIG shareholders.

When it comes to ILFC, again, $1.5 billion was taken as part of our normal routine to look at what's happening in the manufacturing space. Some new announcements were made on new aircraft. That puts pressure on some of our older planes. And as part of our annual review, we've decided to take a charge of about $1.5 billion to deal with that issue within the legacy aircraft, which we've been talking to you about. That's a problem we need to resolve and work on. And we know it's a drag, but I think this resolves a good part of that drag.

So let me come to capital management real quickly. You saw we raised $2 billion in the quarter, and that's really to make sure that our debt maturities are matching to what it is we have in terms of cash on hand. So that deals with some future payments we're going to have to make. You also saw from the capital management point of view that we're going to be buying back shares. Let me be very clear that until we were able to do the re-IPO of the company, we could not do any share repurchase while we had Schedule G here at the company. Being able to launch the re-IPO, to be able to terminate Schedule G and close that out that allowed us to begin to think about how do we want to handle capital management going forward. Our priority, and it's important that you understand, our priority is to be able to work with the U.S. Treasury so that we can continue to be buying back shares from their shares which represents overhang on the stock. That is our priority.

On the other hand, if we see in the marketplace that there are certain anomalies with our stock and we feel it's an opportunity to take advantage of what the market has done, then the Board of Directors has approved a $1 billion share repurchase so that in these markets, if we choose to go out and buy in the open market, we're able to do that and take advantage of where the markets are today. That doesn't change our priority. Our priority is still to begin to think about capital management in the context of the U.S. Treasury shares and what we can do to facilitate taking that overhang off the table.

So as we think about our results for the quarter, Dave is going to bring you up-to-date on it. I just want to make a few comments that clearly, if you look at what's happening after that $4.8 billion, clearly, we had some storms hit us in the quarter, but Chartis is continuing to make great progress. They're continuing to focus on how we get a better return for the risk we're taking and making sure that our combined ratios start to come down as we promised in terms of aspirational goals. They're making very good progress on that.

SunAmerica continues to do well. They're continuing to see client retention strong, sales continue to be strong. And keep in mind, we're down somewhat which you'd expect with this low-interest rate environment in our fixed annuity business, but still strong.

UGC continues to perform well on new business. We got that under control. However, there's still going to be a little pressure yet, as we work out some of the legacy book and some of the legacy issues and foreclosures and so on.

And last but not the least, ILFC continues to do well on an operating basis. We did deal with the write-down, but they continue to get pretty good releasing of the planes that we have available.

So I'd rather wait for some of your questions to rather get into any more detail. But let me turn it over to David on what the issues are specifically in the numbers.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Great, Bob, thanks. And good morning, everyone. Let's turn to Slide 7, and we'll step through the slides and make sure we have plenty of time for Q&A. Third quarter loss, as Bob said, is $4.1 billion, that compares to a loss of $2.5 billion a year ago in our operating income, which is our principal non-GAAP measure was a loss of $3 billion for the quarter versus $114 million a year ago.

Slide 8 is the highlights of what Bob really covered with the AIA share price decline, the ILFC impairments, the spread widening and the -- some lower interest rates, the lower LIBOR rate drove some of the loss on ML III and, obviously, cat losses. So we'll move past, and I think Bob covered that.

On Slide 9 is the ILFC impairment highlight. And again, we conduct this review annually. We typically do that in the third quarter. And much like we did in the fourth quarter, we were -- management's judgments were informed by current market events. So the -- as a result of the review, we determined that the 95 aircraft were impaired from an accounting standpoint and we took a noncash charge of $1.5 billion. So again, there were a number of economic events, aircraft technology announcements, idiosyncratic counterparty issues and other announcements that informed our judgment.

Turning to Slide 10 for our consolidated performance. Chartis reported pretax operating income of $442 million, affected by cat losses of a little over $570 million, in large part due from Hurricane Irene, which totaled a little over $370 million for the quarter, as well as Tropical Storm Lee and typhoons in Japan. Interestingly, that compares to an unusually low level of caps a year ago, which was about $72 million.

Turning to SunAmerica, which posted a $444 million of operating income for the third quarter. The results include a $43 million mark-to-model, mark-to-fair value for our Maiden Lane II investment, again, due largely to spread widening and the underlying nonagency RMBS securities. The third quarter of 2010 actually hit income from Maiden Lane II of $156 million. So you can see the dramatic swing that that had. And also due to the decline in equity markets, we increased our provision for guaranteed minimum death benefits in our variable annuity business. And we had higher DAC amortization as a result thereof as well, though together, they were a little over $180 million for the quarter. The equity market performance in the third quarter of 2010 was actually quite strong and as a result, we had positive effects on operating income of about $100 million from our variable annuity business last year. So again, fairly dramatic swings.

