S&P Global
Market Intelligence

American International Group, Inc. NYSE:AIG

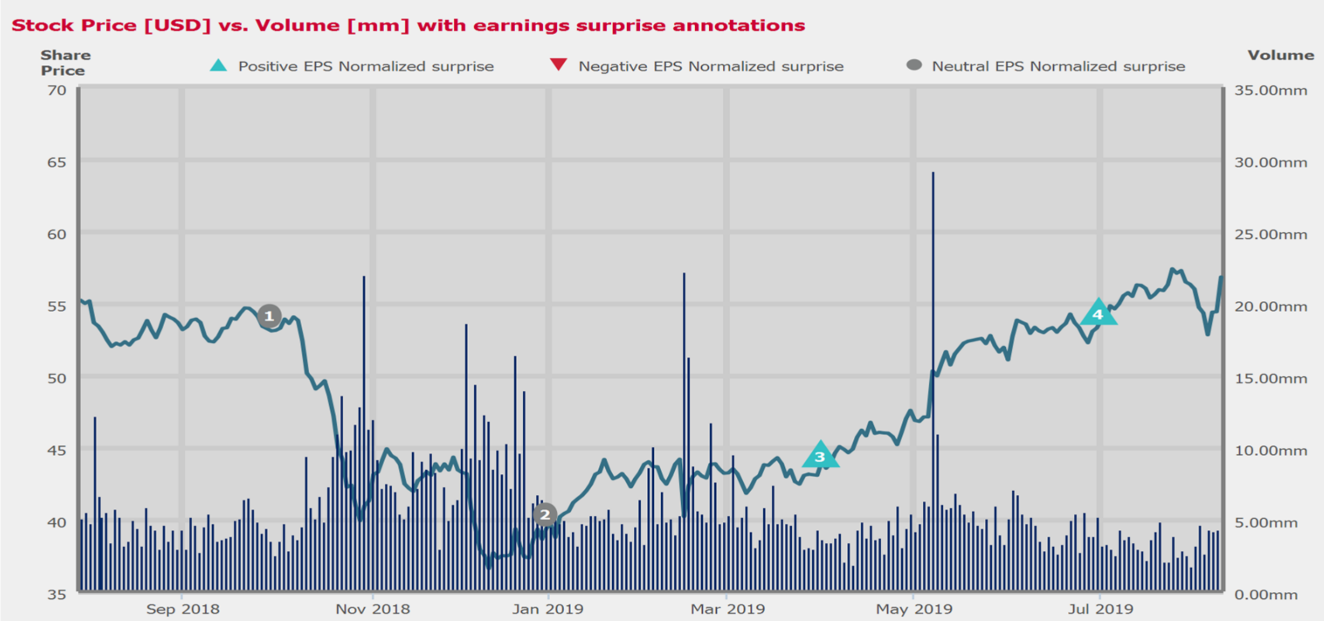
FQ2 2019 Earnings Call Transcripts

Thursday, August 08, 2019 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2019-			-FQ3 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.16	1.43	▲23.28	1.07	5.13	5.15
Revenue (mm)	12071.30	12561.00	▲4.06	12103.13	49380.50	49194.36

Currency: USD
Consensus as of Aug-08-2019 11:06 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2018	0.06	(0.34)	NM
FQ4 2018	0.45	(0.63)	NM
FQ1 2019	1.06	1.58	▲49.06 %
FQ2 2019	1.16	1.43	▲23.28 %

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Call Participants

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Presentation

Operator

Good day and welcome to the AIG's Second Quarter 2019 Financial Results Conference Call. Today's conference is being recorded. And now at this time, I would like to turn the conference over to Ms. Liz Werner, Head of Investor Relations. Please go ahead.

Elizabeth A. Werner
Head of Investor Relations and Vice President

Thank you, Jake, and good morning, everyone. Today's remarks may contain forward-looking statements, including comments relating to company performance, strategic priorities, business mix and market conditions. These statements are not guarantees of future performance or events and are based on management's current expectations. Actual performance and events may materially differ. Factors that could cause results to differ include the factors described in our first quarter 2019 Form 10-Q, our 2018 Annual Report on Form 10-K and other recent filings made with the SEC. 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. Additionally, some remarks may refer to non-GAAP financial measures. The reconciliation of such measures to the most comparable GAAP figures is included in our earnings release, financial supplement and slide presentation, all of which are available on our website, www.aig.com.

This morning you'll hear prepared remarks from our CEO, Brian Duperreault; our COO and CEO of General Insurance, Peter Zaffino; our CEO of Life and Retirement, Kevin Hogan; and, our CFO, Mark Lyons. [Operator Instructions]

And at this time, I'd like to turn the call over to Brian.

Brian Charles Duperreault

Thank you. Good morning, and thank you for joining us to review our second quarter results. As we continue to position AIG for long-term sustainable and profitable growth, disciplined execution of our strategy is reflected on our strong performance in the second quarter and first half of 2019.

Adjusted return on common equity for the second quarter was 10.4% and 11% year-to-date. Adjusted after-tax income was $1.3 billion or $1.43 a share for the second quarter, and $2.7 billion or $3.01 per share year-to-date, nearly $1 per share improvement over the first half of 2018.

Throughout the first half of 2019, we remained focused on the foundational work that continues across AIG, particularly in General Insurance, which delivered a second consecutive quarter of profitability with an accident year -- I mean an accident quarter combined ratio, including actual CATs of 98.7% or 96.1% as adjusted. The calendar quarter combined ratio was 97.8%.

The turnaround at General Insurance, which has been led by Peter Zaffino and his team, is impressive. AIG is taking a leadership position in its approach to disciplined underwriting and innovative reinsurance strategies, and we have strong momentum heading into the second half of 2019. I can confirm that we expect to achieve underwriting profitability for the entire year. Peter will provide more detail in his remarks on the significant progress being made in General Insurance.