As Bob mentioned, United Guaranty, our mortgage guaranty business, reported an operating loss of $96 million versus a loss of $124 million same quarter a year ago. Overall, financial results for United Guaranty were unfavorably affected by continued weakness in the U.S. housing market, as well as sustained high unemployment rates.

Increased delinquencies and the severity of loss cost on some of the older vintages was only partially offset by rescissions. In addition, this third quarter, overturns of previously declined or rescinded claims continued at the somewhat elevated rate.

Our other reporting unit reported a loss of $1.5 billion versus income of little over $400 million a year ago due in large part to the mark-to-model loss of roughly $1 billion on Maiden Lane III and also to a much lesser extent, the wind down AIGFP portfolio. Again, cash flows on Maiden Lane III remain quite strong.

Global markets, our global capital markets had a loss of $174 million, primarily from credit valuation losses or what we call CDA on counterparty derivative balances and interest rate hedges. The super senior credit derivative portfolio withstood wider credit spreads and was flat essentially for the quarter.

At the end of the third quarter, we had about $26 billion for the notional in the CDS portfolio, which $20 billion is -- doesn't require active trading management. The remaining multi-sector book is down to about $5.7 billion in notional for which we hold a GAAP liability of roughly $3.1 billion, most of which we've already posted collateral against. We continue to believe that the actual settlements under these contracts will be less than the GAAP liability and the collateral postings we have, thus giving rise to intrinsic gains. Also, during the third party -- during the third quarter, AIG and counterparty spreads widened substantially and those have requisite effects on the mark-to-market, mark-to-model instruments we have in the derivative portfolio.

Our direct investment book had earnings of $119 million. The increase in that, from a year ago, was driven by net increases in the value of the formerly AIGFP asset book. And finally, we've talked about the AIA mark-to-market, which has already recovered somewhat in the fourth quarter thus far.

Turning to Page 11, which shows our after-tax operating income reconciliation. The only comment I'd make is with respect to taxes. We apply a pro forma tax rate to our operating income, our operating loss for the quarter. We show the benefit in operating -- in this case, the benefit in the operating loss and we've essentially reversed that out for the reconciliation to GAAP net income.

On Page 12 is our capital structure. Our leverage is currently in the low end of our longer-term range, and we still assume a 20% to 25% debt-to-total capital in our aspirational goals, and we continue to actively manage our capital structure and cost of capital. Most recently, we issued debt to refinance some of our Matched Investment Program notes and we launched an exchange offer proportion of our hybrid securities.

Turning to page 14 for a word or 2 on Chartis. The financial results of Chartis are now reported in accordance with the recent reorganization in the global commercial and global consumer businesses. Progress continues to be made toward improving our risk-adjusted profitability and changing the mix of our business. Some highlights are as follows: Net premiums were up about, just shy of 1% from a year ago. And excluding the impact of foreign exchange and restructured loss-sensitive programs and exiting selected workers' compensation business, net premiums were flat for the quarter. Adverse prior year development was a benign $55 million after considering related additional loss-sensitive premiums. We review a portion of the reserves each quarter throughout the year and importantly, the accident year loss ratio was 68.4% versus 67.7% in the second quarter and 68.5% a year ago.

The expense ratio was 30.8%, up from 28.2% a year ago. Last year's quarter included the benefits of negative VOBA amortization related to the acquisition of Fuji Fire & Marine. Fuji DAC amortization this year is higher from new deferrals since the time of acquisition. Excluding the FX and the DAC expenses was -- the ratio was up about 1%.

Chartis premiums are on Page 15. Chartis continues to execute on its strategy to grow higher margin, less capital-intensive business and implementing corrective actions on underperforming business lines. Excluding FX, Consumer Insurance premiums were down about 1%, driven by personal lines, which was a management action to deal with a certain unprofitable warranty program. We see the results of our focus on the growth in higher margin lines.

Turning to commercial insurance premiums, excluding FX, we're down about 2% driven by, again, a focus on capital management and continued discipline in certain challenging markets. I think it's important to note that in the U.S. commercial line, we're seeing rate increase overall of about 4.1% on renewal business with rate increases led by over 8% in our property line. The trend is accelerating from prior periods. Our international business is now about 50% of our net premiums, and that's up from about 45% a year ago

Chartis investment results were on Slide 16. Net investment income for Chartis was $1 billion in 2011, basically flat from a year ago. Chartis continued to reduce its muni bond portfolio, which is now up 27% of its invested assets, and that's down from over 35% a year ago.