With respect to premium rate trends, I want to follow up on my comments from the first quarter. Rate increases accelerated in the second quarter, in some cases, materially. I've seen a number of market cycles and each one has different characteristics. I would describe this market as one where there is more underwriting discipline and rigor around the deployment of capacity rather than a major decline in capacity. That discipline seems to be playing out through the pricing models and underwriting processes that are recognizing increased loss cost frequency, the tort environment and other emerging risks. To me, that means that tort is based on facts rather than emotion and is therefore, more sustainable.

With respect to AIG, we are seeing strong rate improvement across most of our global portfolio. In addition to industry dynamics, rate increases reflect our comprehensive and disciplined strategy to reposition our businesses as market leaders by refining our risk appetite, significantly reducing gross and net limits, tightening terms and conditions and reducing capacity in certain areas. Peter and Mark will provide more details on rate in their comments.

Life and Retirement also added a solid quarter, posting a 17.3% adjusted return on common equity due to continued discipline and execution of its strategy as well as strong private equity returns and favorable market performance. Equity markets remain highly volatile and unpredictable and as a result, we're not changing our 2019 guidance for Life and Retirement of full year adjusted return on common equity in the low to mid-teens. Kevin will provide more additional information on Life and Retirement.

Net investment income was $3.7 billion in the second quarter, reflecting strong performance in the equity markets and tightening spreads in the credit markets as well as a significant gain on private equity investment. Mark will provide more detail on our overall financial results later in the call.

Since I arrived at AIG, we have focused on addressing several critical areas, including refining our approach to underwriting, reducing our risk profile, overhauling our reinsurance strategy to reduce volatility, making our General Insurance business profitable, and remediating challenged legacy businesses. We have also been working on AIG's strategic positioning in the global insurance marketplace and longer-term priorities that define who we are as a company and how we create value for our stakeholders.

Given the progress we have made, we are now placing greater focus on a multi-year enterprise-wide program, which we have branded AIG 200. I've asked Peter, in his capacity as Global Chief Operating Officer, to lead this effort across all of AIG. AIG 200 will focus on opportunities to improve our core processes and infrastructure. If we are to become a top-performing company, we must make transformative and sustainable improvements that will require investment. This work ultimately will lead to a reduced expense base and improved experience for our clients, policyholders and colleagues. Like the foundational work that started in late 2017, we are not taking shortcuts with this program. AIG 200 is critical to our long-term success, and we will report on our progress on future calls.

With respect to capital management, you will hear from Mark that we did not buy back shares in the second quarter. Our capital plan for the remainder of the year remains focused on reinvesting on our business and reducing our leverage.

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

Peter Salvatore Zaffino
Global COO & CEO of General Insurance

Thank you, Brian. Good morning, everyone. Today, I will provide an overview of several highlights in the second quarter. I will provide detail on the financial performance of General Insurance; highlight rate actions, which Brian mentioned; provide insight into the progress we're making in our businesses and the tangible impact our focused and disciplined actions are having to change the composition of our portfolio. I'll briefly update you on Validus, summarize progress on our reinsurance program and lastly, share some observations as we look towards the second half of 2019.

We continue to execute on focused actions across General Insurance that will position our businesses to be leaders in their respective markets. These actions include enhancing the quality of our underwriting and desired risk appetite, evolving our reinsurance program to reflect our improving book of business and exercising expense discipline in order to provide bandwidth for future investments. We are operationalizing these actions throughout General Insurance by embedding more disciplined end-to-end business processes. I'm very pleased with the demonstrable impact these actions are having on our business results as evidenced in our improved financial performance in the second quarter and the first half of the year. I believe this is not only sustainable, but will improve over time.

Building on our momentum from the first quarter, we achieved an accident quarter combined ratio, including actual CATs of 98.7%, an improvement of 460 basis points year-over-year and an accident quarter combined ratio as adjusted of 96.1%, an improvement of 490 basis points year-over-year. The calendar quarter combined ratio was 97.8%, an improvement of 350 basis points year-over-year. The accident quarter loss ratio, excluding CATs, for the second quarter was 61.3%, a 410 basis point improvement year-over-year, and a 50 basis point sequential improvement from the first quarter 2019. This quarter-over-quarter improvement was the result in a change in business mix and continued reduction in lines where we are not achieving our targeted returns. Improved areas of performance, reduced volatilities stemming from our underwriting actions in the comprehensive and vastly improved property reinsurance program and improved loss experience in certain areas such as Japan Personal Auto and Commercial Property.

In the second quarter, we experienced net CAT losses of $174 million, which were primarily driven by storms and tornadoes in North America. Overall, our aggregation strategy, along with reinsurance, continue to reduce our gross and net exposures on a worldwide basis.

Net premiums written for the second quarter were $6.6 billion, down approximately 3.7% year-over-year on an FX constant basis. While our net premium written, excluding Validus and Glatfelter, has declined almost 15% year-over-year, we've reduced our exposures by a greater magnitude and the re-underwriting of our portfolio improved the quality and rate adequacy of our overall book of business. Our focused discipline will continue to improve our combined ratio, which I will expand upon later.

The second quarter expense ratio of 34.8% represents an 80 basis point improvement year-over-year and a 50 basis point increase from the first quarter of 2019. This 50 basis point increase is largely due to the second quarter acquisition expense ratio of 22.2% which reflects an increase of 40 basis points sequentially and 110 basis points higher year-over-year. A significant amount of the year-over-year increase is attributable to a onetime favorable premium adjustment in the second quarter of 2018.

The acquisition ratio on the second quarter of 2019 was impacted by improved performance in the travel and warranty businesses, which have lower loss ratios but higher commissions. The general operating expense ratio was 12.6% in the second quarter, in line with our run rate and expectations, and a 190 basis point improvement from the prior year. Excluding the impact of acquisitions, general operating expenses on an FX constant basis declined by approximately 18% year-over-year.

We continue to execute on our strategy to optimize our portfolio by concentrating on a risk framework and risk appetite that identify areas for growth and remediation and leverage AIG's unique market position.