Turning to SunAmerica on Page 18. SunAmerica's operating income was $444 million for the quarter versus $1 billion a year ago. The decline in operating income reflects much of the market volatility that we've talked about with respect to ML II, some partnership investments, as well as the higher guarantee minimum death benefits DAC amortization of our VA business. Premium deposits and other considerations totaled $5.7 billion for the quarter, that's up nearly 30% over a year ago. Net flows were positive for the third quarter -- third consecutive quarter at just shy of $550 million, and it's interesting to note that year-to-date, it's positive $2.1 billion versus -- year-to-date versus negative $1.6 billion a year ago year-to-date. SunAmerica's business remains diverse, strong, good momentum in sales, deposits and good strong customer retention.

Premiums, deposits and other considerations are on Page 19 and I commented on PDOC overall. Life sales, I would comment, were up 14% driven by a strong retail life sales.

Let's turn to Slide 20 for SunAmerica's investment income. Net investment income was $2.3 billion, down a little over $350 million from a year ago. As I mentioned, ML II affected this quarter by a negative $43 million due mainly to the spread widening partnership. Income was muted this quarter due to private equity and hedge fund investments, which would remind everybody, are reported on a one-quarter lag. There was also a $97 million impairment on equity method investments and trust that hold leased commercial aircraft, the same factors that gave rise to the ILFC impairment affected these aircraft as well.

Excluding ML II and partnership and impairments, the investment income was essentially flat. Importantly, we've redeployed the excess cash we had coming in to the year. And you can see that in our base yields that are set forth in the financial supplement.

Page 21 has some information about the SunAmerica spreads. Base spreads, excluding the impact of partnerships and other enhancements, increased again as we've redeployed the excess cash from the beginning of the year.

Looking ahead, if we continue to take capital gains to realize the economic value of our substantial capital loss carryforwards, again I would just remind everybody that the spreads themselves, the reported spreads could come under some pressure.

Now for a few words on our income taxes on page 23. As more fully described in our third quarter 10-Q, we apply a framework for establishing a valuation allowance. Among other factors, AIG has emerged from its recent cumulative loss, and now we need to demonstrate a level of sustained profitability. At the end of the second quarter, we described that framework for evaluating the reversal of the substantial portion of that valuation allowance as early as the fourth quarter of this year. If the framework is met, the valuation allowance for our net operating loss carryforward, the nonlife capital loss carryforward and the foreign tax credits could be released again as early as the fourth quarter. If the framework isn't met, obviously the release would be delayed.

Realized capital gain -- realized capital loss, I'm sorry, carryforwards remains more challenging to us as we've talked about in the past, and that portion of valuation allowance will be released as the carryforwards are realized.

We still expect an effective tax rate of roughly 25% to 30% for the rest of the year on our operating income, driven by our substantial investment in tax-free muni bonds. So from time to time, other discrete items will affect that rate as well.

Just a couple of other comments then before we turn it over to Q&A. A word or 2 about the new accounting standard on DAC, which is going to be adopted January 1, 2012. We will adopt the standard, and there are specific categories of acquisition costs that are no longer deferrable under the new standard. And if we adopt the standard retrospectively, this will be -- this will reduce our DAC balance by approximately 1/3. So that's about $4.5 billion to $5 billion and will reduce our GAAP shareholders' equity by about 3%. But it'll have no affect at all on our statutory surplus.

Also, during the quarter, the parent company received dividends, distribution and other intercompany payments from the operating companies of about $1.6 billion, bringing the year-to-date total to $2.5 billion. That's consistent with our capital management goals and aspirations, and so that remains on track.

Again, looking ahead, we would expect some continued choppiness in the equity markets with respect to partnership incomes. We will, in fact, have some losses on the Thailand floods, but we're not prepared to quantify that at this time. Lastly, we remain committed to our long-term aspirational goals that we set forth in our first quarter 10-Q.

Bob, now back to you.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Okay. Liz?

Elizabeth A. Werner
Head of Investor Relations and Vice President
Yes, at this time operator, we'd like to open the call up for any questions.