Moving on to rate in the second quarter. As Brian noted, we continue to see meaningful rate increases across our portfolio on average, excluding Validus and Glatfelter, from the high-single digits compared to a mid-single-digit improvement in the first quarter of the year. In North America, excluding Validus and Glatfelter, and in the U.K., we obtained high single-digit increases. The strong rate increases in the U.S. are mostly in E&S Casualty; Commercial Property, both retail and wholesale; D&O; Energy; and Excess Casualty. In the U.K., the accelerated rate increases were led by marine and energy and financial lines. In our reinsurance business, we obtained mid-single-digit rate improvement on a weighted average basis, which I will provide more detail on later.

Let me share some specific business highlights from the second quarter where we made material progress. Lexington has undergone extensive repositioning with revised risk appetite and distribution strategy that has resulted in vastly improved submission flow and tighter limits. As a result, we achieved strong rate improvement in the mid- to high teens in property and casualty. Property submissions were up over 35% year-over-year, and in casualty the increase was almost 75% since the second quarter of 2018. We strategically targeted reductions in most of our volatile accounts resulting in a reduction of property limits of over 55% and of casualty limits of over 50%. I'm very pleased with our leadership team, these outcomes reflect the extent of the recalibration of the business, pace of change and progress in becoming a leader in the E&S marketplace.

In financial lines, we are demonstrating leadership as we aggressively execute on our plans to improve the composition of our portfolio, reduce our gross limits to lead layers and prudently deploy our capital in those lead layers. Rate continues to be very strong and ahead of rising loss costs, which Mark will expand on in his remarks. For example, in primary corporate D&O, we saw a rate increase of over 30%, with a policy account retention of approximately 90%. In parallel, we reduced primary commercial D&O aggregate limits by approximately 30% and primary commercial D&O policies with limits greater than $10 million in lead layer by over 45%. In our European financial lines portfolio, we reduced public U.S. D&O limits by over 50%, with premium increases in the high teens. And in the U.K., we reduced public U.S. D&O limits by over 20% in the quarter and increased premiums by over 20% from the prior year.

In North America Property, we continue to execute on our aggressive actions to improve our overall portfolio. This entailed reducing total gross limits by over 60%, increasing average deductible by over 60% and achieving rate increases of over 20% on a written basis in the quarter.

As Brian noted, there's been industry commentary about the evolving tort environment and the expanding impact of social issues and social inflation. These are not new issues, and we've been following legislative and case law developments for some time now, including as they relate to proposed and adopted reviver statutes.

We're in the business of managing risk and paying claims. AIG is particularly adept at handling very complex claims. Our experienced underwriting, actuarial and claims professionals have been working together to understand these developments and to appropriately address these emerging, complicated and sensitive risks as they mature.

Turning to Validus Re, this business had a very good quarter. The main areas of focus were the April 1 Japan renewals and the June 1 Florida renewals. Demand was generally flat but capacity tightened due to a combination of factors such as prior hurricane loss development and reduced capacity from the ILS and retrocessional markets resulting in rate increases. Validus continued to show discipline in shaping the portfolio. For example, as I mentioned last quarter in connection with Japan renewals at April 1, the average rate change in the portfolio was 10%, with rate increases ranging from 15% to 25% for loss impacted CAT layers and flat to 7% for layers not impacted by CATs.

For the Florida renewals, our portfolio aggregate reduced by 17% year-over-year, while risk-adjusted rates increased by 9%, representing a net 2% premium increase relative to our expiring Florida [business].

A quick update on our reinsurance program. Reinsurance plays a critical role in our overall strategy to manage volatility and we continue to be very pleased with our ongoing accomplishments and strategic position. When combined, the advances we're making on underwriting discipline and the composition of our core portfolio, we see strong progress towards delivering a sustainable, profitable and less-volatile underwriting [business]. In the second quarter, just 2 additional property treaties that were placed below our cap program to address specific areas of concentration, and we purchased an aggregate retro cover from Validus Re. The more meaningful of the 2 property treaties is a single-limit per occurrence CAT cover for the Caribbean and Hawaii. The attachment points are $200 million and $100 million for the Caribbean and Hawaii, respectively, with a single shared limit of $325 million.

We also continue to manage our exposures for large individual property risks. In addition to gross limits management, we purchased facultative automatic reinsurance on some of the higher-hazard risks in the portfolio, providing additional volatility containment.

As we move into the second half of 2019, and into peak hurricane season, we now have comprehensive occurrence and aggregate protection in place and we'll continue to further enhance, refine and evolve our reinsurance program as our gross underwriting improvement begins to earn into future quarters. I look forward to updating you on our next call.

Turning to talent in General Insurance. We continue to focus on building and retaining a best-in-class team. We strengthened our underwriting leadership team in the second quarter, added new talent to our reinsurance organization, expanded our operational capabilities that link to the rest of the organization and overall, continued to build our bench. Additionally, in Personal Insurance, we added a seasoned veteran to lead high net worth as we continue to refine our strategy to reformulate that business. I'm extremely proud of our team globally. The performance of General Insurance in the first half of 2019 reflects the dedication, commitment, capabilities and extraordinary efforts of our colleagues across the globe.

Lastly, I want to comment on AIG 200, which Brian mentioned in his opening remarks. As we look to the second half of 2019 and beyond, it's critical that we focus on our infrastructure and businesses across all of AIG and invest to modernize and digitize our workflows as well as create a more unified AIG. As we did with General Insurance over the last 18 months, we are filling critical roles and adding a number of seasoned executives to corporate center with proven track records of achieving excellent results during transformations. In my capacity as AIG's Global Chief Operating Officer, I look forward to meeting this next phase of work that will accelerate the progress we're making towards achieving AIG's long-term strategic operational and financial goals that enable us to become a top-performing company.

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

Kevin Timothy Hogan
Executive VP and CEO of Life & Retirement

Thank you, Peter, and good morning, everyone. Life and Retirement recorded adjusted pretax income of just over $1 billion for the quarter and adjusted return on common equity of 17.3%. Adjusted pretax income increased by $87 million from the prior year quarter. A primary driver of this increase was a onetime gain of $138 million for a private equity holding following an initial public offering. Our earnings also benefited from the broader capital markets environment. Net investment income reflected both higher returns on fair value option securities of $48 million and higher call and tender income of $22 million due to significantly lower interest rates. Additionally, favorable mortality drove an increase of $35 million. These favorable impacts were partially offset by an allowance for reinsurance recoveries of $38 million in our Life Insurance business and expected spread compression in our retirement businesses.

New money rates are below portfolio yields across our retirement portfolios resulting in reduced, but still attractive spreads in many products. The prior year comparison to adjusted pretax income also reflects net positive actuarial adjustments of $51 million in the second quarter of 2018, a benefit of $98 million in Life Insurance and an unfavorable adjustment of $47 million in Individual Retirement.

Our market assumptions from the full year have not changed, and recent market volatility is a reminder that the second half may be much more challenging from a capital markets perspective. While our first half results provide some balance for the full year outlook, declining equity markets would, among other things, negatively impact fees as well as deferred acquisition cost amortization. Further, with recent large declines in U.S. interest rates, our current expectation was that base net spreads will decline to the higher end of our approximately 0 to 2 basis points range per quarter.

Finally, declining interest rates would typically result in higher returns on fair value option securities, although the overall impact on net investment income would depend on the timing and degree of interest rate movement.

From a statutory perspective, we expect to continue to generate solid earnings and for our strong year-end risk-based capital levels to improve over year-end 2018.

Separately, we are pleased that FASB appears poised to extend the required date for adoption of the new accounting for long-duration contracts until 2022. Nevertheless, we have a large and growing effort underway to understand and operationalize all the changes which are very broad-reaching. It's too early to comment on impact, but we take comfort in the quality, underlying economics and cash flows of our in-force and the new business we write.

Our results for the first half of the year reflects strong growth from our ongoing strategy to leverage our broad product portfolio and diversified distribution network to satisfy customer needs. With strong market demand and favorable pricing conditions during most of this period, we significantly increased sales in Fixed and Index Annuities. We expect lower levels of sales for certain product lines in the second half due to lower interest rates and the uncertain environment. We will remain disciplined with respect to product pricing and features and continue to leverage our broad capabilities to deploy capital to available, attractive new business opportunities.

I will now talk briefly about the results for the quarter for each of the businesses. For Individual Retirement, premiums and deposits grew by 13%. We produced strong sales in Fixed and Index Annuities during the quarter, although Fixed Annuities sales declined from first quarter levels. We do expect lower sales of Fixed Annuities in the prevailing interest rate environment.

We achieved positive net flows, excluding Retail Mutual Funds, which is a comparatively small part of our earnings. Total assets under management increased driven by strong equity markets performance and growth of annuity deposits during the first half of the year.

For Group Retirement, premiums and deposits were lower than the prior year quarter, primarily due to 2 large group acquisitions in the second quarter last year. In-plan contributions and individual product sales continued to be strong. Net flows improved from the prior year quarter due to lower group surrender activity but still remained negative. Although the timing of group acquisitions and individual contributions will result in quarter-over-quarter variances in deposits, we expect surrenders and other withdrawals to continue to drive negative net flows. It is also important to note that the financial impact of outflows will vary based on product characteristics. For example, the impact will be lower if the outflow is from a higher guaranteed minimum interest rate annuity policy or from a lower-margin group mutual fund offering. Despite facing negative flows for a period of time, we've continued to produce solid earnings for this business as assets under administration have continued to grow.

For our Life Insurance business, total premiums and deposits increased for the quarter, driven by sales growth in our U.K. individual protection product line as well as the addition of group protection from the acquisition of Ellipse. Our U.S. life sales declined as we deemphasized guaranteed universal life sales in the current interest rate environment and index universal life sales remained under pressure. Overall, mortality experience was favorable to pricing expectations and the prior year quarter. We have been pleased with our mortality results over the last several quarters by recognizing that there will always be some volatility quarter-to-quarter.

Adjusted pretax income decreased from the prior year quarter, primarily due to the favorable actuarial adjustments in the second quarter of 2018 and the current quarter reinsurance recoveries allowance that I mentioned earlier.

Institutional Markets, premiums and deposits were lower than the prior year quarter, primarily due to large GIC issuance in the second quarter of last year. We continue our opportunistic strategy in the pension risk transfer business, and the market pipeline over the next 12 to 18 months remains robust. Overall, our Institutional Markets business continues to be well positioned to capitalize on available growth across its product lines, while remaining focused on achieving targeted returns.

Lastly, I wanted to briefly comment on AIG 200, which includes Life and Retirement. We plan to focus on investments that will accelerate our efforts to enhance the customer and distributor experience across our businesses, complete the work needed to fully focus our Life Insurance business on the core portfolio, further prepare for the new standards of care in advisory expectations and position our businesses for future product and distribution channel expansion, while improving overall efficiency.

To close, we remain committed to our ongoing strategy to leverage our broad product expertise and distribution footprint to deploy capital to the most attractive opportunities, which we believe positions us well to help meet growing needs for protection, retirement savings and lifetime income solutions.

Now I will turn it over to Mark.

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

Great. Thank you, Kevin, and good morning all. AIG's adjusted after-tax earnings per share was $1.43 for the quarter compared to $1.05 per share in the corresponding quarter of 2018. In dollar terms, AIG had nearly $1.7 billion of adjusted pretax income and $1.3 billion of adjusted after-tax income. Book value per share, which excludes AOCI and DTA, on an adjusted basis increased $1.42 per share, or nearly 2.6% as compared to the first quarter of 2019. As respects adjusted return on common equity, or ROCE, which also excludes AOCI and DTA, AIG returned an annualized 10.4% for the quarter and the segments achieved the following returns on attributed equity: General Insurance achieved a 10.3% return; as Kevin mentioned, Life and Retirement of 17.3% return; and legacy with a 5.2% return. As mentioned last quarter, AIG now is using the term return on common equity because last quarter, we introduced some preferred stock into our capital structure.