Question and Answer

Operator

[Operator Instructions] And our first question will come from Jay Cohen with Bank of America Merrill Lynch.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

A couple of questions. I guess, first, on the share repurchase. You mentioned the priority is to buy back from the Treasury. It seems as though the situation was, they don't want to sell below a certain price. Is it possible they might sell to you below that price versus selling to the public? Or should we just assume that until the price gets up 27, 28 that you won't be buying back from them?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

I can't speak for the U.S. Treasury. I can only say that, that if they want to sell it to us below that price, we'll be happy to buy it. But I think they have their view of what the company is and what the company will be. Their goal and our goal is to make sure that the American taxpayer gets back all of their money, plus a profit, and that's their goal as well. So I think that's clearly up to them. There is no -- the advantage you have, people say, gee, but the U.S. Treasury is not a problem. And as far as we're concerned, they have allowed us to run the company the way we need to run the company. They're a very effective shareholder for us. And their goal is to sell where they can get a profit for the American taxpayer. They're not trying to time the market. They're just wanting to make sure that they get out with a profit and time is not of the essence for the U.S. Treasury. They just want to achieve that goal. So I think if they chose to sell less than that, they could, but that's not what their interest is.

Jay Adam Cohen
BofA Merrill Lynch, Research Division

And Ed Spehar is here, too. He's going to ask a question.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Just a couple of quick ones. Could you give us some sense as what you think the free cash flow is for both Chartis and SunAmerica and kind of normalized to the basis? And then just a couple of questions on top line, the VALIC deposits were very strong this quarter and you mentioned rollovers, is that something that is sustainable? And if so, why? And then on the Western National, was the weakness in sales because others didn't lower crediting rates as fast as you did, or is it just that you're not interested in putting on a lot of fixed business when rates are in such very low levels considering the risk of shock lapses if rates start to go up?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Okay, I'll have David start, and then I think when it comes to VALIC and in terms of the ongoing rollover program, so it's not a onetime thing. But Jay can talk about the ongoing rollover program they've been successful at and also the pricing strategy within Western that deals with making sure that we have the right combination of commissions and price, that's really up to the bank and how they want to deal with that in this low-rate environment. So I'll let Jay handle those 2, but David, why don't you start?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Yes, sure. Thanks, Ed. I would first start by saying, we are reaffirming the capital flow in our long-term aspirational goal. So while the markets are somewhat volatile, again, we've -- our expectations are that those dividend flows and capital flows from the operating companies to the holding company, we would reaffirm those expectations. We had in the quarter about $1.6 billion overall of flows, and again the flows come in a number of different shapes and sizes in terms of outright dividends. We have some surplus notes between the holding company and some of the operating companies and SunAmerica, and so we're paying interest plus principal on that. We've got the tax payments. So while we're not going to quantify a "free cash flow", I would just say that our risk-based capital levels remain very strong and the earnings of the operating companies continue to be strong. And therefore, the dividend flows are in line with our previously discussed expectations. Again, we got about $1.6 billion this quarter. And again, that's -- it'll bounce around a little bit. But that gives just -- it won't be -- you can't take that and annualized it. But again, I would point you back to our longer-term aspirational goals that we set out.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Jay, you want to pick up the other 2?

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

Yes. On the VILAC question, Ed, we did have very strong quarter on individual rollovers. I think that will continue exact numbers in such obviously can't predict. I think the reasons for that are probably threefold. We've had increased emphasis on focusing on rollover sales for some time in our recruitment of financial advisors, in our focus on doing more financial plans for prospective customers. Secondly, we have rolled out a series of new products more focused on that market, something we call PD advantage, which is for people rolling over from our core Portfolio Director product at the end of their service. We've added a new contemporary guaranteed living benefit rider called IncomeLOCK Plus, that's available for nonflowing customers. And then finally, we also rolled out a new variable annuity for the rollover market we call Equity Director. Those have all been picking up momentum and share starting this quarter. And then the last thing I would say is in addition to our core VALIC field of financial advisors, we do have a growing independent distribution organization that is licensed with VALIC. And a large part of their sales have been focused on the rollover market. So I think that you'll see continued progress here and it continues to be a point of emphasis in VALIC. In Western, see, the reasons for the decline sequentially in fixed annuity sales, and I think we still had an increase year-over-year, kind of 3 different reasons there. First, on the positive front, we are now back in Wells Fargo, which had historically been our largest distributor. That just came online in June. We're also back in SunTrust, that just came online in August. So we continue to get reinstatements, and we'll be building back our presence in those organizations in the quarters to come. But in the last quarter, with the absolute level of interest rates declining, that was a meaningful contributor to our reduction in sales sequentially. We did see a few new competitors come into our market. We've seen that over the years. That's fine. Didn't want to compete in a couple of cases. The fact is we've got I think something like 21 proprietary arrangements now going to our banks where we are trading off crediting rates to the customer for lower commissions. So we feel like we're very well positioned. And last thing I'd say is that in the last quarter, the second quarter, we hit our highest market share of the fixed annuities through banks that we had ever hit, I think north of 40% as reported by Kehrer or LIMRA. And I'm expecting this quarter, we'll be back in what is our more typical market share, which is not what we target but just where we end up probably somewhere between 25% and 30% of the market and still far and away the largest. So those are the 3 reasons for the sequential change in Western National and our fixed annuity sales through banks.

Edward A. Spehar
BofA Merrill Lynch, Research Division

Jay, just one quick follow-up. Do you worry at all -- even if you're getting your spread today, do you worry at all about the risk of writing business with rates these low and kind of shock lapses if rates start to go up at some point?

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

We do worry about that. We worry about in all environments and our -- the major mitigant there is very careful matching of our assets and liabilities. Our pricing is very disciplined. Our guaranteed minimum rates are now down to 1% on all products, have been for some time. The yield curve is still reasonably steep, so we're still able to price and get reasonable spreads. But the main thing will be the continued matching of our asset and liability durations, not only initially at purchase but monitoring that very closely on a regular basis. But yes, we worry about that in the sense that we've got to constantly match those durations.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

And keep in mind that what you have here and the way they've designed the product, in many cases there's been a trade-off of commission to rate. And so when you look at disintermediation, it's what you got left that you haven't amortized. If you have left amortized, then the shock lapse aren't as onerous as you might have on more traditional fixed annuity commission products. So it's -- there's lot of contributing factors to make this. We're watching it and Jay is watching it very carefully, but it's not as bad as you might think and if you just think normal fixed annuities.

Operator

And next, we will hear from Jimmy Bhullar with JPMorgan.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

I had a few questions. The first one for Bob, you mentioned that you would be open -- or you'd prefer to buy stock back from the Treasury but also would consider buying it in the open market if the Treasury doesn't want to. So maybe if you could give us some sense of the timing of completion of your share repurchase plan. Second, you mentioned that ILFC was noncore. Wondering if you can share with us what your thoughts are as it relates to AIA. And then finally, for Peter, in the P&C business, just talk a little bit more about pricing. You mentioned commercial property lines getting a little bit better, but maybe more details on the casualty side and personal lines. And related to that, frequency severity trends at Chartis. Obviously, results were affected by high cat losses this quarter. But if you look at the combined ratio ex cats and developments, it still went up from third quarter last year from the second quarter this year. So what you're seeing there and your comfort level with your long-term combined ratio target?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Let me start with the timing of the buyback. We're going -- we've got the authorization, and the team will take a look at what the opportunities are and we'll begin to do what we think makes the most sense based upon where the markets are. I don't have a goal to say we're going to be done in a month, 2 months or 3 months, we're just going to be prudent and see what makes the most sense. So it's the only thing I can give you that answer. We'll know once it's over. As far as ILFC not being core but what about AIA. AIA is -- gives us third interest in Asia. And the question becomes, looking at the value of that position over time and where the markets are and what the opportunity we would have if we were to monetize that and sell it, the question is, what would we do with the cash? And obviously, you'd say, well, how about buying back AIG shares? We would look at that as one of the capital management opportunities, there could be others. But whatever we do, we'd take a look at what the market says that property is worth and what are the -- what else we could do with the money that would give us a better return over time. And that's -- it's just a consideration we have to make as we go forward. Right now, we're going to stay on path from what we see, but that doesn't mean that won't change over time. And so I would then turn it over to, I think and I covered my piece of it, so I want to turn it over to Peter. Can you go through that Peter, if you will.

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

Yes. So Jimmy, in terms of pricing, I think we are seeing some hardening, as David already mentioned, both in the property and in the casualty space. He'd mentioned specifically overall in the U.S. over 4%

year-on-year rate increase. And this is a trend that really started for us as early as the first quarter of this year and it's just a progression of year-on-year rate increase since then. So I think that we are leading the industry by about 1/4 in terms of rate. And on the property side -- on the casualty side, our workers' comp year-on-year in the quarter is up about 6.3%, and again that's a trend that actually was initiated earlier than the property and really as early as the middle of last year. So we feel good about the pricing trends and on the U.S. side. On the international and on the consumer lines, the news really is Japan, which is a vast bulk of our consumer business. And the fact that since the beginning of this year, we got relief from the regulatory block on incremental rate increases that have been in existence for 3 years until January of this year. And it was not just us, it's across the whole industry. And so each quarter, we have seen incremental pricing improvement in Japan, which we expect to continue and has been matched with increased flows as well. So we feel good about trends in Japan, although obviously, somewhat distorted by events in the first quarter both in terms of losses from the tsunami and the earthquake, but also the disruption to new business flows in the second quarter. But rate and demand in Japan is looking good.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And just your views on your -- like margins?