Net investment income, or NII, for the second quarter was $3.74 billion on an adjusted pretax income basis and $3.75 billion on a GAAP basis compared to $3.72 billion and $3.88 billion, respectively, in the sequential first quarter '19. This level of NII had the benefit of an approximate $0.13 per share after-tax gain, associated with an IPO in our alternative private equity asset class. This $142 million pretax gain is reflected in Life and Retirement, or $138 million and $4 million within our legacy segment. Strengthening equity markets and tighter credit spreads also helped this quarter's investor results. I'm pleased to recall that effective last quarter, AIG implemented 2 changes in the accounting presentation that now recognize changes in the fair market value of equity securities below the line and that noninsurance subsidiary, NII, that had been reflected within other income is now reflected in the NII line proper.

Turning to General Insurance. For the second consecutive quarter, the segment produced both a calendar quarter and a current accident quarter underwriting profit, with a calendar quarter combined ratio of 97.8%, as Peter mentioned, which of course, reflects actual catastrophe losses and prior period development. And a 96.1% current accident year -- or accident quarter, combined ratio, excluding CATs. The actual CAT ratio for the second quarter of 2019 was 2.6% of net premium and for the first quarter of 2019, sequentially, it was 2.7%. The prior year development ratio, or PYD ratio, net of the ADC and amortization was a favorable 0.9 loss ratio points for the quarter; and for the prior quarter, it was 1% -- for the first quarter of 2019 sequentially, it was 1%. Furthermore, the improved gross underwriting, along with reinsurance purchases designed to reduce per risk attachment points and provide horizontal exposure coverage reduced the level of large net property losses.

The North America segment of General Insurance produced a 96.8% current accident year excluding CATs combined ratio, with the North America Commercial lines component producing a 99.2% current accident quarter combined ratio, excluding CATs, which represents a 9.3% combined ratio point improvement over the second quarter of 2018. The North America personal lines operation produced a 90.1% current accident quarter combined ratio, excluding CATs, which represents a 7.8% combined ratio point improvement over the corresponding period of 2018.

The international segment of General Insurance produced a 95.5% current accident quarter combined ratio, excluding CATs versus 98% even comparable ratio in the second quarter of 2018. This improvement was driven by the Commercial segment which saw a 6.5% combined ratio point reduction over the second quarter of 2018.

It's also informative to comment on the General Insurance performance on a year-to-date 6 months basis versus the first 6 months of 2018. And on that basis, the year-to-date net earned premiums were up 1.1%; the calendar year combined ratio improved 5 points even; and the current accident year combined ratio, excluding CATs, improved 4.2 points. Furthermore, the general operating expense ratio, or GOE ratio, improved 2.2 points prior to adjustments for the Validus acquisition. Lastly, the year-to-date General Insurance return on attributed common equity is 12.1% in 2019 versus 5.3% in the first half of 2018, a 680 basis point improvement.

Turning to prior year development, or PYD. This quarter saw $63 million of net favorable development, with $66 million of favorable stemming from General Insurance and $3 million of unfavorable emanating from legacy operations. Although actual versus expected loss emergence was reviewed globally, the areas receiving deeper reserve dives this quarter were mostly U.S. exposures, primary in Excess Casualty on both an admitted and nonadmitted basis, environmental, health care, GL and med mal within programs, personal lines property and some specialties lines. The $63 million of net favorable development is mostly driven by the amortization associated with the deferred gain of the adverse development cover, or $58 million. The remaining post-ADC, $5 million, of net favorable development was scattered across many lines.

But unpacking this further and looking at things on a pre-ADC basis, net favorable development was $132 million, split as $129 million favorable in North America, $6 million favorable internationally and preaffirmation -- or mentioned $3 million unfavorable from the legacy segment. But an equally relevant view of this $135 million of pre-ADC favorable General Insurance PYD is that $230 million represents favorable development for accident years 2015 and prior across many lines and is largely subject to the ADC, and $95 million of unfavorable development for accident years 2016 to 2018, which is split $55 million from U.S. admitted Excess Casualty, $10 million from U.S. Primary Casualty and workers' compensation lines combined, and $30 million of unfavorable development emanating mostly from short-tailed personal lines and European Property and Specialty lines.

I am pleased that this quarter's deep dive review, representing 30% of total reserves that also have historically been volatile lines of business, resulted in relatively minor movements. For example, on a year-to-date basis, accident year 2017's loss ratio has only moved 0.1 loss ratio point and accident year 2018's movement doesn't even register.

The legacy segment incurred $47 million of unfavorable development from accident year 2018, stemming from 2 environmental cleanup cost cap policies written in 2000 and 2006, each for 30-year terms, which is totally distinct from General Insurance, but only $3 million unfavorable to legacy across all accident years.

Peter commented earlier on General Insurance's achieved rate increases for the quarter. And hoping to put the pervasiveness of these rate increases in context, nearly 60% of the quarter's gross premium was associated with double-digit rate increases whereas, less than 10% was associated with rate decreases.

I'd also like to add some color on the related concept of margin expansion, which is defined as the beneficial impact of effective rate changes over loss cost trends. In North America Commercial, the weighted average loss cost trend was approximately 3.5%, but that varies widely by product line and ranges from a positive 1% trend to a plus 9% trend, depending upon the line. Given the discussion of rate changes given by Peter earlier on a written basis, one can see that the degree of margin expansion above what was already contemplated with our 2019 plan loss ratio has been significant in the quarter. And this expansion has been centered and led by Commercial Property, E&S Casualty business and directors and officers' liability, although almost all lines had some degree of expansion.