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

Sorry, yes, your point on the combined. As we laid out in the roadshow, last year's combined, on an accident year basis is 103.6. We set out a target to get that number to 90 to 95 by 2015. That's a roughly 2-point improvement per annum. And if you look at the projection for this year on a normalized basis, normalizing out the extraordinary cats, we are right on track for that "2 point per annum" improvement in accident year combined. So we're feeling very good about our long-term aspirational plans on improving the combined.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

Okay. And lastly, does the loss in the third quarter hurt your ability to reduce the valuation allowance against the DTA or could you still do it if the earnings bounce back in the fourth quarter?

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Jimmy, it's David. We had your point to the -- to what happened in the third quarter, it's a factor but there's still very real possibility that if we -- that we can hit our framework and that we can still release the allowance in the fourth quarter. Again, that will be determined by the performance of the company. One of the critical factors was the falling away of the 3-year cumulative loss that's done. And we'll just evaluate the facts and circumstances in the fourth quarter, particularly as they relate or solely as they relate to the U.S. member taxable income for the U.S. member company. So again, I think there's still a possibility, a very real possibility of that happening in the fourth quarter.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

But it's very complex. There's a lot of judgment and we want to make sure that everybody who oversees these kinds of activities as regulating entities all understand what they are. It's not simply saying, well, we look like we're going to be profitable in the future, let's just do it. There's a lot of rules and regulations around how this works, and a lot of complexity and a lot of judgment, and so it's not quite so simple to generalize what it means. And we are going through all of the steps very carefully to make sure that what we do is -- we're not in a hurry. We just want to make sure when we do it, we want to make sure it's right and it's got to be very clearly right and something that's very great.

Jamminder Singh Bhullar
JP Morgan Chase & Co, Research Division

And obviously what you do on the balance sheet doesn't affect the economics of how you use it, right?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

That's correct.

Operator

We'll now hear from Thomas Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

I guess, the first one is just for Bob or David. In terms of the little bit less than $7 billion that's owed on the SPV, is there a fuse on that? Meaning, would you have to make a decision to monetize either AIA, ILFC or come up with the cash in another way by a certain point in time?

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

One, the fuse is you got to make sure you do what's right for the shareholders. And there's 1 shareholder that has 77% of the stock and they want to make sure we maximize their value. So that's the fuse. If, for example, we were pushed to pay it down, we've already developed a strategy and a plan to what we would do if we chose not to sell any of the assets that are collateralized right now, so we could free up the collateral. So at this stage of the game, our primary shareholder has said, "Look, maximize our value, that's what we want, and make sure that we can sell as soon as possible." And so that's the only constraint we have.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Got it, okay. And then, can you talk a little bit, I guess this should be for David, can you talk a bit about your overall capital position today. I see you have north of $15 billion of liquidity resources at the holding company. But can you talk a bit about, aside from the stakes in AIA and ILFC, which I realize are -- at least, I think about them as residual asset values that could be monetized into capital. But as it relates to capital levels at the insurance companies, is there any excess? And I guess the other side question I had for that is the $11.6 billion of cash in short term at the holding company, there was a footnote in your Q that said $8.7 billion in reverse repos is used to reduce unsecured exposures. I'm just not sure what that means, if you could elaborate.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Sure. I'll cover parts of it and I'll ask Brian Schreiber, our Treasurer, to comment on the -- on your last part there with respect to the reverse repos and the strategy behind that and the use of those. How we think about the capital management, you're right, we've -- we grew our cash and short term and financial resources at the holding company to just north of $15 billion in the quarter. Again, we renewed the bank facility, had a terrific stable of banks participating. We were very pleased with that participation. We also announced that we put in place an additional contingent capital facility, again, building up contingent capital and contingent resources in order to, again, allow us the greatest degree of financial flexibility. I think we've talked quite a bit about historically the capital maintenance agreements that we put in place with all of our operating companies. Those agreements, I would say, continue to operate as designed that the capital flows are coming to the holding company in accordance with what we -- what our expectations were with those capital levels. We don't report, or haven't reported yet the RBC levels of the companies. But suffice it to say, our domestic life retirement saving companies remain very strong and in line with where they were at year end, which was upwards of 500% RBC. The capital maintenance agreements levels were in the 350% range and would expect Chartis likewise to be at or above its capital maintenance agreement threshold. So again, the underlying capital positions of our operating companies remains very strong. Again, I won't quantify a "excess capital," but you can get a feel for that where we are there. Brian, you want to comment on the short-term investments and the use of the reverse repos?

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

Sure. A key component of our capital and liquidity plan has been to reduce contingent liquidity risk at AIG. And as you know, AIG in the past had issued debt in foreign currencies and swapped that debt back to dollars. That exposed us to contingent liquidity risk from a strengthening dollar. We have net assets over long capital in many of the currencies in which we've issued the debt. So we've been able to unwind the swaps, eliminate the contingent liquidity risk and effectively invest short term in those currencies to defuse that debt. So we are economically hedged and we've eliminated the contingent liquidity risk. We have chosen to go in reverse repos because it offered the best sort of risk-adjusted returns for the company from a short-term investment standpoint. So I hope that addresses your question.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Yes, it does. Just a follow-up, Brian. So should I be thinking about $8.7 billion still available fully utilizable by your Holdco or is there some level of -- are those funds encumbered in some way, shape or form? Like I just want to understand how to think about -- I hear the technical explanation, but I just want to know practically speaking is, are those funds there for you, or is there some level of that those are encumbered?

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

The cash at parent is not encumbered. It is a fungible asset that can be utilized how the parent company sees fit.

Operator

We'll now hear from Josh Shanker with Deutsche Bank.

Joshua David Shanker
Deutsche Bank AG, Research Division

I wanted to just to follow up a little bit on the CDS book. Back in the time of the roadshow, the maximum capital call was about $1.6 billion. I realize mark-to-markets are not capital calls, but you've had $1.6 billion in marks over the past 2 quarters. I'm wondering if your outlook has changed on that at all in terms of the maximum capital call you could have from that book at this time?

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

No. In fact, we continue to wind down the portfolio and reduce our exposure to contingent liquidity. And as you saw, we've further reduced the impact of a downgrade to AIG, our risk has gone down, and every quarter that contingent liquidity risk is being brought down. So I hope that -- we don't disclose a specific number for the overall contingent liquidity risk. But again, it remains on trajectory downward.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Just let me make a comment on -- keep in mind that we have, at the holding company, a lot more latitude in focusing on economic value instead of just mark-to-the-market and the consequences to capital ratios and so on. So we feel pretty confident that while you're looking at various market anomalies, that we're focusing on the economic value when this stuff comes due. So I think that's what you'll see that we're not worried. It's a matter of what we do think is intrinsic and when are we going to achieve intrinsic.

David Lawrence Herzog
Former Chief Financial Officer and Executive Vice President

Brian, I think maybe you also comment to the effects of what happened in the quarter with respect to capital calls and the like and on the wind down book.

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

Yes, essentially, as Bob mentioned earlier, with the volatility we've seen in rates, spreads, equity markets and FX, we've had effectively 0 postings in the quarter. And again, it's a result of actions that we've taken over the last year plus to, again, reduce our exposure be it by terminating trades, by intermediating trades, and as I just described on the last question about again taking off swaps at where we are effectively, economically hedged.

Joshua David Shanker
Deutsche Bank AG, Research Division

And then on the upside, you made this comment back in the roadshow that you can't predict the future, but you thought there was probably $1.2 billion in upside from that book and now we would get $1.6 billion on the downside. Does that mean, you still think there's $2.8 billion, or has the current market changed your outlook for the value of the upside associated with that?

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

No, no. we believe the intrinsic value of those assets remains and we still believe there's a significant amount of upside consistent with what we've articulated earlier.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Trouble is nobody will sell us this stuff at this price.

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

Yes. That's right. That's why we're all sitting and waiting, and we can afford to wait.

Operator

We'll now go to Michael Nannizzi with Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

I'm just trying to square a couple of things. So rates were up 4% on average. It sounds like U.S. commercial, but premiums were down 8%. Obviously, you had some actions you took that impacted premiums. But excluding those actions, can you help us understand what happened to exposures there?