Turning to the Life and Retirement segment. Kevin has already provided a good overview. But I would add that the boost to NII from the previously referenced IPO had an approximate 230 basis point beneficial impact on the quarter's annualized return on common equity and therefore, their return would have still been approximately 15% without that impact. All units reported increases in adjusted pretax income sequentially and quarter-over-quarter, except for the Life unit, which has experienced growth, along with the associated expense drag on income.

Individual Retirement net flows for the quarter were $300 million negative, but improved materially compared to the $1 billion negative in the second quarter of 2018. These net flows, however, were approximately $470 million positive across all annuity types, Fixed variable and Index combined, with Index Annuities providing $1.1 billion of positive net flows.

As mentioned by Kevin, Retail Mutual Funds outflows were the most challenged in the quarter. On a year-to-date basis, Index and Variable Annuities combined show a flat surrender rate whereas fixed Annuity saw a minor uptick. Net investment spreads for Individual Retirement were under pressure during the quarter whereas group Retirement's net spreads increased.

Life Insurance is seeing growth in international sales, favorable mortality experience relative to the original pricing assumptions. And the comparison with the second quarter of 2018 becomes favorable when controlling for that quarter's $98 million of beneficial actuarial refinements. Assets under administration grew in both Individual and Group Retirement, primarily due to strong equity market performance.

Individual markets -- sorry, Institutional Markets' pretax income improved quarter-over-quarter but deposits and premiums shrank comparatively due to a large GIC issuance in 2018 that was not repeated in 2019.

Turning to legacy. Adjusted pretax income was up slightly on a sequential basis to $119 million and the after-tax income to attributed common shareholders is $93 million in the quarter, which translated to a 5.2% annualized return.

Legacy NII was comparable to the first 6 months of 2018. But even though the year-to-date return on common equity is 4.7%, we continue to anticipate a 2% to 3% returns in the second half of 2019, similar to original guidance.

As respect to tax, the effective tax rate is 22.4% for the year, applicable to adjusted pretax income and 21.8% for the quarter, which is inclusive of discrete items. As you know, the effective tax rate is updated each quarter using actual results and then supplemented by reforecast of the remaining quarters. And as always, the tax rate is heavily influenced each quarter by the geographic distribution of income by tax jurisdiction.

It's worth noting that approximately $350 million of the DTA was consumed this quarter. The utilization of net operating losses and foreign tax credits, with both Life and Retirement and General Insurance contributing towards that consumption.

As Brian noted, we did not repurchase any shares in the second quarter, so our board authorization remains at $2 billion. As compared to the first quarter of 2019, our total debt and hybrids to total capital leverage ratio improved another 120 basis points sequentially this quarter to 26.9%. We also had a bond issuance mature for $1 billion in mid-July that was effectively pre-funded by our March 2019 debt raising. This debt overlapped at June 30 when adjusted, resulting in an additional 80 basis point improvement in the total debt and hybrids to total capital ratio to 26.1%. When you look at that this on a year-to-date basis, there's a 320 point reduction in this leverage metric. Adjusted book value per share increased nearly 2.6% in the quarter and book value per share increased 6.2%, sequentially and 13.2% since year-end 2018, benefiting from AOCI gains.

As respect to the agency discussions, we completed our reviews last month with the following results for our various financial strength ratings. A.M. Best affirmed our A rating and stable outlook; S&P affirmed our A+ rating and upgraded our outlook to stable; and Fitch affirmed our A+ rating and their negative outlook, on an interim basis until their full review, which takes place later this year. Moody's reviewed us as well but this was considered an interim review within their multi-year process.

Lastly, as Kevin alluded to, as for the financial accounting landscape, AIG is in the process of evaluating and planning for 3 fundamental accounting changes currently that will be implemented in 2020 through 2022, depending upon the standard. These are long-duration accounting affecting our Life and Retirement division; IFRS 17, affecting our General Insurance international operations, but mostly in a compliant sense; and thirdly, a FASB CECL, or current expected credit loss model, which really affects both sides of the balance sheet. We will provide more details around the impact of these changing accounting standards over the next few quarters.

And on that exciting note, I'll return it back to Brian.

Brian Charles Duperreault
Thank you. Jake, well, let's go to Q&As portion of this. First question, please.

Question and Answer

Operator

[Operator Instructions] We will begin with Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question on General Insurance. You've again, mentioned a lot of the underwriting actions that you've taken within that book, combined with obviously, now we're getting more of a pricing tailwind. So it does sound like the second half this year, the margin should be better than the first half. Brian, I know you guys said you have the target for the underwriting profit, maintaining that for the full year. Could you just give us a sense of how the second half, that accident year combined ratio is adjusted within General Insurance, the type of improvement that we should expect from that 96.1% that we saw in the first half of the year?

Brian Charles Duperreault

Elyse, I said we expect an underwriting profit for the year. It's very hard to predict accident quarters. I mean we've been improving the volatility of this book and so I think that the results get to be a little bit more predictable, but we still have a relatively interesting mix of business. So I just -- I don't really want to predict some -- to the decimal point change. We want to continue to sequentially improve. But will that happen in some kind of straight line? I can't tell you. But over time, yes, we continue to target an improvement in the General Insurance and as I said, get to a sustainable 10-point return on an adjusted equity over the next couple of years. But don't hold me to what the accident quarter is going to be.

Next question.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. Wait, I just -- excuse me, I also had a follow-up. My second question just on AIG 200 that you guys outlined throughout the call. I just want to get a sense, does that ultimately -- does the 200 mean that you guys are looking for 200 basis points of improvement in your expense ratio. Just trying to get a sense of where that 200 comes from? And if you can just give us a sense of the time frame there and any investments that we should be thinking about that you're making?

Brian Charles Duperreault

That's interesting. It's going to be more than 200 basis points, I'll tell you that. No, it's really a reference to -- we're just, in this year, celebrating -- go back 100 years and so this is to look forward to the next 100. And so maybe I should've called it -- well, I won't give you a number. But anyway, yes. So look, if we're ever going to be a great company, and it's our intention to be a great company, if you assess where we are now, the Life and Retirement, great set of products, great distribution platform, handling issues that come along and in terms of the market; Peter's bringing the General Insurance to an underwriting excellence position where it belongs, it's what we do for a living; we've got the best investment management in the business. But the one thing we've never been noted for is operational excellence. And this is the one thing that we have not invested in. We've got legacy processes, too many manual interventions, on and on and on, and it is a drag on our performance if you look at the GI expense ratio, in particular. To pick a number, it's at least 500 basis points too high, in my mind. And how are you ever going to get that down? You have to -- we have to transform the company. We have to do it fundamentally. It's going to take us some time, but it's the next great step and to me, it's as important as anything we've been doing to date in this company. And so it's a very, very important effort. It's across the whole company. And it'll provide that long-term benefit and get us to that position of greatness that we aspire to.

Next question, please.

Operator

And that question will come from Mike Phillips with Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

Brian, appreciate your comments at the beginning on kind of the comments on the discipline of the market and being more fact-based and how that's driving the cycle. I guess some of your peers have talked about -- have described the cycle as reserve-driven and income statement-driven. And I guess I want to hear your thoughts on that description. And kind of the question kind of goes to, not for your book, but just kind of overall for the industry profitability of the current year versus kind of the profitability of prior years still?

Brian Charles Duperreault

Well, I think the market's reacting to the fact that they don't think the current year profitability, without these rate changes, would have matched prior years. And I mean, that's logical given the kind of trends that we referred to, whether it's social inflation or other kind of tort movements, just frequency of loss. And so I think the market's reacting, as I said, in a natural way, a way that one would expect a well-managed industry to do. So I'm encouraged by it.

What else would you like to ask, Mike?

Michael Wayne Phillips
Morgan Stanley, Research Division

Yes. Okay. Yes, just a specific one on the torts, the legislative changes that we've had. A lot of headlines obviously, on the sexual harassment stuff. Is that the next asbestos for the industry?

Brian Charles Duperreault

I think asbestos has been the next asbestos for this industry. It's the gift that keeps on giving. So I don't want to -- I'm going to leave that as supreme. Do you know what I mean? But let's just say, it's certainly a society-wide problem, all this stuff that's going on. And it will be reflected in society's reaction to it. As Peter pointed out, the one thing that we have been known for, when I talk about being a great company, this kind of large widespread phenomenon is something we've been handling for a very long time. But it's certainly an issue that everybody has at the top of their mind.

Operator

We'll hear from Yaron Kinar with Goldman Sachs.

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Wanted to start with a question on NII. So you had 2 strong quarters opening the year. How should we think of the kind of $13.2 billion to $13.3 billion run rate that you talked about last quarter with the rate environment being what it is today?

Brian Charles Duperreault

Yes. Okay. Well, I think I'll have Mark do this one.

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

Thank you. Thank you, Brian. I mean it's a reasonable question. I mean what I would just kind of comment on. Last quarter, we kind of gave you a framework. We said -- roughly 91% of the carrying value of the investable assets is in pretty stable, predictable stuff. I mean it's still got some variability to it, of course, but on a relative basis. And then there was another 9% that has a lot more volatility to it, some because of the inherent asset class itself and some because of the accounting election that was put through. And that mix is still pretty much in-force this quarter. So there's a couple of things. One, if you look back, even through our finsub, you're going to see, in PE and hedge fund composites, pretty broad volatility. We have a minus 11% in the fourth quarter that rebounded to 18% and 16% this quarter. I mean 5% in the latter part, third quarter of '18. So you can kind of go backwards and pick your own standard error on those kinds of things.

The other thing that, and Brian alluded to it and Kevin alluded to it, if you go into the assumption that where the interest rates are now stays at this level, with natural maturities and natural turnover in fixed income, you're going to be reinvesting in lower-yielding fixed income securities. That could put some downward pressure on it, latter half and then into 2016 (sic) [2020]. So all those things taken into account, we still think that the original guidance we've given coming into the year was $13 billion. And through that [fork] that I mentioned, you could really get to about $13.5 billion in that range. And for the reasons we just mentioned, that's pretty much where we still are.

Brian Charles Duperreault

Other questions, Yaron?

Yaron Joseph Kinar
Goldman Sachs Group Inc., Research Division

Yes. My next question is going back to the AIG 200 initiative. Is that something that you'd expect to complete by the 2021 -- the end of 2021 when you're targeting the double-digit ROE? And also, would the costs associated with this program, would those be included in adjusted operating income or not?

Brian Charles Duperreault

Yes. Well, I would say, yes. I'd put it as probably a 3-plus year program. But once that period ends, this constant improvement should never end. And so I think there'll be continuous improvement after that, but, let's say, a project name will probably end in that period of time. And yes, we would include the cost and benefits net-net in our belief that we'll get to that double-digit position at that point. Did you want to add anything, Mark?

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

Yes. Just one thing. So the second part of your question was, first you'll see that in net income but that kind of restructuring charge is generally excluded from operating income.

Operator

We'll now take a question from Tom Gallagher with Evercore.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

So Mark, just to follow up on the NII question. So if I followed your $13.5 billion expectation for the year, that implies, per quarter, NII would run at around $3 billion-or-so for the next couple of quarters if we stay in the current rate environment. Is that approximately right?

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

Yes, if you're linear on it.

Thomas George Gallagher
Evercore ISI Institutional Equities, Research Division

Got it. And then my follow-up is just from Slide 5, there's a footnote that says about 20% of your fixed maturities are in variable-rate securities. Are those -- I think that's -- I would sell for like $50 billion of variable-rate securities. Are those traditional floaters, and is that the main source of pressure on NII from a base spread standpoint?