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

Yes, this is Peter speaking. To look at the top line, first thing, you'll just strip out foreign exchange, and that's about a 4.2% adjustment. So if you look at the top line adjustment for the foreign exchange, it's down 3.5%. The biggest driver of that reduction, which was about 3.4%, was caused by us changing the policy form of certain policies in the U.S. along the lines that David alluded to, the loss-sensitive business is just simply rebooked in a way that reduces the top line, has 0 impact on the bottom line. It's actually slightly positive because it reduces the premium tax. But it's really dramatic effect on the use of statutory capital. And one example of where our focus on risk-adjusted return and capital efficiency is motivating our behavior as opposed to targeting top line per se. That being said, we're absolutely committed to a strategy of profitable growth, and so we are shifting the mix of business to activities that have long-term sustainable growth. And so in our roadshow, we talked about top line growth expectations of 3% to 6% over the 5-year period, we still expect that. But in any given quarter, you'll see some top line reductions as a result of exiting certain areas. One other area was the excess workers comp, which contributed about 0.3% of the reduction of the top line, and that's something which we've talked about before as a business that we have exited completely.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Right. I guess I'm just focusing specifically on U.S. commercial where premiums were down 8%. So U.S. commercial, only to imagine, shouldn't be a lot of FX in there. And you had said -- I think Bob had said in prepared or maybe David had said in his comments upfront, that rates were up 4% in U.S. commercial. So I'm just trying to understand just U.S. commercial, what happened -- and I get that it's about $300 million from the change in form that you had mentioned. But I'm just trying to understand what's happening to exposures in the U.S? Are they down to -- relative to rate and that's why premiums look to be about flat? That's I'm trying to get to.

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

So, first of all, I was talking about aggregate total top line commercial, consumer and global. As you know, roughly 50% of our business is international and roughly 60% of it is commercial. So secondly, I've made it very clear in all of our discussions that we are seeking to grow international faster than domestic and to grow consumer faster than commercial. So the math works out that we are shrinking U.S. commercial where we feel we're not getting adequately rewarded. And so the reductions there are quite substantial in order to get that net number on a global basis. So that's as far as I'd go to comment on that.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Okay. And can you talk about -- again, in U.S. commercial, can you talk about pricing versus loss trend or how pricing is tracking to your expectations at the beginning of the year? Can you talk about that?

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

I'll ask John Doyle to comment on that.

John Doyle

Michael, it's John. To add to Peter -- to the response to your last question, that we continue to reduce our exposure in the U.S. to cat property to work comp, Peter mentioned excess comp, but also to primary guarantee cost comp and to excess casualty. Rates continue to trend more favorably. They are slightly ahead of what our expectations were in the beginning of the year. We did increase our loss picks for some U.S. commercial lines at the beginning of the year, that accounts for some of the year-over-year change in the loss ratio. But obviously, we had planned for that when we went out on the road in the second quarter. So the pricing trends are a bit ahead of what we expected, and I would add that September pricing was better than August, and August was better than July. So while we still have some work to do to get where we want to go, trends continue to move in the right direction.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

And any difference between large case and small case? And maybe if you could touch a little bit on professional lines, in particular DNO and kind of what you're seeing there.

John Doyle

Yes, our rates in professional liability were down about 0.5 point in the third quarter. That's better than where we were in the first and second quarter. The business there continues to run off very well. So we're certainly confident in our portfolio there. And I've certainly read about lots of other markets talking about the competition there. I would say that we're primarily a lead writer in that market. And I think it can get a bit more competitive as you move up above the lead layer. So we continue to be confident where we're headed there.

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

I want Rob to just clarify something. Did you mention that you thought that our commercial was down 8%?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Well, if I look at U.S. commercial, so just -- so in your supplement, you break out commercial lines by geography. So I was looking at, I guess, it's 3.8% to 3.5% roughly in net written premiums from 3Q '10 to 3Q '11. So I think that's about 8%. And as I understand about $300 million of that, maybe a decent chunk of that is the rate actions you took in the third quarter or the -- but I guess it's...

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

That's principally explained by what I talked about the loss-sensitive business that we have changed the policy form of.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Right. But still if rates are up 4%, even if premiums are flat, that wouldn't mean, I guess, that exposures are down 4%. I mean, is that how should we be thinking about it?

John Doyle

I mean exposures are down in comp, in excess casualty and in property and they're down more than 4% in that area. And we've written less new business year-over-year, quarter-to-quarter because new business pricing isn't as attractive as we'd like it to be.

Robert Herman Benmosche
Former Chief Executive Officer, President and Director

Unfortunately, we're out of time, and so to those of you we didn't able to get to, I apologize for that. But give us a call, and we'll do what we can to answer your questions. I want to close on a very important statement and that is the fact that we have come to the

[Audio Gap]

We have shown the strength and our resilience in this organization going forward. And as it relates to AIA, I want to repeat, again, because I know there's been a lot of speculation, and sometimes people say I'm not clear, so I'm working on my clarity skills. The lockup has allowed us to sell the shares, but our timing and our decisions have nothing to do with the lockup. It has to do with making sure we do the right thing for the shareholders of AIG and at the right time. And so on that note, I thank you all and look forward to hearing from you all next quarter.

Operator
Thank you. That does conclude today's teleconference. We do thank you all for your participation.