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

First off, your mix is right. About 80-20. And the notional sounds approximately right as well. So I mean, yes, with floating, that's going to be a natural impact on it, which -- yes, but you got -- it's not like you can just let it go. I mean there's risk management and hedge aspects associated with it. But Doug, you want to...

Brian Charles Duperreault

Doug Dachille is here, who runs our Investments.

Douglas Adam Dachille
Executive VP & Chief Investment Officer

When you look at that, that's the holdings of the floating rate assets but there's a couple of factors you have to think about with respect to the impact to net investment income. First of all, the reason we hold those floating-rate assets, it provides diversification, but the other reason we hold them is we have a lot of liabilities that reprice frequency -- frequently during the course of the year. So there's some asset/liability management that's associated with holding floaters. So we hold floating-rate assets against liabilities that have a floating rate repricing characteristic. To the extent that there's any excess floaters that we invested in because we thought there was value, to the extent there's an asset/liability mismatch, we typically swap those floating-rate assets into fixed. So while we're telling you what percentage of the portfolio actually has floating rate as a component of the available for sale, that's not necessarily the exact amount of exposure we have to the repricing of the floating rate.

Operator

And we'll now take a question from Jay Gelb with Barclays.

Jay H. Gelb
Barclays Bank PLC, Research Division

With regard to capital management, you had some discussion in the prepared remarks about why the company did not repurchase shares in the first half in terms of taking down the leverage ratio. But at the same time, free cash flow seems quite strong and the stock is currently trading at 80% of book value. Can you talk about what your expectations might be for the second half in terms of buybacks?

Brian Charles Duperreault

I think Mark mentioned it in his prepared remarks. We're going -- and I said the same thing. But we're going to continue to look at our leverage. So let's not forget that. But my advice has always been to invest in the business. And in this situation where we've got a market that's improving daily and also an effort in the company to self-improve through the AIG 200, I think there'd be plenty of opportunities for us to invest in the company itself. And I think that's the long-term best use of the funds, and that's where we're going, Jay.

Jay H. Gelb
Barclays Bank PLC, Research Division

That sounds good. I do have a follow-up. This one's for Peter. I was wondering if you can give us any indications of what you're seeing in terms of the pricing environment so far through the third quarter, if the positive trends are accelerating?

Peter Salvatore Zaffino
Global COO & CEO of General Insurance

It's too early, Jay, really to comment. But I would expect just based on sort of qualitative commentary that the third quarter, early reactions are similar to what we've seen in the second quarter.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

So you talked about rate. Everyone's talking about rate and whatnot. But in some ways, AIG is writing its own ticket. There's an overhaul of the portfolio going on that's ongoing. When you talk about rate, is that pricing only, or is that joined with an overhaul of how AIG underwrites its P&C business?

Brian Charles Duperreault

Well, I'm going to start and Mark and Peter can finish. So these rates that we refer to are really like same-store sales, right, kind of thing, right? So we're matching apples with apples. But as you point out, there's another thing going on, which is the shedding of business that was either poorly selected or underpriced limits that we didn't think we were getting paid for. So there's another underlying improvement taking place in addition to this rate comparison. Mark, do you want to add?

Mark Donald Lyons
Executive VP, CFO & Chief Actuary for General Insurance

Yes. Thank you. First off, Josh, I appreciate the wide opening comment you made that -- in terms of writing your own ticket. One I think clear point of differentiation is, in a lot of sectors, AIG is pushing the market. It's not like we're benefiting from the results of others. We are pushing it, and that's contributory to our view on a lot of different things. In terms of the rate changes Peter quoted before, they are effective rate changes, taking into account as much as you can to the examples that Brian mentioned, limits and contraction and [detachment point] movements and so forth. But there is a broader lift that, that does not reflect. That's the explicit rate change. The implicit rate change is the portfolio quality differential. So when you nonrenew or get rid of business of rate adequacy of x and you're bringing in new business that's much stronger than that x. It has that beneficial lift as well. That will find its way into the ultimate loss ratio, but that's in addition to the individual rate changes that we are talking about.

Brian Charles Duperreault

Peter, you got anything you want to add?

Peter Salvatore Zaffino
Global COO & CEO of General Insurance

I just want to build on what both of you had commented on, which is the most important thing, we're making sure that the underwriters are doing is risk selection, how to recalibrate the portfolio, making disciplined decisions around limit deployment, understanding their aggregations, understanding what's actually happening with loss cost and underlying trends. So we're very pleased with the rate that we've been driving, but that's become an outcome of the discipline that we've been driving over the last 5 or 6 quarters.

Brian Charles Duperreault

Josh, we got maybe time for a follow-up and no other questions. If you have a follow-up.

Joshua David Shanker
Deutsche Bank AG, Research Division

It's absolutely a follow-up. Right on it. And so next year as I think about the shape of the portfolio and your purchase of reinsurance over the past 12 months, can we imagine that the shaping is the same, that you'll have the same reliance on reinsurance for the next 12 months or is that going to change over time?

Brian Charles Duperreault

Well, I think we've been addressing our reinsurance to the portfolio that we add. As that portfolio changes, right, so we get rid of the large limits strategy, you don't have to buy as much in terms of protection, protecting the company from those very large limits portfolio mix. But I'd say the basis of our philosophy around the reinsurance that it is it's geared to addressing exposures that we feel we should share because of accumulations or because of volatility, that's going to continue. But yes, as the portfolio evolves, we'll adjust our total program accordingly.

And I'm going to call this to an end, and thank you. And I just want to just thank everybody for joining us today and for your questions. And before we end the call, of course, I do want to acknowledge our colleagues around the world for their tireless efforts and dedication to the journey that we're on here at AIG. And I am proud of what we're accomplishing and appreciate everybody's hard work. I also want to thank our business partners, shareholders and stakeholders for their support. It's meant a lot to me and my leadership team, and we remain committed to making AIG the leading insurance company in the world. Have a great day.

Operator

And with that ladies and gentlemen, this does conclude your conference for today. We do thank you for your participation and you may now disconnect.